Earnings Preview: What to Expect When Imperial Oil Limited Reports Next Week

Description

Cheap crude will crimp **Imperial Oil Limited's** (TSX:IMO)(NYSEMKT:IMO) profits in the short run—but the doldrums in the energy business could actually *help* the company in the long haul.

Imperial will release its quarterly report next week and analysts expect that low oil prices will rip a hole through the company's earnings. But as one of the largest players in the industry, Imperial is better positioned than most to survive.

In fact, while rivals are dialing down spending, Imperial is taking advantage of current conditions to strengthen its business. Let's take an early look at what's been happening in the company over the past quarter and what we're likely to see in the upcoming report.

Stats on Imperial Oil

Analyst EPS Estimate	$0.40
Change From Year-Ago EPS	(63.3%)
Revenue Estimate	$6.8 billion
Change From Year-Ago Revenue	(27.8%)
Earnings Beats in Past Four Quarters	3

Source: Yahoo! Finance

How badly will Imperial get hurt this quarter?

Canadian energy investors are getting a tough lesson on leverage. Squeezing crude out of Alberta's bitumen deposits is expensive. Oil sand producers have to dig up tons of muck and sand, and then run the mixture through expensive processing facilities.

Because of these high costs, oil sand companies run on razor-thin profit margins. When oil prices rise, their thin margins can soar…along with share prices. But when oil prices fall, this leverage works the other way and share prices can plummet.

Imperial Oil is a great example of this. In 2013 it cost the company US$33 on average to haul a barrel of crude out of the ground. Imperial would sell that barrel for about US$55— representing a healthy 66% profit margin.

These days, a barrel of Western Canadian Select (the benchmark price for oil sands crude) is selling for about US$35. If Imperial can hold costs steady, its margin will have shrunk to a razor-thin 6%. And like I said, when margins drop, share prices follow.

Predictably, this has ripped on hole through the company's income statement. Last quarter, the Calgary-based firm posted only a meager $0.78 per share profit, down 36% from the same period a year earlier.

We can expect more of the same next week. Since the start of the year, analysts have trimmed their earnings estimates for the upcoming quarter by more than a third. The company is now only expected to pull in a $0.40 per share profit during the first three months of 2015.

Yet in spite of today's low oil prices, Imperial has no plans to dial back its expansion. And why not? With other energy producers slashing their capital budgets left and right, the cost of everything from labour to materials is falling. Imperial can now play hardball with suppliers to bring down expenses.

What about acquisitions? Many energy companies are strapped for cash, so now could be the time to scoop up some assets on the cheap.

Syncrude operator **Canadian Oil Sands Ltd** is a rumoured takeover target. From Imperial's standpoint, any acquisition must provide scale, synergistic fit, and high-quality reserves at an attractive price. Canadian Oil Sands would check a lot of those boxes.

What to look for in next week's report

Low oil prices aside, the story at Imperial remains quite positive. The company's Nabiye oil sands project produced its first barrel of bitumen in January. The expansion at Kearl, Imperial's flagship oil sands mine, is on track. Construction is expected to be completed in the second half of 2015, a few months ahead of the original schedule.

Bottom line, Imperial is about to post another ugly quarterly report, but investors need to look beyond the headline numbers. Watch to see how the company's expansion is progressing and if management is on the hunt for acquisitions. While it's a bad time to be telling a good growth story, big investments today could pay off if oil prices rebound.

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