Is Imperial Oil Limited the Next Exxon Mobil Corporation?

Description

With a market cap of $34 billion and only $8 billion in debt, **Imperial Oil Limited** (TSX:IMO)(NYSE:IMO) is one of the better capitalized companies in the oil and gas industry. For comparison, **Encana Corporation** and **Canadian Natural Resources Limited** have debt-to-equity ratios over 50%.

Last month, Imperial agreed to sell 497 of its Esso retail gasoline stations to five Canadian distributors for $2.8 billion, freeing up even more financial leverage. Over the next five years, management expects cash flow from operations to exceed capital expenditure needs by up to $2 billion a year, so cash flow should remain robust.

With all this dry powder, Imperial will need to remain focused on prudent capital allocation; too many companies destroy shareholder value by buying back overpriced shares or making expensive acquisitions.

Exxon Mobil Corporation (NYSE:XOM) is a great model for smaller operators to aspire to as it's widely regarded as the best capital allocator in the industry. Fortunately, there's reason to believe Imperial can follow its lead, possibly becoming the next Exxon Mobil itself.

A focus on capital allocation

Exxon actually owns 69% of Imperial's outstanding shares. Over the past decade, it has clearly imprinted its business model onto Imperial; namely, a focus on capital returns along with big share buybacks and dividends.

If you look at Imperial's return-on-capital metrics, they clearly stand out among an industry of so-so results. Over the past five years, Imperial has averaged a return-on-capital rate of nearly 20%. Competitors like **Cenovus Energy Inc.**, **Suncor Energy Inc.**, and **Husky Energy Inc.** average closer to 10%. Imperial's impressive results stem from its disciplined investment strategy. From 2010 to 2014, production rose from 250 kbp to over 400 kbp, all while dropping production costs.

It's also focused on maintaining a diversified business model (very similar to Exxon's), which uses profits from its Chemicals and Downstream divisions to fund expansion projects even when oil prices collapse. The company has made over $7 billion from these two segments over the past five years with the last 12 months generating record profitability. That’s a huge advantage when competitors are struggling for cash.

In regards to returning capital to shareholders, Imperial also leads the industry with over $12 billion in buybacks and dividends over the previous decade (a third of its current market cap). Massive share buybacks and a focus on sustainable dividends is another trick out of Exxon’s playbook. The company hasn’t missed a dividend payment in over 100 years.

Image Source: Imperial Oil Investor Presentation

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Is Imperial the next Exxon?

It already is.

On nearly every metric, Imperial is already a mini-Exxon. Its capital-allocation strategy is unmatched in Canada, while its focus on dividends and share buybacks have resulted in long-term capital appreciation for shareholders. Since 2000, shares are up roughly 300%, outpacing Exxon's return of just 125%.

If you're interested in an oil and gas major like Exxon Mobil, consider its smaller brother Imperial Oil, which has more room for upside considering its smaller size but similar strategy.

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2. NYSEMKT:IMO (Imperial Oil Limited)
3. TSX:IMO (Imperial Oil Limited)

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rvanzo