Canadian Oil Sands Ltd.: Another Beneficial Acquisition for Suncor Energy Inc.

Description

Weeks after boosting its stake in the controversial Fort Hills oil sands project, **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) has made an offer for **Canadian Oil Sands Ltd.** (TSX:COS). While some investors may still be reluctant to invest in the energy patch, this is yet another sign that now is the time to acquire Canada's largest integrated energy company.

Now what?

When investing in the patch, the secret is not choosing those companies that will survive the current harsh operating environment, but those that will emerge capable of taking full advantage of higher oil prices. Suncor is demonstrating that it will emerge from the current crisis in a solid position and will be able to benefit from higher oil prices when they occur.

This is because it is using the $5 billion war chest it has amassed for acquisitions to take advantage of what is truly a buyer's market. Suncor's purchase of an additional 10% stake in Fort Hills from partner **Total SA** for $310 million, was a bargain; it was well below the independent valuation of $450 million.

Now it has made an unsolicited offer for all of the outstanding shares of the largest partner in the Syncrude project, Canadian Oil Sands. The offer, valued at about $4.3 billion, would see Canadian Oil Sands shareholders receive 0.25 Suncor shares for every Canadian Oil Sands share they own.

The completion of the offer would be a massive coup for Suncor, boosting its ownership of the Syncrude project from 12% to 49% and adding Canadian Oil Sands's considerable long-life reserves totaling 1.4 billion barrels to its own.

To get an idea of what the transaction means for Suncor, you only need to look at the independent valuation of Canadian Oil Sands's reserves at the end of 2014. These were valued at just over $9 billion using an average price of US$89 for WTI over the next 10 years, coupled with a 10% discount rate over that period.

While this may be an optimistic valuation in the current environment, it is likely that oil prices will rebound strongly over the next few years. For a total of $6.6 billion, including Suncor's assumption of

Canadian Oil Sands’s mountain of debt totaling $2.3 billion, this is an attractive acquisition.

Clearly, this acquisition is not without risks.

The Syncrude operation has been dogged by a range of issues over recent years. These have included production outages caused by unscheduled maintenance along with the costly machinery failures.

Then you have the high costs associated with the process used to convert bitumen to light crude, with Canadian Oil Sands’s operating expenses for the first half of 2015 coming in at $43 per barrel. This left it with estimated breakeven costs of US$52 per barrel for the first half of 2015, marginally below the average weighted price per barrel for that period and now 12% higher than the current price.

So what?

When considering that Suncor is acquiring Canadian Oil Sands for a considerable discount to the value of its oil reserves, even after allowing for debt, this is a positive move for Suncor. It will also boost its output of high-value light crude and will markedly boost its reserves, setting the stage for solid earnings growth once crude rebounds.

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