

IMPERIAL OIL LTD  
Form 10-Q  
November 01, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the quarterly period ended September 30, 2006  
OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

Commission file number 0-12014

**IMPERIAL OIL LIMITED**

(Exact name of registrant as specified in its charter)

**CANADA**

(State or other jurisdiction of  
incorporation or organization)

**98-0017682**

(I.R.S. Employer  
Identification No.)

**237 Fourth Avenue S.W.**

**Calgary, Alberta, Canada**

(Address of principal executive offices)

**T2P 3M9**

(Postal Code)

Registrant's telephone number, including area code: 1-800-567-3776

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (see definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Securities Exchange Act of 1934).

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).

YES  NO

**The number of common shares outstanding as of September 30, 2006 is 962,712,556.**

IMPERIAL OIL LIMITED  
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In this report all dollar amounts are expressed in Canadian dollars unless otherwise stated. This report should be read in conjunction with the company's Annual Report on Form 10-K for the year ended December 31, 2005, and Form 10-Q for the quarters ended March 31, 2006 and June 30, 2006.

Statements in this report regarding future events or conditions are forward-looking statements. Actual 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.

IMPERIAL OIL LIMITED  
PART I FINANCIAL INFORMATION

**Item 1. Financial Statements.**

## CONSOLIDATED STATEMENT OF INCOME

(U.S. GAAP, unaudited)

millions of Canadian dollars	Third quarter		Nine months to September 30	
	2006	2005	2006	2005
<b>REVENUES AND OTHER INCOME</b>				
Operating revenues (a)(b)	6,612	7,683	19,002	20,333
Investment and other income (5)	39	28	155	138
<b>TOTAL REVENUES AND OTHER INCOME</b>	<b>6,651</b>	<b>7,711</b>	<b>19,157</b>	<b>20,471</b>
<b>EXPENSES</b>				
Exploration	5	10	18	37
Purchases of crude oil and products (b)	3,832	4,856	10,834	12,745
Production and manufacturing (6)	772	841	2,619	2,406
Selling and general (6)	276	495	891	1,278
Federal excise tax (a)	336	336	954	966
Depreciation and depletion	197	217	627	672
Financing costs (7)	3	(2)	10	8
<b>TOTAL EXPENSES</b>	<b>5,421</b>	<b>6,753</b>	<b>15,953</b>	<b>18,112</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>1,230</b>	<b>958</b>	<b>3,204</b>	<b>2,359</b>
<b>INCOME TAXES</b>	<b>408</b>	<b>306</b>	<b>954</b>	<b>775</b>
<b>NET INCOME (4)</b>	<b>822</b>	<b>652</b>	<b>2,250</b>	<b>1,584</b>
<b>NET INCOME PER COMMON SHARE BASIC (dollars)</b> (10)	<b>0.84</b>	<b>0.64</b>	<b>2.29</b>	<b>1.54</b>
<b>NET INCOME PER COMMON SHARE DILUTED</b> (dollars) (10)	<b>0.84</b>	<b>0.64</b>	<b>2.28</b>	<b>1.53</b>
<b>DIVIDENDS PER COMMON SHARE (dollars) (10)</b>	<b>0.08</b>	<b>0.08</b>	<b>0.24</b>	<b>0.23</b>
(a) Federal excise tax included in operating revenues	336	336	954	966
(b) Amounts included in operating revenues for purchase / sale contracts with the same counterparty. Associated costs are included in purchases of crude oil and products resulting in no impact to net income. (3)		1,413		3,506

The notes to the financial statements are part of these financial statements.

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IMPERIAL OIL LIMITED				
CONSOLIDATED STATEMENT OF CASH FLOWS				
(U.S. GAAP, unaudited)				
inflow/(outflow)				
millions of Canadian dollars	Third quarter		Nine months to September 30	
	2006	2005	2006	2005
<b>OPERATING ACTIVITIES</b>				
Net income	822	652	2,250	1,584
Adjustment for non-cash items:				
Depreciation and depletion	197	217	627	672
(Gain)/loss on asset sales, after income tax (5)	(7)	(5)	(61)	(62)
Deferred income taxes and other	60	(162)	17	(313)
Changes in operating assets and liabilities:				
Accounts receivable	272	(271)	292	(451)
Inventories and prepaids	(54)	(32)	(263)	(391)
Income taxes payable	284	414	(11)	226
Accounts payable	30	484	(97)	1,027
All other items net (a)	36	88	(226)	(137)
<b>CASH FROM (USED IN) OPERATING ACTIVITIES</b>	<b>1,640</b>	<b>1,385</b>	<b>2,528</b>	<b>2,155</b>
<b>INVESTING ACTIVITIES</b>				
Additions to property, plant and equipment and intangibles	(258)	(385)	(850)	(1,036)
Proceeds from asset sales	20	9	154	114
Loans to equity company	2			
<b>CASH FROM (USED IN) INVESTING ACTIVITIES</b>	<b>(236)</b>	<b>(376)</b>	<b>(696)</b>	<b>(922)</b>
<b>FINANCING ACTIVITIES</b>				
Short-term debt net			72	18
Repayment of long-term debt		(1)	(72)	(21)
Issuance of common shares under stock option plan	3	10	7	29
Common shares purchased (10)	(468)	(565)	(1,405)	(1,367)
Dividends paid	(79)	(82)	(238)	(236)
<b>CASH FROM (USED IN) FINANCING ACTIVITIES</b>	<b>(544)</b>	<b>(638)</b>	<b>(1,636)</b>	<b>(1,577)</b>
<b>INCREASE (DECREASE) IN CASH</b>	<b>860</b>	<b>371</b>	<b>196</b>	<b>(344)</b>
<b>CASH AT BEGINNING OF PERIOD</b>	<b>997</b>	<b>564</b>	<b>1,661</b>	<b>1,279</b>
<b>CASH AT END OF PERIOD</b>	<b>1,857</b>	<b>935</b>	<b>1,857</b>	<b>935</b>

(a) Includes contribution to registered pension plans	(13)	(4)	(369)	(346)
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The notes to the financial statements are part of these financial statements.

