Canadian Natural Resources (TSX:CNQ): 4 Reasons to Buy the Top Energy Stock

Description

Just when re-opening efforts started to gain some steam, the new coronavirus variant has brought in a fresh set of uncertainties. While broader markets declined around 5% from the top, energy stocks, on average, dropped more than 10% in the last few weeks. Canada's biggest energy stock **Canadian Natural Resources** (TSX:CNQ)(NYSE:CNQ) fared relatively better, losing 6% in the same period.

The $61 billion Canadian Natural is one of the country's largest crude oil and natural gas producers. It is a low-cost producer of heavy crude oil, mainly because of its extensive land base. It derives almost 90% of its revenues from crude oil and natural gas liquids, and the rest comes from natural gas.

CNQ stock has returned 65% in the last 12 months, notably outperforming peers. Interestingly, the stock still has strong growth potential, given its current valuation and a rosy outlook for global energy markets.

Juicy dividends

CNQ pays stable dividends that yield 4.5% at the moment. It has a strong balance sheet that allows the management to distribute cash among shareholders.

Even during the pandemic last year, the company kept its dividend-growth streak intact when trimming or suspending dividends became the norm. In November 2021, Canadian Natural increased dividends by a notable 25% year over year.

Peer **Suncor Energy** (TSX:SU)(NYSE:SU) recently doubled its dividends after halving last year amid the pandemic. Suncor is an integrated energy giant that yields 5.4%.

Strong financial growth and balance sheet

Canadian Natural exhibited a massive comeback this year, on the back of strength in energy commodity prices. So far in 2021, it reported a net income of $5.1 billion against a loss of $1.12 billion in the same period last year. Crude oil prices more than doubled this year, positively impacting its earnings.

Importantly, CNQ’s low breakeven point allows massive free cash flow generation even at current crude oil levels. It is expected to generate a free cash flow of $7.5 billion this year relative to the $2.1 billion generated last year. Higher free cash could meaningfully unlock value for shareholders in terms of share buybacks, higher dividends, or acquisitions.

Valuation

Despite outperforming peers in the last 12 months, CNQ stock is trading at a relatively cheaper valuation. It has a price-to-earnings ratio of 11 at the moment, which is lower than the industry average as well as lower relative to its five-year historical average. This implies the stock is undervalued compared to peers and could have more room for growth going forward.

SU stock has soared 32% in the last 12 months and has notably underperformed peers. Despite being the laggard, SU is currently trading 19 times its earnings.

Positive sector outlook

Crude oil and gas prices could stabilize if fears over the new variant, Omicron, subside in the next few weeks. Energy demand will likely increase amid re-openings and could reach pre-pandemic levels sometime next year.

JP Morgan has given crude oil a price target of US$125 for 2022 and US$150 for 2023. It sees strong demand recovery in 2022-2023 coupled with slower supply increases from OPEC. If that materializes, oil producers like CNQ could see significant earnings expansion in the next 12 to 18 months.

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