



## Why Canadian Oil Sands Ltd. Shareholders Are Best Left Alone

### Description

With oil prices crashing to \$30 per barrel—a 13-year low—**Suncor Energy Inc.’s** ([TSX:SU](#))([NYSE:SU](#)) deal to **Canadian Oil Sands Ltd.** (TSX:COS) shareholders may seem better and better.

Currently, Suncor is offering 0.25 Suncor shares for each Canadian Oil Sands share as part of a hostile takeover bid, meaning Canadian Oil Sands shareholders would get \$7.85 or so per share. The result is that Canadian Oil Sands shareholders would lock in a 8.2% gain from current prices.

While Suncor may argue this is a good deal for Canadian Oil Sands shareholders, Canadian Oil Sands shares traded at \$22 in September 2014 when oil was more reasonably priced. After enduring a 66% drop in price, those still holding on to Canadian Oil Sands shares would be making a major error by choosing to tender their shares to Suncor at these levels.

The error? Canadian Oil Sands shareholders are effectively locking in their downside, while capping their upside. Suncor shares are far less correlated to the price of oil, and while those shares would certainly rise as prices rebound, the rebound would be far less than Canadian Oil Sands would experience. Currently, Canadian Oil Sands shares are 98% correlated to the price of oil.

Any investor still holding on to Canadian Oil Sands shares has the best hope of recovering their capital by continuing to hold on to their shares. It makes little sense to have endured a 66% drop in price—correlated to oil—and then give up that correlation when prices rise.

For Canadian Oil Sands to recover, however, two things need to occur. Firstly, oil prices need to recover, and secondly, Canadian Oil Sands needs to stay above water until they do. Here’s why these options are both likely.

### Oil prices have more upside than downside

Nobody knows when oil prices will recover, or by how much. Simple economics, however, say that over a medium time frame (one to two years) there is much more room for oil prices to move up than down. This benefits Canadian Oil Sands.

The issue with oil prices is on the supply side. OPEC has refused to keep production targets and is flooding the market with supply, and Iran is set to ramp up more production as sanctions are lifted. This pushes down prices.

This strategy has effect of putting U.S. producers—who have higher costs—out of business. Currently, few producers are economical at current price levels, and the result is that a few things are happening. First, non-OPEC supply growth has fallen from 2.2 million barrels per day at the start of the year to 0.3 million barrels per day by year end. It is expected to contract by 0.6 million barrels per day in 2016 according to the IEA.

Secondly, capital expenses are falling dramatically, which means businesses are not investing actively in new supply. New supply is needed to keep pace with growing demand (which is growing at a quick pace), and current prices simply do not encourage it.

The end result is the IEA expects the gap between supply and demand to shrink in 2016, which should start to support prices.

### **Canadian Oil Sands can survive further pressure**

Canadian Oil Sands expects to have free cash flow of \$338 million in 2016. When you subtract the \$97 million dividend, this means that Canadian Oil Sands will have \$241 million left over at the end of the year.

These calculations assume oil will average \$50 per barrel. Even if they average \$40, however, Canadian Oil Sands should be fine. They would see negative free cash flow of around \$100 million (\$197 million including the dividend), which is affordable since they have \$1.1 billion of undrawn room on their credit facilities, which they can rely on to fund the deficit.

### **CATEGORY**

1. Energy Stocks
2. Investing

### **TICKERS GLOBAL**

1. NYSE:SU (Suncor Energy Inc.)
2. TSX:SU (Suncor Energy Inc.)

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