



## Why Investors Should Avoid Canadian Oil Sands Ltd.

### Description

There continues to be a lot of conjecture swirling among analysts about the future of the single largest investor in the Syncrude Oil Sands project **Canadian Oil Sands Ltd.** (TSX:COS). Everything from takeover rumours to corporate collapse is being discussed, and now with crude again falling to under US\$50 per barrel, its outlook is under significant pressure.

### Now what?

Canadian Oil Sands has been plagued by problems in recent years. The Syncrude project has proved to be highly unreliable, with a number of production outages and maintenance blowouts bedeviling its operations. As a result of these outages, Canadian Oil Sands's annual production has fallen every year since 2009, while cost blowouts associated with maintenance have continued to be a problem.

Canadian Oil Sands and its Syncrude partners, including operator **Imperial Oil Ltd.**, have worked hard to reduce costs as they adjust operations in order to remain profitable in the current harsh operating environment. For Canadian Oil Sands, this has included slashing capital expenditures, costs, and its dividend.

However, the recent plunge in oil prices now has WTI trading at 20% less than the US\$55 per barrel estimated by Canadian Oil Sands in its revised 2015 guidance.

This will have a significant impact on Canadian Oil Sands cash flow. It is estimated that for every US\$1 per barrel change in the price of WTI there is a \$29 million change in cash flow. As a result, should WTI prices remain under US\$50 per barrel for a sustained period, then the impact on Canadian Oil Sands cash flow will be significant.

Of even greater concern is that despite the efforts made to slash operating expenses, they still remain particularly high because of the complexities associated with the process of extracting synthetic crude from bitumen. For the second quarter of 2015, operating expenses came in at \$52.63 per barrel, which is only marginally lower than the current price of oil leaving Canadian Oil Sands with a very thin margin for every barrel produced in the current operating environment.

These operating expenses are also among some of the highest in the energy patch, and this, I believe, is one reason that makes Canadian Oil Sands an unattractive investment, despite its ongoing efforts to slash costs.

Despite all of these factors and its declining cash flow, Canadian Oil Sands continues to pay its dividend of \$0.05 per share. By ending this dividend payment altogether, it could generate annual cost savings of about \$95 million. This will indeed be a necessary step if crude prices remain at current levels for a sustained period.

### **So what?**

Its high operating expenses coupled with the unreliability of Syncrude's operations make Canadian Oil Sands a particularly unappealing investment in the current operating environment. With sharply lower crude prices again bringing the viability of its meager dividend, which has already been cut twice over the last year, into question, it is certainly not stacking up as an attractive investment.

In fact, with crude prices set to remain markedly lower than expected for at least the foreseeable future, I see little to no upside in Canadian Oil Sands's share price, making it an investment to be avoided.

### **CATEGORY**

1. Dividend Stocks
2. Energy Stocks
3. Investing

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1. Editor's Choice

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