## IMPERIAL OIL LIMITED

CONSOLIDATED BALANCE SHEET  
(U.S. GAAP, unaudited)

	As at Sept.30 2006	As at Dec.31 2005
millions of Canadian dollars		
<b>ASSETS</b>		
Current assets		
Cash	1,857	1,661
Accounts receivable, less estimated doubtful accounts	1,782	2,073
Inventories of crude oil and products	716	481
Materials, supplies and prepaid expenses	158	130
Deferred income tax assets	637	654
Total current assets	5,150	4,999
Investments and other long-term assets	114	94
Property, plant and equipment less accumulated depreciation and depletion	22,176 (11,887)	21,526 (11,394)
Property, plant and equipment (net)	10,289	10,132
Goodwill	204	204
Other intangible assets, net	151	153
<b>TOTAL ASSETS</b>	<b>15,908</b>	<b>15,582</b>
<b>LIABILITIES</b>		
Current liabilities		
Short-term debt	171	99
Accounts payable and accrued liabilities (9)	3,070	3,170
Income taxes payable	1,399	1,399
Current portion of long-term debt (8)	907	477
Total current liabilities	5,547	5,145
Long-term debt (8)	361	863
Other long-term obligations (9)	1,520	1,728
Deferred income tax liabilities	1,230	1,213
<b>TOTAL LIABILITIES</b>	<b>8,658</b>	<b>8,949</b>
<b>SHAREHOLDERS EQUITY</b>		
Common shares at stated value (10) (a)	1,692	1,747



Earnings reinvested (11)	6,138	5,466
Accumulated other nonowner changes in equity (12)	(580)	(580)
TOTAL SHAREHOLDERS EQUITY	7,250	6,633
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	15,908	15,582

(a) Number of common shares outstanding was 963 million (2005 - 998 million)

The notes to the financial statements are part of these financial statements. Certain figures for the prior year have been reclassified in the financial statements to conform with the current year's presentation.

IMPERIAL OIL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**1. Basis of financial statement presentation**

These unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles of the United States of America and follow the same accounting policies and methods of computation as, and should be read in conjunction with, the most recent annual consolidated financial statements. In the opinion of the management, the information furnished herein reflects all known accruals and adjustments necessary for a fair presentation of the financial position of the company as at September 30, 2006, and December 31, 2005, and the results of operations and changes in cash flows for the three and nine months ending September 30, 2006 and 2005. All such adjustments are of a normal recurring nature. The company's exploration and production activities are accounted for under the successful efforts method.

The results for the three and nine months ending September 30, 2006, are not necessarily indicative of the operations to be expected for the full year.

All amounts are in Canadian dollars unless otherwise indicated.

**2. Accounting change for Share-based Payments**

Effective January 1, 2006, the company adopted the Financial Accounting Standards Board's revised Statement of Financial Accounting Standards No. 123 (SFAS 123R), Share-based Payment. SFAS 123R requires compensation costs related to share-based payments to be recognized in the income statement over the requisite service period. The amount of the compensation costs is to be measured based on the grant-date fair value of the instrument issued. In addition, liability awards are to be remeasured each reporting period through settlement. SFAS 123R is effective for awards granted or modified after the date of adoption and for awards granted prior to that date that have not vested. In 2003, the company adopted a policy of expensing all share-based payments that is consistent with the provisions of SFAS 123R, and all prior years outstanding stock option awards have vested. SFAS 123R will therefore not materially change the company's existing accounting practices or the amount of share-based compensation recognized in earnings.

The cumulative compensation expense associated with share-based payments made in 2005, 2004 and 2003 has been recognized in the income statement using the nominal vesting period approach. The full cost of awards given to employees who have retired before the end of the vesting period has been expensed. The use of a non-substantive vesting period approach based on the retirement eligibility age, is not significantly different from the nominal vesting period approach. The non-substantive vesting period approach is applicable to grants made after the adoption of SFAS 123R.

**Share-based Incentive Compensation Programs**

Incentive share units, deferred share units and restricted stock units

Incentive share units have value if the market price of the company's common shares when the unit is exercised exceeds the market value when the unit was issued, as adjusted for any share splits. The issue price of incentive share units is the closing price of the company's shares on the Toronto Stock Exchange on the grant date. Up to 50 percent of the units may be exercised after one year from issuance; an additional 25 percent may be exercised after two years; and the remaining 25 percent may be exercised after three years. Incentive share units are eligible for exercise up to 10 years from issuance. The units may expire earlier if employment is terminated other than by retirement, death or disability.

