

Management's discussion and analysis of financial condition and results of operations

Operating results

Third quarter 2018 vs. third quarter 2017

The company's net income for the third quarter of 2018 was \$749 million or \$0.94 per share on a diluted basis, an increase of \$378 million compared to the net income of \$371 million or \$0.44 per share, for the same period 2017. Third quarter results for 2018 include a non-cash impairment charge of \$33 million (\$0.04 per share) associated with the Government of Ontario's revocation of its carbon emission cap and trade regulation.

Upstream net income was \$222 million in the third quarter, up \$160 million from the same period of 2017. Improved results reflect the impact of higher Canadian crude oil realizations of about \$320 million and higher Kearl volumes of \$120 million, partially offset by lower Syncrude volumes of about \$150 million and higher operating expenses of about \$70 million.

West Texas Intermediate (WTI) averaged US\$69.43 per barrel in the third quarter of 2018, up from US\$48.23 per barrel in the same quarter of 2017. Western Canada Select (WCS) averaged US\$47.49 per barrel and US\$38.29 per barrel respectively for the same periods. The WTI / WCS differential widened to approximately US\$22 per barrel in the third quarter of 2018, from around US\$10 per barrel in the same period of 2017.

The Canadian dollar averaged US\$0.76 in the third quarter of 2018, a decrease of US\$0.04 from the third quarter of 2017.

Imperial's average Canadian dollar realizations for bitumen and synthetic crudes increased generally in line with the North American benchmarks, adjusted for changes in exchange rates and transportation costs. Bitumen realizations averaged \$50.42 per barrel for the third quarter of 2018, an increase of \$11.40 per barrel versus the third quarter of 2017. Synthetic crude realizations averaged \$89.70 per barrel, an increase of \$28.56 per barrel for the same period of 2017.

Gross production of Cold Lake bitumen averaged 150,000 barrels per day in the third quarter, compared to 163,000 barrels per day in the same period last year. Lower volumes were primarily due to production timing associated with steam management.

Gross production of Kearl bitumen averaged 244,000 barrels per day in the third quarter (173,000 barrels Imperial's share), up from 182,000 barrels per day (129,000 barrels Imperial's share) during the third quarter of 2017. Higher production was mainly the result of improved operational reliability associated with ore preparation, enhanced piping durability and feed management, partially offset by planned turnaround activity.

The company's share of gross production from Syncrude averaged 45,000 barrels per day, compared to 74,000 barrels per day in the third quarter of 2017. Lower production was due to a site-wide power disruption that occurred on June 20, 2018, resulting in a complete shutdown of all processing units. Production was progressively restored throughout the quarter and all cokers were back on-line by mid-September.

Downstream net income was \$502 million in the third quarter, up \$210 million from the third quarter of 2017. Earnings increased mainly due to stronger margins of about \$220 million, partially offset by a non-cash impairment charge of \$33 million associated with the Government of Ontario's revocation of its carbon emission cap and trade regulation.

Refinery throughput averaged 388,000 barrels per day, up from 385,000 barrels per day in the third quarter of 2017. Capacity utilization increased to 92 percent from 91 percent in the third quarter of 2017.

IMPERIAL OIL LIMITED

Petroleum product sales were 516,000 barrels per day, up from 500,000 barrels per day in the third quarter of 2017. Sales growth continues to be driven by optimization across the full downstream value chain, and the expansion of Imperial's logistic capabilities.

Chemical net income was \$69 million in the third quarter, up \$17 million from the same quarter of 2017, reflecting strong polyethylene pricing and advantaged feedstocks.

Corporate and other expenses were \$44 million in the third quarter, compared to \$35 million in the same period of 2017. As part of the implementation of the Financial Accounting Standards Board's update, Compensation – Retirement Benefits (Topic 715): *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, beginning January 1, 2018, Corporate and other includes all non-service pension and postretirement benefit expenses. Prior to 2018, the majority of these costs were allocated to the operating segments.

Nine months 2018 vs. nine months 2017

Net income in the first nine months of 2018 was \$1,461 million, or \$1.79 per share on a diluted basis, an increase of \$834 million compared to a net income of \$627 million or \$0.74 per share in the first nine months of 2017.

Upstream net income was \$172 million in the first nine months of 2018, an increase of \$397 million compared to a net loss of \$225 million from the same period of 2017. Improved results reflect the impact of higher Canadian crude oil realizations of about \$670 million and higher Kearn volumes of about \$120 million, partially offset by the impact of lower Cold Lake and Syncrude volumes of about \$170 million, higher operating costs of about \$120 million and higher royalties of about \$60 million.

West Texas Intermediate averaged US\$66.77 per barrel in the first nine months of 2018, up from US\$49.40 per barrel in the same period of 2017. Western Canada Select averaged US\$44.98 per barrel and US\$37.57 per barrel respectively for the same periods. The WTI / WCS differential widened to approximately US\$22 per barrel in the first nine months of 2018, from around US\$12 per barrel in the same period of 2017.

The Canadian dollar averaged US\$0.78 in the first nine months of 2018, an increase of about US\$0.01 from the same period of 2017.

Imperial's average Canadian dollar realizations for bitumen and synthetic crudes increased generally in line with the North American benchmarks, adjusted for changes in the exchange rate and transportation costs. Bitumen realizations averaged \$45.04 per barrel for the first nine months of 2018, an increase of \$7.22 per barrel versus 2017. Synthetic crude realizations averaged \$83.66 per barrel, an increase of \$19.29 per barrel from the same period of 2017.

