



Should You Avoid Imperial Oil Limited?

Description

In comparison to oil prices falling roughly 50% over the past 12 months, shares of **Imperial Oil Limited** ([TSX:IMO](#))(NYSE:IMO) have done remarkably well, falling only 30%. This drop is on par with larger, more diversified competitors such as **Chevron Corporation**, which also fell nearly 30%. **Exxon Mobil Corporation**, which owns 70% of Imperial, fell about 20%.

Most companies closer to Imperial's \$30 billion size have been crushed in the face of falling oil prices. With Imperial shares performing closer to its larger and better-positioned peers, have shares become relatively overvalued?

A few factors have supported the stock against industry troubles

Imperial is Canada's second-largest energy producer by market cap, second only to **Suncor Energy Inc.** So, although the company's size is dwarfed by larger, multi-national operators, it still represents one of the higher quality Canadian names.

In times of trouble, when investors flee to safer stocks, Imperial should be expected to attract an inordinate amount of interest. This is likely a primary factor in supporting the stock price over the past 12 months.

Another factor deals with Exxon's majority stake. It's very likely that the market sees Imperial as being financially and intellectually backed by Exxon. This is incredibly important in a time when many oil and gas operators are filing for bankruptcy due to liquidity issues. Although Imperial has a rock-solid balance sheet compared with the rest of the industry, it will most likely warrant an additional premium due to Exxon being an emergency backstop.

The production portfolio is in trouble without higher oil prices

Oil sands production will eventually comprise about 90% of Imperial's total production output. While the capital costs involved in these projects are huge, the company has already incurred most of the startup costs, meaning that ongoing maintenance costs should be much lower.

Still, oil sands are some of the most expensive oil operations in terms of how much it costs to extract a barrel of oil. At the current price of \$55 a barrel, it's doubtful that many oil sands projects are profitable. Estimates vary, but breakeven costs of oil sands production are generally in the \$75 range. New oil sands projects would require an even higher figure.

Many of its past projects (including a 25% interest in Syncrude) have had cost overruns and production delays. Although the market may give the company a pass due to its Exxon affiliation, Imperial's production sites aren't the most desirable.

New taxes also lower future value

The Alberta government recently presented a proposal to raise the corporate tax rate from 10% to 12%. This is expected to eventually become law, adversely affecting the profits of any oil and gas operator.

Taxes on carbon emissions have also recently been raised. This is an obvious headwind for a company operating oil sands projects, notorious emitters of greenhouse gases. The latest rules expired in June, with the government subsequently instituting stricter policies.

The New Democratic Party said it will boost the cost of excess carbon output to \$20 per tonne at the start of 2016 from the current \$15, and will raise it to \$30 per tonne for 2017. Its target for carbon-emissions cuts will climb to 15% of normal emissions in 2016 from 12 percent, rising to 20 percent in 2017.

Imperial looks safe, but there are probably better values out there

Of all the Canadian energy producers, Imperial Oil is probably one of the safest options. This, however, has also forced many investors who were fleeing to quality into the shares. Priced at 19 times 2015 earnings, Imperial's stock has a similar valuation to better-quality peers such as Exxon and Chevron. If you're looking for quality, it might be better to consider some of Imperial's competitors.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

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