



# Imperial Oil (IMO)

Updated February 5<sup>th</sup>, 2019 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b>	\$28	<b>5 Year CAGR Estimate:</b>	13.7%	<b>Volatility Percentile:</b>	48.0%
<b>Fair Value Price:</b>	\$35	<b>5 Year Growth Estimate:</b>	7.0%	<b>Momentum Percentile:</b>	40.7%
<b>% Fair Value:</b>	80%	<b>5 Year Valuation Multiple Estimate:</b>	4.6%	<b>Growth Percentile:</b>	64.8%
<b>Dividend Yield:</b>	2.1%	<b>5 Year Price Target</b>	\$49	<b>Valuation Percentile:</b>	84.4%
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Total Return Percentile:</b>	81.5%

## Overview & Current Events

Imperial Oil is one of Canada's largest integrated oil businesses. The company operates through three reporting segments: Upstream, Downstream, and Chemical. Imperial Oil is headquartered in Calgary, Alberta, Canada. Exxon Mobil (XOM) owns approximately 70% of Imperial Oil's common equity. Imperial Oil is cross-listed on both the Toronto Stock Exchange and the New York Stock Exchange, where it trades with a market capitalization of US\$22 billion. Imperial Oil reports financial results in Canadian dollars, but the figures shown in the data tables of this research report have been converted to U.S. dollars and refer to the company's NYSE-listed shares.

Imperial Oil is completely different from the well-known integrated oil majors, such as Exxon Mobil and Chevron, in one aspect. While the well-known oil majors generate most of their earnings from their upstream segment, Imperial Oil generates most of its earnings from its downstream segment. In 2018, Imperial Oil generated essentially all its earnings (CAD\$2.3 billion) from its downstream segment (CAD\$2.4 billion) while the earnings of the chemical segment (CAD\$0.3 billion) almost offset upstream losses. The reason behind the great contribution of downstream to the earnings of Imperial Oil is the fact that its refineries enjoy high margins thanks to the use of heavy Canadian crude as input. This type of crude trades at a deep discount to WTI, which in turn trades at a wide discount to Brent. This competitive advantage of Imperial Oil is paramount.

In early February, Imperial Oil reported (2/1/19) its financial results for the fourth quarter of fiscal 2018. In the quarter, its earnings essentially doubled. The upstream segment incurred losses due to the collapse of the oil price in the quarter. However, the downstream segment almost quadrupled its earnings, from CAD\$290 million to CAD\$1,142 million, thanks to strong refining margins, which resulted from the excessive discount of Western Canadian Select (WCS) to WTI. The discount widened from \$12 per barrel in Q4-2017 to about \$40 per barrel in Q4-2018. The downstream segment also benefited from increased utilization (96% vs. 92%). In the full year, Imperial Oil achieved record downstream earnings and the highest petroleum product sales in nearly 30 years.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	\$1.76	\$2.48	\$3.77	\$4.35	\$2.98	\$3.30	\$1.17	\$0.56	\$0.86	\$2.20	<b>\$2.50</b>	<b>\$3.50</b>
<b>DPS</b>	\$0.35	\$0.40	\$0.44	\$0.48	\$0.46	\$0.45	\$0.39	\$0.44	\$0.50	\$0.58	<b>\$0.66</b>	<b>\$0.90</b>
<b>Shares</b>	847.60	847.60	847.60	847.60	847.60	847.60	847.60	847.60	831.24	790.0	<b>760.0</b>	<b>700.0</b>

Imperial Oil's earnings-per-share history has been volatile, largely due to the high volatility of refining margins and the downturn in oil prices that began in 2014. Indeed, 2017 earnings-per-share were less than one-fourth of their peak levels. With that said, Imperial Oil is now in strong recovery mode, mostly thanks to the excessive discount of WCS to WTI. The company is doing its best to increase downstream earnings by processing more cost-advantaged crude grades. We expect earnings-per-share of around \$2.50 for this year, with continued growth to \$3.50 in 2024.

