Rating: Buy
S&P 500: 1089

Imperial Oil Limited
Canada Blue Chip

Symbol	IMO	*Ebitda Next Twelve Months ending 3/31/05 (US$mm)*	3,400
Rating	Buy	*North American Natural Gas/Ebitda (%)*	18
Price (US$/sh)	43.94	*Natural Gas and Oil Production/Ebitda (%)*	72
Pricing Date	5/20/04	*Adjusted Reserves/Production NTM*	10.7
Shares (mm)	362	*EV/Ebitda*	5.3
Market Capitalization (US$mm)	15,900	*PV/Ebitda*	6.2
Debt (US$mm)	2,100	*Undeveloped Reserves (%)*	31
Enterprise Value (EV) (US$mm)	18,000	*Natural Gas and Oil Ebitda (US$/boe)*	21.30
Present Value (PV) (US$mm)	20,900	*Present Value Proven Reserves(US$/boe)*	10.43
Net Present Value (US$/share)	52	*Present Value Proven Reserves(US$/mcfe)*	1.74
Debt/Present Value	0.10	*Earnings Next Twelve Months (US$/sh)*	4.86
McDep Ratio - EV/PV	0.86	*Price/Earnings Next Twelve Months*	9
Dividend Yield (%/year)	1.4	*Indicated Annual Dividend (US$/sh)*	0.63

Note: Estimated cash flow and earnings tied to one-year futures prices for oil, natural gas and refinery crack.
Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

Summary and Recommendation

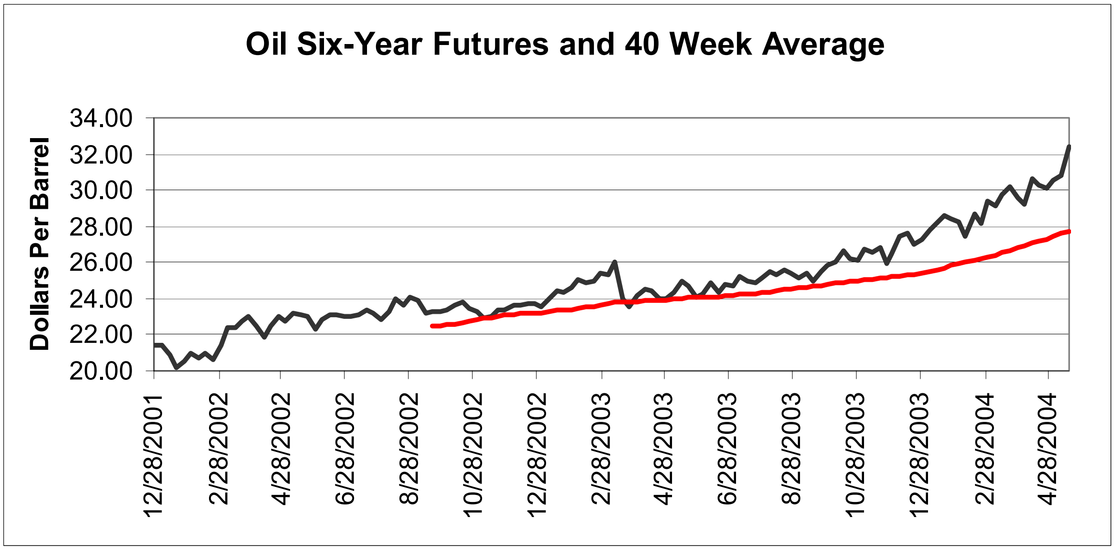
We initiate a "Buy" rating on the common shares of **Imperial Oil Limited (IMO)** as a direct participation in Canadian operations of 70% owner **ExxonMobil (XOM)**. Through IMO investors can own directly one of XOM's choicest businesses. Managed Exxon style, IMO generated a five fold return for investors in the past ten years as high cash flow from quality assets was transmitted to owners in the form of high dividends, stock buybacks and share price appreciation. Looking ahead, long-life oil production, frontier natural gas potential, and the largest and most profitable oil products business in Canada define an attractive outlook. We see 18% appreciation potential to net present value of US$52 a share and a long term return of about 5% per year above inflation thereafter. Risks are low for Canada's safest energy stock.

Oil Looks Up by the Charts, Fundamentals, Inflation and Security

Six-year futures describe the commodity price trends most relevant to estimating resource value. The longer time horizon better matches the period during which more of current resources will actually be produced. The longer term measure also smoothes the frantic near-month fluctuations and has the potential to keep climbing even if near-month quotes drop back temporarily.

The plots of weekly results since the beginning of 2002 trace a trend of six-year oil price rising 16% a year (see chart). We measure momentum with the 40-week moving average.
The charts look good as long as the current six-year quote remains above the trailing average.

Fundamental factors support the price trends. Oil demand is strong with world economic growth paced by developing countries, especially China. Supply is tight as the Middle East is showing maturity with the workhorse giant fields on the verge of peaking.



