Equities

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Canadian Natural Resources Ltd (CNQ)

Q1 Miss But Horizon Repairs On Track; Investor Days Ahead

- Company Update
- Estimate Change

- **Q1'11 Recap** – As outlined in our previously published 'Quick Read' note, CNQ reported Q1'11 financial results modestly below our and consensus expectations primarily due to soft Cdn heavy oil price realizations and higher blending expense. However, although production was down ~13% versus Q4 (solely due to the Horizon's coker fire), Q1 output was in-line with guidance.
- **Partial Horizon Restart Around Mid-Year** – CNQ estimates that repairs to the largely undamaged Coker 2A/2B drums are now ~70% done with full completion by May-end. Following a ~3 week startup process, it expects to restore one-half of output (~55 MBbl/d) by the start of Q3. Meantime, the fire-affected 1A/1B drums are ~50% fixed, with remaining repairs slated by mid-August, restoring full production (~110 MBbl/d) by Q3-end. CNQ reiterated its full-year Horizon target of ~43-55 MBbl/d. We continue to model ~46 MBbl/d based on no Q2 output, partial restoration in Q3, but full rates in Q4.
- **Total Production Guidance Unchanged; Capex Increased –** Full-year production guidance was unchanged at 582-633 MBOE/d (~flat to down 8% vs. 2010). We are modeling ~613 MBOE/d (-3% absolute growth, but +5% excl. Horizon). However, CNQ now expects a slightly "gassier" mix due to strong Montney well performance (EUR's now pegged at ~6 Bcfe vs. pre-drill ~4 Bcfe) offset by an equipment failure at Olowi offshore Gabon and reduced growth at the Pelican Lake polymer-flood project due to slower production response and regulatory delays. But full-year CapEx budget was increased to $6.5-6.6 billion, or $550 million (~5%), with increase allocated to more primary heavy oil drilling, another Montney pad, and leasehold acquisitions (heavy oil), partially offset by less U.K. North Sea activity and spending on Horizon.
- **Estimates –** Our 2011-13 EPS/CFPS estimates decline slightly to incorporate actual Q1 results, oil/gas mix shift and recent cost trends. However, we have revised up our proved-only NAV to ~$40 (from ~$35) based on CNQ's 40-F SEC filing.
- **Investor Days Ahead** – Analyst meetings are scheduled for May 17th/May 19th in Calgary/New York, respectively, which should provide more details on operations.

Buy/High Risk	1H
Price (06 May 11)	US$43.62
Target price	US$60.00
Expected share price return	37.6%
Expected dividend yield	0.8%
Expected total return	**38.4%**
Market Cap	US$47,823M

Price Performance
(RIC: CNQ.N, BB: CNQ US)

EPS	Q1	Q2	Q3	Q4	FY	FC Cons
2010A	0.61A	0.63A	0.55A	0.57A	2.36A	2.36A
2011E	**0.21A**	**0.49E**	**0.73E**	**0.86E**	**2.28E**	**2.59E**
Previous	0.36E	0.58E	0.69E	0.83E	2.46E	na
2012E	**na**	**na**	**na**	**na**	**4.02E**	**3.61E**
Previous	na	na	na	na	4.08E	na
2013E	**na**	**na**	**na**	**na**	**3.75E**	**3.82E**
Previous	na	na	na	na	3.83E	na

Source: Company Reports and dataCentral, CIR. FC Cons: First Call Consensus.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Dec	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	18.3	17.9	18.5	10.5	11.2
EV/EBITDA adjusted (x)	12.9	7.8	7.6	5.0	5.0
P/BV (x)	2.4	2.2	2.0	1.7	1.5
Dividend yield (%)	1.0	0.9	0.9	0.9	0.9
Per Share Data (C$)					
EPS adjusted	2.30	2.36	2.28	4.02	3.75
EPS reported	1.46	1.56	2.12	4.02	3.75
BVPS	17.91	19.24	20.61	24.27	27.65
DPS	0.42	0.38	0.36	0.40	0.40
Profit & Loss (C$K)					
Net sales	9,384,000	13,022,000	13,300,308	17,276,803	17,472,350
Operating expenses	-7,736,000	-9,996,000	-9,525,481	-10,562,698	-11,175,656
EBIT	**1,648,000**	**3,026,000**	**3,774,828**	**6,714,105**	**6,296,694**
Net interest expense	-410,000	-449,000	-409,000	-450,000	-450,000
Non-operating/exceptionals	631,000	182,000	67,000	0	0
Pre-tax profit	**1,869,000**	**2,759,000**	**3,432,828**	**6,264,105**	**5,846,694**
Tax	-289,000	-1,062,000	-1,092,312	-1,816,591	-1,695,541
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**1,580,000**	**1,697,000**	**2,340,516**	**4,447,515**	**4,151,153**
Adjusted earnings	2,493,000	2,568,000	2,522,516	4,447,515	4,151,153
Adjusted EBITDA	4,461,000	7,062,000	7,185,824	10,606,003	10,401,919
Growth Rates (%)					
Sales	-38.9	38.8	2.1	29.9	1.1
EBIT adjusted	-79.2	83.6	24.7	77.9	-6.2
EBITDA adjusted	-58.0	58.3	1.8	47.6	-1.9
EPS adjusted	-29.5	2.6	-3.3	76.3	-6.7
Cash Flow (C$K)					
Operating cash flow	**5,377,000**	**5,328,000**	**5,425,206**	**8,975,219**	**8,849,818**
Depreciation/amortization	2,813,000	4,036,000	3,410,997	3,891,898	4,105,226
Net working capital	-683,000	-769,000	-637,000	0	0
Investing cash flow	**-3,600,000**	**-1,770,000**	**-5,821,000**	**-6,671,500**	**-7,338,650**
Capital expenditure	-3,120,000	-3,638,000	-6,135,000	-6,671,500	-7,338,650
Acquisitions/disposals	0	1,868,000	314,000	0	0
Financing cash flow	**-1,646,883**	**-407,843**	**-393,727**	**-437,474**	**-437,474**
Borrowings	-1,338,000	0	0	0	0
Dividends paid	-281,883	-407,843	-393,727	-437,474	-437,474
Change in cash	**130,117**	**3,150,157**	**-789,521**	**1,866,245**	**1,073,694**
Balance Sheet (C$K)					
Total assets	**41,024,000**	**42,669,000**	**45,949,318**	**48,650,185**	**51,798,365**
Cash & cash equivalent	13,000	22,000	50,000	50,000	50,000
Accounts receivable	1,148,000	1,481,000	1,624,000	1,624,000	1,624,000
Net fixed assets	39,115,000	40,472,000	43,283,318	45,984,185	49,132,365
Total liabilities	**21,598,000**	**21,684,000**	**23,355,098**	**22,045,923**	**21,480,425**
Accounts payable	240,000	274,000	453,000	453,000	453,000
Total Debt	9,658,000	8,499,000	8,294,404	6,325,423	5,141,485
Shareholders' funds	**19,426,000**	**20,985,000**	**22,594,221**	**26,604,262**	**30,317,940**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	47.5	54.2	54.0	61.4	59.5
ROE adjusted	13.2	12.7	11.6	18.1	14.6
ROIC adjusted	3.5	5.0	6.6	11.3	10.0
Net debt to equity	49.6	40.4	36.5	23.6	16.8
Total debt to capital	33.2	28.8	26.9	19.2	14.5

