Canadian Natural Resources (TSX:CNQ): A Cash Flow and Dividend Machine

Description

Higher oil has been a boon for Canada's beaten-down energy patch. One energy stock that's often overlooked by investors is oil sands giant **Canadian Natural Resources** (TSX:CNQ)(NYSE:CNQ). As Canada's largest oil sands operator producing an average of 1.2 million barrels of oil equivalent daily, the company doesn't receive the attention it deserves.

Growing earnings

Canadian Natural owns an oil sands focused geographically diversified portfolio of petroleum assets with proven and probable oil reserves of 13 billion barrels.

For the first nine months of 2019, the company's total oil production remained relatively flat compared to a year earlier. The lack of production growth can be attributed to Alberta's mandatory production curtailments.

Flat production growth coupled with weaker oil saw cash flow from operating activities plunge by 27% to $6.4 billion and adjusted funds from operations (AFFO) soften by a modest 1% to $7.8 billion.

Despite that weaker performance, Canadian Natural's net income for the period shot up by an impressive 43% to $4.8 billion. This can be attributed to a lower discount being applied to Canadian heavy crude because of Alberta's production cuts, a higher netback and gains on commodity as well as currency hedges.

In fact, Canadian Natural's average realized price of $57.49 for the period was 6% greater than for the equivalent period in 2018 despite the North American benchmark West Texas Intermediate (WTI) being almost 15% lower.

This is due to the price differential between the Canadian heavy oil benchmark Western Canadian Select (WCS) and WTI falling by 46%, giving Canadian Natural's average realized sales price a solid boost.

A higher sales price coupled with production expenses being 5.5% lower year over year saw Canadian Natural report a netback of $22.17 per barrel sold, which was a healthy 19% higher year over year.

More important, the company continues to be a free cash flow generating machine despite the impact of weaker oil prices during the period.

For the third quarter 2019, Canadian Natural reported that after deducting capital expenditures and dividend payments, it had generated free cash flow of almost $1.5 billion.

This is a significant number for an energy company operating in the current difficult operating environment where extreme volatility and weaker prices are weighing on the profitability of oil companies.

Canadian Natural remains focused on strengthening its balance sheet and used a large portion of its free cash flow to reduce its debt. By the end of the third quarter, the company's long-term debt totalled $18.5 billion, 4% lower than a year earlier.

That not only increases Canadian Natural's financial flexibility, but also will bolster its profitability because of lower interest expense and financing costs. The combination of quality long-life, low-cost assets, growing earnings despite the difficult operating environment and stronger balance sheet make Canadian Natural a very attractive play on higher crude.

While shareholders wait for Canadian Natural's stock to appreciate, they will be rewarded by its regular dividend which is yielding a juicy 3.7%.

That payment certainly appears sustainable given that it has a conservative payout ratio of 43% enhanced by the company's ongoing moves to strengthen its balance sheet and boost profitability.

Foolish takeaway

While there is considerable risk attached to investing in energy stocks, Canadian Natural shapes up as one of the best plays on higher oil. Its robust balance sheet and ability to generate large amounts of free cash flow in a difficult operating environment makes it stand out from its peers.

For the aforementioned reasons, Canadian Natural is not only an ideal way to profit from higher oil, but also to generate a regularly recurring income stream, making now the time to buy.

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