Oil Prices Plummet: Will Canadian Natural Resources (TSX:CNQ) Cut its Dividend?

Description

Oil prices recently plunged to lows not seen since 2002. That provoked a spate of production and dividend cuts across North America's oil patch. Even the latest deal on production cuts between Russia and OPEC has done little to boost oil prices.

The North American West Texas Intermediate (WTI) benchmark is down 66% since the start of 2020 to be trading at under US$20 per barrel. There are signs that oil prices will deteriorate further, causing earnings to collapse leading to further production and dividend cuts.

Canada's oil patch is in crisis

This is bad news for Canada's energy patch. The key Canadian oil benchmark Western Canadian Select (WCS) has plunged to a new record low of US$4.71 per barrel. There are signs of lower to come. This was exacerbated by a widening price differential between WCS and WTI and a growing Canadian supply glut.

There is considerable speculation that Canada's oil storage facilities are close to reaching capacity. Once that occurs, additional production cuts are inevitable — even more so when it is considered that crude by rail at current oil prices is uneconomic. Canada also lacks the pipeline capacity to ship all the crude, notably bitumen, produced to crucial North American energy markets.

Oil stocks are suffering

It is for this reason that Canadian oil stocks, notably oil sands operators, have been hit particularly hard by the latest oil price collapse. Canada's largest oil sands company **Canadian Natural Resources** (TSX:CNQ)(NYSE:CNQ) has shed a whopping 60% since the start of 2020.

It is easy to understand why. The latest lows for the WCS price, which is the key benchmark for bitumen, means that many of Canadian Natural's operations are pumping oil at a loss. In fact, for 2019, Canadian Natural reported company-wide operating costs of $11.49 per barrel of crude produced. It incurred an additional $3.14 per barrel in transportation costs. Based on those numbers, Canadian Natural is pumping oil at a loss of up to $8 per barrel with WCS trading at $6.68 a barrel.

Of Canadian Natural's assets, only its Pelican Lake heavy oil operation has operating expenses that are lower than the current WCS price. During the last year, it cost Canadian Natural $6.22 per barrel of crude produced but another $5.40 in transportation costs.

It is for these reasons that Canadian Natural is repositioning its operations to survive the harsh operating environment that currently exists. Last month, Canadian Natural slashed its 2020 capital budget by 27%.

Importantly, despite that spending cut, Canadian Natural expected its forecast 2020 oil output to remain unchanged at an average of 1,137,000 to 1,207,000 barrels of oil daily.

Canadian Natural believes that its oil sands and upgrading operation, which is responsible for around 39% of its production, will operate during 2020 with average operating expenses of $13 per barrel. This highlights that if WTI rebounds to pre-OPEC meeting levels of around US$28 per barrel, Canadian Natural can deliver solid cash flow.

Further cuts on the way

There are signs that Canadian Natural could be forced to shutter higher-cost operations if WTI weakens further, which would push WCS into negative territory. Many of Canadian Natural's operations have combined production and transportation costs in excess of $12 per barrel produced. That makes them uneconomic to operate if crude falls further.

Canadian Natural has established oil price hedges to mitigate the financial impact of sharply weaker oil on its earnings. These will offset some of the losses but won't be enough to protect the viability of all of Canadian Natural's oil production.

WTI's downward spiral, with it poised to hit its lowest price in two decades, makes it inevitable that Canadian Natural will be forced to shutter uneconomic production. That will magnify the impact of sharply weaker oil prices on its earnings.

Looking ahead

There is a growing likelihood that Canadian Natural will be forced to consider cutting its dividend. After the latest market decline, the oil sands heavyweight is yielding a very juicy 9%. If WTI remains at below US$20 per barrel, Canadian Natural will have no choice but to cut is dividend to preserve vital cash flows and its balance sheet.

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Author
mattdsmith