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Q1 Miss But Horizon Repairs Underway

Canadian Natural Resources Ltd. (CNQ) reported a headline first quarter profit of C$0.04 per share which aside from usual adjustments for unrealized commodity derivatives, FX and stock-based compensation, incorporated a negative $104 million deferred tax adjustment associated with the recent UK oil & gas tax hike. Adjusted for these items, CNQ posted “clean” EPS/CFPS of C$0.21/$0.97 which was below both our C$0.36/$1.14 forecast and company-compiled consensus of C$0.31/$1.05. Variance to our model emanated primarily from lower-than-projected Cdn heavy oil prices due to lingering effects of Enbridge pipeline curtailments, and higher-than-expected heavy oil blending costs as light condensate traded at a ~$6.00/Bbl premium to WTI during the quarter. Non-cash DD&A was also higher than our projection due to mix shift with fewer low reserve cost Horizon barrels, but this was offset by modestly lower than anticipated G&A and interest expense.

First quarter production averaged 566 MBOE/d, down ~13% sequentially with the drop solely attributable to the Horizon outage. Total production was ~1% below our forecast but at the mid-point of the company’s 556-577 MBOE/d guidance range. Excluding oil sands, Canadian crude oil and natural gas production was essentially unchanged from the fourth quarter. Internationally, UK North Sea volumes rose 7% benefitting from a new Ninian Field well onstream in December 2010, however this was largely offset by a 6% decline in West Africa due to maintenance activity.

CNQ’s average crude oil price realization of ~$69.00/Bbl was substantially below our ~$75.50/Bbl estimate as Canadian heavy oil spreads widened with Enbridge pipeline capacity remaining constrained during the quarter. However, management noted that both pipeline availability and spreads have normalized subsequent to quarter-end, and thus oil realizations should show a marked improvement in Q2. Positively, its average natural gas selling price of $3.83/MMBtu was slightly ahead of our modeled $3.73/MMBtu, with the company benefitting from higher sales of liquids-rich Montney gas.

Horizon Repairs Largely On Schedule

The company’s Horizon oil sands facility remains shut down following the January 6^{th} coking unit fire, but the company provided extensive details regarding the progress of repairs. Notably, the collateral damage from freezing temperatures subsequent to the incident were somewhat worse than previously indicated, and the company raised its repair cost estimate by ~14% to ~$350-$450 million (from ~$300-$400 million previously) but it expects this tab to be fully reimbursed by insurance. Meanwhile, procurement activity is nearly complete and most of the replacement items are now on-site with the remainder slated to arrive within the next two weeks.

The company estimates that repairs at the relatively undamaged Coker 2A/2B drums is now ~70% complete, but the fire-affected Coker 1A/1B units are only ~50% fixed at this juncture. Subject to timely completion of ongoing activity and subsequent regulatory approval, CNQ expects to finish Coker 2A/2B repairs by the end of this month followed by a 3 week startup and commissioning period. Thus, about one-half of production (~55 MBbl/d) is slated for restoration around the beginning of the third quarter. Coker 1A/1B work is expected to be complete by mid-August, but followed by a shorter 1 week startup to enable full output (~110 MBbl/d) to resume by the end of the third quarter. Importantly, the company pushed forward other scheduled maintenance activity (including a 17-day turnaround previously planned for 2012) to take advantage of this unexpected downtime, and thus anticipates strong production once the facility finally returns to service. Management reiterated its full-year Horizon guidance of 43-55 MBbl/d that it

previously issued along with Q4 earnings in March. We continue to conservatively model a full year average of ~46 MBbl/d assuming no output in the second quarter, partial restoration in the third quarter but full production in the fourth quarter.

2011 Production Guidance Unchanged; But Capital Spending Increased

CNQ issued second quarter production guidance while modestly tweaking its previously-issued full-year guidance. For Q2, the company anticipates average output of ~548-582 MBOE/d (with the mid-point implying sequentially flat production). However, full-year guidance was essentially unchanged at a range of ~582-633 MBOE/d, implying volumes will be flat to down 8% year-over-year, entirely due the Horizon outage (excluding Horizon, the guidance implies ~0-8% growth). We model ~613 MBOE/d, a ~3% drop, but up 5% excluding Horizon.

However, although the total output target is essentially unchanged, CNQ now expects a slightly "gassier" mix with its anticipated Canadian natural gas production guidance raised ~3%, driven primarily by stronger than expected output (~60 MMcf/d versus previous 50 MMcf/d) from its new Montney pad that was brought onstream in late Q4. Conversely, planned crude oil output was cut ~2% due to an unexpected facility issue at Olowi (Gabon) coupled with slower-than-expected production response and regulatory delays at its Pelican Lake (Alberta) polymer flood (see the operational highlights section below for further details).

Importantly, CNQ has scheduled Investor Days on May 17th/May 19th in Calgary/New York, respectively. We expect to provide a comprehensive operational update following these meetings, but highlight a few key items below.

Operational Highlights

In Canada, CNQ noted much better-than-anticipated results from its recently completed B.C. Montney 15-well pad with EUR's now pegged at above 6 Bcfe versus its pre-drill 4 Bcfe estimate. Consequently, it now plans to drill an additional 8 Montney wells in the second half of the year, and will likely expand its gas processing capacity to ~100 MMcf/d. Meanwhile, it is also boosting its primary heavy oil drilling program and now expects a ~13% year-over-year uptick to ~105 MBbl/d (up from its prior ~11% growth target). However, due to some facility maintenance as well as steaming strategy changes at its Primrose East (deferring some volumes to 2012), the company now expects a ~8% thermal oil increase (down from its earlier ~12% goal) this year to nearly ~100 MBbl/d, although it expects this pace to rise to ~10% next year.

The company also disclosed that growth at the Pelican Lake polymer flood project will be much lower than previously expected (6% year-over-year versus earlier mid-teens goal). This is attributed to a significantly slower-than-expected production response in the southern section of the pool, coupled with regulatory delays in obtaining approval to expand its drilling and injection program. CNQ claims that the slower response will eventually result in higher recoveries and a longer plateau in subsequent years although this is not definitive. Meanwhile, most of the regulatory issues are now resolved, but have delayed higher output rates until 2012.

Internationally, the already troubled and poorly-perfoming Olowi project (offshore Gabon) suffered a further setback. Subsequent to quarter-end, its mid water arch, which supports its production and gas lift flowlines and power lines experienced a

support failures, causing a total production suspension. Two of the three platforms are expected to remain shut-down for the rest of the year, reducing production by ~2 MBbl/d. In the UK North Sea, the company has canceled planned development drilling and will accelerate a platform abandonment as a direct result of the U.K. tax hike. Notably, it stated that approximately one-half of its UK project inventory no longer competes for capital within its overall portfolio following the tax change.

