Is Canadian Natural Resources Limited Overpriced or Underpriced?

Description

Canadian Natural Resources Limited (TSX:CNQ)(NYSE:CNQ) is a very popular way to bet on an oil price recovery, and for good reason. The company has a fantastic track record that emphasizes cost control and smart capital allocation.

When oil prices are low, CNRL is able to take advantage by reducing costs and picking up cheap assets. There's every reason to believe this will happen again. So, if oil does end up recovering, shareholders should win in the end.

This is a nice story, but one critical question remains: Just how expensive are the shares? That question is now a lot easier to answer. CNRL recently released its annual filings for 2014, which show the fair value of its reserves. Below we compare this number to the company's stock price.

A simple comparison

According to the filings, CNRL's reserves are worth just under $70 billion. This assumes a 10% discount rate and also factors in income taxes. From this amount, we must subtract the company's $14 billion in debt. This leaves a fair value of $55 billion for CNRL, or roughly $50 per share.

Just to compare, CNRL's shares trade for about $40, about 20% less than this fair value number. This seems to be a bargain, especially for such a strong company.

Hold on just a second

Before you go snatching up CNRL shares, let's look at the assumptions that go into this "fair value" number.

Like other energy companies, CNRL uses the Sproule price deck as of December 31st, which now seems to be out of date. According to these forecasts, oil will *average* $65 per barrel this year, US$80 per barrel in 2016, and US$90 per barrel in 2017. By comparison, the U.S. Energy Information Agency expects an average oil price of US$52.15 this year and US$70 in 2016.

Sproule’s estimates are about 15-25% more optimistic than the EIA’s. All of a sudden CNRL doesn’t seem like a bargain anymore.

How does this compare with other oil companies?

CNRL still seems to be a better option than other oil producers. Just to draw a clearer picture, **Crescent Point Energy Corp.** trades at a premium to its fair value, using the same assumptions.

It’s anyone’s guess why CNRL isn’t trading for more. One possibility is a low dividend, which turns off some investors. Its balance sheet isn’t perfect either. That said, this company seems to be one of the better options for betting on an oil rebound.

For my part, this is a bet I won’t be making at all. There’s still a lot of optimism in the industry, and stock prices generally haven’t fallen as far as they could. So, even CNRL shares could tank if this optimism isn’t warranted.

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1. Energy Stocks
2. Investing

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1. Editor's Choice

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