Will Canadian Oil Sands Ltd. Survive $40 Oil?

Description

As the price of oil continues to decline, many investors are once again shunning the sector, convinced the pain is here to stay.

It seems like analysts are practically tripping over each other to issue bearish reports on the future of crude. The latest is a piece from Moody's, which says that the price of the commodity will only average US$50 for the rest of 2015, rising only slightly to average US$60 in 2016. In fact, the report says investors should expect low prices for years to come. "We expect prices for oil, natural gas and natural gas liquids—and particularly oil—to remain below recent historical highs through 2018."

While I don't want to immediately discard a report from smart analysts, I have to admit I take most of these types of stories with a massive grain of salt. I've yet to encounter an analyst who can consistently predict the price of crude. Analysts are usually a pretty good contrarian indicator. When they seem to be universally bearish, it's best to take the opposite side of the bet.

With that in mind, I've been looking for cheap oil producers who have the strength to weather this current storm, but have huge potential upside when the price of crude recovers. Here's why **Canadian Oil Sands Ltd.** (TSX:COS) is one such stock.

Cheap assets

Forget about the company's earnings for a second. Let's look at the value of the underlying assets.

At the end of 2014 Canadian Oil Sands's share of the Syncrude oil sands project was approximately 37%. That translates into 1.6 billion barrels of proved and probable reserves, along with 1.7 billion barrels of contingent reserves.

The company has a market cap of just $3.23 billion as well as net debt of $2.35 billion. That means that investors are paying a total enterprise value of just $5.58 billion for the whole company. Or, to put it another way, investors are paying just $1.64 per share for both the proved and probable reserves and the contingent reserves.

And remember, Canadian Oil Sands isn't a start-up. All the equipment is in place to upgrade the messy tar-like bitumen into light sweet crude. Yes, the process does have a cost, but it also means it gets a much better price for its crude than the other oil sands producers.

There's more to like about those massive reserves too. Based on current production of approximately 36 million barrels per year, the company has more than 47 years of reserves left before it even touches the contingent reserves.

This means that investors in Canadian Oil Sands are avoiding a risk that almost every other energy producer has to deal with, and that's the danger in acquiring new reserves. A traditional producer has to be constantly on the lookout for more reserves, while Canadian Oil Sands just has to focus on its existing infrastructure.

Solid financials

The list of energy producers who can survive indefinitely with oil flirting with $40 per barrel is pretty short. But there are plenty with the balance sheet strength to make it through this current rough patch.

Although Canadian Oil Sands has more than $2.3 billion in net debt, that's not a whole lot when you compare it to the company's assets, which are approximately $10 billion. The company also has a $1.5 billion credit facility it can utilize, and doesn't have any major debt repayments due until 2019.

It's also doing a nice job cutting costs. In 2014 Canadian Oil Sands's operating cost per barrel was $49 per barrel. In the first quarter it was $36 per barrel, and the company expects costs to be $39 per barrel through the rest of 2015. That means the company's breakeven costs are about $49 per barrel once all the expenses are considered, which isn't much higher than current prices.

Plus, capital expenditures are slated to be cut back significantly this year. Add in the savings the company has after cutting the dividend, and it looks to me it'll be able to survive even if this environment persists. All investors need to do is be patient and wait for oil to go back up, and Canadian Oil Sands should go up with it.

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