Financials, Estimates & Valuation

CNQ boosted the mid-point by ~5% (and tightened the range) of its full-year capital budget to ~$6.5-$6.6 billion (from prior ~$6.15-$6.55 billion). This includes a ~$200 million property acquisition increase, a ~$150 million uptick in Canadian natural gas-directed spending (largely attributable to the aforementioned Montney activity boost) and a ~$175 million increase in Canadian crude oil drilling (mainly from higher primary heavy drilling). These are partially offset by a ~$85 million drop in U.K. North Sea activity following the tax increase, a ~$75 million decrease at the in-progress Kirby thermal oil project (full-scale activity will not kick off until mid-year), and lower planned Horizon spend following the fire. Importantly, the higher spending will not yield any incremental production in 2011, primarily due to the back-loaded nature of the increased activity. In fact, 40% of this year's capital spending will not benefit 2011 production. Due to the spending uptick coupled with the cash flow decrease caused by the Horizon fire, we now project CNQ's Capex plus its $400 million annual dividend to exceed discretionary cash flow (we project $6.3 billion) by ~$600 million.

However, the company's financial position remains strong with its net debt to capitalization ratio at a reasonable ~35%, and $2.3 billion of availability under its bank facilities, and thus we expect this shortfall to be easily funded. CNQ's first quarter Capex was ~$1.7 billion including ~$225 million spent on a Canadian heavy oil land acquisitions (with ~200 drilling locations but no associated production).

Incorporating actual below-expectation first quarter results, the slightly "gassier" anticipated production mix, and recent cost trends, we have revised our 2011-2013 EPS/CFPS estimates slightly lower. We now project 2011 EPS/CFPS estimates of C$2.28/$5.70 from C$2.46/$5.92, 2012 at $4.02/$8.21 from C$4.08/$8.33, and 2013 at C$3.75/$8.10 from C$3.83/8.24. However, we recently revised up our proven reserve-only NAV using year-end 2010 data obtained from its annual 40-F SEC filing. Consequently, our NAV valuation (based on flat ~$100 WTI crude oil) rises to ~$40 per share (from ~$35 per share) previously.

Overall, we continue to view CNQ as strongly positioned to benefit from secularly higher long-term crude oil prices given its long reserve life resources and minimal geopolitical risk with over ~95% of its production located in Canada or the U.K. Despite the near-term Horizon disruption, we are heartened by the extensive progress made towards restoring production by the end of the third-quarter. We see its upcoming analyst days (May 17th/May 19th) as a potential positive catalyst as its further outlines the timing of Horizon production resumption as well as its longer-term Canadian growth plans. Our Buy rating and $60 per share price target is unchanged at this juncture. We set our $60 target based on its shares achieving a 2012 EV/DACF multiple of 7.3x and ~148% of proven reserve only NAV based on "normalized" WTI spot crude oil and composite spot natural gas prices of $100.00/Bbl and $5.25/MMBtu, respectively.

Additional Information

Please see our previous research reports on Canadian Natural Resources:

May 5th, 2011 report titled: Canadian Natural Resources Ltd - 'Quick Read' – Q1 Miss On Soft Cdn Oil Prices, High Costs

April 13th, 2011 report titled: EPS/CFPS Rise as Production/Oil Price Gains Offset Gas Weakness

March 24th, 2011 report titled: Lowering Estimates For APA, CNQ, NXY, TLM To Reflect Tax Hike

March 7th, 2011 report titled: Raising 2011 Brent/WTI Forecasts To $105/$95; 2012 to $100/$95

March 4th, 2011 report titled: Despite Horizon Loss, Oil Prices Continue To Provide Tail Wind

February 15th, 2011 report titled: Canadian Natural Resources Ltd - Adjusting 2011 Estimates Lower On Extended Horizon Downtime

January 13th, 2011 report titled: 2011 E&P Sector Outlook - Still Higher Beta Play On S&P With An Eye On Natural Gas Prices

January 7th, 2011 report titled: Canadian Natural Resources Ltd - Horizon Fire Shuts Down Oil Sands Facility

December 3rd, 2010 report titled: Canadian Natural Resources Ltd - Boosts Medium-Term Visibility; Raising Price Target To US$48

November 4th, 2010 report titled: Canadian Natural Resources Ltd - Another Quarter, Another 1.5 Billion Dollars

October 8th, 2010 report titled: The View From The North - Canada Trip Notes: Activity Ramping Back To Peak…

August 5th, 2010 report titled: Canadian Natural Resources Ltd - On Course For Solid 2010 With Strong Oil Volume Growth

June 20th, 2010 report titled: Calgary Trip Wrap-Up - The Anti-Gulf of Mexico: Onshore Now An Advantage…

May 19th, 2010 report titled: Canadian Natural Resources Ltd - Analyst Mtg: No Surprises but Boring Is Good; Staying On-Track

May 7th, 2010 report titled: Canadian Natural Resources Ltd - Excellent Quarter Led By Oil Growth; Analyst Meetings Ahead

March 4th, 2010 report titled: Canadian Natural Resources Ltd - Strong Growth, Free Cash Flow Ahead in 2010

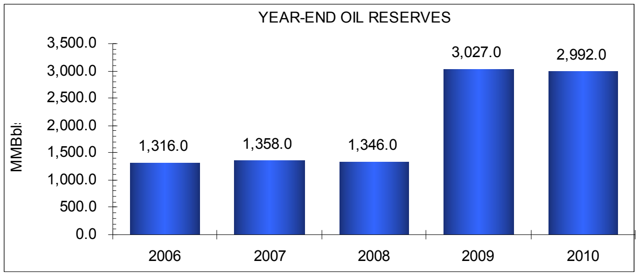
December 7th, 2009 initiation report titled: E&P Shares Look To 2010 With An Eye On Commodity Prices

