

How CNQ differs from Talisman

Similar companies perform differently

By Sunil Vidyarthi

If the investment world was simple, no one would need money managers, mutual fund dealers, financial planners, analysts or brokers.

The U.S. Federal Reserve's recent decision to cut interest rates by 0.5 of a percentage point started to separate the strong from the weak players. First, the shorts got caught and had to spend billions to cover or change direction. Then the market started to ask what now.

Buy commodities because it will be another goldilocks season ahead? or sell commodities as the housing crisis will spill over into weak economies all over the world not just U.S.? Buy growth stocks for growth will be harder to find in a slow environment? or buy value stocks as they have proven to have the lowest volatility when times are rough?

There are many more examples to show how confused the markets can get and how amazing it is that there is still enough rationality left to make an investment, rather than speculative, decision.

In the end, the numbers do win out. I will take a pair of companies that look the same, feel the same but have offered dramatically different results over the last few years. I will be the financial sleuth for you to show that often there is a reason for such madness.



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The pair I have selected is a couple of widely known energy companies. **Talisman Energy Inc.** (TLM-TSX, \$19.80) and **Canadian Natural Resources Ltd.** (CNQ-TSX, \$74.21). Both are energy companies with major holdings in Alberta. Compare the two companies' descriptions provided below.

Talisman says that it explores for, develops, produces and transports crude oil, natural gas and natural-gas liquids in North America, the North Sea, Southeast Asia and Australia, North Africa and Trinidad and Tobago, as well as other areas including Alaska, Colombia, Qatar and Peru.

And, CNQ acquires, explores for, develops, produces and markets petroleum and natural gas in North America, primarily western Canada, the United Kingdom sector of the North Sea and offshore West Africa. Also it has midstream assets consisting of three crude-oil pipeline systems and 50 per cent working interest in an 84-megawatt cogeneration plant at Primrose, Alta.

I can't really tell the difference, can you? Not just that, I have listened to many experts on these two companies and nothing could explain why the stock price of one has risen by nearly 50 per cent (CNQ), while the other (TLM) only by about 20 per cent over the last three years to this September. They both have similar ratios, like return on equity of 22 per cent,

growth rate of 10 per cent to 15 per cent. Current price to earnings in the 15-16 range and price to cash flow ratio of five to six.

There are subtle differences to note, however, and this is what you have to focus on. For instance, Talisman has a history. This company used to be British Petroleum in Canada and had its tentacles all over the world including some parts of Africa (Sudan) where war lords still roam free. Some argue that they use oil money to do their nasty stuff. Talisman managed to sell all of its controversial assets to an Indian oil company, but for some investors the smell persists.

On the other hand, CNQ is primarily a Canadian operator with some assets in the North Sea and western Africa. We can't say what the real situation is and if one company is any holier than the other but often that has little to do with stock price. Even after years of soap and water, Talisman suffers from a tainted image. Perhaps another name change would help.

Well, Talisman is not changing its name as far as I know but it is definitely getting a new CEO and that could be an ideal opportunity to declare a "new" improved era. But that is not a financial reason for the difference in stock performance. Well, as it happens there is indeed a financial reason.

While looking forward, both companies are promising a 15 per cent growth in earnings and cash flow, but the hard-nosed investors

are not buying this. They want to see what happened last year. Who can blame them? Earlier this year, there was talk of \$10 natural gas and \$50 oil.

Well, natural gas was \$4 something this summer, and oil is hitting high 80s. And as luck would have it, Talisman seemed to be gassier than CNQ and is so perceived even now. So, while forecast earnings are the way to decide how much to pay for a stock, it is almost impossible in commodities and particularly oil.

Answer

Well, here is my answer to this dilemma as to why two seemingly similar energy companies performed so differently. CNQ produced earnings per share of \$2.73 in 2006 and is on track to do \$3.48 this year. That is a very immediate growth of 27 per cent, year over year. So while the next year's forecast for both companies is an average growth rate of 15 per cent, Talisman's 2007 over 2006 performance is pitiful.

In fact it delivered a lower EPS of \$1.01 compared to \$1.34 last year. It is "one in the hand" that seems to matter to investors these days. They won't pay for promises any more, at least not in the energy sector. There you have it then. Don't just gloss over those numbers. Pay attention, your profits may depend upon it.

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