The deferred share unit plan is made available to selected executives and nonemployee directors. The selected executives can elect to receive all or part of their performance bonus compensation in units and the nonemployee directors can elect to receive all or part of their directors' fees in units. The number of units granted to executives is determined by dividing the amount of the bonus elected to be received as deferred share units by the average of the closing prices of the company's shares on the Toronto Stock Exchange for the five consecutive trading days immediately prior to the date that the bonus would have been paid. The number of units granted to a nonemployee director is determined at the end of each calendar quarter by dividing the amount of director's fees for the calendar quarter that the nonemployee director elected to receive as deferred share units by the average closing price of the

company's shares for the five consecutive trading days immediately prior to the last day of the calendar quarter. Additional units are granted based on the cash dividend payable on the company's shares divided by the average closing price immediately prior to the payment date for that dividend and multiplying the resulting number by the number of deferred share units held by the recipient, as adjusted for any share splits.

## IMPERIAL OIL LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Deferred share units cannot be exercised until after termination of employment with the company or resignation as a director and must be exercised no later than December 31 of the year following termination or resignation. On the exercise date, the cash value to be received for the units is determined based on the average closing price of the company's shares for the five consecutive trading days immediately prior to the date of exercise, as adjusted for any share splits.

Under the restricted stock unit plan, each unit entitles the recipient to the conditional right to receive from the company, upon exercise, an amount equal to the five-day average of the closing price of the company's common shares on the Toronto Stock Exchange on and immediately prior to the exercise dates. Fifty percent of the units are exercised three years following the grant date, and the remainder are exercised seven years following the grant date. For units granted in 2002 to 2005, the exercise date has been changed from December 31 to December 4 for units exercised in 2006 and subsequent years. For units granted in 2002, 2003, 2004 and 2005 to be exercised subsequent to the company's May 2006 three-for-one share split, the company has indicated that it will increase the cash payment or number of shares issued per unit, as the case may be, by the factor of three.

All units require settlement by cash payments with one exception. The restricted stock unit program was amended for units granted in 2003 and future years by providing that the recipient may receive one common share of the company per unit or elect to receive the cash payment for the units to be exercised in the seventh year following the grant date. In accordance with SFAS 123R, the company accounts for these units by using the fair-value-based method, which is the same method of accounting as under SFAS 123. The fair value of awards in the form of incentive share, deferred share and restricted stock units is the market price of the stock. Under this method, compensation expense related to the units of these programs is measured each reporting period based on the company's current share price and is recorded in the consolidated statement of income over the vesting period.

The following table summarizes information about these units for the nine months ended September 30, 2006:

	Incentive share units (a)	Deferred share units (a)	Restricted stock units (a)
Outstanding at December 31, 2005	10,884,891	138,567	10,556,730
Granted		5,113	
Exercised	(1,478,496)	(60,781)	(1,185,705)
Cancelled or adjusted	(900)		(6,851)
Outstanding at September 30, 2006	9,405,495	82,899	9,364,174

(a) Reflects number of units granted after the share split in 2006, plus the number of units granted prior to the share split in 2006 as adjusted for the share splits that occurred in 1998 and 2006.

There was a \$8 million favourable adjustment to previously recorded compensation expenses for these programs in the third quarter of 2006 and the compensation expense charged against income for these programs was \$128 million for the third quarter of 2005. The compensation expense charged against income for these programs was \$63 million and \$280 million for the nine months ended September 30, 2006 and 2005, respectively. Income tax expense associated with the favourable adjustment to compensation expense in the third quarter of 2006 was \$4 million and income tax benefit recognized in income related to the compensation expense in the third quarter of 2005 was \$74 million. Total income tax benefit recognized in income related to this compensation expense was \$10 million and \$151 million for the nine months ended September 30, 2006 and 2005, respectively.

As of September 30, 2006, there was \$177 million of total before-tax unrecognized compensation expenses related to nonvested restricted stock units based on the company's share price at the end of the current reporting period. The weighted-average vesting period of nonvested restricted stock units is 3.1 years. All units under the incentive share and deferred share programs have vested as of September 30, 2006.

#### Incentive stock options

In April 2002, incentive stock options were granted for the purchase of the company's common shares at an exercise price of \$15.50 per share (adjusted to reflect the three-for-one share split). Up to 50 percent of the options may be exercised on or after January 1, 2003, a further 25 percent may be exercised on or after January 1, 2004, and the remaining 25 percent may be exercised on or after January 1, 2005. Any unexercised options expire after April 29, 2012. The company has not issued incentive stock options since 2002 and has no plans to issue incentive stock options in the future.

The company has purchased shares on the market to fully offset the dilutive effects from the exercise of stock options. The practice is expected to continue.

As permitted by SFAS 123, the company continues to apply the intrinsic-value-based method of accounting for the incentive stock options granted in April 2002. Under this method, compensation expense is not recognized on the issuance of stock options as the exercise price is equal to the market value at the date of grant. All incentive stock options have vested as of January 1, 2005.

## IMPERIAL OIL LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

The following table summarizes information about stock options for the nine months ended September 30, 2006:

	Units (a)	Weighted-average exercise price (dollars) (b)	remaining contractual term (years)
Incentive stock options			
Outstanding at December 31, 2005	6,135,000	15.50	
Granted			
Exercised	(450,660)	15.50	
Cancelled or adjusted	5,400		
Outstanding at September 30, 2006	5,689,740	15.50	5.5

(a) Reflects number of units granted, as adjusted for any share splits.

(b) Adjusted to reflect the three-for-one share split.

No compensation expense and no income tax benefit related to stock options were recognized for stock options in the nine months ended September 30, 2006, and 2005. Cash received from stock option exercises for the nine months ended September 30, 2006, was \$7 million. The aggregate intrinsic value of stock options exercised in the nine months ended September 30, 2006, was \$12 million, and for the balance of outstanding stock options is \$125 million.