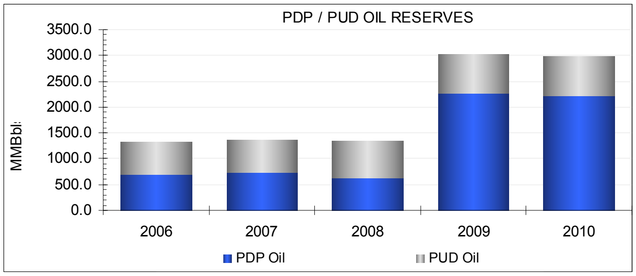
Figure 1. CNQ Operating Summary

	Q4	2010	Q1	Q2E	Q3E	Q4E	2011E	2012E	2013E
WTI Crude Oil (US$/Bbl)	**$85.16**	**$79.49**	**$93.79**	**$100.00**	**$95.00**	**$90.00**	**$95.00**	**$95.00**	**$90.00**
Natural Gas (US$/MMBtu)	**$3.77**	**$4.33**	**$4.19**	**$3.75**	**$4.00**	**$5.15**	**$4.25**	**$5.50**	**$5.50**
Total Production									
Oil (Bbls/d)	438,835	424,985	356,988	357,000	431,000	472,000	404,635	505,626	541,188
Gas (Mcf/d)	1,252,000	1,243,362	1,256,000	1,236,000	1,249,000	1,263,000	1,251,014	1,291,778	1,328,000
Equivalent (BOE/d)	647,502	632,212	566,321	563,000	639,167	682,500	613,138	720,922	762,522
INCOME STATEMENT ($,000)									
Oil and Gas Sales	3,787,000	14,322,000	3,302,000	3,429,858	4,029,738	4,347,175	15,108,771	19,360,415	19,607,573
Royalties	(431,000)	(1,421,000)	(351,000)	(433,331)	(450,072)	(450,060)	(1,684,463)	(2,083,611)	(2,135,223)
Realized hedging gains (loss)	(26,000)	96,000	(70,000)	0	0	0	(70,000)	0	0
Unrealized hedging gains (loss)	(173,000)	25,000	(54,000)	0	0	0	(54,000)	0	0
Midstream Margin	0	0	0	0	0	0	0	0	0
Operating Revs (net of royalties)	3,157,000	13,022,000	2,827,000	2,996,527	3,579,666	3,897,115	13,300,308	17,276,803	17,472,350
Lease Operating	874,000	3,447,000	845,000	844,708	893,320	921,472	3,504,500	4,051,205	4,308,623
Production Taxes	25,000	119,000	24,000	30,000	30,000	30,000	114,000	140,000	150,000
DD&A	1,578,000	4,036,000	849,000	768,495	867,349	926,153	3,410,997	3,891,898	4,105,226
General & Administrative	53,000	210,000	54,000	56,000	59,000	59,000	228,000	250,000	260,000
Stock-based compensation	336,000	294,000	128,000	0	0	0	128,000	0	0
Total Operating Expenses	3,353,000	9,996,000	2,554,000	2,146,979	2,354,790	2,469,712	9,525,481	10,562,698	11,175,656
Total Operating Income	(196,000)	3,026,000	273,000	849,548	1,224,876	1,427,404	3,774,828	6,714,105	6,296,694
Interest Expense	120,000	449,000	94,000	100,000	105,000	110,000	409,000	450,000	450,000
Unrealized FX loss (gain)	($114,000.000)	($182,000.000)	($67,000.000)	$0.000	$0.000	$0.000	($67,000.000)	$0.000	$0.000
Earnings before income taxes	(202,000)	2,759,000	246,000	749,548	1,119,876	1,317,404	3,432,828	6,264,105	5,846,694
Income Taxes (Benefit)	214,000	1,062,000	200,000	209,873	313,565	368,873	1,092,312	1,816,591	1,695,541
% Effective Tax Rate	*-105.9%*	*38.5%*	*81.3%*	*28.0%*	*28.0%*	*28.0%*	*31.8%*	*29.0%*	*29.0%*
Reported Net Income (Loss)	(416,000)	1,697,000	46,000	539,674	806,311	948,531	2,340,516	4,447,515	4,151,153
Reported NI (Loss) Per Share	(0.38)	1.56	0.04	0.49	0.74	0.87	2.14	4.07	3.80
Recurring, Fully-Diluted NI (Loss)/Share	0.57	2.36	0.21	0.49	0.73	0.86	2.28	4.02	3.75
Discretionary Cash Flow	1,641,000	6,309,000	1,074,000	1,401,235	1,801,543	2,021,112	6,297,891	9,077,955	8,960,062
Cash Flow Per Diluted Share	1.51	5.80	0.97	1.27	1.63	1.83	5.70	8.21	8.10
COMPONENTS ($/BOE)									
Operating Revenues	63.12	62.98	63.66	66.41	68.57	69.64	67.27	74.00	71.15
Royalties as % of revenues	0.11	0.10	0.11	0.13	0.11	0.10	0.11	0.11	0.11
Lease Operating Expenses	16.57	16.70	18.67	18.72	17.11	16.47	17.65	17.35	17.55
Production taxes	0.47	0.58	0.53	0.66	0.57	0.54	0.57	0.60	0.61
D.D.&A.	29.91	19.56	18.76	17.03	16.61	16.55	17.18	16.67	16.72
General & Administrative	1.00	1.02	1.19	1.24	1.13	1.05	1.15	1.07	1.06
Stock-based comp.	6.37	1.42	2.83	0.00	0.00	0.00	0.64	0.00	0.00
Interest Expense	2.27	2.18	2.08	2.22	2.01	1.97	2.06	1.93	1.83
Discretionary Cash Flow	31.11	30.57	23.73	31.05	34.51	36.12	31.72	38.88	36.49
DISCRETIONARY CF ($ '000s)									
Net Income (recurring)	(416,000)	1,697,000	46,000	539,674	806,311	948,531	2,340,516	4,447,515	4,151,153
D.D.&A.	1,578,000	4,036,000	849,000	768,495	867,349	926,153	3,410,997	3,891,898	4,105,226
Asset Retirement Accretion	27,000	107,000	33,000	25,104	28,814	30,767	117,685	118,736	125,244
Deferred Taxes	58,000	364,000	43,000	62,962	94,070	110,662	310,694	635,807	593,439
Unrealized FX loss (gain)	(120,000)	(238,000)	(89,000)	0	0	0	(89,000)	0	0
Unrealized Risk Management	173,000	33,000	54,000	0	0	0	54,000	0	0
Deferred Petroleum Revenue Tax	5,000	28,000	10,000	5,000	5,000	5,000	25,000	24,000	25,000
Stock-based compensation	336,000	294,000	128,000	0	0	0	128,000	0	0
Discretionary Cash Flow	1,641,000	6,309,000	1,074,000	1,401,235	1,801,543	2,021,112	6,297,891	9,077,955	8,960,062

Source: CNQ, Citi Investment Research and Analysis

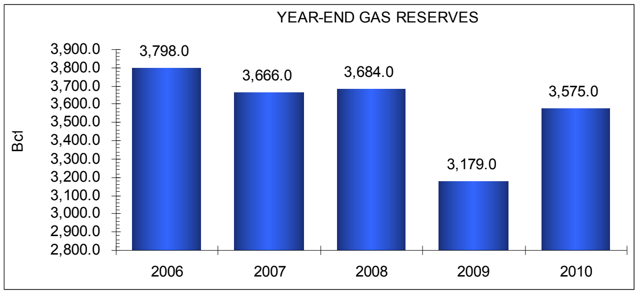
Figure 2. CNQ Reserve Summary

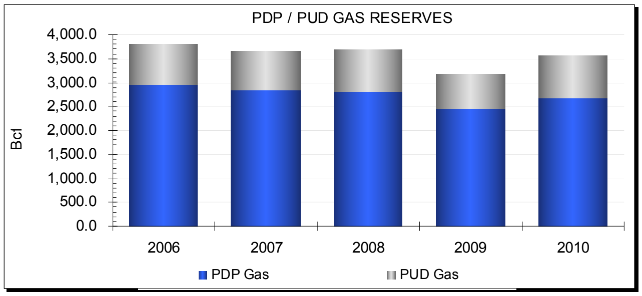




MMBbls	2006	2007	2008	2009	2010
Beginning Balance	1,118.0	1,316.0	1,358.0	1,346.0	3,027.0
+ Drilling	272.0	49.0	78.0	1,770.0	92.0
+ Acquisitions	26.0	1.0	0.0	1.0	107.0
+ Revisions	10.0	102.0	11.0	8.0	(100.0)
Reserves Added	308.0	152.0	89.0	1,779.0	99.0
- Sales	0.0	(3.0)	0.0	0.0	0.0
- Production	(110.0)	(107.0)	(101.0)	(98.0)	(134.0)
Year-End Reserves	**1,316.0**	**1,358.0**	**1,346.0**	**3,027.0**	**2,992.0**
% Domestic	67%	68%	70%	88%	88%
% Foreign	33%	32%	30%	12%	12%