Gross production of Cold Lake bitumen averaged 145,000 barrels per day in the first nine months of 2018, compared to 161,000 barrels per day from the same period of 2017. Lower volumes were primarily due to planned maintenance and production timing associated with steam management.

Gross production of Kearn bitumen averaged 202,000 barrels per day in the first nine months of 2018 (144,000 barrels Imperial's share) up from 179,000 barrels per day (127,000 barrels Imperial's share) from the same period of 2017. Increased 2018 production reflects improved operational reliability associated with ore preparation, enhanced piping durability and feed management.

During the first nine months of 2018, the company's share of gross production from Syncrude averaged 53,000 barrels per day, compared to 56,000 barrels per day from the same period of 2017. Syncrude year-to-date production was impacted by a site-wide power disruption that occurred on June 20 resulting in a complete shutdown of all processing units. Production was progressively restored throughout the third quarter 2018 and all cokers were back on-line by mid-September. Production in 2017 was impacted by repairs associated with the Syncrude Mildred Lake upgrader fire.

Downstream net income was \$1,224 million, an increase of \$474 million versus the prior year. Higher earnings primarily reflect stronger margins of about \$910 million, partially offset by the impact of increased planned turnaround activity and reliability events of about \$190 million, the absence of the \$151 million gain on the sale of a surplus property in 2017, and a non-cash impairment charge of \$33 million associated with the Government of Ontario's revocation of its carbon emission cap and trade regulation.

Refinery throughput averaged 386,000 barrels per day in the first nine months of 2018, up from 381,000 barrels per day from the same period of 2017. Capacity utilization increased to 91 percent from 90 percent in the same period of 2017.

Petroleum product sales were 503,000 barrels per day in the first nine months of 2018, up from 492,000 barrels per day from the same period of 2017. Sales growth continues to be driven by optimization across the full downstream value chain, and the expansion of Imperial's logistics capabilities.

Chemical net income was \$220 million, an increase of \$59 million versus the prior year, reflecting higher margins and volumes.

IMPERIAL OIL LIMITED

Corporate and other expenses were \$155 million for the first nine months of 2018, compared to \$59 million in the same period of 2017. Beginning January 1, 2018, Corporate and other includes all non-service pension and postretirement benefit expenses. Prior to 2018, the majority of these costs were allocated to the operating segments.

Liquidity and capital resources

Cash flow generated from operating activities was \$1,207 million in the third quarter, up from \$837 million from the corresponding period in 2017, reflecting higher earnings.

Investing activities used net cash of \$352 million in the third quarter, compared with \$234 million used in the same period of 2017, reflecting higher additions to property, plant and equipment.

Cash used in financing activities was \$580 million in the third quarter, compared with \$393 million used in the third quarter of 2017. Dividends paid in the third quarter of 2018 were \$155 million. The per share dividend paid in the third quarter was \$0.19, up from \$0.16 in the same period of 2017. During the third quarter, the company, under its share purchase program, purchased about 10 million shares for approximately \$418 million, including shares purchased from Exxon Mobil Corporation.

The company's cash balance was \$1,148 million at September 30, 2018, versus \$833 million at the end of third quarter 2017.

Cash flow generated from operating activities was \$3,051 million in the first nine months of 2018, up from \$1,683 million from the same period of 2017, primarily reflecting higher earnings.

Investing activities used net cash of \$1,096 million in the first nine months of 2018, compared with \$454 million used in the same period of 2017, reflecting higher additions to property, plant and equipment, and lower proceeds from asset sales.

Cash used in financing activities was \$2,002 million in the first nine months of 2018, compared with \$787 million used in the same period of 2017. Dividends paid in the first nine months of 2018 were \$421 million. The per share dividend paid in the first nine months of 2018 was \$0.51, up from \$0.46 from the same period of 2017. During the first nine months of 2018, the company, under its share purchase program, purchased about 38.5 million shares for approximately \$1,561 million, including shares purchased from Exxon Mobil Corporation.

Recently issued accounting standards

Effective January 1, 2019, Imperial will adopt the Financial Accounting Standards Board's standard, *Leases (Topic 842)*, as amended. The standard requires all leases with an initial term greater than one year to be recorded on the balance sheet as a right of use asset and a lease liability. Imperial expects to use the transition method that applies the new lease standard at January 1, 2019 and recognizes any cumulative effect adjustment to the opening balance of the 2019 retained earnings. The company acquired lease accounting software to facilitate implementation, and is currently configuring and testing the software. Based on leases outstanding at the end of 2017, the company estimates the operating lease right of use asset and lease liability would have been in the range of \$200 million to \$250 million at that time. The effect on Imperial's consolidated balance sheet as a result of implementing the standard on January 1, 2019 could differ considerably depending on operating leases commenced in 2018, as well as interest rates and other factors such as the expiry or renewal of leases during the year.

Forward-looking statements

Statements in this report regarding future events or conditions are forward-looking statements. Actual future financial and operating results could differ materially due to the impact of market conditions, changes in law or governmental policy, changes in operating conditions and costs, changes in project schedules, operating performance, demand for oil and gas, commercial negotiations or other technical and economic factors.

Quantitative and qualitative disclosures about market risk

Information about market risks for the nine months ended September 30, 2018, does not differ materially from that discussed on page 24 of the company's annual report on Form 10-K for the year ended December 31, 2017 and Form 10-Q for the quarter ended June 30, 2018.