### 3. Accounting change for purchases and sales of inventory with the same counterparty

Effective January 1, 2006, the company adopted the Emerging Issues Task Force (EITF) consensus on Issue No. 04-13, Accounting for Purchases and Sales of Inventory with the Same Counterparty. The EITF concluded that purchases and sales of inventory with the same counterparty that are entered into in contemplation of one another should be combined and recorded as exchanges measured at the book value of the item sold. In prior periods, the company recorded certain crude oil, natural gas, petroleum product and chemical sales and purchases contemporaneously negotiated with the same counterparty as revenues and purchases. As a result of the EITF consensus, the company's accounts operating revenue and purchases of crude oil and products on the consolidated statement of income will be reduced by associated amounts with no impact on net income. All operating segments are affected by this change, with the largest impact in the petroleum products segment.

## IMPERIAL OIL LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**4. Business segments**

Third quarter millions of dollars	Natural Resources		Petroleum Products		Chemicals	
	2006	2005	2006	2005	2006	2005
<b>REVENUES AND OTHER</b>						
INCOME External sales (a)	1,178	1,252	5,086	6,117	348	314
Intersegment sales	1,090	977	570	498	87	92
Investment and other income		10	21	12		
	2,268	2,239	5,677	6,627	435	406
<b>EXPENSES</b>						
Exploration (b)	5	10				
Purchases of crude oil and products	736	707	4,535	5,398	307	317
Production and manufacturing	453	480	271	306	49	56
Selling and general	3	10	266	271	19	12
Federal excise tax			336	336		
Depreciation and depletion	131	158	61	56	3	3
Financing costs			(2)	1		
<b>TOTAL EXPENSES</b>	1,328	1,365	5,467	6,368	378	388
<b>INCOME BEFORE</b>						
INCOME TAXES	940	874	210	259	57	18
INCOME TAXES	323	282	61	88	19	6
<b>NET INCOME</b>	617	592	149	171	38	12
<b>Export sales to the United States</b>						
	585	440	233	233	193	182
<b>Cash flows from (used in) operating activities</b>						
	1,236	1,022	378	93	33	(3)
<b>CAPEX (b)</b>						
	183	243	63	133	5	5
<b>Corporate and Other</b>						
Third quarter millions of dollars	Corporate and Other		Eliminations		Consolidated	
	2006	2005	2006	2005	2006	2005
<b>REVENUES AND OTHER</b>						
<b>INCOME</b>						

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External sales (a)					6,612	7,683
Intersegment sales			(1,747)	(1,567)		
Investment and other income	18	6			39	28
	18	6	(1,747)	(1,567)	6,651	7,711
<b>EXPENSES</b>						
Exploration (b)					5	10
Purchases of crude oil and products			(1,746)	(1,566)	3,832	4,856
Production and manufacturing			(1)	(1)	772	841
Selling and general	(12)	202			276	495
Federal excise tax					336	336
Depreciation and depletion	2				197	217
Financing costs	5	(3)			3	(2)
<b>TOTAL EXPENSES</b>	<b>(5)</b>	<b>199</b>	<b>(1,747)</b>	<b>(1,567)</b>	<b>5,421</b>	<b>6,753</b>
<b>INCOME BEFORE</b>						
<b>INCOME TAXES</b>	<b>23</b>	<b>(193)</b>			<b>1,230</b>	<b>958</b>
<b>INCOME TAXES</b>	<b>5</b>	<b>(70)</b>			<b>408</b>	<b>306</b>
<b>NET INCOME</b>	<b>18</b>	<b>(123)</b>			<b>822</b>	<b>652</b>
Export sales to the United States					1,011	855
Cash flows from (used in) operating activities	(7)	273			1,640	1,385
CAPEX (b)	12	14			263	395

(a) Includes crude oil sales made by Products in order to optimize refining operations.

(b) Capital and exploration expenditures (CAPEX) include exploration expenses, additions to property, plant, equipment and intangibles and additions to



capital leases.

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## IMPERIAL OIL LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**4. Business segments (continued)**

Nine months to September 30 millions of dollars	Natural Resources		Petroleum Products		Chemicals	
	2006	2005	2006	2005	2006	2005
<b>REVENUES AND OTHER INCOME</b>						
External sales (a)	3,584	3,349	14,367	16,013	1,051	971
Intersegment sales	2,942	2,530	1,776	1,618	255	253
Investment and other income	65	80	44	41		
	6,591	5,959	16,187	17,672	1,306	1,224
<b>EXPENSES</b>						
Exploration (b)	18	37				
Purchases of crude oil and products	2,201	2,067	12,678	14,203	926	874
Production and manufacturing	1,498	1,366	976	897	147	145
Selling and general	10	6	751	782	58	59
Federal excise tax			954	966		
Depreciation and depletion	443	488	172	174	9	9
Financing costs			(2)	2		
<b>TOTAL EXPENSES</b>	4,170	3,964	15,529	17,024	1,140	1,087
<b>INCOME BEFORE INCOME TAXES</b>						
TAXES	2,421	1,995	658	648	166	137
INCOME TAXES	653	658	248	217	58	48
<b>NET INCOME</b>	1,768	1,337	410	431	108	89
Export sales to the United States	1,540	1,141	725	632	608	552
Cash flows from (used in) operating activities	2,052	1,616	447	279	100	77
CAPEX (b)	544	704	278	330	9	12
Total assets as at September 30	7,383	7,274	6,459	6,710	493	491