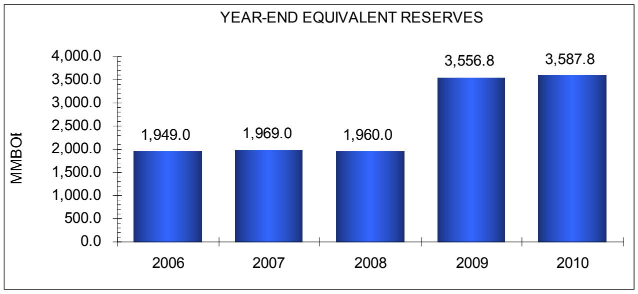
MMBbls	2006	2007	2008	2009	2010
Proved Developed	697.0	736.0	632.0	2261.0	2225.0
Proved Undeveloped	619.0	622.0	714.0	766.0	767.0
% Proved Developed	53%	54%	47%	75%	74%
% Proved Undeveloped	47%	46%	53%	25%	26%
% PDP Domestic	60%	58%	68%	91%	92%
% PDP Foreign	40%	42%	32%	9%	8%
% PUD Domestic	75%	79%	73%	79%	76%
% PUD Foreign	25%	21%	27%	21%	24%

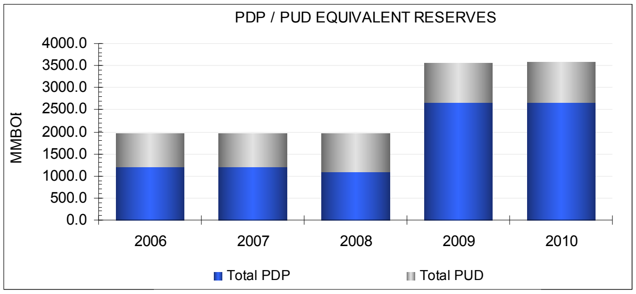




Bcf	2006	2007	2008	2009	2010
Beginning Balance	2,842.0	3,798.0	3,666.0	3,684.0	3,179.0
+ Drilling	324.0	269.0	197.0	103.0	268.0
+ Acquisitions	1,111.0	12.0	77.0	15.0	364.0
+ Revisions	(37.0)	99.0	202.0	(164.0)	199.0
Reserves Added	1,398.0	380.0	476.0	(46.0)	831.0
- Sales	(1.0)	0.0	(1.0)	(6.0)	0.0
- Production	(441.0)	(512.0)	(457.0)	(453.0)	(435.0)
Year-End Reserves	3,798.0	3,666.0	3,684.0	3,179.0	3,575.0
% Domestic	98%	96%	96%	95%	96%
% Foreign	2%	4%	4%	5%	4%

Bcf	2006	2007	2008	2009	2010
Proved Developed	2,963.0	2,842.0	2,824.0	2,459.0	2,678.0
Proved Undeveloped	835.0	824.0	860.0	720.0	897.0
% Proved Developed	78%	78%	77%	77%	75%
% Proved Undeveloped	22%	22%	23%	23%	25%
% PDP Domestic	99%	96%	95%	95%	95%
% PDP Foreign	1%	4%	5%	5%	5%
% PUD Domestic	92%	96%	97%	96%	96%
% PUD Foreign	8%	4%	3%	4%	4%



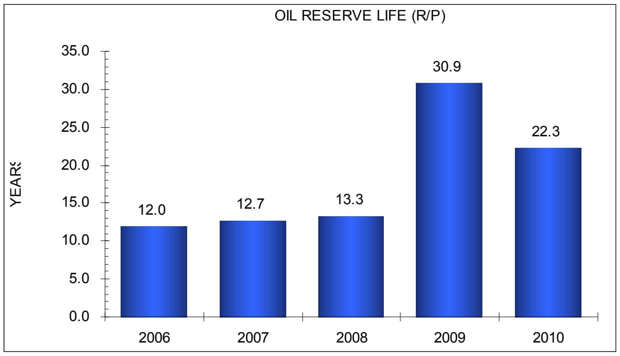


MMBOE	2006	2007	2008	2009	2010
Beginning Balance	1,591.7	1,949.0	1,969.0	1,960.0	3,556.8
+ Drilling	326.0	93.8	110.8	1,787.2	136.7
+ Acquisitions	211.2	3.0	12.8	3.5	167.7
+ Revisions	3.8	118.5	44.7	(19.3)	(66.8)
Reserves Added	541.0	215.3	168.3	1,771.3	237.5
- Sales	(0.2)	(3.0)	(0.2)	(1.0)	0.0
- Production	(183.5)	(192.3)	(177.2)	(173.5)	(206.5)
Year-End Reserves	**1,949.0**	**1,969.0**	**1,960.0**	**3,556.8**	**3,587.8**
% Oil	68%	69%	69%	85%	83%
% Gas	32%	31%	31%	15%	17%

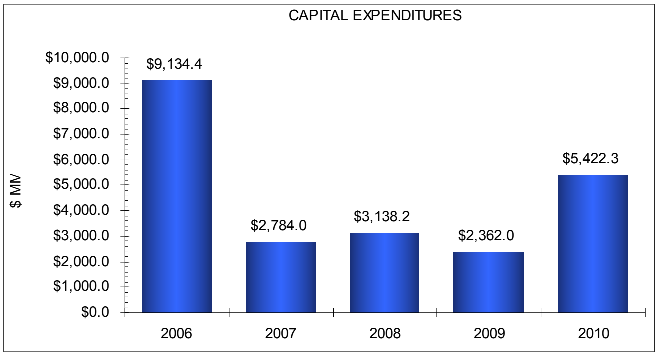
MMBOE	2006	2007	2008	2009	2010
Proved Developed	1190.8	1209.7	1102.7	2670.8	2671.3
Proved Undeveloped	758.2	759.3	857.3	886.0	916.5
% Proved Developed	61%	61%	56%	75%	74%
% Proved Undeveloped	39%	39%	44%	25%	26%
% PDP Domestic	76%	73%	79%	92%	93%
% PDP Foreign	24%	27%	21%	8%	7%
% PUD Domestic	79%	82%	77%	81%	80%
% PUD Foreign	21%	18%	23%	19%	20%

