OPEC May Have Sealed the Fate of Canadian Oil Sands Ltd.

Description

Monday was a bloodbath for energy investors as the market continued to digest news of OPEC's decision to keep the spigots open. The WTI oil price even reached a new six-year low and trades well under US$38 as of this writing.

As would be expected, the most heavily levered companies saw their shares fall especially hard. **MEG Energy Corp.** fell by nearly 10%. **Baytex Energy Corp.** fell by 17%. **Penn West Petroleum Ltd**. fell by 18%.

Yet **Canadian Oil Sands Ltd.** (TSX:COS), another heavily indebted energy producer, fell by only 6%. The reason for its relatively tepid fall is rather obvious: it's because of the unsolicited takeover offer from **Suncor Energy Inc.** (TSX:SU)(NYSE:SU). Yet the decision by OPEC affects Canadian Oil Sands in other ways. We take a closer look below.

The Suncor offer looks more tempting

As we all know by now, Suncor's diversified operations and strong balance sheet protect the company from decreases in oil prices. Monday was yet another example as the company's shares fell by only 3.5%.

As a result, Canadian Oil Sands now trades at a 6% discount to Suncor's offer. In other words, if Canadian Oil Sands were to accept Suncor's offer today, then its shares would instantly jump by 6%. On the other hand, if Suncor's offer fails and Canadian Oil Sands is unable to find a rival offer, then the shares would probably fall below $6, a decrease of more than 25%.

There's another way of looking at this. Back on October 5, when Suncor offered the equivalent of $8.84 per Canadian Oil Sands share, WTI was at US$45.54. In the two months since then, WTI has fallen by 18%, while the value of Suncor's offer has fallen by less than 2%.

Meanwhile, Canadian Oil Sands has roughly one month to find a higher offer. But given how attractive Suncor's offer looks now, there's little chance of a higher offer emerging.

A deal looks likely

Now that Canadian Oil Sands is trading so far below Suncor's offer, this could easily draw the attention of risk arbitrageurs looking to make a quick buck.

So how would these risk arbitrageurs make their money? Well, the first step is buying Canadian Oil Sands shares. Step two is selling Suncor shares short. Then as long as the deal goes through, anyone making this bet ends up with a nice return.

This presents a problem for Canadian Oil Sands's executives. They are trying to convince shareholders that over the long term, Canadian Oil Sands is better off on its own. But as oil prices fall and risk arbitrageurs enter the picture, such arguments are likely to fall on deaf ears.

With all that in mind, it now looks very likely that Suncor's bid will be successful.

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1. NYSE:SU (Suncor Energy Inc.)
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