Nine months to September 30 millions of dollars	Corporate and Other		Eliminations		Consolidated	
	2006	2005	2006	2005	2006	2005

**REVENUES AND OTHER  
INCOME**

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External sales (a)					19,002	20,333
Intersegment sales			(4,973)	(4,401)		
Investment and other income	46	17			155	138
	46	17	(4,973)	(4,401)	19,157	20,471
<b>EXPENSES</b>						
Exploration (b)					18	37
Purchases of crude oil and products			(4,971)	(4,399)	10,834	12,745
Production and manufacturing			(2)	(2)	2,619	2,406
Selling and general	72	431			891	1,278
Federal excise tax					954	966
Depreciation and depletion	3	1			627	672
Financing costs	12	6			10	8
<b>TOTAL EXPENSES</b>	<b>87</b>	<b>438</b>	<b>(4,973)</b>	<b>(4,401)</b>	<b>15,953</b>	<b>18,112</b>
<b>INCOME BEFORE INCOME TAXES</b>						
TAXES	(41)	(421)			3,204	2,359
INCOME TAXES	(5)	(148)			954	775
<b>NET INCOME</b>	<b>(36)</b>	<b>(273)</b>			<b>2,250</b>	<b>1,584</b>
Export sales to the United States					2,873	2,325
Cash flows from (used in) operating activities	(71)	183			2,528	2,155
CAPEX (b)	37	27			868	1,073
Total assets as at September 30	2,055	1,160	(482)	(472)	15,908	15,163

(a) Includes crude oil sales made by Products in order to optimize refining operations.

(b) Capital and exploration expenditures (CAPEX) include exploration expenses, additions to property, plant, equipment and intangibles and additions to capital leases.



## IMPERIAL OIL LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**5. Investment and other income**

Investment and other income includes gains and losses on asset sales as follows:

millions of dollars	Third quarter		Nine months to September 30	
	2006	2005	2006	2005
Proceeds from asset sales	20	9	154	114
Book value of assets sold	13	4	69	29
Gain/(loss) on asset sales, before tax	7	5	85	85
Gain/(loss) on asset sales, after tax	7	5	61	62

**6. Employee retirement benefits**

The components of net benefit cost included in production and manufacturing and selling and general expenses in the consolidated statement of income are as follows:

millions of dollars	Third quarter		Nine months to September 30	
	2006	2005	2006	2005
Pension benefits:				
Current service cost	25	22	75	65
Interest cost	60	60	179	180
Expected return on plan assets	(75)	(64)	(225)	(192)
Amortization of prior service cost	5	6	15	18
Recognized actuarial loss	29	21	86	63
Net benefit cost	44	45	130	134
Other post-retirement benefits:				
Current service cost	2	2	6	6
Interest cost	6	6	18	18
Recognized actuarial loss	2	1	6	4
Net benefit cost	10	9	30	28

**7. Financing costs**

millions of dollars	Third quarter		Nine months to September 30	
	2006	2005	2006	2005
Debt related interest	17	11	46	32

Capitalized interest	(13)	(14)	(37)	(27)
Net interest expense	4	(3)	9	5
Other interest	(1)	1	1	3
Total financing costs	3	(2)	10	8

**8. Long-term debt**

Issued	Maturity date	Interest rate	As at Sept.30 2006	As at Dec.31 2005
			millions of dollars	
2003	\$250 million due May 26, 2007 and \$250 million due August 26, 2007	Variable		500
2003	January 19, 2008	Variable	318	318
Long-term debt			318	818
Capital leases			43	45
Total long-term debt (a)			361	863

(a) These amounts exclude that portion of long-term debt totalling \$907 million (December 31, 2005 \$477 million), which matures within one year and is included in current liabilities.

## IMPERIAL OIL LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**9. Other long-term obligations**

	As at Sept.30 2006	As at Dec.31 2005
millions of dollars		
Employee retirement benefits (a)	902	1,152
Asset retirement obligations and other environmental liabilities (b)	413	423
Other obligations	205	153
Total other long-term obligations	1,520	1,728

(a) Total recorded employee retirement benefits obligations also include \$47 million in current liabilities (December 31, 2005 \$47 million).

(b) Total asset retirement obligations and other environmental liabilities also include \$76 million in current liabilities (December 31, 2005 \$76 million).

**10. Common shares**

	As at Sept.30 2006	As at Dec.31 2005
thousands of shares		
Authorized (prior period data have not been restated)	1,100,000	450,000

Common shares outstanding 962,713 997,874  
 Effective May 23, 2006, the issued common shares of the company were split on a three-for-one basis and the number of authorized shares was increased from 450 million to 1,100 million. The prior period number of shares outstanding and shares purchased, as well as net income and dividends per share, have been adjusted to reflect the three-for one split.

In 1995 through 2005, the company purchased shares under eleven 12-month normal course share purchase programs, as well as an auction tender. On June 23, 2006, another 12-month normal course program was implemented with an allowable purchase of up to 48.8 million shares (five percent of the total on June 21, 2006), less any shares purchased by the employee savings plan and company pension fund. The results of these activities are as shown below:

Year	millions of	
	shares	dollars
1995 2004	697.6	6,840
2005 Third quarter	14.3	565
Full year	52.5	1,795
2006 Third quarter	11.5	468
Year-to-date	35.6	1,405
Cumulative purchases to date	785.7	10,040

Exxon Mobil Corporation's participation in the above maintained its ownership interest in Imperial at 69.6 percent. The excess of the purchase cost over the stated value of shares purchased has been recorded as a distribution of earnings reinvested.