Source: Company Reports, Citi Investment Research and Analysis

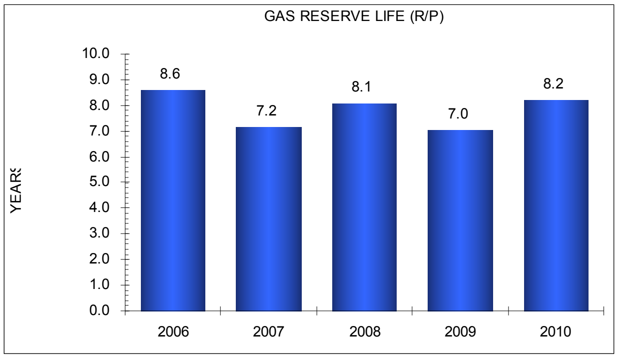
Figure 3. CNQ Capital Expenditure and Drilling Summary



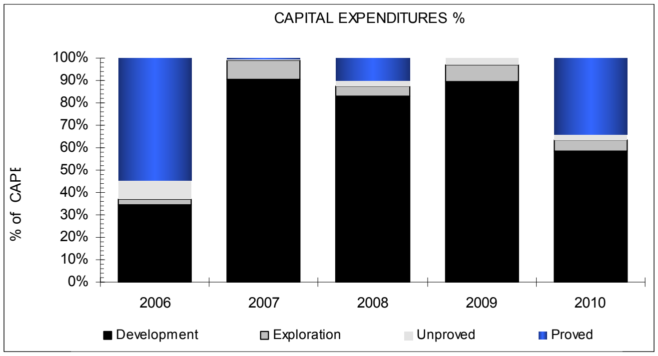
Years	2006	2007	2008	2009	2010
Domestic	11.8	11.9	12.5	36.5	23.5
Foreign	12.3	14.6	15.9	14.5	16.3
Total Oil Reserve Life	12.0	12.7	13.3	30.9	22.3



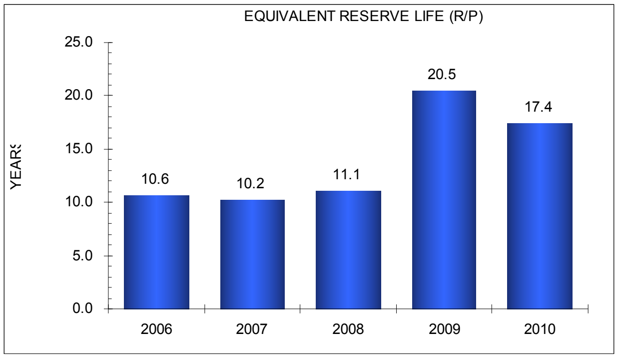
$ MM	2006	2007	2008	2009	2010
Proved Acquisitions	$4,962.2	$15.8	$315.0	$5.3	$1,848.5
Unproved Acquisitions	802.3	13.0	80.6	60.5	136.9
Exploration	224.0	241.1	138.8	184.0	271.8
Development	3,145.9	2,514.1	2,603.7	2,112.3	3,165.0
Total Capital Expenditures	$9,134.4	$2,784.0	$3,138.2	$2,362.0	$5,422.3



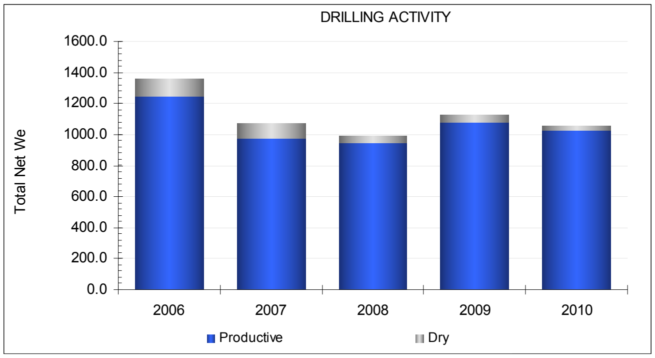
Years	2006	2007	2008	2009	2010
Domestic	8.6	7.0	7.8	6.8	8.0
Foreign	11.6	16.1	20.1	15.2	17.1
Total Gas Reserve Life	**8.6**	**7.2**	**8.1**	**7.0**	**8.2**



% of Total	2006	2007	2008	2009	2010
Proved Acquisitions	54%	1%	10%	0%	34%
Unproved Acquisitions	9%	0%	3%	3%	3%
Exploration	2%	9%	4%	8%	5%
Development	34%	90%	83%	89%	58%
Total Capital Expenditures	100%	100%	100%	100%	100%



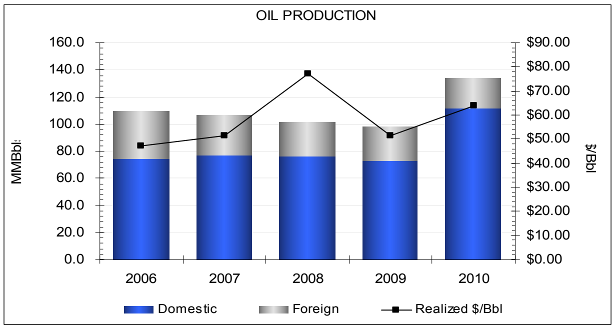
Years	2006	2007	2008	2009	2010
Domestic	10.2	9.4	10.2	21.6	17.5
Foreign	12.2	14.7	16.1	14.6	16.4
Total Reserve Life	**10.6**	**10.2**	**11.1**	**20.5**	**17.4**



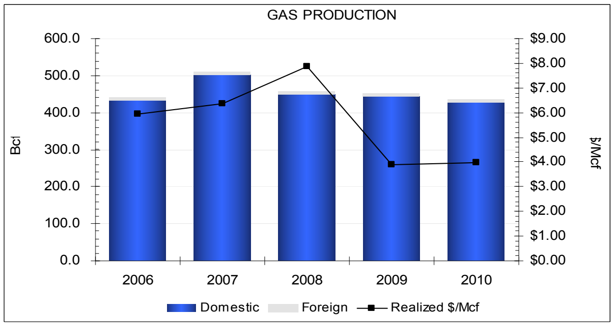
No. of Wells	2006	2007	2008	2009	2010
Productive	1244.0	975.0	951.0	1081.5	1025.3
Dry	119.0	93.0	39.0	46.2	33.4
Total Wells	**1363.0**	**1068.0**	**990.0**	**1127.7**	**1058.7**
% Exploratory	0%	0%	0%	8%	19%
% Development	100%	100%	100%	92%	81%
Success Rate					
Exploratory	N/M	N/M	N/M	90%	95%
Development	91%	91%	96%	96%	97%

Source: Company Reports, Citi Investment Research and Analysis

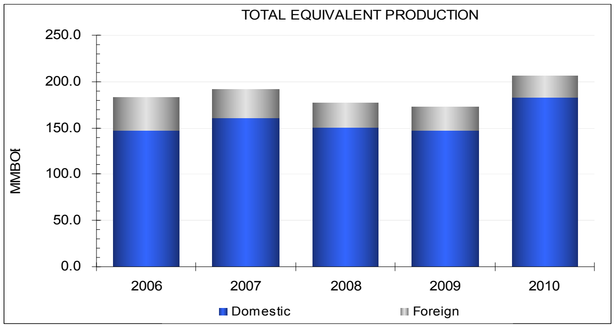
Figure 4. CNQ Production and Finding Costs Summary



