Will Canadian Oil Sands Survive?

Description

Producing oil these days isn't nearly as profitable as it used to be. It's especially less profitable when you operate high-maintenance projects that require a high cost of oil to break even.

Canadian Oil Sands Ltd. (TSX:COS) has seen its share of issues, both operationally and politically. With oil prices remaining depressed, however, what does the future look like for investors?

It always starts with a dividend cut

In January Canadian Oil Sands announced it was cutting its dividend to $0.05 per share from $0.35, while also announcing plans to cut up to $400 million from its operating and development costs for 2015. The company also dropped its spending budget by roughly 20%, or just over $100 million.

Shares sold off sharply after the drastic dividend cut, and a reduced capital budget puts strain on their projects that have historically needed fresh infusions of cash to sustain production volumes.

Consistently struggling projects

Canadian Oil Sands' chief asset is its 37% stake in Syncrude Canada Ltd., the second-oldest oil sands property. Unfortunately, the aging project has been consistently susceptible to breakdowns that have routinely dented production volumes.

Syncrude's major mechanical breakdowns forced Canadian Oil Sands to cut its production expectations three times last year. Equipment breakdowns throughout 2014 caused Syncrude to post its lowest average production numbers since 2006.

Operational issues, coupled with collapsing oil prices, have put growing pressures on the company's solvency. Due to its minority stake however, Canadian Oil Sands has few options in turning around Syncrude's operations. **Imperial Oil Ltd.**, controlled by **Exxon Mobil Corp**., controls 25% of the project and has control over daily operations.

According to the CEO, "it is a large facility, with many aspects to the operation. As we fix significant things, we have seen other issues crop up."

New regulations won't help

This May Canada reaffirmed its commitment to cut greenhouse emissions by 30% (from 2005 levels) by 2030. A good chunk of this reduction should come from new regulations in the oil and gas sector.

Specifically, Canada wants to cut methane emissions from oil and gas companies, such as industrial leaks and gas flares. While far from devastating, these regulations add another layer of costs and uncertainty for already struggling projects.

2015 forecast will be difficult to achieve

Canadian Oil Sands expects Syncrude to produce between 95-110 million barrels of oil in 2015. The company made the same call in 2014 and had to reduce its range to 95-100 million barrels fairly quickly, with the final outcome coming in towards the low end of the range. If history is any indication, the company will have a difficult time meeting its targets.

The company's forecast also assumes oil will trade at an average of US$75 a barrel in 2015. With current oil prices 10 to 15% below that, Canadian Oil Sands should be forced to realign its budget and financial forecasts yet again. Meanwhile, pressure is mounting with falling earnings estimates, $2.3 billion in debt, and only $120 million in cash.

Conclusion: stay away

While it's tempting to scoop up shares that are down almost 75% from their 52-week high, there is just too much uncertainty at this point to get in. There are still plenty of options that should perform well given higher oil prices, all with lower debt loads and more financial flexibility.

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