Why EOG Resources Inc. Is a Better Investment Than Canadian Natural Resources Limited

Description

On Thursday of last week, **Canadian Natural Resources Ltd.** (TSX:CNQ)(NYSE:CNQ) President Steve Laut warned that the Canada's oil sands industry faces a "death spiral" if it doesn't cut costs.

And Mr. Laut is backing up his words. CNRL has sent letters to its suppliers asking what can be done to cut rates. Most replied that a 10% reduction is possible, but CNRL has stated it wants bigger discounts. The question is, will that even be enough? After all, American drillers generally face lower costs. But just how big is this advantage?

To answer these questions, we take a look at **EOG Resources Inc.** (NYSE:EOG), the largest shale oil producer in the United States. We'll also compare EOG with its Canadian counterparts, including CNRL.

EOG certainly has lower costs

For the year 2015, EOG Resources expects production costs to average less than US$7 per barrel of oil equivalent (BOE). Meanwhile, the production expense at CNRL was just over $18 per barrel in its most recent quarter.

Granted, this isn't a perfect comparison. Natural gas (which comes with lower production costs, as well as prices) accounts for nearly half of EOG's expected production—a much bigger proportion than that at CNRL. But there's plenty of other evidence that EOG is better positioned for lower oil prices.

EOG's economics are stronger

EOG's investor presentation provides some nice clues about the economics of its operations. One slide highlights four plays that together, account for nearly 90% of the company's drilling locations. And all four of them earn greater than a 35% rate of return with oil prices of US$55. So, even with oil prices below US$50, EOG can keep drilling as long as it likes.

Meanwhile, CNRL reported just a 9% annual return on capital employed last fall, and that was with oil prices averaging close to US$100 per barrel. Needless to say, CNRL will have a much tougher time coping with low oil prices than EOG.

So, what should investors do?

First of all, you shouldn’t count on a quick oil price recovery. American drillers such as EOG don’t have to stop production any time soon, and as long as supply is maintained, prices will stay low.

Second, you should probably avoid any Canadian oil stocks at this point. In Canada, there seems to be a belief that low oil prices are temporary. As a result, stock prices haven’t fallen as far as they should have. Only when investors have truly given up on the sector—and producers have taken Mr. Laut’s advice—should you think about betting on a rebound.

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