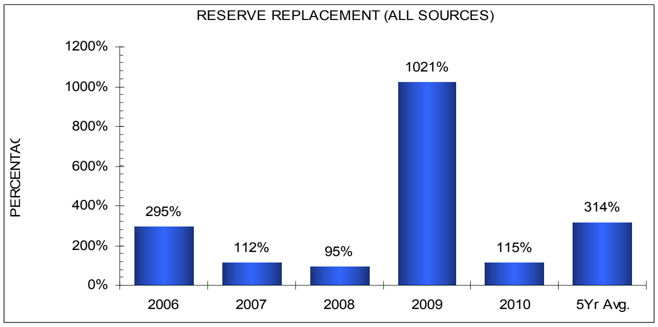
MMBbls	2006	2007	2008	2009	2010
Pricing ($/Bbl)	$47.30	$51.61	$77.27	$51.45	$63.89
Domestic	75.0	77.0	76.0	73.0	112.0
Foreign	35.0	30.0	25.0	25.0	22.0
Total Oil Production	**110.0**	**107.0**	**101.0**	**98.0**	**134.0**
% Domestic	68%	72%	75%	74%	84%
% Foreign	32%	28%	25%	26%	16%



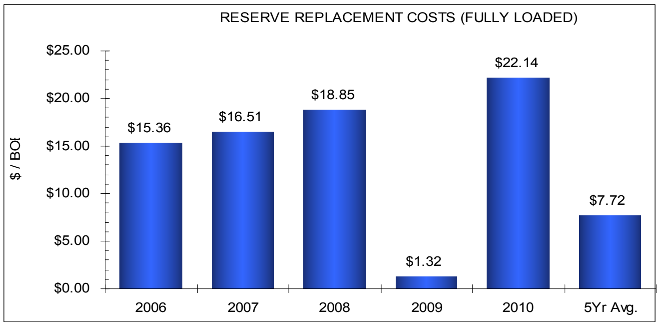
Bcf	2006	2007	2008	2009	2010
Pricing ($/Mcf)	$5.93	$6.38	$7.87	$3.87	$3.96
Domestic	433.0	503.0	449.0	443.0	426.0
Foreign	8.0	9.0	8.0	10.0	9.0
Total Gas Production	**441.0**	**512.0**	**457.0**	**453.0**	**435.0**
% Domestic	98%	98%	98%	98%	98%
% Foreign	2%	2%	2%	2%	2%



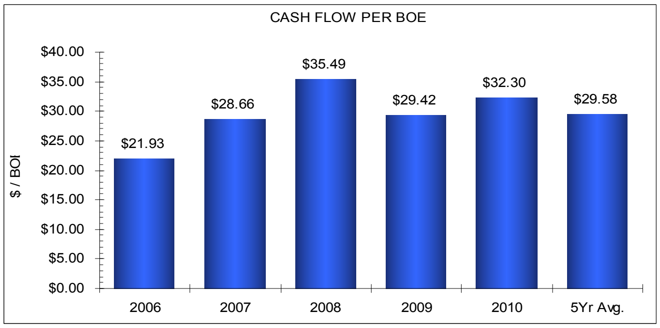
MMBOE	2006	2007	2008	2009	2010
Pricing ($/BOE)	$42.60	$45.69	$64.34	$39.17	$49.81
Domestic	147.2	160.8	150.8	146.8	183.0
Foreign	36.3	31.5	26.3	26.7	23.5
Total Production	**183.5**	**192.3**	**177.2**	**173.5**	**206.5**
% Oil	60%	56%	57%	56%	65%
% Gas	40%	44%	43%	44%	35%



PERCENTAGE	2006	2007	2008	2009	2010	5Yr Avg.
All Sources	295%	112%	95%	1021%	115%	314%
Drilling	178%	49%	63%	1030%	66%	263%
Drilling + Revisions	180%	110%	88%	1019%	34%	272%
Acquisitions	115%	2%	7%	2%	81%	43%



$/BOE	2006	2007	2008	2009	2010	5Yr Avg.
Fully Loaded	$15.36	$16.51	$18.85	$1.32	$22.14	$7.72
Exploration & Developmer	$10.15	$16.67	$18.38	$1.42	$48.82	$6.11
E&D w/o Revisions	$10.27	$37.73	$25.78	$1.30	$24.95	$6.31
Acquisitions	$23.50	$5.27	$24.55	$1.50	$11.03	$17.95



$/BOE	2006	2007	2008	2009	2010	5Yr Avg.
Cash Flow per BOE	**$21.93**	**$28.66**	**$35.49**	**$29.42**	**$32.30**	**$29.58**
Oil & Gas Revenue	$38.09	$46.81	$56.40	$46.90	$54.32	$48.59
- Production Costs	(12.05)	(12.88)	(15.46)	(13.54)	(18.36)	(14.54)
Gross Margin	*26.04*	*33.93*	*40.95*	*33.36*	*35.95*	*34.05*
- G & A	(1.18)	(1.31)	(1.24)	(0.91)	(0.99)	(1.13)
Gross Profit	*24.86*	*32.62*	*39.70*	*32.44*	*34.97*	*32.93*
- Net Interest & Preferred	(1.70)	(3.16)	(3.27)	(2.57)	(2.24)	(2.58)
- Cash Taxes	(1.23)	(0.80)	(0.94)	(0.46)	(0.43)	(0.77)
Cash Flow	**$21.93**	**$28.66**	**$35.49**	**$29.42**	**$32.30**	**$29.58**
RRE	**1.4x**	**1.7x**	**1.9x**	**22.3x**	**1.5x**	**3.8x**

Source: Company Reports, Citi Investment Research and Analysis

Canadian Natural Resources Ltd

Company description

Canadian National Resources Limited (CNRL) explores for, develops and produces natural gas, crude oil and natural gas liquids with about 4.5 billion barrels of oil equivalent (BOE) of proved reserves. The company has about two-thirds of its production as crude oil, and one-third as natural gas. CNRL was founded in 1973 with headquarters in Calgary, Canada.

Canada accounts for most of CNRL's production and reserves with the company holding over 18 million acres in British Columbia, Alberta, and Saskatchewan, and is the second-largest Canadian producer of natural gas. It holds extensive conventional gas assets as well as a sizeable position in the emerging Montney shale area. To produce crude oil, CNRL owns and operates their flagship Horizon Oil Sands Projects in Alberta, the Primrose thermal project, as well as heavy crude production at Pelican Lake and elsewhere in Western Canada. Internationally, CNRL owns and operates assets in the UK North Sea. It also operates in offshore Africa – Cote d'Ivoire and Gabon, with exploration planned in offshore South Africa.

In the last few years, CNRL has focused on successfully starting up the Horizon project, and utilizing free cash flow to pay down debt to improve balance sheet metrics. The company has long-term potential to expand Horizon as well as expand and develop thermal assets at Primrose, Kirby and five other potential locations.

