



What Will the Next Decade Mean for Imperial Oil Limited?

Description

Despite operating in the production and distribution of crude oil and natural gas, **Imperial Oil Limited** ([TSX:IMO](#))(NYSE:IMO) stock has fared well in the face of falling commodity prices. Over the past 12 months shares have declined only 11% compared to a 26% decline for oil. Still, long-term shareholders don't have much to cheer about over the past decade as the stock is only 17% higher than it was in 2006.

What can investors expect for the next decade?

Long-term tailwinds still in place

While U.S. shale and continued OPEC pumping has created a current supply glut (driving prices below \$40 a barrel), the long-term drivers of higher oil demand are still in place. Estimates by both OPEC and the IEA have demand growing by roughly 1% annually for the next decade. While this is much lower than previous decades, the tailwinds are fairly reliable. They include a climbing global population and bigger, richer economies. Imperial Oil expects these trends to continue until at least 2040.

To meet this growing demand, a significant amount of supply will need to come online, even with today's oversupplied market. Today roughly 90 million barrels a day of energy liquids are produced globally. Over the next 10 years nearly a quarter of that supply will be retired. This means that even before additional demand is considered, the market will be undersupplied. This should lead to a continued need for Imperial Oil's products and likely higher prices.

Diversified revenue streams reduce risk

One of the keys to Imperial Oil's relative success during the recent oil rout has been the company's diversified businesses. While many companies focus primarily on either upstream (production) or downstream (refining, distribution, and retail), Imperial Oil has a roughly 50/50 earnings mix. This is a huge advantage during downturns.

When oil prices fall, margins in downstream businesses typically rise, mitigating lower profitability from production. For example, in 2011 when oil was over \$100 a barrel, less than 20% of Imperial Oil's

earnings came from downstream production. As upstream earnings started to deteriorate, its downstream business grew to over 50% of profits. So, even if oil prices remain depressed, investors can have a bit of relief compared to less-diversified competitors.

Cheap growth ahead

Fortunately, Imperial Oil was able to wrap up a series of large, long-term investments while oil was high. While these projects won't be as profitable as anticipated, the company funded the initiatives largely with internal cash flows, resulting in low-risk growth opportunities for years to come.

For example, from 2000 to 2009, the company only invested an average of \$1.7 billion a year back in to the business. From 2010 to 2014, however, annual capital expenditures averaged roughly \$5.7 billion a year. Over the next decade, Imperial Oil should be able to grow production by over 40%, while reducing capital expenditures to just \$2-3 billion a year.

While competitors are cutting costs and sacrificing future production growth, Imperial Oil should be able to save on expenditures while still growing the core business.

A solid option for long-term energy investors

There are still plenty of secular tailwinds in place for the industry, and the company is well positioned to operate in both a low and high oil price environment. In all, shares of Imperial Oil look attractive if you're interested in a lower-risk, long-term energy play.

CATEGORY

1. Energy Stocks
2. Investing

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