What Does the Future Hold for Canadian Natural Resources Limited?

Description

Canadian Natural Resources Limited (TSX:CNQ)(NYSE:CNQ) is about to achieve a major milestone. Once the next two expansion phases of its Horizon oil sands facility come online, it will be in the position to thrive under virtually any oil-price scenario. That was one of the key messages of President Steve Laut on the company's second-quarter conference call, in which he provided a glimpse into the future.

If oil prices stay low

Laut ran through two oil-price scenarios that demonstrated Canadian Natural Resources's potential future paths.

He noted that with capex spending at Horizon starting to wind down, Canadian Natural Resources needs oil to average just $30 a barrel to cover maintenance capex and the dividend going forward. Because of that, it is in the position to generate a significant amount of excess cash flow if oil stays at its current price range of $45-50 a barrel.

In fact, if oil prices are $45 next year and $48 after that, the company only needs to spend $2.4-2.7 billion to keep its production flat. That puts it in the position to generate more than $600 million in free cash flow in 2017 and $1.5 billion in 2018. That is money the company could use to boost shareholder returns as well as grow production.

Even under a low-oil-price scenario where oil averages about $50 a barrel and natural gas is about $2, the company could economically add 155,000 barrels per day of incremental oil production along with 1.7 Bcf per day of natural gas and NGLs.

If oil prices improve

Laut then noted that those numbers only go higher along with oil prices. For example, at $60 oil the company's free cash flow rises to $1.4 billion in 2017, $3 billion in 2018, and $3.5 billion by 2019.

Meanwhile, its economic production growth options also expand as it has the capacity to add up to

210,000 barrels per day of oil and 4.5 Bcf a day of gas at $60 oil and $2.50 gas, respectively. In fact, under its current assumptions, it has the potential to grow production at an 8% compound annual rate while still generating a significant amount of cash flow.

Further, as production and cash flow grow, the balance sheet takes care of itself. That growth will quickly get its debt-to-EBITDA ratio well within its target range of 1.8-2.2 times. That leaves the company with the ability to buy back stock, significantly boost its dividend, and make acquisitions.

One thing remains constant

However, Laut wanted to make one thing clear:

> [We] believe it's critical that we balance and optimize what we call the four pillars of cash flow allocation: balance sheet strength, returns to shareholders, resource development, and opportunistic acquisitions. How we balance the pillars depends on where we are in the commodity price cycle, where we are in the transition to long-life assets and other potential opportunities. At all times, the primary goal of balancing the four pillars is to maximize shareholder value.

In other words, the one constant is getting the most value out of its capital. As such, under a lower-oil-price scenario, the company's focus likely shifts towards protecting its balance sheet and away from growth. Meanwhile, if oil rises the balance sheet takes care of itself, leaving the company with more cash flow for shareholder returns or growth, depending on which option creates more value for investors.

Investor takeaway

Canadian Natural Resources's CEO believes his company has a bright future. It is on the cusp of completing its major growth projects, which positions it to thrive no matter what oil prices do in the future. Because of that, the company expects to have a lot of excess cash flow, which it intends to use to maximize shareholder value by allocating it to the best options according to the market environment.

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1. Editor's Choice

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