Why I Remain Bearish on Canadian Oil Sands Ltd.

Description

One time high-flying, dividend-favourite **Canadian Oil Sands Ltd.** (TSX:COS) has been savaged by the oil rout. The rout has caused it to slash its dividend as oil prices fell lower than management initially expected. This triggered a sharp sell-off that made its share price plunge to lows not seen for over a decade.

However, since then it has bounced back, more than doubling in value on the back of takeover rumours and an improving outlook. This has left many investors considering whether now is the time to invest.

Now what?

Canadian Oil Sands is pure leveraged play on higher oil prices. All of its oil production is unhedged, thereby reducing costs and creating the potential for considerable upside should oil prices rebound. Yet there are considerable risks for investors because Canadian Oil Sands is exposed to the vagaries of crude prices.

However, the one aspect of its operations that continues to attract considerable attention is its long-life oil reserves. These reserves total 1.4 billion barrels after allowing for royalties and have an independently assessed value after income taxes and the application of a 10% discount rate of $9.2 billion.

After deducting net debt totaling $1.6 billion, this equates to a value of $15.60 per share, or a 29% premium over Canadian Oil Sands current share price. It is this that makes Canadian Oil Sands an attractive takeover target and investment in the eyes of some analysts and investors.

Nonetheless, I certainly wouldn’t count on Canadian Oil Sands becoming a takeover target, even if oil prices remain depressed. With an enterprise-value of almost $8 billion, it would be a tremendous acquisition for any major oil company to digest.

I am also yet to be convinced that Canadian Oil Sands offers investors a deep-value investment opportunity.

You see, the Syncrude project over the years has been plagued by operational problems; a range of production outages has caused oil production to be lower than forecast. These production outages, along with ongoing maintenance issues, have also caused costs to grow, further impacting Canadian Oil Sands profitability.

All of these issues can be attributed to the complex nature of the machinery required to convert bitumen into synthetic crude. While Canadian Oil Sands and its Syncrude partners have taken considerable steps to improve the reliability of the operation and reduce costs, I am yet to be convinced that its reliability has improved.

Canadian Oil Sands also has a massive $8 billion in financial obligations, of which, $2 billion falls due over the next four years. When the current harsh operating environment is considered, these financial obligations could have a significant impact on Canadian Oil Sands financial condition. If oil prices remain low for longer than expected, I would expect to see its financial condition deteriorate further, forcing it to make additional cuts to expenditures, including its dividend.

So what?

Canadian Oil Sands’ long-life oil reserves make it an attractive investment.

However, I don’t believe this is sufficient to make it a worthwhile investment at this time because there are too many issues relating to its financial health and operational sustainability that leave it particularly vulnerable in the current harsh operating environment.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

POST TAG

1. Editor's Choice

Category

1. Dividend Stocks
2. Energy Stocks
3. Investing

Tags

1. Editor's Choice

Date
2025/10/02
Date Created

2015/04/29
Author
mattdsmith