Time to Buy This Oil Sands Giant Yielding 4%

Description

Even oil's latest rally, which sees the North American benchmark West Texas Intermediate (WTI) up by 21% since the start of 2019 to be trading at US$57 per barrel, has done little to lift Canadian energy stocks. While there are a range of reasons for this, key being the lack of pipeline exit capacity, it shouldn't deter investors from adding **Canadian Natural Resources** (TSX:CNQ)(NYSE:CNQ) to their portfolios. Canada's largest oil sands operator has gained 10% since the start of the year, which is less than half of WTI's rally, indicating that now is the time to buy.

Growing production

Canadian Natural Resources reported some mixed third-quarter 2019 results. Despite production rising by 11% year over year to 1.2 million barrels daily and a lower price differential for Western Canadian Select (WCS), which was almost half of what it had been a year earlier, net income declined by 41% to $0.87 per diluted share. That can be attributed to weaker crude with the average WTI price 19% lower than a year earlier. Higher transportation costs, which rose by 23% year over year to $3.69 per barrel, also impacted Canadian Natural Resources's profitability.

While cash flow from operating activities fell by 31% year over year, it was still an impressive $2.5 billion.

What many investors fail to appreciate is that while oil sands typically have higher overall breakeven costs per barrel than shale or conventional oil production, operating expenses for operational assets are typically lower. This is because developing oil sands assets is much like mining; large amounts of capital are required upfront for construction and other development-related activities, but operational costs fall significantly once commercial production commences.

Oil sands assets, on commencing operations, have a long-life and exceptionally low decline rates, meaning that they require the investment of significantly less capital to sustain oil production than other forms of oil extraction. Canadian Natural Resources has estimated that it needs to spend around US$4.50 per barrel to maintain production compared to over double that for shale oil, which has some of the highest decline rates in the oil industry. The company has an overall corporate decline rate of around 10% compared to 20% or more for conventional and shale oil drillers, underscoring why its sustaining capital requirements are so low.

For the third quarter, Canadian Natural Resources's oil sands and upgrading division reported operating expenses of $18.82 per barrel, which were 6% lower year over year. This highlights the growing profitability of the operations, which are responsible for 37% of the company's total hydrocarbon output. Canadian Natural Resources's ongoing focus on cost reductions and implementing efficiencies across its operations will boost profitability.

The company's refining operations help to offset the risks associated with lower oil prices, especially a wider price differential between WCS and WTI, which remains a key risk for oil sands producers.

Foolish takeaway

Canadian Natural Resources's large volume of long-life oil reserves, growing oil production, and focus on reducing costs make it an attractive play on higher oil. When you factor in the low decline rates of those assets and hence the industry low sustaining capital required to maintain production from existing operations, it becomes clear that Canadian Natural Resources is a cash flow machine. While investors wait for its market value to appreciate, they will be rewarded by its sustainable dividend yielding a juicy 4%.

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