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Feb 18, 2020

Canadian Natural Ltd. (CNQ)

$29.29 (As of 02/14/20)

Price Target (6-12 Months): **$31.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 02/09/20) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:C
	Value: B | Growth: D | Momentum: D	

Summary

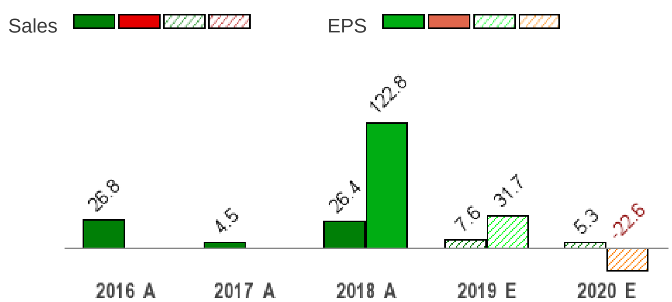
Canadian Natural Resources' balanced and diverse production mix facilitates long-term value and reduces the risk profile. Canadian Natural's acquisition of Athabasca Oil Sands project in 2017 has added significant value to its asset base and buoyed the production prospects. Notably, lower capital needs and improving operational efficiencies have enabled the company to generate significant free cash flow. What's more, the company remains committed to investor friendly moves by the way of dividend payouts and stock buybacks. However, discounted crude prices in Canada is a drag on the company's revenues. Further, the C$3.25-billion term loan to fund the Devon Energy asset buy has worsened the company's debt-to-capital ratio and lead to higher interest outgo. The interplay of these factors account for the cautious stance.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	$32.79 - $22.58
20 Day Average Volume (sh)	2,527,224
Market Cap	$34.8 B
YTD Price Change	-9.5%
Beta	1.25
Dividend / Div Yld	$1.13 / 3.9%
Industry	Oil and Gas - Exploration and Production - Canadian
Zacks Industry Rank	Bottom 22% (200 out of 255)
Last EPS Surprise	31.7%
Last Sales Surprise	4.6%
EPS F1 Est- 4 week change	-9.9%
Expected Report Date	03/05/2020
Earnings ESP	-4.2%
P/E TTM	16.2
P/E F1	14.0
PEG F1	2.3
P/S TTM	2.1

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2020	4,477 E	4,428 E	4,393 E	4,298 E	18,388 E
2019	3,947 A	4,158 A	4,666 A	4,546 E	17,464 E
2018	4,538 A	4,613 A	4,514 A	2,801 A	16,224 A

EPS Estimates

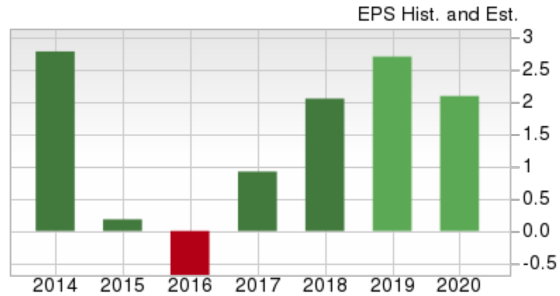
	Q1	Q2	Q3	Q4	Annual*
2020	$0.67 E	$0.54 E	$0.50 E	$0.49 E	$2.09 E
2019	$0.53 A	$0.65 A	$0.79 A	$0.54 E	$2.70 E
2018	$0.56 A	$0.81 A	$0.85 A	-$0.16 A	$2.05 A

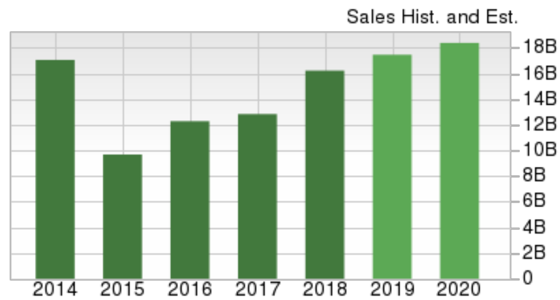
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/14/2020. The reports text is as of 02/18/2020.

Overview

Established in 1973, Calgary-based Canadian Natural Resources Limited is one of the largest independent energy companies in Canada engaged in the exploration, development and production of oil and natural gas. The company boasts of a diversified portfolio of crude oil (heavy as well as light), natural gas, bitumen and synthetic crude oil (SCO). Canadian Natural Resources' core operations are focused in Western Canada, the United Kingdom sector of the North Sea and offshore Africa, which includes Côte d'Ivoire, Gabon, and South Africa. The company reports its activities into two segments: Exploration & Production, and Oil Sands Mining and Upgrading.





