Canadian Natural Resources Limited Is Ramping Production: Will Earnings Growth Follow?

Description

As oil prices reverse course from US$30 to over US$50 a barrel, **Canadian Natural Resources Limited** (TSX:CNQ)(NYSE:CNQ) is getting ready to bolster its production.

This week it announced a $50 million boost to its capital-expenditure budget to help drill 123 new heavy oil wells, five new light oil wells, and 11 thermal oil wells. Executives said the company could add over 200,000 barrels of daily oil production with gains being felt as early as July. The move, while limited in magnitude, is a huge shift from an industry stricken with budget cuts and limited financing.

Is Canadian Natural Resources ready to leave this oil-bear market behind?

On one condition

Steve Laut, the company's president, emphasized that higher capital expenditures are purely a function of rising commodity prices. "Right now, we're pretty happy with taking this first step. We'll wait and see," he said. If oil prices continue rising, even higher capital expenditures is only a "possibility," he added. "I think we'll need to wait until we set our budget for 2017."

Still, Wall Street analysts are piling in on the positive news. This week, the company was deemed **Royal Bank of Canada's** "top pick," with analyst Greg Pardy commenting that the stock "offers investors the best of all worlds," including free cash flow generation, production growth, and leverage to rising oil prices.

In fact, a majority of Canadian Natural Resources's output remains unhedged, so earnings should see a commensurate boost if oil prices sustain their rebound. If oil climbs to US$70 a barrel, Greg Pardy anticipates cash flow hitting $5.4 billion, roughly 13% of the company's current market cap.

What could go wrong?

As mentioned, most of Canadian Natural Resources's production remains unhedged, which means it's also exposed to falling prices. According to one major investment bank, oil's latest run may face stiff resistance in the coming year.

Damien Courvalin, an energy analyst at **Goldman Sachs Group Inc.**, has been warning that oil markets could face another supply glut by 2017. While his estimates show that prices could go as high as US$51 a barrel by then end of this year (above his previous call of US$45), they will fall back to US$45 in the first three months of 2017 (down from his previous call of US$55).

“In essence, this forecast revision reflects our long-held view that expectation for long-term surpluses can create near-term shortages and leaves us cyclically bullish but long-term bearish,” he wrote. “We believe that the industry still has further to adjust.”

From its lows set in January, Canadian Natural Resources has already nearly doubled in price. If you’re piling in on this week’s good news, bear in mind that any hiccup in oil’s rise could damage the company’s stock price more drastically than its better-hedged competitors.

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