# Should Canadian Oil Sands Ltd. Be Your Top Energy Pick Today?

## Description

I wish I knew when the price of crude was going to go up. That would make investing a lot easier.

Unfortunately, I don't think any of us can accurately predict the price of oil. And if I could, believe me, I wouldn't be telling anyone about it.

Instead, I invest with a very simple mantra. I don't know where the price of crude is going to be tomorrow, next week, or next year. I don't know whether it'll go down 10% or 50% from here. What I do know is that the next 100% move in oil will be up and not down. It might take years. Heck, it might take decades. But I'm convinced that oil will double at some point in the future. It's only a matter of time.

Knowing that, investing in the sector now is a no-brainer. All I need to do is identify the kinds of companies that can make it through this downturn, and are leveraged to the price of crude.

I think **Canadian Oil Sands Ltd.** (TSX:COS) is one such company. Here's why I'm buying more of the stock.

### Cheap assets

The nice thing about buying an oil sands producer is you don't have any exploration risk. There's decades worth of oil just sitting right there, waiting to be extracted. Based on current production, Canadian Oil Sands has about 40 years of reserves in the ground, and that's assuming there are no contingent reserves.

There's also the replacement cost of the assets. According to a recent presentation by the company's vice president of investor and corporate relations, it would cost between $80,000 and $120,000 per flowing barrel to build Syncrude from scratch, the project in which Canadian Oil Sands owns a 36% stake. These days, the company has an enterprise value of about $40,000 per flowing barrel.

To put that simply, investors are paying between a third and a half of what it would cost to replicate those assets today. When crude recovers and those assets are worth close to (or more than) replacement value, there's huge upside on that metric alone.

But wait. It gets better.

According to the same presentation, all crude needs to do is modestly recover and Canadian Oil Sands is in good shape. If oil gets back to just $55 per barrel, the company would earn approximately $1 per share in cash from operations. Based on current capital expenditures, it would approximately break even on a free cash flow basis at $55 oil.

Anything above $55 is just gravy, at least from a survival perspective. At $65 oil, cash from operations is projected to be approximately $1.50 per share, putting free cash flow at about $0.50 per share. That's more than enough to support the company's $0.20 per share annual dividend.

**Can it afford to wait?**

Canadian Oil Sands isn't the only Canadian oil producer with major upside when crude recovers. Many mid-sized producers have the same risk/reward profile.

Then why do I like Canadian Oil Sands over the others? Simple. It has a good balance sheet, which is something energy investors should be looking for.



Currently, Canadian Oil Sands is sitting on $2.35 billion in net debt. That seems like a lot, but it isn't so bad. There are no major debt repayments due until 2019, which gives the company plenty of time to wait until crude recovers.

Besides, the company has available credit it can use in the meantime. It has a credit facility for $1.5 billion that is currently untapped, which was recently extended until 2019. If the weakness in crude persists, a combination of drawing from the credit line and cutting more costs will easily be enough to cover any operating shortfalls.

Over the long term, there's potential for Canadian Oil Sands shares to end up much higher. It has the balance sheet strength to weather today's storm, and the operational leverage to end up much higher when crude eventually recovers. For those reasons, I own the stock; perhaps you should, too.

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nelsonpsmith