3 Reasons Canadian Oil Sands Ltd. Should Have Accepted the $4.5 Billion Bid From Suncor Energy Inc.

Description

In a move that was not unexpected, **Canadian Oil Sands Ltd.** (TSX:COS) formally rejected a $4.5 billion offer from **Suncor Energy Inc.** (TSX:SU)(NYSE:SU). This comes after COS adopted a poison pill last week, one that will last longer than Suncor's bid.

But the COS board is playing a very dangerous game. We take a look below at three reasons why they should reverse course and accept the Suncor bid instead.

1. We're unlikely to see a higher offer

In a conference call Monday morning, COS management identified 11 reasons to reject Suncor's bid. One of them is that "the Board of COS and its advisors continue to examine alternatives." In other words, they are expecting a higher offer to come, either from Suncor or from another company.

But that is very unlikely to happen. As we all know by now, there are plenty of companies looking to sell themselves, and very few companies looking to buy. So, if you're running an oil company and are looking to make an acquisition, there's no reason to start a bidding war with Suncor.

Likewise, it's unlikely that Suncor will make a higher offer. The company has already offered a 43% premium, and doesn't want to send any messages of weakness. Besides, Suncor will probably try to acquire other companies in the near future, and certainly doesn't want to encourage them to mimic COS's approach.

2. The outlook doesn't look good for oil

COS's management rightly points out that the company offers higher leverage to oil prices. This should make perfect sense. Suncor has a large downstream business (refining and gas stations), and also has relatively little debt.

But is that really such a good thing? As 2015 drags on, evidence is mounting that oil prices aren't recovering any time soon. And that could be a major concern for the company, especially given its high debt levels.

3. A sudden, steep drop

If COS rejects Suncor's bid and no higher offers are made, then it won't be pretty for COS's shareholders.

To understand what this would look like, one only has to look at what happened to **Pacific Exploration and Production Corp.** (TSX:PRE). The company received a takeover offer worth more than $2 billion, but rejected the bid, claiming it significantly undervalued the company. As a result, its share price decreased by more than 45% in one day. The same thing could easily happen to COS.

So, if you hold COS stock and are looking for exposure to higher oil prices, you should sell your stock now. Then you can buy any number of levered oil producers.

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