# What Does Imperial Oil Limited Need to Stop Falling?

## Description

Very few shareholders of **Imperial Oil Limited** (TSX:IMO)(NYSE:IMO) have made money over the past decade. While returns over the past year have been -30%, long-term results haven't been much better. Over the past five years, shares have fallen 15%, while investors have only realized an 8% gain if they've held on for the previous 10 years.



The latest drop, of course, is due to rapidly falling oil prices. This week, crude averaged only $46 a barrel. Still, Imperial Oil has been mitigating this impact through capacity improvements and the reduction of expenses, resulting in profitability despite perhaps the most difficult operating environment in the firm's history.

What else is the company doing, and what will it need for shares to rebound?

**Profitability is surprisingly intact due to management's efforts**

While many peers have posted losses stemming from low oil prices and massive write-downs, Imperial Oil actually turned a profit last quarter of $479 million. Still, this is nearly 50% lower than the year before. Key to maintaining profitability has been through controlled costs.

In total, management has been able to lower recurring costs by $1.1 billion through supply-chain negotiations and refocused capital expenditures. For a company that is making less than $500 million a quarter, this is a big deal.

Imperial Oil has also found room to cut project development and exploration spending, something nearly every competitor is doing. Previously, a significant portion of projects were being developed based on high oil prices. After crude fell over 50%, many of these once-promising properties have been reassessed and deemed unattractive. Last quarter, capital and exploration expenses decreased by $292 million, providing yet more breathing room.

Even with depressed earnings, profits are still nearly 30 times higher than interest expenses. This represents one of the best metrics in the industry.

**Still investing for the long term**

Because Imperial Oil’s balance sheet is in order and earnings are still positive, management is capable of investing for the long term.

Based on estimates from the International Energy Agency, nearly 50% of oil demand by 2040 will need to be met by new sources. Over the same period, natural gas is expected to surpass coal as the second-largest fuel source. Because these are such long-term estimates, it’s difficult to plan a strategy around such macro tailwinds. Imperial Oil is one of few companies with that luxury.

The company plans to increase production in all three segments of its business and has plenty of long-term projects in its portfolio. For example, oil sands projects are typically very long life, and its Nabiye thermal project should come online shortly.

**Still needs higher oil prices**

By boosting efficiencies, limiting leverage, and focusing on long-term projects, Imperial Oil has positioned itself to survive in the current market. No matter what, however, the company will need higher oil prices to reverse its downward trajectory.

While the matter is hotly debated, the U.S. Energy Information Administration anticipates sub-$55 oil prices for the entirety of next year. While it sees the potential for prices to rise above its expectations, Imperial Oil shareholders need to have loftier oil projections for an investment to make sense.



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1. Energy Stocks
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