Of particular significance is Canadian Natural's substantial world class oil sands mining assets - Horizon Oil Sands and the Athabasca Oil Sands Project (AOSP). Through these properties, the company holds leases that contain an estimated six billion barrels of proved and probable SCO reserves.

As of year-end 2018, the company had approximately 9,893 million oil-equivalent barrels (MMBOE) in total proved reserves. About 86% of the reserves are liquids and 77% proved developed. Approximately 98% of the company's proves reserves are located in North America. In 2018, production averaged 1,078,813 barrels of oil equivalent per day (BOE/d) – the most in Canada – comprising 76% crude oil/ liquid hydrocarbons and 24% natural gas. Meanwhile, the SCO assets in Northern Alberta accounted for 39% of 2018 output.

Canadian Natural, which trades on both the TSX and NYSE, also has midstream operations through its two wholly owned crude oil pipelines (namely ECHO and Pelican Lake pipelines) via which the company transports over 50% of its heavy crude oil. Its midstream portfolio also comprises of 50% stake in both Primrose electricity co-generation system and the North West Redwater Partnership.

Canadian Natural's net capital expenditures totaled C$3.7 billion in 2018, of which approximately 59% went to the Exploration & Production business.

The company raised its quarterly dividend by 12% recently to 37.5 Canadian cents per share or C$1.50 per share annualized. This marks the 19th consecutive annual payout hike.

Reasons To Buy:

Canadian Natural's accretive acquisitions, high-quality assets and surplus cash makes it a best in class stock.

- ▲ Canadian Natural Resources has a broad portfolio of low-risk exploration and development projects with a strong international exposure that yields long-term volume growth at above-average rates. The company's balanced and diverse production mix – 39% SCO, 24% heavy crude oil, 24% natural gas and 13% light crude oil – facilitates long-term value. This also significantly reduces Canadian Natural's risk profile and lends its results a high level of stability.

- ▲ Canadian Natural's prudent and well-timed acquisitions have allowed the company to improve its competitive edge apart from boosting revenues and earnings. In 2017, the company acquired 70% interests in the Athabasca Oil Sands project ('AOSP') for $8.5 billion, which has added significant value to its asset base and buoyed the cash flow prospects. The company's $807 million Pelican Lake heavy oil assets buy has further strengthened its operations. Very recently, the firm upped its oilsands game with the buyout of Devon Canada.

- ▲ Lower capital expenditure needs, accretive acquisitions and improving operational efficiencies have enabled Canadian Natural to generate significant free cash flow. The company achieved free cash flow of around C$4.6 billion in 2018 and per a recent presentation, management expects free cash flow to hit a record C$6.2 billion this year. This favorable cash flow situation, combined with the company's ongoing commitment to capital discipline, enabled Canadian Natural to repurchase around 22 million shares for an aggregate total of more than C$800 million in the first nine months of 2019. The company is counted as a 'Canadian Dividend Aristocrat' with an attractive yield. What's more, the company has a solid track record of dividend hikes, recently increasing payout for the 19th consecutive year.

Reasons To Sell:

Limited pipeline infrastructure, and the resulting large discount for Canadian crude compared to the New York-traded WTI oil benchmark continue to plague Canadian Natural's earnings.

- In a bid to further solidify its position on its home turf, Canadian Natural Resources Limited recently inked a mega deal of C$3.8 billion to snap up Devon Energy Corporation's Canadian business. The pact represents Canadian Natural's biggest buyout since 2017, when it acquired Shell's oilsands assets for C$8.16 billion. While the transaction is expected to increase Canadian Natural's crude production capacity substantially, the company will borrow C$3.25-billion three-year term loan to fund the deal. Apart from an increase in the debt-to-capital ratio, the loan will lead to a higher interest outgo for Canadian Natural.

- While oil production is surging in Canada, the country's exploration and production companies remain out of favor, primarily due to the scarcity of pipelines. In short, pipeline construction in Canada has failed to keep pace with rising domestic crude volumes – the heavier sour variety churned out of the oil sands – resulting in infrastructural bottlenecks. This has forced producers to give away their products in the United States – Canada's major market – at a discounted rate. Canadian Natural is more exposed to the ill effects of discounted WCS pricing. This reduces the amount of money company earns and therefore makes it harder to generate profits.

- Further, languishing Canadian crude prices are expected to affect the fortunes of the company's newly acquired Joslyn oil sands project that has been long grappling with challenges of ballooning costs. As it is, oil sands developments frequently draw protests over environmental concerns associated with such projects.