## IMPERIAL OIL LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

The following table provides the calculation of net income per common share:

	Third quarter		Nine months to September 30	
	2006	2005	2006	2005
Net income per common share basic				
Net income (millions of dollars)	822	652	2,250	1,584
Weighted average number of common shares outstanding (millions of shares)	969.6	1016.6	980.7	1030.9
Net income per common share (dollars)	0.84	0.64	2.29	1.54
Net income per common share diluted				
Net income (millions of dollars)	822	652	2,250	1,584
Weighted average number of common shares outstanding (millions of shares)	969.6	1,016.6	980.7	1,030.9
Effect of employee stock-based awards (millions of shares)	4.5	4.7	4.4	4.2
Weighted average number of common shares outstanding, assuming dilution (millions of shares)	974.1	1,021.3	985.1	1,035.1
Net income per common share (dollars)	0.84	0.64	2.28	1.53

**11. Earnings reinvested**

millions of dollars	Third quarter		Nine months to September 30	
	2006	2005	2006	2005
Earnings reinvested at beginning of period	5,841	4,906	5,466	4,889
Net income for the period	822	652	2,250	1,584
Share purchases in excess of stated value	(448)	(539)	(1,343)	(1,295)
Dividends	(77)	(81)	(235)	(240)
Earnings reinvested at end of period	6,138	4,938	6,138	4,938

**12. Nonowner changes in shareholders equity**

millions of dollars	Third quarter		Nine months to September 30	
	2006	2005	2006	2005

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Net income	822	652	2,250	1,584
Other nonowner changes in equity (a)				
Total nonowner changes in shareholders equity	822	652	2,250	1,584

(a) Minimum  
pension liability  
adjustment.

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**IMPERIAL OIL LIMITED**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

**OPERATING RESULTS**

The company's net income for the third quarter was \$822 million or \$0.84 a share on a diluted basis, compared with \$652 million or \$0.64 a share for the same quarter of 2005. Net income for the first nine months of 2006 was \$2,250 million or \$2.28 a share on a diluted basis, versus \$1,584 million or \$1.53 a share for the first nine months of 2005.

Earnings in the third quarter were higher than the same period of 2005 due mainly to higher realizations for Cold Lake bitumen and crude oil of about \$110 million and record production volumes at Cold Lake of about \$55 million.

Earnings were also positively impacted by lower stock-related compensation expenses of about \$135 million and lower operating costs primarily from lower energy costs of about \$40 million. These factors were partially offset by lower natural gas realizations of about \$55 million and lower conventional crude oil volumes of about \$45 million. Stronger marketing and petrochemical product margins were essentially offset by weaker industry refining margins. A stronger Canadian dollar also negatively impacted earnings by about \$75 million.

For the first nine months, higher natural resources realizations and stronger refining and marketing margins contributed about \$765 million to earnings when compared to the same period in 2005. Also positive to earnings were lower stock-related compensation expenses of about \$220 million and lower tax expenses of about \$125 million.

Partially offsetting these positive factors was the impact of a stronger Canadian dollar of about \$225 million, higher planned refinery maintenance and capital project effects of about \$100 million, heavier mix of resources volumes of about \$70 million and higher Syncrude and other operating costs of about \$60 million.

**Natural resources**

Net income from natural resources in the third quarter was \$617 million, versus \$592 million in the same period in 2005. Earnings increased primarily due to higher realizations for Cold Lake bitumen and crude oil of about \$110 million and record production volumes at Cold Lake in the third quarter of about \$55 million. These positive items were offset partially by the negative impact of a stronger Canadian dollar of about \$60 million, lower natural gas realizations of about \$55 million and lower conventional crude oil and natural gas liquids (NGL) volumes of about \$45 million.

Net income for the first nine months was \$1,768 million, up \$431 million from the same period last year. Cold Lake bitumen and crude oil realizations were stronger by about \$570 million compared to the first nine months of 2005. These positive items were partially offset by the negative impact of a higher Canadian dollar of about \$165 million and higher operating costs of about \$60 million, primarily driven by higher Syncrude costs. The impact of natural resources volumes was unfavourable due to mix effects with lower conventional crude oil volumes of about \$140 million being partially offset by higher Cold Lake bitumen and Syncrude volumes totaling about \$70 million. Tax expenses in the first nine months were lower by about \$150 million primarily from reductions in federal and Alberta tax rates.

**IMPERIAL OIL LIMITED**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. (continued  
.....)**

While Brent crude oil prices in U.S. dollars averaged 13 percent higher in the third quarter and 25 percent higher for the first nine months compared with the same periods last year, increased realizations for conventional crude oil averaged less at one and 11 percent respectively mainly because of a stronger Canadian dollar. Average realizations for Cold Lake bitumen were higher in 2006, by over 10 percent in the third quarter and over 40 percent in the first nine months, reflecting a narrowing price spread between light crude oil and Cold Lake bitumen more consistent with historical trend levels.

Realizations for natural gas averaged \$6.29 a thousand cubic feet in the third quarter, down from \$8.80 a thousand cubic feet in the same quarter last year, primarily a result of increased industry inventory levels of natural gas. For the first nine-month period, realizations for natural gas averaged \$7.42 a thousand cubic feet in 2006, down from \$7.86 a thousand cubic feet in the same period of 2005.

Total gross production of crude oil and NGLs was 281 thousand barrels a day, up from 250 thousand barrels in the third quarter of 2005. For the first nine months of the year, total gross production of crude oil and NGLs averaged 273 thousand barrels a day, compared with 258 thousand barrels in the same period of 2005.

