



## Is Imperial Oil Ltd. (TSX:IMO) Canada's Top Oil Sands Stock?

### Description

Oil rallied sharply at the end of May 2018, pushing the North American benchmark West Texas Intermediate (WTI) to over US\$70 a barrel. Even after pulling back because of the growing likelihood that OPEC and Russia will add supply back to a market where demand growth has been stronger than anticipated, WTI is still [trading at over](#) US\$68 per barrel — up by roughly 12% for the year to date.

While light oil producers have rallied significantly in response, many Canadian heavy oil producers have failed to keep pace. Integrated energy major **Imperial Oil Ltd.** ([TSX:IMO](#))(NYSE:IMO) has only gained 10% compared to many U.S. shale oil producers, which have gained 20% or more. This has created an opportunity for investors seeking lower-risk exposure to oil.

### Now what?

A key factor weighing on the market price of Canadian oil sands stocks is that the discount applied to Western Canadian Select (WCS) — the benchmark price for Canadian heavy oil — has [deepened significantly](#). By late May 2018, the discount was hovering around US\$17 a barrel, but since then it has widened to over US\$24 per barrel.

That has occurred because of growing worries over transportation capacity constraints and the higher costs associated with refining heavy crude. The impact of this discount on oil sands companies is being magnified by the high breakeven costs associated with their operations.

You see, the economics of producing petroleum from oil sands is just not as good as U.S. shale. While the breakeven price can be as low as US\$25 a barrel in the Permian basin, on average, it's somewhere between US\$40 and US\$50 per barrel for the majority of oil sands operations.

While these factors bode poorly for smaller heavy oil producers, the long-term impact on Imperial Oil is minimal. This is because it owns and operates a diversified portfolio of energy assets spanning upstream, midstream, and downstream businesses.

That allows it to offset as well as mitigate the impact of the price differential between WCS and WTI on its financial performance. Because of sharply depressed prices for WCS, Imperial Oil's refining and

chemical business experienced a solid spike in first-quarter 2018 earnings.

Overall, first-quarter net income came to \$516 million, which was 55% higher than the equivalent quarter in 2017 when Imperial Oil reported \$333 million. It is, however, important to note that net income for the first quarter 2017 included a one-off gain of \$151 million from the sale of a surplus property. Once this is deducted, first-quarter 2018 net income was almost three times greater than a year earlier.

Because of this strong performance, Imperial Oil rewarded shareholders with a quarterly dividend hike of almost 20%, which sees it yielding around 1.8%. This recent dividend increase comes after a long history of regular hikes, where the company has boosted its dividend for the last 24 years straight. That is an impressive record, especially when it is considered that with a payout ratio of 79%, the dividend is sustainable.

There is every sign that the dividend's sustainability will grow, and that there are further increases on the way. This is because Imperial Oil is boosting oil production and expects 2018 oil output to grow by around 7% year over year, which — along with ramping up activities in its downstream business and firmer crude — will give earnings a solid boost.

### **So what?**

Imperial Oil is an attractive, valued means of playing the increasingly positive outlook for oil and is well positioned to not only benefit from higher oil, and it will unlock considerable value for investors as the operating environment improves. This is supported by the company's solid balance sheet and ability to generate tremendous returns on capital invested, which is among the best in Canada's energy patch.

### **CATEGORY**

1. Dividend Stocks
2. Energy Stocks
3. Investing

### **TICKERS GLOBAL**

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

### **PARTNER-FEEDS**

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