5 Reasons to Be Bullish on Canadian Natural Resources Ltd.

Description

Canadian Natural Resources Ltd. (TSX:CNQ)(NYSE:CNQ) has a track record of outperformance. Over the last five years, it saw the second-best total return of its large-cap peers, and during the three-month period last year when oil prices crashed, Canadian Natural's shares were resilient, declining less than 30% compared with the peer average of 50%.

Looking beyond the short-term volatility and to the company's long-term earnings power—the true determining factor of a company's value—there are compelling reasons to be bullish on Canadian Natural. Here are five of them.

1. Significant free-cash-flow growth

Free cash flow—defined as the cash that is left over after all operating and capital expenditures have been paid, is a major driver of total returns. Not only does free cash flow allow a company to buy back shares, grow dividends, and invest in growth opportunities without utilizing costly measures like equity issue or debt, it also provides a cushion for the bad times.

Canadian Natural will be growing its free cash flow by an impressive compound annual growth rate of 34% over the next four years as they transition production to their long-life, low-decline Horizon oil sands project. Canadian Natural already has some of the lowest sustaining capital as a percentage of cash flow in the business due to their low-cost oil thermal in situ projects, as well as mining projects.

2. Low breakeven costs

As mentioned, free cash flow ultimately comes from low-cost assets. This includes assets that have both low operating costs and low sustaining capital costs. Sustaining capital is the money required to maintain production levels, and certain assets (like tight oil plays) have high sustaining capital costs because production drops off, or declines very quickly.

Canadian Natural is transitioning its production largely to its Horizon oil sands mine, which has extremely low breakeven costs. In fact, with a breakeven cost of US$37.99/bbl, it is firmly profitable even in the current market.

3. A strong history and future of rewarding shareholders

Growing free cash flow fueled by low breakeven costs gives Canadian Natural significant room to grow its dividend, and buy back shares. These types of activities are critical for energy companies, as they can support shares and improve total returns in weak price environments and in strong price environments.

Canadian Natural has grown its dividend for 14 consecutive years, increasing it by 320% since 2010. It also has a strong buyback program in place, buying back 2% of the float in the past several years. These trends should accelerate as free cash flow grows.

4. A large, long-life asset base

As mentioned earlier, the value of a stock is not determined by its short-term earnings power, but rather its ability to produce earnings over a long time-frame. For oil and gas companies, their ability to do this is dictated by the size and longevity of their reserves.

Canadian Natural currently has the largest, and perhaps most diverse asset base among its peers. With 4.5 billion boe of proven reserves, and nine billion boe of proven and probable reserves, Canadian Natural can deliver returns for 40+ years. This asset base is diversified among natural gas, synthetic crude oil, and heavy oil.

5. Affordable valuation

With an EV/EBITDA of 5.43, Canadian Natural is trading at the very bottom of its historical valuations for the past 10 years, with its valuation only being lower in 2008 during the financial collapse.

With free cash flow expected to grow to nearly $4 billion even in a weak pricing environment, its valuation does not reflect the inevitable recovery of oil prices (even if it recovers to levels lower than before the crash), and the unprecedented growth in free cash flow.

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