Investment strategy

We rate Canadian National Resources Buy/High Risk (1H) based on the upside to our current price target in the context of the risk rating. CNQ has built a very attractive highly oil-oriented, long reserve life portfolio with significant expansion potential. We believe that the firm provides an excellent vehicle for investors to position themselves for secularly higher oil prices and structurally limited supply. With 95% of its production coming from either Canada or the U.K., the company has broad upside potential without any of the political risk inherent in many other oil companies that operate in unstable countries.

Valuation

Our $60 price target is based on CNQ's stock achieving an EV multiple of 7.3x our 2012 debt-adjusted cash flow estimates based on 'normalized' WTI spot oil and composite spot gas prices of $100.00/Bbl and $5.25/MMBtu, respectively, and ~148% of NAV.

Risks

We rate Canadian Natural Resources High Risk. Our risk rating on CNQ is High based on a combination of quantitative and qualitative risk assessments compared to other stocks covered by Citi Investment Research.

Horizon Facility Fire - CNQ recently had a fire at its Horizon Oil Sands project and production has been suspended. At this juncture the exact timing and regulatory approval for production restart is uncertain..

Volatile Commodity Prices – CNQ is sensitive to changes in the prices of crude oil, and natural gas. They have some commodity hedges in place, but the majority

of their natural gas and crude oil production is unhedged and subject to market price volatility.

Expensive Long-Term Projects – CNQ pursues long-term oil projects which require large capital outlays and several years of development before any cash flows are realized. These projects are subject to substantial uncertainties in terms of projects costs, as well as the timing and amount of eventual returns.

Environmental Risks – CNQ's existing and proposed oil sand and thermal oil assets in Canada could be subject to both increased scrutiny as well as new rules to mitigate environmental impact. These changes could substantially increase costs, decrease viability, or block certain projects.

If the impact on the company from any of these factors proves to be less than we anticipate, the stock could materially outperform our target. Conversely, if the impact on the company from any of these factors proves to be greater than we anticipate, the stock could underperform our target price.

Appendix A-1

Analyst Certification

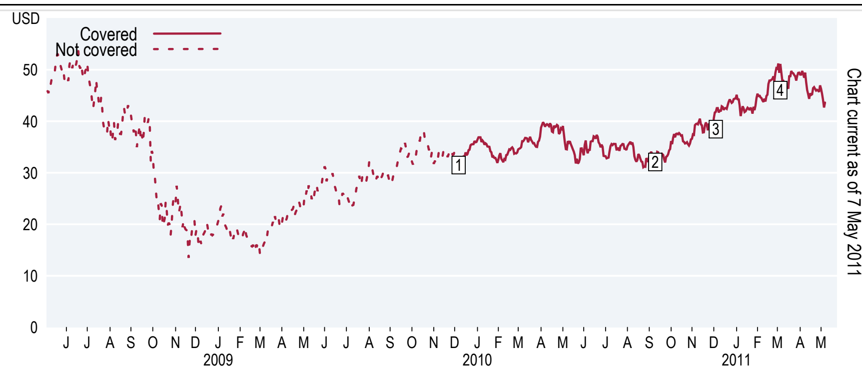
The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Canadian Natural Resources Ltd (CNQ)

Ratings and Target Price History
Fundamental Research

Analyst: Robert S Morris
Covered since December 7 2009



	Date	Rating	Target Price	Closing Price
1	7-Dec-09	*1H	*42.50	32.68
2	9-Sep-10	1H	*40.00	33.29
3	3-Dec-10	1H	*48.00	41.82
4	4-Mar-11	1H	*60.00	51.12

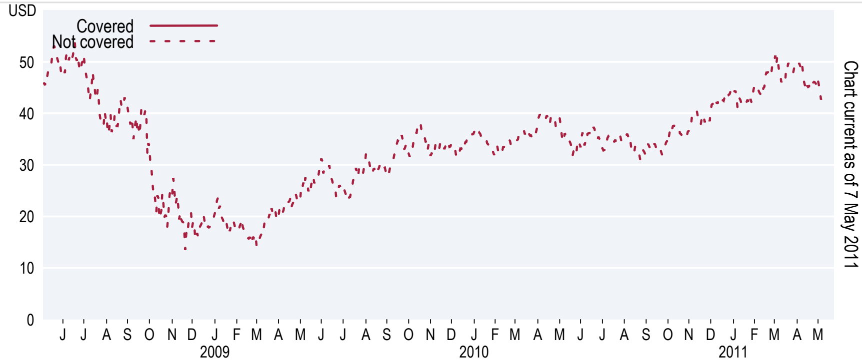
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Canadian Natural Resources Ltd (CNQ)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Robert S Morris
Covered since December 7 2009



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Robert S Morris, Analyst, holds a long position in the securities of Canadian Natural Resources Ltd.

Robert S Morris, Analyst, holds a derivative position in the securities of Canadian Natural Resources Ltd.

Citigroup Global Markets Inc. or an affiliate received compensation for products and services other than investment banking services from Canadian Natural Resources Ltd in the past 12 months.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, securities-related: Canadian Natural Resources Ltd.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, non-securities-related: Canadian Natural Resources Ltd.

Analysts' compensation is determined based upon activities and services intended to benefit the investor clients of Citigroup Global Markets Inc. and its affiliates ("the Firm"). Like all Firm employees, analysts receive compensation that is impacted by overall firm profitability which includes investment banking revenues.

For important disclosures (including copies of historical disclosures) regarding the companies that are the subject of this Citi Investment Research & Analysis product ("the Product"), please contact Citi Investment Research & Analysis, 388 Greenwich Street, 28th Floor, New York, NY, 10013, Attention: Legal/Compliance. In addition, the same important disclosures, with the exception of the Valuation and Risk assessments and historical disclosures, are contained on the Firm's disclosure website at www.citigroupgeo.com. Valuation and Risk assessments can be found in the text of the most recent research note/report regarding the subject company. Historical disclosures (for up to the past three years) will be provided upon request.

Citi Investment Research & Analysis Ratings Distribution

	12 Month Rating			***Relative Rating***		
Data current as of 31 Mar 2011	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Investment Research & Analysis Global Fundamental Coverage	52%	37%	11%	9%	82%	9%
% of companies in each rating category that are investment banking clients	43%	41%	41%	51%	41%	45%

Guide to Citi Investment Research & Analysis (CIRA) Fundamental Research Investment Ratings:
CIRA's stock recommendations include a risk rating and an investment rating.
Risk ratings, which take into account both price volatility and fundamental criteria, are: Low (L), Medium (M), High (H), and Speculative (S).
Investment ratings are a function of CIRA's expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating.
Analysts may place covered stocks “Under Review” in response to exceptional circumstances (e.g. lack of information critical to the analyst's thesis) affecting the company and/or trading in the company's securities (e.g. trading suspension). Stocks placed “Under Review” will be monitored daily by management. As soon as practically possible, the analyst will publish a note re-establishing a rating and investment thesis.
To satisfy regulatory requirements, we correspond Under Review to Hold in our ratings distribution table for our 12-month fundamental rating system. However, we reiterate that we do not consider Under Review to be a recommendation.
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