Imperial Oil Is Attractively Priced, But I Still Prefer Suncor

Description

Once touted as the next hot source of unconventional oil, Canada's oil sands industry fell into disfavor with investors because of high development costs and low margins. Share prices of many companies operating in the industry fell to new lows despite remaining profitable, leaving them with attractive valuations. One company that currently looks cheap is **Exxon** (NYSE:XOM)-controlled **Imperial Oil** (TSX:IMO).

Renewed interest in Canada's oil sands industry
As valuations in among many of Canada's oil sand industry participants have gotten more appealing, institutional investors and international oil majors have taken a renewed interest in the industry. Already, the Oracle of Omaha, Warren Buffett, has acquired a $500 million stake in Canada's largest energy company, **Suncor** (TSX:SU)(NYSE:SU).

At the same time, Exxon, along with its subsidiary Imperial Oil, has acquired **ConocoPhillips'** Clyden oil sands project in Alberta for $720 million. This will boost Exxon's oil sands presence by 226,000 acres. Through its wholly owned subsidiary Exxon Canada, Exxon will own 72% of the development, with the remainder to be owned by Imperial Oil.

The acquisition is a natural fit for Exxon's and Imperial's Kearl oil sands project, located in Alberta. It will generate synergies that will help to reduce the cost of development and production at both projects.

Second-quarter results
Imperial's second-quarter results were dismal. The bottom line plunged 32% year over year to $1.1 billion, despite revenue growing 6% from the year-ago quarter. The key driver of this poor bottom-line result was an after-tax non-cash charge of $264 million associated with the conversion of the Dartmouth refinery to a fuels terminal.

Like the majority of integrated oil companies, Imperial also experienced lower refining margins in its downstream business due to softer crude prices. In addition, it was hit with higher startup costs for its Kearl project, which it shares with Exxon, as well as higher maintenance costs at Cold Lake. Finally, decreased production because of planned maintenance outages at Cold Lake and Strathcona ate into the bottom line.

Production will grow

Despite higher costs and a drop last quarter, Imperial should be able to significantly grow production. With planned maintenance at Cold Lake and Strathcona now completed, production should return to normal levels, boosting daily output by up to 18% (51,000 barrels) for the remainder of 2013.

Imperial also expects the Nabiye expansion at Cold Lake to commence production in 2014, adding an additional 40,000 barrels of oil per day to its total daily output. The Kearl expansion, expected to come online in 2015, will add an additional 78,000 barrels per day to Imperial's daily totals. Add all that up and I estimate daily production could grow by 42%. That should flow through to Imperial's top and, hopefully, bottom lines.

Valuation

Just like its Canadian peers, Imperial's share price has remained flat for the year. In Imperial's case, that's led to some particularly compelling valuation metrics — it trades with an enterprise value of eight times EBITDA and 11 times its proved reserves.

When compared to peers such as **Suncor**, **Husky Energy**, **Chevron**, or its parent **Exxon**, Imperial's enterprise value to EBITDA is not particularly cheap. But its enterprise value to proved reserves *is* quite cheap, illustrating that investors may have yet to recognize the value of Imperial's assets.

Company	**EV to EBITDA**	**EV to Proved Reserves**
Imperial Oil	8	11
Suncor	5	14
Husky Energy	6	26
Exxon	6	16
Chevron	5	21

Source data: 2Q 2013 financial filings.

Clearly, when examining the table, it is Suncor that stands out as the best value among Canada's energy companies — explaining Buffett's recent foray into the company. (For my take on Suncor, click here.)

The yield isn't much

Even though Imperial continues to pay a quarterly dividend of 12 cents per share, its yield is just over 1%, significantly lower than its peers.

Company	Dividend Yield
Imperial Oil	1%
Suncor	2%
Husky Energy	4%
Exxon	3%
Chevron	3%

Clearly, investors would not invest in Imperial solely for the dividend — superior dividend yields can be obtained elsewhere.

Foolish bottom line
Imperial, like many of its peers, is clearly undervalued according to the metrics above, and it has some catalysts that should help it grow its bottom line. Still, it is not the best investment opportunity among its peers — Suncor offers more potential and a higher dividend yield. That combo may explain Buffett's preference for investing in Suncor over other companies in Canada's energy sector.

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Matt Smith does not own shares of any companies mentioned.

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1. Investing

TICKERS GLOBAL

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3. TSX:IMO (Imperial Oil Limited)
4. TSX:SU (Suncor Energy Inc.)

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