



## Why Canadian Natural Resources (TSX:CNQ) Stock Surged 40%

### Description

**Canadian Natural Resources** ([TSX:CNQ](#))([NYSE:CNQ](#)) was once one of the [worst-performing stocks](#) in Canada. Through the first nine months of 2019, shares fell by 20%, while the **S&P/TSX Composite Index** *increased* by 10%.

That all changed last September, when the stock went on a four-month winning streak, rising by more than 40%.

What's behind the surge? Is there still time to profit, or have the gains been priced in?

### Understand what you're buying

To understand Canadian Natural, you have to dig through a bit of history — look at what's behind its multi-billion-dollar asset base.

Roughly 36% of Canadian Natural's production comes from oil sands, with another 32% coming from heavy oil. If you know anything about energy production, you'll know that these are poor sources of profits. That's because oil sands and heavy oil require higher levels of refining to reach the market. More refining means higher costs, causing these types of output to sell at a discount.

According to *Oil Sands Magazine*, "Since simple refineries have little flexibility in their product slate, processing heavy sour crude would produce too much low-value residue. These refineries typically see much lower profit margins when processing heavier feedstock, and would therefore only buy that crude if priced at a significant discount."

Additionally, oil sands are often the target of environmental groups, raising the ever-present risk of increased regulation.

For example, this year, the International Maritime Organization mandated that the sulphur content limit of maritime fuel move from 3.5% to 0.5%. This will require *significantly* more refining. As a result, as much as 20% of all oil sands production may be rendered uneconomical.

## Threading the needle

To be sure, Canadian Natural is presently throwing off plenty of cash thanks to strict cost cutting and a normalization in Canada's pipeline market. Shares currently trade at a 13% free cash flow yield based on 2020 estimates. That's clearly value territory. Why then aren't shares moving even higher?

Many oil sands projects break even at prices above US\$40 per barrel. Meanwhile, major oil companies are developing U.S. shale projects that target breakeven levels below US\$20 per barrel. Take a guess at which initiatives will stand the test of time.

Jeremy Grantham, founder of GMO Asset Management, once noted that oil sands stand a good chance of becoming "stranded assets." That means that they'll ultimately provide zero value for shareholders. He said that in 2014. What's happened to Canadian Natural stock since then? It's returned roughly 0%.

That doesn't mean CNQ stock hasn't fluctuated wildly along the way. Over the last decade, shares have moved 40% in either direction seven times. But no matter what the impetus was, no long-term value was ever accrued.

Canadian Natural is doing all it can to succeed, but that fact remains that the odds are stacked against it. Its assets aren't cost competitive and face severe risks regarding environmental regulation. Despite the recent upward move, this still doesn't look like a business you want to own in the new decade.

### CATEGORY

1. Energy Stocks
2. Investing

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2. TSX:CNQ (Canadian Natural Resources Limited)

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