

PALOS

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Weekly Commentary

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Canadian Natural Resources Ltd. – Continuing our Oil Patch Update

Following up on our theme from last week (Suncor Energy), we are providing an update on **Canadian Natural Resources Ltd.** (CNQ: TSX, NYSE). CNQ's core operations include the exploration, development and production of natural gas, crude oil and other related products. The company is one of the largest natural gas producers in the country with assets located primarily in Alberta, British Columbia and Saskatchewan. CNQ is a major player in the Canadian Oil sands. Ex-Canada, CNQ has offshore holdings in the North Sea and offshore Africa.

The company released Q1/2021 results on May 6. Despite the impacts of Covid-19 on operations, CNQ delivered very strong results. The first quarter achieved record quarterly production of 1.2 MBOE/d (million barrels of oil equivalent per day). Oil Sands produced record quarterly production of 979,000 bbl/d (barrels per day) of synthetic crude oil (SCO). Synthetic crude is the output produced from the mining of heavy bitumen which is sequentially upgraded into a transportable state. Also known as "heavy oil", diluents are often added to facilitate the transportation of heavy crude to refineries, many of which are located on the U.S. Gulf Coast.

CNQ's balance sheet was strengthened considerably in Q1. Free Cash Flow (FCF) after capital expenditures and dividends was approximately C\$1.4 billion. Long term debt was reduced by approximately the same amount. The company is committed to further strengthening the balance sheet through debt reduction and since Q2/2020 net debt has been reduced by roughly C\$2.9 billion. With West Texas Intermediate (WTI) oil, which is a widely followed benchmark, using a target of US\$60/bbl would significantly enhance cash flow through year end. As we write this, the WTI June futures contract is trading above US\$66/bbl.

In March, CNQ declared a quarterly dividend of C\$0.47/share which is an increase of 11% from the prior payout. This marked the 21st consecutive year of dividend increases and distinguishes CNQ from many of its peers who cut or reduced dividend payouts during the pandemic-related demand and price crisis in the spring of 2020. Also in March, management authorized the continuation of repurchasing shares in the open market. These measures continue to enhance shareholder value.

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On the ESG front (Environmental, Social, Governance), CNQ is firmly on a path to being recognized for its leadership. Greenhouse gas emissions have decreased by 18% from 2016 to 2020. Methane emissions from the North American Exploration and Production segment has dropped by 28% during the same four-year period. The company is also a significant contributor to Carbon Capture and Storage (CCS) and sequestration capacity in the Canadian oil patch. Projects include the storage of CO₂ in geological formations and the industrial application of CO₂ in the oil recovery process. According to information contained in the company's May 6 press release, gross carbon capture capacity is approximately 2.7 million tonnes annually – the equivalent of taking approximately 576,000 cars off the road.

The **Palos Income Fund LP** and the **Palos Equity Income Fund** currently hold shares in Canadian Natural Resources. The company has a market cap of C\$49 billion and a sustainable dividend yield of 4.2%. We initiated our current position on October 30, 2020 and through the closing price of last Friday CNQ shares have provided a return of 101.7% including dividends.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$9.66	12.79%
Palos Equity Income Fund - RRSP	PAL101	\$7.18	12.95%
Palos Merchant Fund L.P. (Dec 31, 2020) ²	PAL500	\$1.35	-21.15%
Palos WP Growth Fund - RRSP	PAL210	\$22.57	41.43%
Palos-Mitchell Alpha Fund ³	PAL300	\$11.90	13.01%
S&P TSX Composite (Total Return with dividends reinvested)			12.22%
S&P 500 (Total Return with dividends reinvested)			11.72%
S&P TSX Venture (Total Return with dividends reinvested)			6.44%
Chart 2: Market Data ¹			Value
US Government 10-Year			1.63%
Canadian Government 10-Year			1.56%
Crude Oil Spot			US \$65.37
Gold Spot			US \$1838.10
US Gov't10-Year/Moody BAA Corp. Spread			204 bps
USD/CAD Exchange Rate Spot			US \$0.8264

¹ Period ending May 14, 2021. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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