Canadian Natural Resources (CNQ)

Updated November 11th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$36	**5 Year CAGR Estimate:**	7.4%	**Volatility Percentile:**	76.4%
Fair Value Price:	$33	**5 Year Growth Estimate:**	5.7%	**Momentum Percentile:**	34.3%
% Fair Value:	111%	**5 Year Valuation Multiple Estimate:**	-2.0%	**Growth Percentile:**	57.4%
Dividend Yield:	4.2%	**5 Year Price Target**	$43	**Valuation Percentile:**	50.5%
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**Total Return Percentile:**	54.7%

Overview & Current Events

Canadian Natural Resources is an energy company that operates in the acquisition, exploration, development, production, marketing, and sale of crude oil, natural gas liquids (NGLs), and natural gas. The company is headquartered in Calgary, Alberta. Canadian Natural Resources' common stock is cross-listed on the Toronto Stock Exchange and the New York Stock Exchange, where it trades with a market capitalization of US$33 billion. In this report, all figures referenced are in Canadian dollars and the TSX-listed shares have been used for the purpose of valuation analysis.

In early November, Canadian Natural Resources reported (11/7/19) financial results for the third quarter of fiscal 2019. Production jumped 11% over last year's quarter and 15% sequentially, as the production cuts of Alberta eased. In addition, the company reduced its operating costs and thus grew its adjusted earnings-per-share from $0.87 in the second quarter to $1.04 and exceeded analysts' expectations by $0.22. The company also grew its adjusted funds flow 9% sequentially, to an all-time high of $2.89 billion. Thanks to the impressive results of Canadian Natural Resources in the third quarter, the market rewarded the stock with an 8% rally on the day of the earnings release.

On June 27th, Canadian Natural Resources completed the acquisition of the Canadian assets of Devon Energy for $3.8 billion. These assets are characterized by long life, low-decline reserves and hence they are a great fit to the assets of Canadian Natural Resources. Moreover, the latter expects to achieve significant synergies from the takeover.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$2.48	$2.36	$2.30	$1.47	$2.23	$3.47	$0.24	-$0.61	$1.19	$2.67	***$2.50***	***$3.30***
DPS	$0.21	$0.30	$0.35	$0.42	$0.58	$0.90	$0.92	$0.94	$1.10	$1.30	***$1.50***	***$1.90***
Shares[1]	1,085	1,091	1,097	1,092	1,087	1,092	1,095	1,101	1,223	1,205	***1,185***	***1,150***

As Canadian Natural Resources is an almost pure upstream company, its financial performance has been extremely volatile over the last decade. Given its high sensitivity to commodity prices, it is nearly impossible to make accurate forecasts. With that said, we believe the company's performance is likely to improve considerably moving forward thanks to production growth and somewhat higher prices of oil and natural gas. Management expects to grow production by 7.5% per year on average until 2022. However, due to the extreme volatility of the company's earnings, we prefer to be somewhat conservative and have assumed earnings-per-share of $3.30 by 2024 for a 5.7% average annual earnings-per-share growth rate.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	12.2	15.7	17.3	21.5	14.3	12.1	---	---	34.6	15.8	***14.4***	***13.0***
Avg. Yld.	0.7%	0.8%	0.9%	1.3%	1.8%	2.1%	2.7%	2.5%	2.7%	3.1%	***4.2%***	***4.4%***

[1] In millions.

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Canadian Natural Resources has traded at an average price-to-earnings ratio of 15.5 over the last decade if we exclude the 2015 – 2017 period, in which the stock's valuation was not meaningful due to depressed earnings. If the company achieves our anticipated earnings-per-share of $3.30 by 2024, we expect the stock to trade around 13 times its annual earnings in that year. As a result, the stock could incur a -2.0% annualized drag due to contraction of its valuation level.

Income investors should note that while the Canadian government applies a 15% withholding tax on dividends paid to U.S. residents (including those paid by Canadian Natural Resources), this withholding tax is waived if shares are held within a retirement account like a 401(k).