Imperial Oil has other growth drivers as well. According to the company's estimates, Canada has the third-highest level of oil reserves worldwide, behind only Venezuela and Saudi Arabia. Imperial Oil expects to grow its production by 15% from 2018 to 2020. Opportunistic share repurchases should also play a role in Imperial Oil's per-share growth. The

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company's share count has decreased by 5% in the last 12 months and management intends to maintain a significant buyback rate.

## Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	20.8	15.5	11.8	10.3	14.1	14.4	31.5	---	35.6	13.9	11.2	14.0
Avg. Yld.	0.9%	1.0%	1.0%	1.1%	1.1%	0.9%	1.1%	1.4%	1.6%	1.9%	2.4%	1.8%

Imperial Oil is trading at a price-to-earnings ratio of 11.2, which is lower than our assumed fair price-to-earnings ratio of 14.0. If the stock approaches our fair value estimate over the next five years, it will enjoy a 4.6% annualized gain thanks to the expansion of its valuation level.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

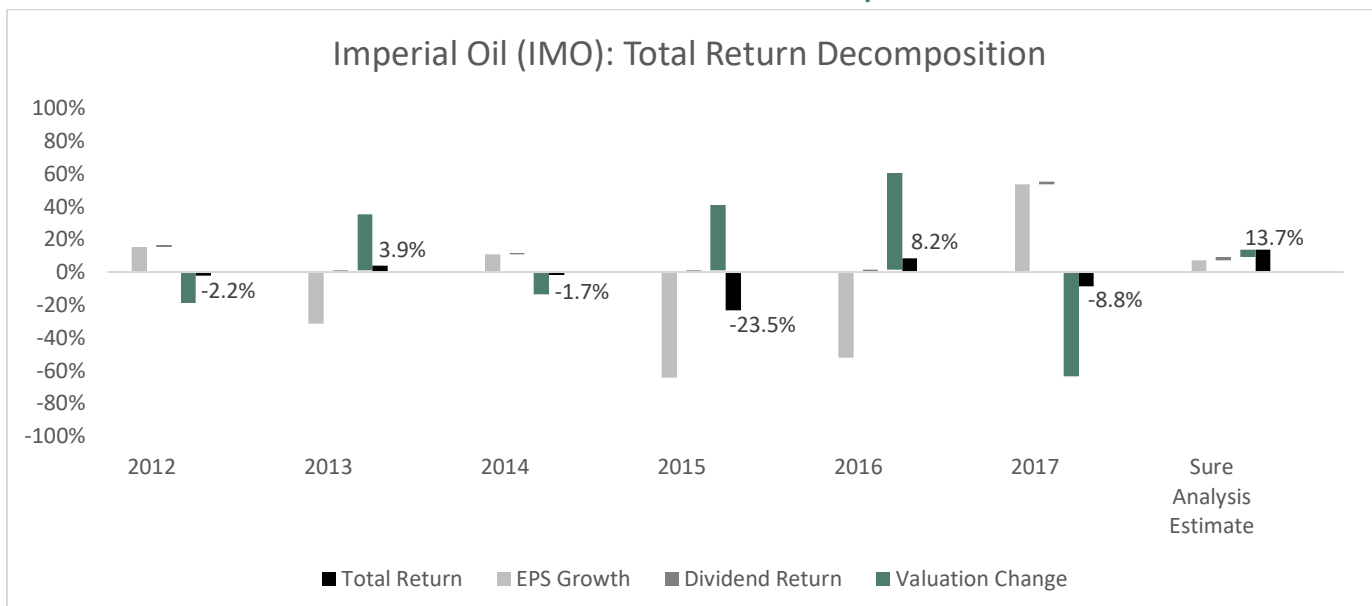
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	19.9%	16.1%	11.7%	11.0%	15.4%	13.6%	33.3%	78.6%	58.1%	26.4%	26.4%	25.7%

Imperial Oil is one of the highest-quality energy businesses in the Canadian market. The company has a credit rating of AA+ from S&P, which is higher than all of its peers in the Canadian energy space. Moreover, the company has paid 100+ years of consecutive dividends and has increased its dividend (in Canadian dollars) for 24 consecutive years. The company's 10-year average dividend growth rate (again, in Canadian dollars) is 6.5%. Imperial Oil seems laser-focused on returning capital to shareholders and we expect this to continue moving forward. Furthermore, the company benefits from leveraging the expertise of its major shareholder, Exxon Mobil.

