

PALOS

CONTENTS

Weekly Commentary

Issue No. 10 | MARCH 7, 2022

Canadian Natural Resources Inc. – Four Pillars of Strength	1
Palos Funds vs. Benchmarks (Total Returns)	3
Disclaimer & Contacts	4

By Charles Marleau CIM[®] and William Mitchell CIM[®]

Canadian Natural Resources Inc. – Four Pillars of Strength

Canadian Natural Resources Inc. (TSX/NYSE: CNQ) is Canada's largest senior oil and gas producer with a market capitalization exceeding \$87 billion (Mar. 4, 2022). With core operations in Western Canada and other producing assets located in the North Sea and West Africa (offshore), CNQ produces over 1.3 million barrels of energy equivalent per day (boe/d) which includes conventional oil, natural gas, and synthetic crude oil (SCO) from Canada's oil sands.

Canadian Natural announced Q4/2021 financial and operating results on March 3. The company reported record quarterly production of approximately 1.31 million boe/d. North American light oil and natural gas liquids (NGL) annual production increased by 12% over 2020, attributed to operational efficiency, prior acquisitions and investment in the liquids rich Montney play. International production fell slightly from 2020 with Africa producing approximately 14,000 boe/d versus 17,000 in 2020 and the North Sea averaging 17,600 boe/d compared with 23,000 the prior year. Oil Sands SCO also saw record production, +7% from 2020.

Free cash flow for Q4 was approximately \$3 billion after capex and dividends that were paid to shareholders. CNQ was able to reduce net debt by \$1.4 billion and total net debt now sits below its previously targeted \$15 billion. Moving forward, CNQ should easily achieve its previously stated objective of allocating 50% of free cash flow to share buybacks and 50% to further debt reduction. The Board has also approved a 28% increase in the quarterly dividend to \$0.75 commencing April 5, 2022, equating to a 4% yield. The bump in the dividend is the third since last March and marks 22 consecutive years of dividend increases, a remarkable achievement given the challenges presented by the pandemic and low prices in 2020.

CNQ plans to balance capital allocation between what management calls its "four pillars" which consists of increasing returns to shareholders (dividends and buybacks), reducing debt, responsibly developing the resource base, and opportunistic acquisitions. CNQ already owns a large, diversified, low decline asset base that requires less capex to maintain production levels and reserves. Recent acquisitions of **Painted Pony Energy Ltd. (TSX: PONY)** in 2020, and **Storm Resources Ltd. (TSX: SRX)** in 2021, are from a "reserves perspective" performing "better than we anticipated" according to comments from CEO Tim McKay during

By Charles Marleau CIM[®] and William Mitchell CIM[®]

the earnings call. While the company certainly has the financial strength to make additional acquisitions we expect any future “tuck-ins” would be opportunistic.

CNQ continues its journey to achieving net zero greenhouse gas (GHG) emissions from its oil sands operations by 2050 (see our [Oil Sands Pathway to Net Zero Project](#), issue 38, published Sept. 20, 2021). In the second half 2022, CNQ is expected to publish its “21 Stewardship Report” which will include “third-party independent reasonable assurance” on Scope 1 and Scope 2 emissions. Generally, Scope 1 relates to direct emissions from owned or controllable operations, whereas Scope 2 covers indirect emissions from “purchased” energy. The report will also describe how CNQ is leveraging innovative technologies to lower its carbon footprint. CNQ’s emissions reduction program includes a leadership role in CCUS (carbon capture, utilization and storage). CNQ is the largest owner of carbon capture capacity in Canada. Other initiatives include power cogeneration (using waste heat to generate steam), operational efficiencies designed to reduce CO2 emissions, investing in water management and assuming a leadership role for decommissioning abandoned wells and land reclamation projects.

We view Canadian Natural as a “best-in-class” energy company as exemplified not only by its operational excellence, financial strength, and its long-life top tier reserves, but also by its commitment to socially responsible principles of environmental stewardship, social responsibility, long-term sustainability of the oil and gas industry and the highest standards of corporate governance. The **Palos Income fund LP** and the **Palos Equity Income Fund** currently hold in CNQ shares.

Follow us on LinkedIn:



Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$9.86	0.19%
Palos Equity Income Fund - RRSP	PAL101	\$7.23	-0.14%
Palos Merchant Fund L.P. (Dec 31, 2021) ²	PAL500	\$1.16	24.67%
Palos WP Growth Fund - RRSP	PAL213	\$17.72	-6.51%
Palos-Mitchell Alpha Fund ³	PAL300	\$10.09	-1.28%
S&P TSX Composite (Total Return with dividends reinvested)			1.24%
S&P 500 (Total Return with dividends reinvested)			-8.94%
S&P TSX Venture (Total Return with dividends reinvested)			-9.78%
Chart 2: Market Data ¹			Value
US Government 10-Year			1.73%
Canadian Government 10-Year			1.67%
Crude Oil Spot			US \$115.68
Gold Spot			US \$1,966.60
US Gov't 10-Year/Moody BAA Corp. Spread			226 bps
USD/CAD Exchange Rate Spot			US \$0.7856

¹ Period ending March 4th, 2022. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

Weekly Commentary

Issue No. 10 | MARCH 7, 2022

Disclaimer:

This publication is proprietary to Palos Management Inc. (along with its affiliate Palos Wealth Management Inc., "Palos"). This publication may be copied, downloaded, stored in a retrieval system, further transmitted, reproduced, disseminated, and/or transferred, in any form or by any means, but only as long as it is unaltered and attributed to Palos. This publication and its contents may not be sold or licensed without Palos' written permission. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made or implied regarding accuracy or completeness. The information provided does not constitute investment advice and it should not be relied upon on as such. If you have received this communication in error, please notify us immediately by electronic mail or telephone. This document may contain certain forward-looking statements that are not guarantees of future performance and future results could be materially different. Past performance is not a guarantee of future performance. "S&P" is a registered trademark of Standard and Poor's Financial Services LLC. "TSX" is a registered trademark of TSX Inc. The Bloomberg USD High Yield Corporate Bond Index is a rules-based, market value weighted index engineered to measure publicly issued noninvestment grade USD fixed rate, taxable, corporate bonds. To be included in the index a security must have a minimum par amount of 250MM.

PALOS

1 Place Ville Marie, Suite 1670
Montreal (QC) H3B 2B6, Canada

T. +1 (514) 397-0188
F. +1 (514) 397-0199

1 St. Clair Avenue East Suite 504
Toronto, Ontario M4T 2V7

T. +1 (647) 276-0110
F. +1 (647) 343-7772

www.palos.ca