Market Crash: Will Canadian Natural Resources (TSX:CNQ) Stock Go to $0?

Description

In October of 2019, I'd warned investors of a coming market crash. Of course, I didn't predict the coronavirus pandemic. Instead, I highlighted how certain energy producers would face severe difficulties in the year ahead, potentially resulting in bankruptcies.

"Rule number one: ditch companies focused on high-cost exploration and production," I wrote, calling out one company in particular. "**Canadian Natural Resources** (TSX:CNQ)(NYSE:CNQ) is a perfect case."

Understand what is happening

As early as February, Canadian Natural was touting its free cash flow growth, dividend increases, and sizable share buybacks. If you'd listened to company executives, you would have concluded that shares were a screaming buy. But as we all know, management teams are often overly optimistic in their predictions.

In 2005, for example, Canadian Natural was talking up its growth potential, as it expanded its operations quickly. The market believed the stock would become the next energy giant, assigning shares a $30-per-share valuation. At the start of 2020, the stock was *still* valued at $30 per share. That's a 0% return, even after holding the stock for nearly 15 years straight.

Historically, this company has been skilled at destroying shareholder value. Last October, I'd argued that the trend would continue. That month, shares were priced at $25. Today, just six months later, the stock is valued at $14.

What happened? Pure economics happened.

The oil market crash

Canadian Natural owns some of the largest oil sands assets in Canada. When oil sands projects were first being developed, famed investor Jeremy Grantham noted that they'll likely end up as "stranded assets." Years later, it appears as if he was right.

What exactly is a stranded asset? We can glean the answer by looking directly at Canadian Natural's operations.

Oil sands projects rarely break even at prices below US$35 per barrel. Many need prices of US$45 or more to stay afloat. When factoring in reserve replacements, some analysts believe that there isn't an oil sands project on earth that can generate positive lifetime returns with oil below US$50 per barrel.

Saudi Arabia, for comparison, can produce oil for less than US$10 per barrel. Massive new shale projects in the U.S. are targeting breakeven returns as low as US$15 per barrel. Canadian Natural's position as a high-cost producer should be clear.

When Grantham noted that oil sands will become stranded assets, he was remarking on CNQ's vulnerability at the top of the cost curve. If oil prices remained below US$40 per barrel for an extended period of time, it's possible that the entire business will produce losses.

After a while, the company will shut down completely, despite having invested billions into developing its asset base. That's the definition of a stranded asset, and it's happening right before our eyes.

Earlier this year, Saudi Arabia started a global price war, with crude oil dropping to just US$20 per barrel. As long as this oil market crash continues, it's doubtful that prices will exceed the US$30 mark. That's *terrible* news for Canadian Natural.

Many believe that the pricing war is specifically meant to push out high-cost producers like Canadian Natural. By keeping prices low for a year or longer, Saudi Arabia's revenues will be reduced, but they'll still remain profitable. Oil sands operators, for comparison, will almost surely go bankrupt. That means Saudi Arabia can retake a large chunk of market share once it re-enters the market.

Not convinced that CNQ's asset base will ultimately be worthless? Just remember that over the past 15 years, despite more than $30 billion in capital investment, the company's stock price hasn't gained an inch.

There are plenty of bargain stocks to buy during the market crash, but Canadian Natural remains a long-term loser.

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