This Is Why Imperial Oil Ltd. Is Undaunted by Low Oil Prices

Description

Oil sands producers are not only unafraid of plunging oil prices, but most plan to keep expanding in spite of weak oil prices. **Imperial Oil Ltd.** (TSX:IMO)(NYSEMKT: IMO), which is majority owned by **Exxon Mobil Corporation** (NYSE:XOM), is the most recent example of this boldness amid the oil crisis after the company's CEO recently said that its "near-term investment plans remain largely unchanged." However, by keeping its growth plans in place the company isn't making a big bet that oil prices will head higher. Instead, its investments are all about improving its margins.

Looking past the past

Imperial Oil has decided to continue to move forward with its plans to double the output of its massive $20 billion Kearl oil sands project. In one sense this is a surprise as Kearl has been an issue for Imperial and Exxon Mobil in the past. The first phase of the project, for example, was originally expected to cost about $8 billion, however, that was boosted to $10.9 billion and then finally to $12.9 billion when all was said and done. Cost overruns weren't the only issues as Imperial had problems transporting equipment for the project and it was further delayed by rough winter conditions in Canada.

This past experience alone should have given the partners pause before moving forward on the project's second phase. Even more pause should have been required given the rapid decline in oil prices, which have eaten away at the profits of higher cost oil out of the oil sands. However, instead of pulling back Imperial and Exxon are moving forward on the second phase of Kearl because it really is the key to the project's success.

Spending money to save money

Currently, Kearl has operating costs in the US$29 to US$32 per barrel range, which is well above initial expectations of about $20 per barrel. However, those costs should fall after the company finishes its second phase and runs at full capacity, which is why it's planning to move forward with the expansion project despite weaker oil prices. The additional capacity will increase the project's scale, which will reduce its operating costs.

In fact, by boosting capacity the project should see its operating costs drop to US$19 to US$23 per barrel once both phases are running at full capacity. By dropping its operating costs by about $10 per barrel the partners will enjoy higher margins on all the oil that is produced from Kearl enabling them to make more money in the current oil price environment while really cashing in should oil prices improve. In a sense, the partners are spending money in the short-term in order to save money over the long-term.

Investor takeaway

Sometimes decisions like continuing to pour more money into Kearl don't make sense on the surface. However, by digging a little deeper we can see why it actually makes a lot of sense for Exxon Mobil and Imperial Oil to continue investing in Kearl as completing the second phase should improve the economics of the entire project. This is why Imperial Oil is looking past slumping oil prices and focusing on what will improve its business in the future.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:XOM (Exxon Mobil Corporation)
2. NYSEMKT:IMO (Imperial Oil Limited)
3. TSX:IMO (Imperial Oil Limited)

Category

1. Energy Stocks
2. Investing

Date
2025/08/22
Date Created
2015/02/05
Author
mdilallo