This Oil Stock Could Unleash a Massive Dividend Increase

Description

Canadian Natural Resources Limited (TSX:CNQ)(NYSE:CNQ) has done a superb job returning cash to shareholders in recent years. In fact, since completing the first phase of its Horizon Oil Sands project in 2009, the company has increased shareholder distributions by a 31% compound annual rate.

Now, with the company recently completing the second expansion phase of that facility and nearing completion of the third phase, it will have an abundance of free cash flow, which it could use on a substantial dividend increase.

Restarting the income engine

Canadian Natural Resources started paying dividends to investors in 2001. Since that time, the company has grown the payout almost every year. I say "almost" because it recently went through a dry spell where it did not increase the dividend for nearly two years. However, it broke that streak at the end of last year by declaring an 8.7% dividend increase.

With that raise, Canadian Natural Resources will pay out $1.1 billion in cash to investors this year. While that sounds like a lot, the company estimates that it will generate enough money to meet that obligation and fund its $3.9 billion capex program with a gaudy $1.7 billion in cash left over. That is assuming that the price of oil averages slightly more than US$55.50 per barrel this year while gas averages just over $3.

The company intends to use that excess cash to strengthen its balance sheet as well as to provide it with the flexibility to boost capital spending by up to $595 million, which would allow it to respond quickly should oil and gas prices run above forecast.

Ready to launch

An even larger dividend increase could be on the way at the end of this year given what the company sees on the horizon. If everything goes according to plan, Canadian Natural Resources should finish up phase three of its Horizon Oil Sands expansion by the fourth quarter. Once that happens, the company should see an exponential increase in free cash flow because it will go from spending money on the project to generating cash from the new facility.

CEO Steve Laut put the potential size of the increase in context on the company's second-quarter conference call. At the time, he initially thought that free cash flow would be between $600 million and $1.4 billion in 2017 in a $40-60 oil-price world and increase to between $1.5 billion and $3 billion in 2018 under those oil-price assumptions as a result of the completion of phase three.

Given that outlook, it is possible that free cash flow could double next year even with just a modest increase in oil prices. Because of that, Canadian Natural Resources could pay investors twice as much in dividends in future years.

That said, the company probably will not pour all of its available cash flow into boosting the dividend. Instead, it will likely allocate some of it to other priorities, including strengthening the balance sheet, investing in growth projects, buying back stock, and making acquisitions. Still, there's good reason to believe that the company will deliver a sizable dividend increase within the next year, likely more than the nearly 9% boost it provided at the end of last year.

Investor takeaway

Canadian Natural Resources is putting the final touches on a major expansion phase, which will see the company start generating a substantial amount of free cash flow. The odds are pretty good that a meaningful portion of that money will go towards increasing the dividend. That makes now a great time to consider buying the stock before other buyers start bidding up the price in anticipation of a potentially massive pay raise.

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