Why I Believe Investors Should Avoid Canadian Oil Sands Ltd.

Description

The bad news hasn't stopped for investors in **Canadian Oil Sands Ltd.** (TSX:COS), which holds a 37% interest in the Syncrude project. Since the rout in crude prices commenced, it has slashed its dividend by 43% and cut capital expenditures to preserve cash flow and protect its balance sheet. This rout has also triggered a savage sell-off of its shares, with its share price plunging a massive 56% over the last three months.

But it now appears the bad news has yet to stop for investors and I now believe investors are best advised to avoid one of the energy patch's troubled operators.

Let me explain why.

Unexpected production outages

A recent unexpected production outage at the Syncrude project highlighted the complex nature of the operations and compounded growing concerns over the reliability of Canadian Oil Sands' 2015 guidance.

This outage forced the company to trim its full-year 2015 production guidance to 94 million barrels of crude, from an initial range of 95 million to 100 million barrels. It also comes on the back of a history of unexpected outages at the project that have interrupted production and caused maintenance costs to rise. I expect these interruptions and maintenance costs to grow because of the complex nature of the machinery involved in converting bitumen to synthetic crude.

Any further interruptions certainly don't bode well for Canadian Oil Sands being able to meet its forecast 2015 crude production.

Another dividend cut?

Of greater concern is that Canadian Oil Sands' 2015 guidance leaves insufficient free cash flow to meet its capital expenditure commitments and the amended dividend. Ever worse, this guidance was formulated using an average 2015 oil price of US$75 per barrel.

Now with crude prices having plunged to their lowest point in around five years to well under US$50 per barrel and no signs of a rebound of any time soon, there is mounting pressure on the company to further cut expenses. Canadian Oil Sands will likely have to slash its dividend and capital expenditures once again as it battles with lower than expected crude prices.

Because of the unreliable nature of the Syncrude operations, growing unexpected maintenance costs, and the increasing likelihood of yet another dividend cut, I believe Canadian Oil Sands is a company best avoided by investors.

CATEGORY

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