Why Imperial Oil Limited Should Buy Penn West Petroleum Ltd. Instead of Canadian Oil Sands Ltd.

Description

Ever since **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) offered $4.3 billion for **Canadian Oil Sands Ltd.** (TSX:COS), the target company's shareholders have been anticipating a higher bid. As of this writing, COS's shares trade at nearly a 10% premium to Suncor's offer. But where would a higher bid come from?

Probably not from Suncor. The energy giant will probably be making more acquisitions in the future (whether or not this one is successful), and certainly doesn't want to send the signal it will cave at the first sign of resistance. Besides, Suncor offered a premium of more than 40%, which, in most situations, would be enough to get the job done.

Instead, **Imperial Oil Limited** (TSX:IMO)(NYSE:IMO) is by far the most likely company to submit a rival bid. It already owns a stake in the Syncrude joint venture, and has plenty of financial firepower as well.

But Imperial should go after another company instead: **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE). Below are three reasons why.

1. Penn West is cheaper

The Suncor bid for COS is equivalent to $64,000 per daily barrel of production. That's not a very high price to pay, especially relative to some recent project costs (including Imperial's Kearl oil sands mine). But Penn West is even cheaper. Even after factoring in debt, the company trades at just over $30,000 per daily barrel.

Granted, there are some big differences between the companies. Syncrude is an oil sands mining project, which tends to last many years, and has very steady production. Meanwhile, Penn West's wells can have steep decline rates, meaning that big dollars must be spent just to maintain production.

But this alone does not explain the dramatic difference in prices. Penn West even sold some assets recently for $43,000 and $82,000 per daily barrel. That's a lot higher than where its stock trades.

2. There are more synergies

Put simply, Suncor is trying to score a bargain by bidding for COS. There is practically no other motivation for the offer—the Syncrude project will run as it has before, no matter what happens.

By contrast, Imperial would be gaining some valuable assets if it were to bid for Penn West. It's hard to say exactly what synergies could be obtained, but there is certainly potential.

3. Imperial could avoid a fight with Suncor

Imperial and Suncor are in an enviable position. They are two of only a handful of buyers in a sector with many sellers. All they have to do is not fight over the same assets, and they should each score some bargains.

So, it would be quite reckless for Imperial to fight with Suncor over a company like COS. It would be better simply to find its own targets.

CATEGORY

1. Energy Stocks
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