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

Description

Canadian dividend stocks are under considerable pressure, particularly in the oil patch. In a surprise move earlier this month, Canadian integrated energy major **Suncor Energy** slashed its dividend by 55%. This came on the back of a massive first-quarter 2020 $3.5 billion net loss. This caught many investors off guard, because Suncor had hiked its dividend for the last 17 years straight. It had increased the payment, even during earlier oil price collapses.

This has sparked considerable speculation as to whether Canada's largest oil sands operator and Dividend Aristocrat **Canadian Natural Resources** (TSX:CNQ)(NYSE:CNQ) will be next to take a knife to its dividend. The payment is yielding almost 7%, which is high for a conservative oil stock and oil sands operator in the current difficult environment. That coupled with sharply weaker oil, significantly softer earnings, and a poor industry outlook point to a dividend cut being ahead.

Is the dividend sustainable?

Canadian Natural has hiked its dividend for the last 19 years straight, making it a Dividend Aristocrat and stalwart for income-hungry investors. The oil sands operator even increased its dividend during the last oil price collapse, where crude plunged to under US$30 per barrel. The key fear is that as net earnings deteriorate because of sharply weaker oil (caused by the fallout from the pandemic), the dividend-payout ratio will spike to over 100%, making the payment unsustainable.

The concerns regarding the potential for a sharp decline in Canadian Natural's earnings are supported by its first-quarter 2020 results. It reported a massive $1.3 billion net loss for the period compared to a $961 million profit a for the equivalent period in 2019.

That can be blamed on sharply weaker oil prices.

Canadian Natural's average basket price for its exploration and production business for the first quarter was $21.90 per barrel. This was 44% lower than the $39.27 per barrel reported a year earlier. There was a similar trend for Canadian Natural's oil sands mining and upgrading business where the average price fell 23% year over year to $50.88.

That had a sharp impact on Canadian Natural's operating netback, which is a key measure of operational profitability. The company's exploration and production division reported a netback of $4.83 per barrel sold, which was a quarter of what it had been a year earlier. For oil sands mining, it plunged 32% year over year to $27.97 a barrel.

What is the impact on the dividend?

As a result of that large loss Canadian Natural's trailing 12-month earnings fell 41% to $3.2 billion. Surprisingly, even after such a significant decline, Canadian Natural's dividend-payout ratio is still a conservative 60% of net income.

This indicates that at this stage, the regular payment is sustainable.

Nevertheless, a combination of sharply weaker oil prices and lower production will cause earnings to plunge further. That could easily see the dividend-payout ratio rise to over 100%, bringing into question whether Canadian Natural should follow in Suncor's footsteps and cut its dividend.

Management has stated that it believes the company's dividend can be sustained through the latest slump in oil prices. A combination of cost cutting, low breakeven costs, and commodity price hedges will blunt the impact of sharply weaker oil prices on Canadian Natural's earnings.

Canadian Natural possesses considerable financial resources. At the end of the first quarter, it had $1 billion of cash on hand and $3.9 billion available from existing credit facilities. That substantial liquidity will allow Canadian Natural to continue paying the dividend, even if earnings over the short term deteriorate further.

Foolish takeaway

Canadian National's commitment to its shareholders underscored by its decision to maintain its dividend in this harsh operating environment, even after recently hiking it by 13%, is admirable. There is every indication that if oil prices recover during the second half of 2020 that the payment can be sustained with little to no damage to Canadian Natural's financial position.

For the reasons discussed, the dividend and that juicy 6.7% yield is safe for now, even if second- and third-quarter 2020 earnings deteriorate further. That makes Canadian Natural an attractive investment in the current difficult environment.

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