Should You Buy Imperial Oil (TSX:IMO) Stock After the 50% Plunge?

Description

The market crash has crushed countless stocks — and **Imperial Oil Ltd** (TSX:IMO)(NYSEMKT:IMO) is no exception.

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Despite being majority-owned by oil behemoth **Exxon Mobil Corporation**, Imperial stock has been cut in half since the year began. Its dividend yield now surpasses 5%.

When conditions normalize, Imperial stock could more than *double* in price, back toward its previous trading range. But that's the big question: When will conditions normalize?

Don't hate Imperial Oil

To figure out whether Imperial Oil stock is a buy, we must first question why shares plummeted in the first place. The answer is telling: None of this was Imperial's fault.

At the start of 2020, oil prices were at US$60 per barrel. Today, they're below US$20 per barrel. This is truly a rare event. The last time oil prices were this low was in 1999. The time before that was 1973.

As a multi-billion dollar energy producer, Imperial Oil was on the front lines of the crash. Its production is now worth 60% to 70% less. That means revenues will be hit at similar levels.

But this issue is far more nefarious than depressed revenues. Few oil producers can profitably pump below US$20 per barrel, which means that the industry, including Imperial Oil, is racking up huge losses on a daily basis. Of course, if prices rebound quickly, this issue will be resolved. But if prices remain this low, major pain will come.

Will prices remain low? That's up to Saudi Arabia.

The main reason behind the oil price collapse is a spat between Saudi Arabia and Russia. Back in 2014, oil was consistently above US$100 per barrel. In recent years, prices were only half that. Surging supply from the U.S. and Canada were partially to blame.

In response, Saudi Arabia called on industry-wide supply cuts to boost pricing. Russia refused, prompting Saudi Arabia to *slash* prices and *increase* production. As one of the largest oil-producing countries in the world, this move had a huge impact on the market. Prices plunged immediately.

Place your bets

If Saudi Arabia normalizes prices and production, oil should revert back to its former levels. If this happens quickly, Imperial Oil shareholders would profit immensely. It would be back to business as usual, implying a valuation that's 50% to 100% higher than current levels.

But what if Saudi Arabia maintains the status quo? Producers like Imperial Oil could face severe financial impairment, even bankruptcy.

The risk here is a high breakeven price. Oil sands assets, which constitute the bulk of Imperial's production, are some of the highest-cost projects in the world. Even with Imperial's world-class technology and direct assistance from Exxon, the company's breakeven price is significantly higher than prevailing prices.

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According to *Morningstar*, "Imperial has been at the forefront of the solvent revolution and has spent the most resources developing and testing these technologies. We estimate that Imperial can lower its project break-evens to $45 per barrel of West Texas Intermediate on Aspen, putting it at the head of the class."

With oil trading at US$20 per barrel, Imperial is racking up *huge* losses on a daily basis. The company has one of the best balance sheets in the industry, but no business can sustain losses forever.

Saudi Arabia, meanwhile, can break even below US$10 per barrel, so it's in no rush, especially if higher-cost competitors like Imperial Oil eventually exit the market permanently.

A bet on Imperial Oil today is a wager on how quickly Saudi Arabia will normalize production — so the company isn't in charge of its own destiny.

With so many other bargains available from the market crash, I'm leaving this stock in the bargain bin.

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