Gross production of Cold Lake bitumen averaged a record 158 thousand barrels a day during the third quarter versus 123 thousand barrels in the same quarter last year. For the first nine months, gross production was 155 thousand barrels a day this year, up from 137 thousand barrels in the same period of 2005. Higher production was due to the cyclic nature of production at Cold Lake and increased volumes from the ongoing development drilling program.

The company's share of Syncrude's gross production was 71 thousand barrels a day in the third quarter compared with 59 thousand barrels during the same period a year ago. Higher production volumes were from the new coker unit at the Stage 3 expansion project. During the first nine-month period, the company's share of gross production from Syncrude averaged 61 thousand barrels a day in 2006, up from 52 thousand barrels in the same period of 2005. Higher production volumes were primarily due to lower maintenance activities in the first nine months of 2006.

In the third quarter and first nine months of this year, gross production of conventional crude oil averaged 31 and 32 thousand barrels a day respectively, compared with 35 and 38 thousand barrels during the corresponding periods in 2005. The natural reservoir decline in the Western Canadian Basin and the impact of divested producing properties were the main reasons for the reduced production.

Gross production of NGLs available for sale was 21 thousand barrels a day in the third quarter, down from 33 thousand barrels a day in the same quarter last year. During the first nine months of 2006, gross production of NGLs available for sale decreased to 25 thousand barrels a day, from 31 thousand barrels in the same period of 2005, mainly due to declining NGL content of Wizard Lake gas production.

**IMPERIAL OIL LIMITED**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. (continued  
.....)**

Gross production of natural gas during the third quarter of 2006 decreased to 560 million cubic feet a day from 579 million cubic feet in the same period last year. In the first nine months of the year, gross production was 566 million cubic feet a day, down from 580 million in the first nine months of 2005. Lower production volumes were primarily due to natural decline in the Western Canadian Basin.

During the quarter, Syncrude restarted its Stage 3 expansion facilities that were temporarily shutdown earlier in the year. Bitumen feed was successfully reintroduced into the new coker at the end of August. Gradual ramp-up was achieved over the next several weeks with the feed rate reaching 95 thousand barrels a day at the end of the third quarter.

**Petroleum products**

Net income from petroleum products was \$149 million in the third quarter of 2006, compared with \$171 million in the same period a year ago. Improved marketing margins were more than offset by weaker refining margins when compared to the third quarter of 2005.

Nine-month net income was \$410 million versus \$431 million in the same period of 2005. Stronger refining and marketing margins were partially offset by higher planned refinery maintenance and ultra-low sulphur diesel project activities, which impacted both refinery utilization and expenses by a total of about \$100 million versus the prior year. Earnings were also negatively impacted by a stronger Canadian dollar of about \$60 million and higher tax expenses of \$25 million.

**Chemicals**

Net income from chemicals was \$38 million in the third quarter, \$26 million higher than the same period last year due primarily to improved industry margins across all product channels. Nine-month net income was \$108 million, up \$19 million from the same period in 2005. Improved industry margins for polyethylene and intermediate products were the main contributor to higher earnings.

**Corporate and other**

Net income from corporate and other at \$18 million in the third quarter compared with negative \$123 million in the same period of 2005. Nine-month net income was negative \$36 million versus negative \$273 million last year. Higher earnings were due mainly to lower stock-related compensation expenses.

**LIQUIDITY AND CAPITAL RESOURCES**

Cash flow from operating activities was \$1,640 million during the third quarter of 2006, up from \$1,385 million in the same period last year. Year-to-date cash flow from operating activities was \$2,528 million, versus \$2,155 million during the first nine months of 2005. Increases in cash flow in the third quarter and the first nine months of 2006 were driven primarily by higher net income and lower accounts receivable balances offset partially by lower accounts payable balances. Lower crude oil prices towards the latter part of the third quarter in 2006 contributed to the lower accounts receivable and payable balances. Accounts payable balances were also impacted by lower crude oil and petroleum product purchases and the timing of expenditures.

**IMPERIAL OIL LIMITED**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. (continued  
.....)**

Capital and exploration expenditures were \$263 million in the third quarter, down from \$395 million during the same quarter of 2005, and \$868 million in the first nine months of 2006, versus \$1,073 million in the same period a year ago. For the resources segment, capital and exploration expenditures were used mainly at Syncrude and Cold Lake to maintain and expand production capacity. The petroleum products segment spent its capital expenditures mainly on projects to improve operating efficiency, reduce the sulphur content of diesel fuel and upgrade the network of Esso retail outlets.

During the third quarter of 2006, the company repurchased more than 11 million shares for \$468 million. Under the current share-repurchase program, which began on June 23, 2006, the company has repurchased about 13 million shares, and can purchase up to an additional 36 million shares before June 22, 2007 when the current program expires. Cash dividends of \$238 million were paid in the first nine months of 2006. This compared with dividends of \$236 million in the comparable period of 2005. Per-share dividends paid in the first three quarters of 2006 totaled \$0.24, up from \$0.23 in the same period last year.

The above factors led to an increase in the company's balance of cash and marketable securities to \$1,857 million at September 30, 2006, from \$1,661 million at the end of 2005.