Safety, Quality, Competitive Advantage, & Recession Resiliency

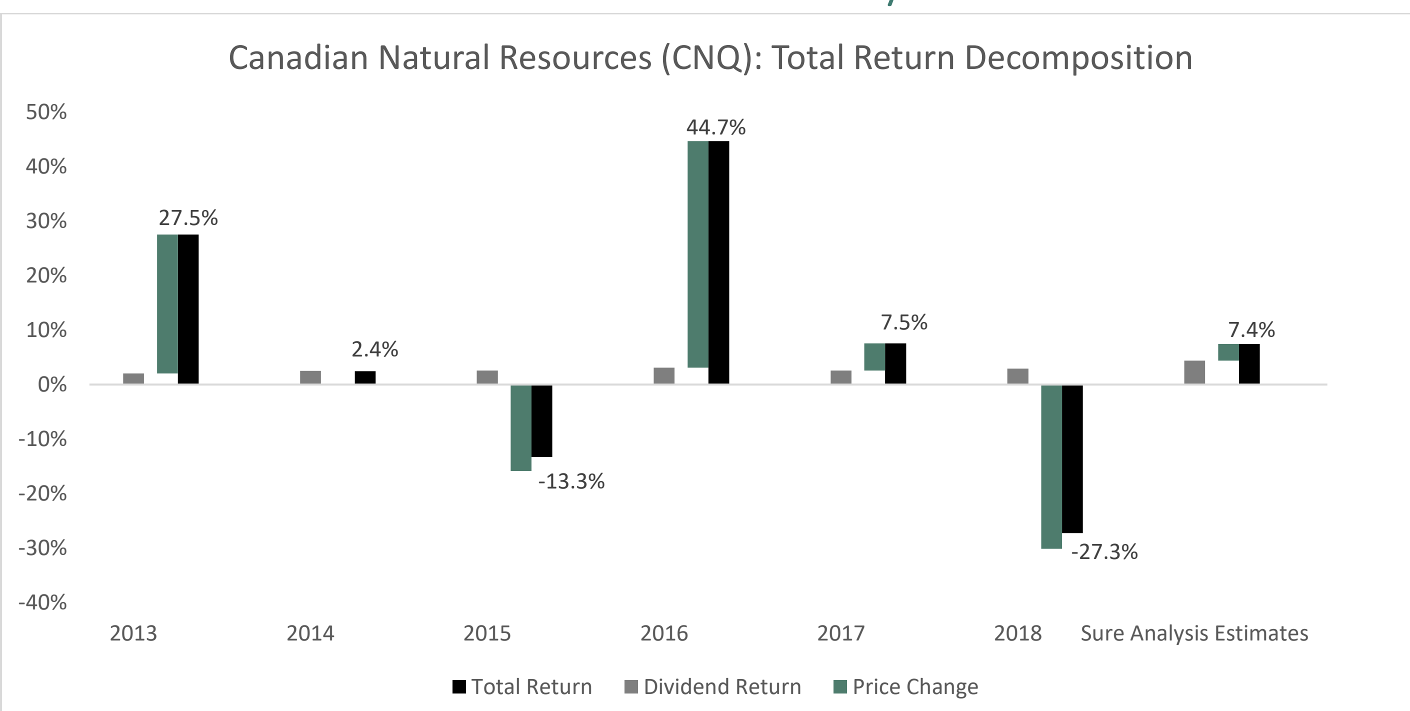
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Std. Dev.	40.4%	21.6%	31.4%	24.8%	19.0%	27.7%	33.6%	31.6%	23.9%	48.7%	***60.0%***	***57.6%***

The competitive advantage of Canadian Natural Resources is the high quality of its assets, which have a long life and low decline rates. However, due to the almost pure upstream nature of its business, the company is greatly affected by the price of oil and natural gas. This is evident from its depressed earnings during the period of low commodity prices in 2015 - 2017.

Final Thoughts & Recommendation

In the first half of the year, Canadian Natural Resources posted poor production due to the enforced production cuts of Alberta but the company has returned to strong growth mode in the second half of the year. Nevertheless, as the stock has rallied 23% since the end of August, it has become less attractive in our view. As a result, we now expect it to offer a 7.4% average annual return over the next five years and thus we have lowered its rating from "buy" to "hold". Moreover, investors should note the high sensitivity of the stock to commodity prices and its huge downside risk in the event of a recession or a fall of the prices of oil and natural gas.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	11078	14322	15507	16195	17945	21301	13167	11098	17669	22282
Gross Profit	5937	3549	4190	3260	3804	5486	-225	-437	2952	5213
Gross Margin	53.6%	24.8%	27.0%	20.1%	21.2%	25.8%	-1.7%	-3.9%	16.7%	23.4%
SG&A Exp.	536	414	593	56	470	433	344	700	453	179
Operating Profit	2582	3012	4653	3053	3163	4860	-742	-1279	2335	4848
Op. Margin	23.3%	21.0%	30.0%	18.9%	17.6%	22.8%	-5.6%	-11.5%	13.2%	21.8%
Net Profit	1580	1673	2643	1892	2270	3929	-637	-204	2397	2591
Net Margin	14.3%	11.7%	17.0%	11.7%	12.6%	18.4%	-4.8%	-1.8%	13.6%	11.6%
Free Cash Flow	2827	947	42	105	151	-2939	1164	-345	2564	5680
Income Tax	395	1188	1267	717	766	1234	-30	-859	476	931

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	41024	42954	47278	48980	51754	60200	59275	58648	73867	71559
Cash & Equivalents	13	22	34	37	16	25	69	17	137	101
Acc. Receivable	1148	1481	2077	1197	1427	1889	1277	1434	2397	1148
Inventories	584	477	550	554	632	665	525	689	894	955
Total Liabilities	21598	22586	24380	24697	25982	31309	31894	32381	42214	39585
Accounts Payable	240	274	526	465	637	564	571	595	775	779
Long-Term Debt	10301	8485	8571	8736	9661	14002	16794	16805	22458	20623
Total Equity	19426	20368	22898	24283	25772	28891	27381	26267	31653	31974
D/E Ratio	0.53	0.42	0.37	0.36	0.37	0.48	0.61	0.64	0.71	0.65

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	3.8%	4.0%	5.9%	3.9%	4.5%	7.0%	-1.1%	-0.3%	3.6%	3.6%
Return on Equity	8.4%	8.4%	12.2%	8.0%	9.1%	14.4%	-2.3%	-0.8%	8.3%	8.1%
ROIC	5.2%	5.7%	8.8%	5.9%	6.6%	10.0%	-1.5%	-0.5%	4.9%	4.9%
Shares Out.	1084.7	1090.8	1096.5	1092.1	1087.3	1091.8	1094.7	1101.0	1222.8	1205.0
Revenue/Share	10.22	13.07	14.06	14.73	16.46	19.42	12.04	10.08	14.94	18.21
FCF/Share	2.61	0.86	0.04	0.10	0.14	-2.68	1.06	-0.31	2.17	4.64

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.