The Suncor Energy Inc. and Canadian Oil Sands Ltd. Deal Is Dead. What Now?

Description

Earlier this week, **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) announced a bid to acquire **Canadian Oil Sands Ltd.** (TSX:COS), the largest partner in the infamous Syncrude oil sands project. The offer was for $4.3 billion in Suncor shares, and the assumption of about $2.3 billion of debt, making the total transaction worth $6.6 billion.

The size of the offer was surprising, coming in at a 40% premium over Canadian Oil Sands's previous closing price.

Until recently, Suncor was confident in the strength of its bid: "We believe this is a financially compelling opportunity for shareholders. We're offering a significant premium to its current market price and also providing exposure to a meaningful dividend increase. We're confident in the value this offer provides to Canadian Oil Sands shareholders," said Suncor CEO, Steve Williams.

It seems as if Canadian Oil Sands's management viewed things differently. The company announced a "shareholder rights plan" on Wednesday that effectively bars it from being acquired. The plan requires a bid to be considered for at least 120 days, despite Suncor's offer expiring after just 60 days.

What's next for shareholders of both companies?

Suncor continues onward

Without the support of current management, Suncor will now go around the board and appeal straight to shareholders. Because Suncor already owns 12% of the Syncrude project, adding Canadian Oil Sands's stake will allow it a nearly 50% stake.

It shouldn't be surprising that Suncor has brushed off the recent hurdle:

"We're disappointed but not surprised by the board's decision to adopt a new board approved shareholder rights plan in the face of our offer. This inappropriate defensive tactic limits the ability of shareholders to decide. With a 43% premium to market price and investment in a company that has a strong track record of returning cash to shareholders, we're confident in the value our offer provides to shareholders," Williams said.

Can Canadian Oil Sands afford the risk of rejection?

While the risky move gives Canadian Oil Sands more room to attract higher bids from other companies, it may not have much time. Lower oil prices mean that Canadian Oils Sands will likely be forced to use its cash flow to pay for operating losses. Because oil sands projects are notoriously high cost and over budget, this could spell disaster for a company that is extremely levered to a single project.

With global demand for oil forecasted to grow only 1% in 2015, an oil price rebound is likely to be delayed until there are major reductions in production from U.S. shale plays, or until OPEC members cease their supply glut. Last week, OPEC members signaled that they would continue producing at historic highs for the foreseeable future. This means that $50 oil may be here to stay.

Last year, Canadian Oil Sands posted total operating expenses of $46.69 a barrel. Positive cash flow would likely need something closer to $60 a barrel.

The company is clearly betting on a rebound in prices. If that doesn't happen, management may regret rejecting such an enticing offer from Suncor.

Shareholders should be displeased

Clearly, Canadian Oil Sands is in big trouble if oil prices stay near today's prices. Continued high production and tepid demand growth makes this a real possibility. Because other industry players are facing liquidity issues of their own, the potential list of suitors willing to trump Suncor's offer is fairly limited. Current investors better hope that management wises up and accepts what could be a lifeline offer.

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