**RECENTLY ISSUED ACCOUNTING STANDARD**

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48),

Accounting for Uncertainty in Income Taxes. FIN 48 is an interpretation of FASB Statement No. 109 Accounting for Income Taxes and must be adopted by the company no later than January 1, 2007. FIN 48 prescribes a comprehensive model for recognizing, measuring, presenting, and disclosing in the financial statements uncertain tax positions that the company has taken or expects to take in its tax returns. The company is evaluating the impact of adopting FIN 48. In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158 (SFAS 158), Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment to FASB Statements No. 87, 88, 106 and 132(R). SFAS 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit post retirement plan as an asset or liability in its balance sheet and to recognize changes in that funded status in the year in which the changes occur through other non-owner changes in equity. The standard also requires disclosure in the notes to the financial statements of additional information about certain effects on net periodic benefit costs of the next fiscal year that arise from delayed recognition of gains or losses, prior service costs and transition asset or obligation. SFAS 158 must be adopted by the company in the financial statements for the year ending December 31, 2006. The company is evaluating the impact of adopting SFAS 158.

Based on December 31, 2005 pension and other postretirement plan balances, we expect that the accrued benefit obligation would have been increased by approximately \$600 million. Net of the effects of changes in deferred income taxes and other balance sheet accounts, shareholder's

**IMPERIAL OIL LIMITED**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. (continued  
.....)**

equity would have been reduced by approximately \$450 million. We do not expect that the impact as of December 31, 2006 would be materially different. The standard will not have any impact on the company's operations, earnings or cash flows.

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**IMPERIAL OIL LIMITED**

**Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

Information about market risks for the nine months ended September 30, 2006 does not differ materially from that discussed on page 31 in the company's annual report to shareholders for the year ended December 31, 2005 and Form 10-Q for the quarters ended March 30, 2006 and June 30, 2006, except for the following sensitivities:

Earnings sensitivity (a)

millions of dollars after tax

Nine cents decrease (increase) in the value of the Canadian dollar versus the U.S. dollar + (-) 325

The sensitivity of net income to changes in the Canadian dollar versus the U.S. dollar increased from the second quarter 2006 by about \$12 million (after tax) for each one-cent difference. This is primarily due to the decrease in crude oil prices and industry refining margins.

(a) The amount quoted to illustrate the impact of the sensitivity represents a change of about 10 percent in the value of the commodity at the end of the third quarter 2006. The sensitivity calculation shows the impact on annual net income that results from a change in one factor, after tax and royalties and holding all other factors constant. While the sensitivity is applicable under current conditions, it may not apply proportionately to larger fluctuations.

**Item 4. Controls and Procedures.**



The company's principal executive officer and principal financial officer have evaluated the company's disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, these officers have concluded that, as of the end of the period covered by this quarterly report, the company's disclosure controls and procedures are effective for the purpose of ensuring that information required to be disclosed by the company in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms.

There has not been any change in the company's internal control over financial reporting during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.

**IMPERIAL OIL LIMITED**  
**PART II OTHER INFORMATION**

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

During the period July 1, 2006 to September 30, 2006, the company issued 163,800 common shares to employees or former employees outside the U.S.A. for \$15.50 per share upon the exercise of stock options. These issuances were not registered under the *Securities Act* in reliance on Regulation S thereunder.

## Issuer Purchases of Equity Securities (1)

<b>Period</b>	<b>(a) Total number of shares purchased</b>	<b>(b) Average price paid per share</b>	<b>(c) Total number of shares purchased as part of publicly announced plans or programs</b>	<b>(d) Maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs</b>
<b>July 2006</b> (July 1 July 31)	1,680,449	40.90	1,680,449	45,703,137
<b>August 2006</b> (August 1 August 31)	4,578,669	43.18	4,578,669	41,066,313
<b>September 2006</b> (Sept. 1 Sept. 30)	5,283,135	38.08	5,283,135	35,718,232

- (1) The purchases were pursuant to a 12 month normal course share purchase program that was renewed on June 23, 2006 under which the company may purchase up to 48,772,466 of its outstanding common shares less any shares purchased by the employee savings plan and company pension fund. If not previously

terminated, the  
program will  
terminate on  
June 22, 2007.

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**IMPERIAL OIL LIMITED**

**Item 6. Exhibits.**

[10(iii)(A)(1)] Amended Restricted Stock Unit Plan with respect to Restricted Stock Units granted in 2002, as amended effective August 4, 2006

[10(iii)(A)(2)] Amended Restricted Stock Unit Plan with respect to Restricted Stock Units granted in 2003, as amended effective August 4, 2006

[10(iii)(A)(3)] Amended Restricted Stock Unit Plan with respect to Restricted Stock Units granted in 2004 and 2005, as amended effective August 4, 2006

[10(iii)(A)(4)] Amended Restricted Stock Unit Plan with respect to Restricted Stock Units granted in 2006 and subsequent years, as amended effective August 4, 2006

(31.1) Certification by the principal executive officer of the company pursuant to Rule 13a-14(a)

(31.2) Certification by the principal financial officer of the company pursuant to Rule 13a-14(a)

(32.1) Certification by the chief executive officer and of the company pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350.

(32.2) Certification by the chief financial officer and of the company pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350.

**SIGNATURES**

Pursuant to the requirements of the *Securities Exchange Act* of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

IMPERIAL OIL LIMITED  
(Registrant)

Date: October 31, 2006

*/s/ P.A. Smith*

(Signature)  
Paul A. Smith  
Controller and Senior Vice-President,  
Finance and Administration  
(Principal Accounting Officer)

Date: October 31, 2006

*/s/ Brent A. Latimer*

(Signature)  
Brent A. Latimer  
Assistant Secretary

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