Last Earnings Report

Canadian Resources Posts Strong Q3 Results

Quarter Ending	09/2019
Report Date	Nov 07, 2019
Sales Surprise	4.63%
EPS Surprise	31.67%
Quarterly EPS	0.79
Annual EPS (TTM)	1.81

Canadian Natural reported third-quarter 2019 adjusted earnings per share of 79 cents, above the Zacks Consensus Estimate of 60 cents. The beat was driven by robust production. Precisely, Canada's largest oil producer's average daily output of 1,176,361 barrels of oil equivalent increased nearly 11% from the year-ago period and surpassed the Zacks Consensus Estimate of 1,163,913 barrels of oil equivalent.

However, the bottom line was lower than the prior-year adjusted earnings of 85 cents as average realized commodity prices fell.

Total revenues of $4,666 million beat the Zacks Consensus Estimate of $4,460 million. Also, the top line improved from third-quarter 2018 revenues of $4,514 million.

Apart from trumping revenue and earnings estimates, the company's third-quarter results offered something more to buoy long-term investors' optimism as free cash flow totaled $1,471 million after capital expenditure and dividend payments.

Production & Prices

Canadian Natural reported quarterly production of 1,176,361 barrels of oil equivalent per day (BOE/d), up by 10.9% from the prior-year quarter. Oil and natural gas liquids (NGLs) output (accounting for more than 79% of total volumes) increased to 931,546 barrels per day (Bbl/d) from 801,742 Bbl/d a year ago. Crude oil and NGLs production from operations in North America – including synthetic crude oil production of 432,203 Bbl/d and bitumen output of 206,395 Bbl/d – came in at 882,865 Bbl/d, higher than the year-ago quarter's 754,238 Bbl/d due to the contribution from buyout of Devon Energy's Canadian business.

Natural gas volumes recorded a 5.4% year-over-year decline - from 1,553 million cubic feet per day (MMcf/d) to 1,469 MMcf/d in the quarter under review. Production in North America totaled 1,425 MMcf/d compared with 1,489 MMcf/d in the prior year.

Canadian Natural's realized natural gas price was C$1.64 per thousand cubic feet compared with the year-ago level of C$2.32. Realized oil and NGLs price decreased 4.7% to C$55.19 per barrel from C$57.89 in the third quarter of 2018.

Costs, Capital Expenditure

Total expenses incurred in the quarter were C$4,796 million, higher than C$3,754 million recorded a year ago. Ramp up in transportation costs, foreign exchange loss and the absence of revaluation gains bloated the overall costs. In the reported quarter, capital expenditure summed C$963 million excluding costs associated with the Devon Energy assets.

Dividend & Share Repurchase

The company, which is committed to adding shareholder value, returned C$447 million and C$169 million via dividends and stock buybacks, respectively.

Balance Sheet

As of Sep 30, the company had C$176 million in cash and cash equivalents, and a long-term debt of C$18,453 million, representing a debt-to-capitalization ratio of approximately 34.7%.

Guidance Maintained

Canadian Natural reiterated its capital expenditure and output forecast for 2019. The company expects capex to be around C$3.8 billion in 2019 and envisions total volumes in the band of 1,087,000-1,146, 000 BOE/d. While liquids output is expected between 839,000 Bbl/d and 888,000 Bbl/d, natural gas production is predicted within 1,485-1,545 MMcf/d. Guidance for crude oil and NGL production from North American operations remains within 231,000-251,000 Bbl/d. The company's thermal in situ oil sands production outlook is estimated within 157,000-172,000 Bbl/d.

Valuation

Canadian Natural Resources shares are up 8.5% over the trailing 12-month period. Over the past year, the Zacks sub-industry and sector are down 4.2% and down 14.7%, respectively.

The S&P 500 index is up 23.3% in the past year.

The stock is currently trading at 7.81X trailing 12-month EV/EBITDA, which compares to 4.85X for the Zacks sub-industry, 4.72X for the Zacks sector and 12.31X for the S&P 500 index.

Over the past five years, the stock has traded as high as 25.29X and as low as 4.91X, with a 5-year median of 9.32X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our $31 price target reflects 2.01X F12M sales.

