Canadian Oil Sands Ltd.: Could a Buyout Really Be in the Works?

Description

Investors in **Canadian Oil Sands Ltd.** (TSX:COS) have watched their shares nearly double in the past month and fans of the stock are wondering if the move is based on fundamentals, or simply wishful thinking by a handful of speculators.

Let's take a look at one reason for the crazy action.

Takeover rumours

On January 29, the company announced its latest round of spending cuts. The move was highly expected, but the reaction by the market certainly wasn't. The stock dropped at the opening bell the next morning, but immediately began to recover, and hasn't looked back since.

Short sellers probably accounted for part of the move as they booked some profits on the stock, but the rest of the uptrend has continued on the back of stronger oil prices and rumours that the company could be taken over.

Canadian Oil Sands owns 37% of the Syncrude oil sands project. Given the challenges facing the company and the oil market as a whole, it would be reasonable to think that the business could be acquired, but who would be the buyer(s) and at what price?

Financial snapshot

Before we look at the possible suitors, let's get a sense of whether or not Canadian Oil Sands is ready to throw in the towel.

At the time of writing, Canadian Oil Sands had a market cap of $5.5 billion. In the Q4 2014 earnings statement, the company said it finished 2014 with about $1.9 billion in net debt.

The company also has some significant contractual obligations that it has entered into, either directly,or as per its ownership stake in Syncrude. Excluding the cash outflows for long-term debt, these commitments add up to roughly $4 billion.

During 2014, the weakening of the Canadian dollar drove up the value of the company’s long-term debt. In the first two months of 2015, the Canadian dollar has fallen another 7.5%, making the situation even worse.

Canadian Oil Sands saw its net debt-to-total net capitalization more than double last year from 14% to 29%. Lending covenants limit the company’s long-term debt-to-total capitalization to 55%, which means the company still has some wiggle room on the balance sheet, especially after the reductions in the dividend and other spending.

At the moment, Canadian Oil Sands still has the financial means to meet its obligations and management isn’t at risk of having its hand forced on a sale of the company.

Syncrude problems

Syncrude has been struggling with operational issues for the past three years. Output capacity for the project is 350,000 barrels per day, but Syncrude only managed to average 258,100 barrel per day in 2014. This worked out to about 94.2 million barrels for the year, which was at the bottom of significantly reduced guidance. While the resource base might be attractive, Syncrude isn’t exactly an oil sands star.

Frenemies

Given the ongoing uncertainty in the oil market, it is unlikely that Syncrude partners **Suncor Energy** and **Imperial Oil** would buy out Canadian Oil Sands while it is still solvent. Companies partner on these projects because the arrangement helps spread out the financial risks. If one partner gets into trouble, the others go into vulture mode, and will wait for the best possible moment to acquire the assets.

The only scenario I see that will cause a takeover to happen would be one where Canadian Oil Sands can no longer meet its financial commitments to the project. If things get that bad, the ownership stake could be carved up among the other owners, but it would be at a distressed price, and Canadian Oil Sands shares would be a lot lower than they are today.

If you think oil prices are headed significantly higher, you can make a case for owning the stock, but buying on the hopes of a buyout might not be a wise move.

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Author
aswalker