Canadian Natural Resources (TSX:CNQ) Stock: What to Expect in 2020

Description

Canadian Natural Resources (TSX:CNQ)(NYSE:CNQ) is a controversial stock. Several analysts are now calling shares too cheap to ignore, especially if you're bullish on oil prices. The stock now trades for less than 11 times 2019 earnings. Others, however, are pointing to the company's long-term destruction of shareholder wealth. Since 2006, shares have returned roughly 0%.

In past years, CNQ stock has run nearly 100%. In other years, shares have lost more than 50% of their value. What does 2020 hold in store for Canadian Natural?

Shares are cheap

There's no denying Canadian Natural stock is cheap. Shares trade at just 2.1 times trailing sales versus a five-year average of 2.9 times sales. It doesn't matter which metric you look at, the stock trades at historically low valuations. Shares trade at 1.3 times book value versus a five-year average of 1.5 times book value. They trade at 4.8 times cash flow versus a five-year average of seven times cash flow.

Run down the list, and you quickly realize that CNQ shares are out of favour. Even the dividend yield of 4% is a third higher than its multi-year norm. There's one catch, though: the stock is cheap for a reason.

Bottlenecks dominate

Cheap stocks are often cheap for a reason. For CNQ, it's *multiple* reasons, the biggest of which is that the company simply doesn't control its own future. In late 2018, the Canadian energy sector was wracked by capacity constraints. Regional production ballooned, placing intense pressure on transportation avenues like pipelines and crude by rail. There simply wasn't enough capacity to ship surging supply. In response, local pricing fell by as much as 70%. Global crude prices, meanwhile, held steady, meaning Canadian producers like CNQ were at a sizable competitive disadvantage.

If you can't ship your product, your business is dead. While current conditions aren't that dramatic, they're extraordinarily difficult. Alberta instituted a production cap last year, which helped short-term prices, but the government recently extended the industry-wide supply cuts through at least the end of 2020. Building new pipeline capacity can take a decade or more, and production is expected to continue rising through at least 2030. The transportation dilemma isn't going away anytime soon, no matter what Canadian Natural management does.

Risks are rising

Canadian Natural doesn't control its own future because it's reliant on other companies building long-term pipeline capacity. But that's not the only headwind Canadian Natural doesn't control. There's also a massive regulatory hurdle and a falling industry cost-curve to contend with.

Oil sands are already an expensive way to produce oil. Current estimates peg CNQ's breakeven price at around US$40 per barrel. Compare that to **Chevron** and **Exxon Mobil**, which are both pursuing North American shale plays with breakevens as low as US$15 per barrel, and you start to get a sense of how uneconomical Canadian Natural's production is. In a world of falling exploration and production costs, oil sands output is finding it difficult to compete.

To make things even worse, new environmental regulations could make up to 20% of all oil sands projects economically unviable. Next year, international standards dictate that marine fuel's sulphur content must drop from 3.5% to 0.5%. Economist Allan Fogwill, head of the Canadian Energy Research Institute, thinks that this could add US$5 in additional costs to oil sands output. That could push Canadian Natural dangerously close to loss-making territory.

In total, 2020 is going to be extremely difficult for the stock. Current woes won't dissipate next year, and new challenges will arise. Shares are cheap, but they're cheap for a reason. I'm staying away.

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