What Do Negative Oil Prices Mean for Imperial Oil (TSX:IMO)?

Description

Last week was historic for the energy sector, as we saw something that has never happened before. Thanks to the collapse in energy demand and traders looking to make a buck speculating in oil futures, we saw negative oil prices for the very first time.

Here's what happened: essentially, it was the same as a short squeeze, but only in reverse. Oil traders were left with contracts that would force them to take delivery of crude, but they had nowhere to store the oil. So, they started dumping their contracts. When no buyers showed up, the price of the commodity crashed. The result of negative oil prices was historic.

Naturally, investors assumed this isn't a good thing for many oil companies, and they'd be right. Sort of, anyway. Let's take a closer look at negative oil prices and how they impact one of Canada's largest energy producers, **Imperial Oil** (TSX:IMO)(NYSE:IMO).

The skinny

You wouldn't think it would take much analysis. Of course negative oil prices are bad news for Imperial Oil. It's tough to make any money when you're forced to pay someone to take your product away from you.

But it starts to look a whole lot better for Imperial Oil once we take a closer look at the business model. Imperial is a vertically integrated oil producer, owning everything from the means of production all the way down to the distribution of gasoline. Major assets include oil sands production, several large refineries, and a fleet of Esso gas stations.

This business model insulates Imperial from major shocks in oil prices. The crude goes from its production facilities to the refineries and then to service stations. The end customer isn't some oil trader who is forced to take possession of some commodity. It's people like you and me, filling up our cars. It's also construction crews and airlines, since Imperial's refineries also produce ancillary products like jet fuel and asphalt.

Now, that's not to say Imperial is completely insulated from what's going on in the energy market right now. The same shutdown that's impacting the whole industry is also hitting Imperial Oil hard, too. People aren't travelling, and many aren't even commuting to work, either.

But we need to remember that negative oil prices aren't the norm right now. It happened once — and could happen again — but that's just because of a temporary glut in supply after demand has fallen off a cliff. The situation will remedy itself once the economy reopens. Remember, future oil prices — we're talking one to two years out, here — are hardly negative.

Balance sheet strength

There are very few oil companies that can withstand temporary negative oil prices and a weak overall crude market. Imperial Oil is pillar of strength in such an environment.

The company has a great balance sheet. At the end of 2019, Imperial owed just $4.5 billion to creditors. It has some $42 billion worth of assets. That's the kind of fortress balance sheet most other publicly traded companies envy.

And investors should remember that the company is also sitting on a large cash position of nearly $2 billion, although some of that may get spent. Still, with a balance sheet that healthy, Imperial is perhaps the best choice in the entire sector.

The bottom line on Imperial oil and negative oil prices

There's a reason why many investors consider Imperial Oil the finest company in the entire energy sector. It owns solid oil sands assets that will still be viable decades from now, fantastic refineries, and a gas station brand that is the top choice for many Canadian consumers. In times of weakness, you want to own top assets like these ones.

Combine that with Imperial Oil's pristine balance sheet, and it's obvious the company can survive negative oil prices for months to come.

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