What's Next for Canadian Oil Sands Ltd.?

Description

The last few weeks have been pretty crazy for **Canadian Oil Sands Ltd.** (TSX:COS) and its investors.

On January 28, the company slashed its dividend again to preserve capital. The next morning, shares plummeted and some pundits were calling for a drop through the $5 mark.

That's not what happened. Instead, the stock bottomed at $6.01 per share and then began to rise like the phoenix and hasn't looked back. Investors who decided to throw in the towel at the opening trade that day have spent the last week screaming at their monitors, or their advisors, because the stock has nearly doubled off the low.

What happened?

Short sellers who had ridden the stock all the way down to the $6 mark decided to take some profits and exited their positions. At the same time, oil prices have enjoyed a mini rally back above the $50 mark after bottoming out below $45.

Finally, speculators have piled into the stock on rumours that the other Syncrude partners might acquire Canadian Oil Sands.

In the days leading up to the dividend cut, I wrote an article suggesting that **Imperial Oil Ltd.** (TSX:IMO)(NYSEMKT:IMO) and **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) might be interested in buying Canadian Oil Sands as a way to consolidate the ownership of Syncrude. Apparently, I'm not the only one who was considering the possibility.

What will happen next?

At the time of writing this article, Canadian Oil Sands had a market capitalization of $5.4 billion. In the latest earnings release, the company said its total net debt stood at roughly $1.9 billion. That would mean a minimum takeout price of about $7.3 billion.

Suncor Energy currently owns 12% of Syncrude but is unlikely to buy Canadian Oil Sands on its own. The company certainly has the financial firepower to do the deal, but it would still be a hefty investment, and boosting the ownership from 12% to 49% would involve a serious annual cash commitment to a struggling project in a very shaky oil environment.

Imperial Oil could take a run at Canadian Oil Sands because it already owns a 25% stake in Syncrude and has the contract to operate the facility on behalf of the other partners.

As with Suncor, Imperial could pull off the deal on its own, but the more likely scenario would be a purchase using cash from **Exxon Mobil Corporation**, which owns a majority stake in Imperial. Exxon has a market capitalization of about US$384 billion, so the deal would be a simple drop in the bucket.

It will be interesting to see how the story pans out.

What should you do?

Investing in Canadian Oil Sands requires some guts right now because Syncrude is a troubled project. In the Q4 2014 earnings statement, Canadian Oil Sands said its per barrel operating cost was a lofty $44.

Total output for 2014 came in at 94.2 million barrels, at the low end of significantly reduced guidance. The project has a design capacity to produce 350,000 barrels of oil per day but only averaged 258,100 barrels per day throughout 2014. Output expectations for 2015 have been set at 95 to 110 million barrels — the same place they started in 2014.

New WTI price assumptions for the year are $55 per barrel, and operating expenses are forecast to be $40 per barrel. Time will tell if these numbers are conservative or simply wishful thinking.

On the bright side, two major capital projects are almost complete. This reduces financing and execution risks and frees up significant cash flow.

Betting on a buyout is risky. If Suncor and Imperial decide to absorb Canadian Oil Sands, they will probably wait until the company is unable to meet its commitments on the Syncrude project. For the moment, that’s not the case.

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