Canadian Natural Resources Limited Has Done it Again

Description

Canadian Natural Resources Limited (TSX:CNQ)(NYSE:CNQ) is one of the most respected companies in Canada's energy patch, and for good reason. The company has proved very adept over the years at cutting costs and allocating capital wisely, both of which are critical skills in the energy sector.

And as CNRL reported fourth-quarter results, investors once again rewarded the company for some shrewd moves. We take a closer look below.

The good news

Interestingly, CNRL's fourth-quarter results actually fell short of expectations. The company reported revenue of $2.79 billion, missing estimates by $100 million, and adjusted net earnings per share of -$0.04, which missed by $0.03. Yet as of this writing, the stock has reacted by surging 9%.

It's CNRL's outlook for 2016 that investors are so happy about. The company has once again cut its capital budget for this year, and is now planning to spend between $3.5 billion and $3.9 billion, down from a previous range of $3.5 billion and $4.5 billion. Better yet, production will decline by only about 2%.

Roughly $2 billion of this budget is directed towards the Horizon Oil Sands Phase 2B and Phase 3 expansions, and because Phase 2B is only seven months away from completion, CNRL's investment spending should drop off significantly in the near future. And once Phase 2B starts up, the company will be able to cover all forecast base annual expenditures as well as the dividend, even at US$30 oil.

Phase 3 won't start up until the end of 2017, but once this happens, then CNRL's expansion capital budget drops to zero, which generates significant unallocated cash flow. This will allow the balance sheet to strengthen.

And it's not as if CNRL has such a weak balance sheet now. With a debt-to-book-capitalization ratio of just 38%, the company is far better positioned than some of its competitors and should be able to withstand a prolonged period of low oil prices.

The bad news

When it comes to investing in energy, there's a very clear trade off. Either you can invest in a weak producer and get significant upside if oil recovers, or you can invest in a strong company like CNRL. But this comes with another problem: the company's shares already imply a much higher oil price.

To illustrate, CNRL generated $1.9 billion in free cash flow at a time when oil prices averaged US$50 per barrel. Yet the company is valued at nearly $40 billion, even though oil prices have fallen to the mid-US$30s.

So even if oil prices recover and the company continues to execute, there's little upside for the share price at this point. Your best bet is to look elsewhere.

CATEGORY

1. Energy Stocks
2. Investing

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Date
2025/07/21
Date Created
2016/03/04
Author
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