Canadian Oil Sands Ltd. and Canadian Natural Resources Limited May Be Acquired

Description

The stocks of oil sands operators have been weak over the past 12 months alongside low oil prices. Shares of **Canadian Oil Sands Ltd.** (TSX:COS) and **Canadian Natural Resources Limited** (TSX:CNQ)(NYSE:CNQ) are down roughly 20% over that time period. Over the past five years both are down over 30%.

A primary reason why oil sands operators have struggled in recent years has been high costs. One way to measure costs is by calculating the energy return on investment. This calculates how much energy goes in to producing a unit of energy. For example, conventional oil plays need to expend an equivalent of one barrel of oil to produce 25 barrels–not bad.

Oil sands, however, set records for how far operators are willing to go to up supply. Many estimates put the ratio at one barrel of oil to produce only three barrels. That’s not nearly as attractive as traditional oil plays.

When global prices were high, producers could afford the high costs involved. With prices falling 60% over the past 12 months to under $40 a barrel, many oil sands operators face extinction. Fortunately for the industry, investors have been a bit surprised by one thing: falling costs.

Costs drop for the first time in 15 years

According to a new report from IHS Energy, production costs are coming down for Canadian oil sands–and fast. “Capital costs are down 6%; operating costs are down 20%. You add them together from the end of 2014 to the end of 2015, [and] that could be a $10 reduction to break even,” a report said. IHS Energy also expects costs to continue to fall over the next 12 months as suppliers continue to adapt to lower oil.

While lower production costs will drop breakeven prices, the reduction is nothing in the face of sub-$40 oil. That’s why an estimated 70% of oil sands production growth over the next five years will come from the expansion of existing fields, not new projects. With few new projects, today’s big oil sands operators will likely be tomorrow’s as well.

What does this all mean for major producers such as Canadian Oil Sands and Canadian Natural Resources?

Don’t be surprised to see some big acquisitions

Exposure to oil sands is already slim-picking, with only a handful of publicly traded companies having multi-billion dollar market caps. With costs finally being reigned in, many large producers may look to buy exposure in the sector’s beaten-down stocks. Many integrated operators may believe that their industry know-how will allow them to lower costs even faster.

This isn’t just theoretical. In the past few months Canadian Oil Sands revealed that it has received takeover interest from 25 potential buyers. While it’s always difficult to predict acquisition targets, it’s clear that there is growing interest in buying up some of the industry’s limited number of leaders. For now, Canadian Oil Sands and Canadian Natural Resources look to be near the top of that list.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:CNQ (Canadian Natural Resources)
2. TSX:CNQ (Canadian Natural Resources Limited)

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