3 Reasons Why Suncor Energy Inc. Thinks Canadian Oil Sands Ltd. Investors Should Accept its Offer

Description

Friday is a key day for **Canadian Oil Sands Ltd.** (TSX:COS) because it marks the end of the 60-day period to accept **Suncor Energy Inc.'s** (TSX:SU)(NYSE:SU) merger offer.

While Canadian Oil Sands has resisted the bid in a fight that is growing increasingly bitter, Suncor CEO Steve Williams recently detailed several key considerations about its bid in the company's third-quarter conference call. These are things that Canadian Oil Sands investors really need to consider.

Same upside, less risk

One of Canadian Oil Sands's biggest gripes against the deal is the fact that it is opportunistic, with Suncor sweeping in at the low point in the cycle. To this, Williams noted the correlation of Suncor's stock to oil prices:

> If you go back and look at the correlation to oil price over almost any historical period you'll find that Suncor enjoys a very similar upside to Canadian Oil Sands, but of course far less downside when oil prices fall, and that's due to the integrated stratagem. We think that should be very attractive to Canadian Oil Sands investors in what we and many others believe is the new business reality of a lower for longer oil price environment.

With just as much upside but less downside thanks to the buffer of its refining assets, Suncor offers investors the best of both worlds for a long-term oil holding, especially in light of what could be a prolonged downturn.

Opportunistic, yes. Cheap, no

Williams also discussed the offer price:

> Suncor is actually offering to pay more for Canadian Oil Sands than we recently paid for a 10% increased working interest in Fort Hills. If you do the math based on Syncrude's actual historical production we are offering $67,500 per flowing barrel at Syncrude for Canadian Oil Sands versus the $56,000 per flowing barrel we paid for our additional ownership stake in Fort Hills. So, roughly speaking, that represents a 20% premium.

Williams also noted that it's an apples-to-apples comparison due to the type of oil produced and the fact that Syncrude is flowing cash right now. That said, he actually thinks that Fort Hills will turn out to be a better asset long term, therefore suggesting that Suncor's bid is more than fair.

The offer is full and fair

Williams concluded by noting that the offer, while remaining unchanged, has actually become more appealing to Canadian Oil Sands investors because of the following four factors:

1. "Oil prices have sharply declined in the six months following Canadian Oil Sands's rejection of our initial offer. More importantly, the outlook for oil prices is much more bearish."
2. "The Syncrude asset has continued to underperform. In the third quarter it ran approximately 67% and average production so far in the fourth quarter has further declined from this level."
3. "At this time there is no competing offer or alternative that we are aware of."
4. "Suncor, with its integrated model, diversified portfolio, and strong balance sheet can handle the risk of a lower for longer price environment and/or continued operational challenges at Syncrude, but Canadian Oil Sands, with its single-asset exposure and a high debt rating only one notch above speculative, is in a precarious position."

In other words, with oil prices poised to remain lower for longer and Syncrude faltering, Canadian Oil Sands has its back against the wall.

On the other hand, Suncor has outperformed during the downturn with its assets running at about 90% capacity the last few quarters, enabling the company to generate substantial cash flow. Add that to a strong balance sheet and Suncor can handle the downturn much better than most rivals, especially one as weak as Canadian Oil Sands.

Investor takeaway

With time ticking away on Suncor's offer, Canadian Oil Sands investors need to consider the fact that the company's future solely relies on Syncrude's performance and the price of oil improving substantially before its financial condition deteriorates any further.

In a sense, the decision Canadian Oil Sands makes this week could really make or break its future.

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