



Why a Takeover of Canadian Oil Sands Ltd. Is Unlikely

Description

Canadian Oil Sands Ltd. (TSX:COS) is, in many ways, a unique energy company. Unlike its competitors that are diversified across geography, assets, and product type, Canadian Oil Sands has one asset—its 36.74% stake in the Syncrude oil sands mining project.

This lack of diversity provides both risk and opportunity, and Canadian Oil Sands embraces both of these by being one of the few Canadian energy companies that chooses to expose itself directly to oil prices by having no production hedged.

As a result, Canadian Oil Sands was hit exceptionally hard by the oil rout, with its current share price 54% lower than it was in September 2014. This has prompted takeover rumours, as larger producers seek to purchase high-quality assets at attractive prices. Canadian Oil Sands fits the criteria, having access to over 40 years of reserves (with the possibility to extend it over 10 years should the Mildred Lake Extension project go through), and it has a non-declining production profile that keeps sustaining capital costs low.

The result is that Canadian Oil Sands has been called a prime candidate for takeover. Here's why this is not as likely as it seems.

Potential buyers may not be interested

Who would buy Canadian Oil Sands? The most obvious possibilities would be Canadian Oil Sands fellow Syncrude owners. While Canadian Oil Sands is the largest owner of Syncrude, the second- and third-largest stakes belong to **Imperial Oil Ltd.** and **Suncor Energy Inc.**, with 25% and 12% stakes, respectively. One or both of these companies would be the most probable buyers given the fact that they already own stakes, and synergies with current operations would be readily available.

The problem? There is a good chance neither of these buyers are interested. Suncor has a recent track record of being extremely disciplined with acquisitions, focusing more recently on divesting assets that do not fit with its core business. The company is also focusing on low-cost capital projects, such as debottlenecking initiatives that work to maximize production and allow it to be more profitable on a per-barrel basis.

Suncor's strategy is focused on profitable growth rather than simply growing the top line through acquisitions, and as a result, CEO Steve Williams said recently that any potential acquisitions would need to pass a very high hurdle. He also stated that oil sands acquisitions are very difficult for them to make work due to the fact that Suncor has some of the highest-quality resources in the industry, and any potential acquisitions would need to be benchmarked against them.

While Syncrude is a high-quality asset, it is considered lower quality than Suncor's Millenium mining project, and has higher operating and sustaining capital costs. These have been caused partially by frequent reliability and production problems, and it is likely Suncor would look to higher return areas for any potential acquisition, should they even make any.

As for Imperial Oil, while Canadian Oil Sands would indeed meet many of the firm's key requirements for an acquisition, including synergy, high-quality reserves, and scale, RBC analyst Greg Pardy estimates the odds of such an acquisition are 10% or less. This is because Imperial already has an extremely large upstream portfolio, and that the company has been having difficulties generating solid operating results at Syncrude.

Imperial Oil manages Syncrude's operations after signing a 10-year management agreement in 2006, which was supposed to see best practices and operating expertise from **Exxon** and Imperial's operations brought to Syncrude. This has been a challenging road, however, and Syncrude has since suffered the worst reliability in the oil sands, with equipment breakdowns being a regular occurrence.

Canadian Oil Sands is not interested

Most importantly, Canadian Oil Sands CEO recently stated that selling is not on their minds, and it's questionable if investors would support such a move either. Canadian Oil Sands investors see the company as a pure play on oil prices, as well as a source of income, and with WTI prices up 40% since mid-March, the company is set to generate positive free cash flow even after dividends are factored in. Should oil prices stay where they are or recover, it is unlikely Canadian Oil Sands management or investors would favour a takeover.

CATEGORY

1. Energy Stocks
2. Investing

POST TAG

1. Editor's Choice

Category

1. Energy Stocks

2. Investing

Tags

1. Editor's Choice

Date

2025/08/26

Date Created

2015/05/28

Author

amancini

default watermark

default watermark