The table below shows summary valuation data for CNQ

Valuation Multiples - CNQ

		Stock	Sub-Industry	Sector	S&P 500
EV/EBITDA TTM	Current	7.81	4.85	4.72	12.31
	5-Year High	25.29	17.19	10.26	12.85
	5-Year Low	4.91	3.73	4.59	8.47
	5-Year Median	9.32	7.83	6.54	10.7
P/S F12M	Current	1.9	1.18	0.81	3.58
	5-Year High	3.9	2.76	1.45	3.58
	5-Year Low	1.48	1.07	0.67	2.54
	5-Year Median	2.4	1.79	0.99	3
P/B TTM	Current	1.32	0.82	1.12	4.68
	5-Year High	1.96	1.55	1.6	4.68
	5-Year Low	0.8	0.59	1.03	2.85
	5-Year Median	1.52	1.18	1.31	3.62

As of 02/14/2020

Industry Analysis **Zacks Industry Rank:** Bottom 22% (200 out of 255)

Top Peers

Encana Corporation **(OVV)**	Outperform
ConocoPhillips **(COP)**	Neutral
Crescent Point Energy Corporation **(CPG)**	Neutral
Cenovus Energy Inc **(CVE)**	Neutral
EOG Resources, Inc. **(EOG)**	Neutral
Imperial Oil Limited **(IMO)**	Neutral
Occidental Petroleum Corporation **(OXY)**	Neutral
Suncor EnergyInc. **(SU)**	Neutral

Industry Comparison Industry: Oil And Gas - Exploration And Production - Canadian

Industry Peers

	CNQ Neutral	X Industry	S&P 500	CVE Neutral	IMO Neutral	SU Neutral
VGM Score	C	-	-	C	B	B
Market Cap	34.77 B	87.05 M	24.61 B	10.95 B	17.86 B	45.63 B
# of Analysts	5	1.5	13	6	5	6
Dividend Yield	3.86%	0.00%	1.78%	2.11%	2.76%	4.25%
Value Score	B	-	-	C	A	B
Cash/Price	0.02	0.02	0.04	0.03	0.07	0.03
EV/EBITDA	6.63	2.44	14.06	-18.58	5.79	5.39
PEG Ratio	2.34	1.29	2.09	2.65	NA	2.23
Price/Book (P/B)	1.32	0.35	3.29	0.75	0.96	0.04
Price/Cash Flow (P/CF)	5.32	1.45	13.65	NA	6.34	4.05
P/E (F1)	14.01	8.90	19.21	42.09	15.61	13.99
Price/Sales (P/S)	2.11	0.59	2.70	0.69	0.69	1.55
Earnings Yield	7.14%	9.00%	5.19%	2.36%	6.41%	7.15%
Debt/Equity	0.53	0.30	0.71	0.42	0.20	0.01
Cash Flow ($/share)	5.50	0.75	6.92	-0.39	3.79	7.36
Growth Score	D	-	-	A	B	A
Hist. EPS Growth (3-5 yrs)	9.44%	-2.28%	10.85%	NA	15.55%	20.08%
Proj. EPS Growth (F1/F0)	-19.10%	-9.94%	7.17%	-24.40%	-7.35%	0.39%
Curr. Cash Flow Growth	32.80%	18.69%	8.56%	-131.28%	19.50%	46.54%
Hist. Cash Flow Growth (3-5 yrs)	0.07%	-0.82%	8.36%	NA	-3.82%	4.04%
Current Ratio	0.60	0.91	1.23	1.12	1.45	0.94
Debt/Capital	34.65%	23.87%	42.91%	29.61%	16.59%	1.00%
Net Margin	18.37%	-4.95%	11.81%	10.38%	6.43%	7.35%
Return on Equity	7.87%	-0.05%	16.86%	2.45%	6.77%	1.05%
Sales/Assets	0.29	0.27	0.54	0.59	0.81	0.42
Proj. Sales Growth (F1/F0)	5.29%	0.00%	3.85%	-4.66%	7.07%	9.90%
Momentum Score	D	-	-	F	F	F
Daily Price Chg	-0.27%	0.00%	0.06%	-0.78%	0.33%	0.91%
1 Week Price Chg	2.99%	-1.11%	2.47%	2.53%	-0.80%	-4.87%
4 Week Price Chg	-7.84%	-10.08%	0.59%	-5.11%	-12.18%	-12.39%
12 Week Price Chg	4.12%	4.92%	6.98%	-1.66%	-4.65%	-6.00%
52 Week Price Chg	9.91%	-36.93%	16.62%	6.58%	-10.11%	-8.51%
20 Day Average Volume	2,527,224	36,666	2,020,569	4,225,168	352,107	3,508,545
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-2.60%	0.00%	-3.04%
(F1) EPS Est 4 week change	-9.91%	-9.91%	-0.05%	0.00%	-7.01%	-7.33%
(F1) EPS Est 12 week change	24.09%	0.00%	-0.17%	43.53%	4.20%	3.03%
(Q1) EPS Est Mthly Chg	0.00%	-11.24%	-0.24%	216.67%	-0.93%	2.04%

Zacks Style Scores

Value Score	B
Growth Score	D
Momentum Score	D
VGM Score	C

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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