Canadian Natural Resources Limited Got a Steal of a Deal

Description

Canadian Natural Resources Limited (TSX:CNQ)(NYSE:CNQ) made a big splash last week when it signed agreements to acquire several oil sands assets from **Royal Dutch Shell plc (ADR)** (NYSE:RDS.A)(NYSE:RDS.B) and **Marathon Oil Corporation** (NYSE:MRO).

Overall, the Canadian oil giant paid a massive $12.74 billion to bulk up its position in western Canada, which marked the largest acquisition in the company's history. However, what was more impressive about the deal wasn't the size of the purchase price, but the size of the discount the company got on the assets, which was well below the replacement cost.

Drilling down into the deal

Canadian Natural Resources's acquisition is as complex as it is costly. As part of the deal, Shell and Canadian Natural Resources are jointly buying out Marathon Oil's 20% stake in Athabasca Oil Sands Project (AOSP). From there, Canadian Natural Resources will acquire a 70% interest in AOSP, which includes the 126,000-barrel-per-day Jackpine Mine, the 154,000-barrel-per-day Muskeg River Mine, and the Jackpine Mine Expansion, which is an approved 100,000-barrel-per-day expansion.

The deal also includes a stake in the Scotford upgrader and the Quest Carbon Capture and Storage facility. Further, the company will acquire various producing and non-producing oil sands leases, including the Peace River Complex and Carmon Creek thermal in situ operations and the Cliffdale heavy oil field.

To pay for the deal, Canadian Natural Resources will issue Shell more than 97.5 million shares of stock valued at roughly $4 billion, and it will also make a combined upfront cash payment of $8.24 billion to Shell and Marathon Oil. Further, the company will pay Marathon Oil a US$325 million deferred payment in the first quarter of next year.

Price is what you pay; value is what you get

While the purchase price was a staggering $12.74 billion, what's noteworthy about the deal is that Canadian Natural Resources could not replicate these assets for that price. In fact, most analysts believe that it would cost more than $20 billion to build these assets from scratch, implying the company bought them at a 40% discount to replacement costs.

Meanwhile, Canadian Natural Resources is getting a much better deal than Marathon Oil did when it initially bought its stake in the project for US$6.6 billion in 2007, because Marathon Oil will only receive US$2.5 billion for selling that stake today. That's despite the fact that ASOP has expanded significantly since that time and now includes the Jackpine mine.

While Canadian Natural Resources will take on a hefty $9 billion of incremental debt to close this deal, its credit metrics will actually improve significantly. That's because it is getting these assets for such a good value that the transaction will be immediately accretive to the company's cash flow and earnings.

As a result, its book-to-capitalization ratio will fall to 41% at the end of this year and 35% next year. Further, its debt-to-EBITDA will improve from 2.4 times to 1.6 times over the next year at current oil prices, thanks in part to the upcoming completion of its Horizon oil sands expansion.

In other words, Canadian Natural Resources will get both bigger and better with this deal.

Investor takeaway

Canadian Natural Resources pounced on the opportunity to acquire a top-tier oil sands asset at a significant discount. That sets the company up to thrive even if oil prices remain low. Meanwhile, if oil prices improve in the years ahead, this deal will pay even bigger dividends for investors.

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mdilallo