



Canadian Oil Sands Ltd.: Why I Voted No to Suncor Energy Inc.'s Takeover Offer

Description

The other day, I received the official recommendation in the mail from **Canadian Oil Sands Ltd.** (TSX:COS), urging me to vote against the proposed bid from **Suncor Energy Inc.** ([TSX:SU](#))([NYSE:SU](#)).

Back in early October, Suncor offered Canadian Oil Sands shareholders 0.25 Suncor shares for each share of Canadian Oil Sands. At the time of the offer, that worked out to a 43% premium to Canadian Oil Sands's closing price. At today's price, the offer works out to \$9.55 per share, while Canadian Oil Sands shares trade at almost exactly \$9.55 each.

Suncor is already intimately familiar with Canadian Oil Sands's only asset, its 37% ownership of the Syncrude oil sands project. Suncor is already a 12% owner of the project. If it were able to acquire Canadian Oil Sands's stake, it would effectively gain control of Syncrude.

Now that we know the details of the offer, here are the three big reasons why I'm saying no to it.

It's too low

Right before the offer from Suncor, I took a stab at valuing Canadian Oil Sands from an asset-replacement basis.

To make a long story short, I thought shares were substantially undervalued. Before the offer, the company traded at between one-third and one-half of its replacement cost based on a price per flowing barrel. And that wasn't putting much value on the reserves, which are some of the best in the oil sands.

Even after shares went up 50% on news of the offer, they're still not at replacement levels. Depending on how aggressively you value Syncrude, the replacement level for the assets is between \$12 and \$18 per Canadian Oil Sands share. An offer of \$9.55 does not get me excited when I think shares will be worth much more when the price of crude recovers.

No second bid

According to reports, Suncor approached the management of Canadian Oil Sands once before with a takeover offer back in April. The offer was for 0.32 Suncor shares per Canadian Oil Sands share, which would be worth more than \$12.20 per share based on today's prices.

Considering that Suncor is only offering its shares and no actual cash, it's a bit of an insult to Canadian Oil Sands shareholders that it's sticking to its offer of 0.25 Suncor shares for each Canadian Oil Sands share. Giving a few extra shares is much easier to swallow than coming up with the cash. It shouldn't be a big deal if Suncor really wants the assets.

Perhaps Suncor will up the bid. But with less than a month to go before the deal's expiry date of December 4, it needs to do so relatively quickly.

I don't want to own Suncor shares

It appears that Suncor's management is missing one important factor in regards to its bid. If I wanted to own Suncor shares, I would have done so already. It's not like they're hard to get.

There were several reasons why I chose Canadian Oil Sands over Suncor as an investment. As I already mentioned, I thought it was undervalued. And I liked the pure play exposure to the Syncrude project, an asset I want to own over the long term.

But mostly, I own Canadian Oil Sands because it's a leveraged play on the price of crude. At \$45 per barrel, Canadian Oil Sands is just barely breaking even. If crude rises to \$65 per barrel, cash from operations would increase to about \$1.50 per share.

Suncor would also benefit from an increase in oil prices, but not nearly as much as Canadian Oil Sands would. Remember, Suncor has downstream assets that insulate it from swings in the price of crude. For many investors, this diversification is a good thing. If oil declines further, Suncor shares would likely outperform compared with others in the sector. But I was looking for a play on crude recovering.

Even at Suncor's offer price, I still think Canadian Oil Sands is undervalued. It's obvious that Suncor thinks the same. It's for those reasons why I'm not interested in taking the offer on the table.

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nelsonpsmith

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