Is Canadian Natural Resources Ltd. Ready for What Lies Ahead?

Description

Back in early November, **Canadian Natural Resources Ltd.** (TSX:CNQ)(NYSE:CNQ) released its 2015 capital spending budget. The plan called for total expenditures of $8.6 billion, a decrease of 28% relative to 2014. The company also said that "approximately $2.0 billion" was flexible, and could be cut if oil prices continued to fall.

In that same press release, CNRL also projected roughly $800 million of free cash flow in 2015. This was based on an average American oil price of US$81 during the year. Of course we now know that this projection was wildly optimistic.

This brings me to Monday, when CNRL revised its budget plan. The company now plans to spend approximately $6.2 billion, cutting $2.4 billion from the original budget. And this time, CNRL did not make any projections about oil prices or cash flow.

The company's 2015 budget is now barely 50% of what was spent in 2014. So how prepared is the company for what lies ahead? And should you buy the stock?

Where are the spending cuts coming from?

In the recent release, CNRL slashed spending across the board. The natural gas budget was cut by 47%. Primary heavy crude oil spending was slashed by more than 50%. But two items in particular stood out.

One is the Kirby North Phase 1 thermal in situ project, which CNRL is deferring. By doing so, it is saving $470 million in 2015, from an initial budget of $575 million. Meanwhile, the Horizon oil sands budget remained relatively untouched. Why has CNRL made this choice?

Well, Horizon accounts for roughly 20% of CNRL's current crude production, while the Kirby project is still two years away from producing oil. So by shunning projects like Kirby, CNRL can cut spending without having to slash 2015 production forecasts. Tellingly, the company still expects production growth of 7%, despite the far lower budget.

And that's what we're seeing throughout the industry. Companies are willing to cut spending budgets, but not at the expense of current production. Consequently, long-term projects are the ones getting cancelled. As a result, industry supply is not really taking a hit, and oil prices will probably remain depressed for a while. ARC Financial expects 3% oil supply growth from Canada in 2015.

How prepared is CNRL for this fight?

CNRL has weathered downturns very nicely in the past, taking advantage of cheaper labour and equipment costs. The company has also managed to pick up some cheap acquisitions during troubled times. So this may even be viewed as an opportunity.

But this doesn't mean you should jump on the CNRL bandwagon. After all, most producers are employing the exact same strategy, and for this reason oil prices could stay low for a while longer. You may want to sit this one out.

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