



A Perfect Storm Is Coming for Canadian Natural Resources Limited

Description

Canadian Natural Resources Limited ([TSX:CNQ](#))([NYSE:CNQ](#)) is seen by most investors as the premier large producer, and the share performance is a testament to this — out of 41 Canadian oil names, Canadian Natural is the third best-performing name over the past three months.

The past three months have seen a massive sell-off in Canadian oil stocks with around of a quarter of Canadian names down over 25%. The three-month period has also seen oil prices plunge below US\$50 once again. Despite nearly every headwind possible for the sector (falling prices, fears of a border adjustment tax, rotation out of Canadian oil stocks to stronger-performing sectors), Canadian Natural is one of the few names to break even in terms of price performance during the period.

There are many signs that that the worst is now over for Canadian oil stocks, and Canadian Natural is poised to ride changing sentiment and improving oil prices.

CNQ's recent acquisition will boost production to over one million bpd

Part of the reason Canadian Natural shares have outperformed as of late is due to the company's \$12.7 billion acquisition of a 70% in **Shell** and **Marathon's** Albian Oil Sands assets. This acquisition is being widely applauded by analysts, not only for the massive discount paid, but also for the excellent strategic fit.

Canadian Natural will be receiving interest in two oil sands mines as well as an upgrader; these two mines will contribute an additional 218,000 bpd of production, which will push Canadian Natural's total production to over one million bpd in 2017. The presence of an upgrader is also valuable since it largely produces synthetic crude oil, which is sold at a large premium to the heavy blended oil that oil sands assets would typically produce.

Canadian Natural was also able to purchase these assets at a major discount, which means that the acquisition will add about 17% to Canadian Natural's 2018 cash flow, assuming \$60 oil. The assets were estimated to cost about \$20 billion, and Canadian Natural purchased them for only \$12.7 billion. This worked out to about \$58,000 per barrel per day of production, which is a 40% discount to what Canadian Natural paid for its Horizon mine.

This discount was obtained because that many U.S. corporations are looking to exit the oil sands. Canadian Natural, however, will acquire assets that see no production declines for 40 years and have significant synergies with its other oil sands assets. This means less sustaining capital expenditures for more production, which means more free cash flow.

An expanding free cash flow will allow Canadian Natural to de-leverage, pay dividends, buy back shares, and grow production further, and as oil prices rise Canadian Natural will see its free cash flow grow from \$500 million in 2016 to over \$5 billion in 2018 with \$60 oil.

Sentiment around heavy oil and Canadian producers will improve

While Canadian Natural is now expanding solid production growth (800,000 bpd in 2016 to 1.2 million bpd in 2020) and expanding free cash flow, investors are still fairly negative on Canadian oil producers and Canadian heavy oil producers in general.

Canadian Natural sees about 32% of its production sold as heavy oil, and U.S. investors see Canadian heavy oil prices plunging if the Trump Administration implements a border adjustment tax. It is important to note, however, that U.S. refiners need Canadian heavy oil, since the U.S. only produces 400,000 bpd of heavy oil. In other words, border tax or not, Canadian imports of heavy oil to the United States will continue.

Once uncertainty over a border tax lessens, U.S. investors should continue to gain interest in Canadian Natural once again.

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