Canadian Oil Sands Ltd.: An Update on the Math

Description

As the new year approaches, it's looking more and more likely that **Canadian Oil Sands Ltd.** (TSX:COS) shareholders will have their say on the $4.3 billion offer from **Suncor Energy Inc.** (TSX:SU)(NYSE:SU).

Canadian Oil Sands's poison pill expires on January 4, and Suncor's offer expires on January 8. So unless Canadian Oil Sands can find a rival offer in the meantime, then the bid's fate will be determined between these two dates.

With all that said, should you own shares of Canadian Oil Sands? Is there an opportunity to profit here?

The upside

Suncor is offering a quarter of its own shares for every share of Canadian Oil Sands. Based on current market prices, that means the bid is worth $8.93 per Canadian Oil Sands share. Meanwhile, Canadian Oil Sands's stock price is $8.30. Thus if Canadian Oil Sands were to accept Suncor's offer immediately, then shareholders would make a return of 7.6%.

So it's easy to see the upside in Canadian Oil Sands shares. After all, Suncor's shares are relatively immune from oil prices. Therefore, even if oil prices decline between now and January 8, you should still make a decent return, especially for such a short time frame. That is, of course, assuming the bid goes through.

The downside

When Suncor originally bid for Canadian Oil Sands in early October, the target's shares were trading for just $6.17. And since then, oil prices have declined by just over 20%.

Remember, Canadian Oil Sands is very heavily exposed to oil-price movements thanks mainly to its high debt level. For that reason, if Suncor's bid is rejected and no rival offers are found, you should expect Canadian Oil Sands shares to fall to $5 (or perhaps even lower). That's a return of negative40%.

The odds

In order for Suncor's bid to succeed, a full two-thirds of shares must be tendered. How likely is this outcome?

Well, first of all, you must remember that tendering shares requires action by the shareholder. In other words, in order for a shareholder to reject the offer, they don't have to do anything. This means that if someone is on (a very long) vacation, or forgets that they hold Canadian Oil Sands shares, or is a severe procrastinator, then those shares won't be tendered.

On the other hand, Suncor is offering financial advisors compensation for getting their clients to tender their Canadian Oil Sands shares. The arrangement may smell fishy, but it is meant to provide a counterweight to the inactive-shareholder problem.

There's one other thing to consider. Billionaire Seymour Schulich owns roughly 5% of Canadian Oil Sands, and he has ranted against the bid, even calling it a "no-ball offer." Thus Suncor cannot count on his support, even though oil prices have declined in the meantime. This means that over 70% of the remaining shareholders must tender.

The conclusion

Based on where Canadian Oil Sands trades today, the market believes there's an 84% chance the deal will go through. And while I believe the bid is likely to succeed, there's no way the probability is over 80%.

So for that reason, I would hold off for now. But this could easily change, so it is worth keeping an eye on.

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Date
2025/07/21
Date Created
2015/12/24
Author
bensinclair