## Final Thoughts & Recommendation

Since our last research report, in November, Imperial Oil has lost 12%, mostly due to the plunge in benchmark refining margins. However, the company's performance has not been affected so far thanks to the excessive discount of WCS to WTI. As we expect the company's earnings to remain in an uptrend, we expect the stock to offer double-digit average annual returns in the upcoming years. We rate Imperial Oil as a buy today.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Revenue</b>	29739	18745	24186	30819	31062	31777	32818	20963	18915	22473
<b>Gross Profit</b>	7867	4625	5228	6825	7361	5991	6335	3595	2324	2400
<b>Gross Margin</b>	26.5%	24.7%	21.6%	22.1%	23.7%	18.9%	19.3%	17.1%	12.3%	10.7%
<b>SG&amp;A Exp.</b>	978	974	1037	1181	1081	1051	974	875	853	689
<b>Operating Profit</b>	4969	1848	2729	4216	4858	3439	3886	1434	154	279
<b>Op. Margin</b>	16.7%	9.9%	11.3%	13.7%	15.6%	10.8%	11.8%	6.8%	0.8%	1.2%
<b>Net Profit</b>	3652	1390	2143	3409	3767	2746	3428	879	1635	378
<b>Net Margin</b>	12.3%	7.4%	8.9%	11.1%	12.1%	8.6%	10.4%	4.2%	8.6%	1.7%
<b>Free Cash Flow</b>	2855	-611	-629	576	-798	-2918	-802	-648	711	1366
<b>Income Tax</b>	1317	547	721	1047	1227	883	1120	628	211	71

## Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Total Assets</b>	13826	16583	20577	24908	29517	34954	35172	31109	30895	33082
<b>Cash &amp; Equivalents</b>	1602	487	267	1177	485	255	185	146	290	950
<b>Acc. Receivable</b>	1181	1627	2000	2243	1986	1957	1326	1139	1500	2157
<b>Inventories</b>	692	770	773	981	1113	1289	1293	1163	1051	1193
<b>Goodwill &amp; Int.</b>	213	249	267	259	261	262	242	161	138	148
<b>Total Liabilities</b>	6469	7625	9401	11860	13055	16618	15764	14229	12337	13651
<b>Accounts Payable</b>	2099	2668	3469	4229	4271	4243	3419	2154	2368	3083
<b>Long-Term Debt</b>	1918	133	756	1160	1520	5784	5792	5696	3448	3697
<b>Total Equity</b>	7357	8958	11175	13048	16462	18336	19408	16881	18558	19431
<b>D/E Ratio</b>	0.26	0.01	0.07	0.09	0.09	0.32	0.30	0.34	0.19	0.19

## Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Return on Assets</b>	24.2%	9.1%	11.5%	15.0%	13.8%	8.5%	9.8%	2.7%	5.3%	1.2%
<b>Return on Equity</b>	47.8%	17.0%	21.3%	28.1%	25.5%	15.8%	18.2%	4.8%	9.2%	2.0%
<b>ROIC</b>	42.2%	15.1%	20.4%	26.1%	23.4%	13.0%	13.9%	3.7%	7.3%	1.7%
<b>Shares Out.</b>	859.4	847.60	847.60	847.60	847.60	847.60	847.60	847.60	847.60	831.24
<b>Revenue/Share</b>	33.45	21.88	28.31	36.11	36.50	37.36	38.58	24.65	22.24	26.57
<b>FCF/Share</b>	3.21	-0.71	-0.74	0.68	-0.94	-3.43	-0.94	-0.76	0.84	1.61

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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