TFSA Investors: Buy This Dirt Cheap Energy Stock for Tax-Free Income and Big Capital Gains Potential

Description

For TFSA investors, Canadian energy stocks have been problematic. On the one hand, many of them appear to offer exposure to quality, cash flow rich business at dirt cheap valuations, but on the other hand, the sector is plagued with many short and longer-term obstacles.

Through all this, one fact remains. TFSA investors are constantly looking for the right stocks to help them generate tax-free dividend income and capital gains.

With this in mind, let's revisit an energy stock that continues to offer TFSA investors a very generous dividend yield of 4.53%, a very attractive cash flow and free cash flow profile, and a long and strong history of operational excellence, top tier execution and dividend growth and consistency.

With a diversified portfolio of oil and gas assets in North America, the U.K. North Sea, and offshore Africa, **Canadian Natural Resources Ltd.** (TSX:CNQ)(NYSE:CNQ) is one of Canada's largest independent producers.

The company owns long-life, low decline assets that provide sustainable and predictable cash flow, with significant development opportunities and a large undeveloped land base.

Cash flows rule the day

At CNQ, a hallmark of its business has been its ability to generate impressive cash flows. This has presented the company with the best of "problems," that is, what to do with all this cash?

It's a good dilemma to have, and as a shareholder, one I'm perfectly happy to watch unfold as I collect hefty dividend payments.

Strong cash flows have really put the company in a power position. At a time when energy companies in general have depressed market valuations, Canadian Natural can use its financial strength to come in and swoop up some attractive assets at a bargain.

The company's purchase of Devon Energy Corp.'s Canadian business this year is an example of the type of value creation that CNQ's strong position affords it.

The acquisition is right in CNQ's core areas in Western Alberta, will add 128,300 barrels a day of production and will provide the opportunity to achieve $135 million in synergies (annualized).

Since 2015, operating cash flow has increased at a compound annual growth rate (CAGR) of 16% and free cash flow has increased at a CAGR of more than 50% to $4.6 billion. With these dramatic increases, management has also been able to return some of this cash to shareholders.

The dividend was increased at a CAGR of 13.3% during the same three-year period and the company bought back approximately $1 billion worth of its shares in 2018, and $500 million so far in 2019.

All this at dirt cheap valuations

This description of Canadian Natural Resources sounds like a TFSA investor's dream come true, doesn't it? It certainly does to me, but the key here is patience.

We've seen the downside that exists when an industry is going through major pains, and it is not pretty. For those of us with the will and the fortitude though, I think the end result will be very pretty indeed.

CNQ stock price has continued to falter despite the fact that the company's actual company-specific fundamentals look really good. The stock is down more than 20% in the last year and more than 24% in the last five years.

Which brings me to my next point. This stock trades at cyclically low valuations, and while it is a difficult thing to do, these are the times to be buying these types of cyclical stocks.

When they are trading at cyclically high valuations and everybody loves them, it is an easy thing to do, but not necessarily the best. CNQ stock is trading at 3.7 times this year's expected cash flow and 3.4 times next year's expected cash flow.

Foolish bottom line

TFSA investors would do well to consider Canadian Natural Resources stock — a stock that's trading at dirt cheap valuations but supported by vast amounts of cash flow that continues to grow.

While it's always difficult to buy a stock when sentiment is so bad, these are often the absolute best times to buy. It might take a while for this stock to get going, but in the meantime, the dividend income can keep you warm.

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