Monetary factors also favor oil investment as interest rates below inflation drive investors to real assets for protection against currency debasement. Compared to Treasury Inflation Protected Securities that we also favor, oil price is likely to rise more than the official government determined inflation measure.

There appears to be little of the cost of maintaining global security reflected in the price of oil. As a result oil from safe areas like Canada has greater value than might appear in today's price.

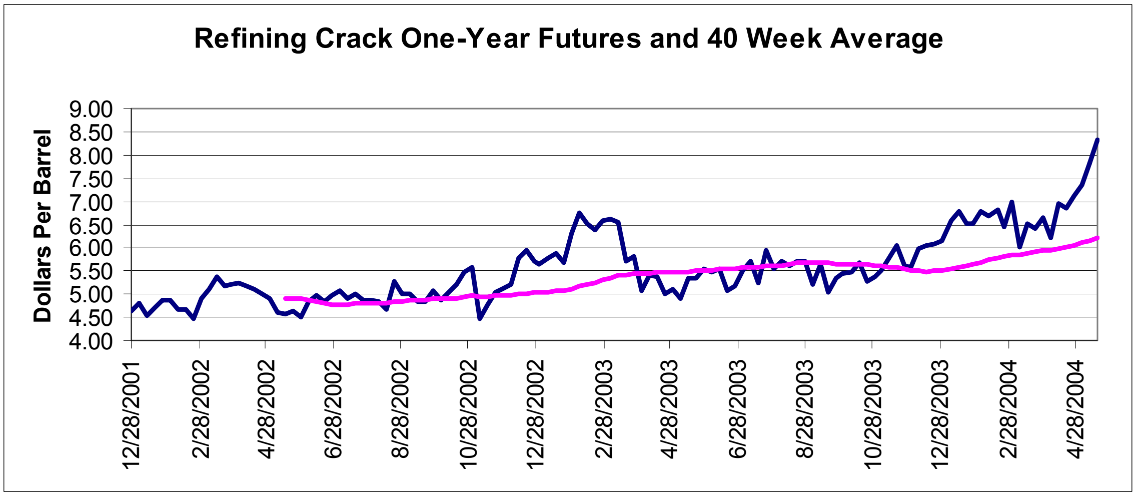
At some point oil price could be too strong and economic activity would be adversely affected. Six times in the past thirty years the annual gain in monthly price exceeded 70% briefly. June futures near $40 a barrel for Light, Sweet Crude Oil would have to exceed $52 a barrel to trigger a 70% warning.

Downstream Trends Also Strong

Industry people like to refer to the oil producing business as upstream and the oil refining/marketing business as downstream. Strong upstream business prospects captured in the rising trend of six-year futures are complemented by improving downstream prospects captured in the trend of one-year refining crack futures (see chart).

Compared to the two previous years, there has been no sign yet of a temporary peak in the trend. Perhaps there will be some falloff this year as in the past, but it would occur from a higher level.

The crack spread we measure is the price of two/thirds barrel of gasoline plus one/third barrel of heating oil minus a barrel of crude oil. While there are innumerable varieties of crude oil and products quoted around the world there is only one source of transparent, public quotes of futures prices for the next year, the New York Mercantile Exchange. As a result we use the Nymex quotes as an indicator of future downstream profitability globally, recognizing that markets are linked meaningfully, if not perfectly. Finally, the crack spread should be seasonally neutral because it always includes twelve months.



Volume, Price and Costs Translate to Attractive Cash Flow

Our process of estimating company-specific present value begins with an estimate of next twelve months cash flow. Current projections lead to a healthy level of unlevered cash flow, also known as Ebitda, short for earnings before interest, tax, depreciation and amortization (see table). We choose the next twelve months ending March 31, 2005 as the relevant time period.

For the next twelve months we project constant natural gas and oil volume at the first quarter 2004 level. That is sufficient for our valuation calculation. Management provides rich detail in conference calls, presentations and copious regulatory disclosures to put more color on a projection of growth for the rest of the decade.

We take the futures market at face value in projecting price for the next twelve months. Henry Hub quotes guide our projection of natural gas revenue. Light Sweet Crude quotes guide our projections of oil revenue. The refinery crack futures guide our projections of downstream cash flow. Because futures are constantly changing, our projection is adjusted accordingly. As a result, the specific amounts we project today may not be the amounts realized when the company next reports.

Assess Present Value Multiple Depending on Reserve Life

The important variables in the valuation of future production are captured in base year cash flow and a multiple of that cash flow that depends on reserve life. Indeed investors do differentiate on that basis as reflected in a high correlation of unlevered cash flow multiple with adjusted reserve life. We convert the market relationship to a formula that produces an anticipatory value with somewhat more sensitivity to reserve life.

Imperial Oil Limited
Next Twelve Months Operations
(Canadian Dollars)

	Q1 *3/31/04*	*Q2E* *6/30/04*	*Q3E* *9/30/04*	*Q4E* *12/31/04*	***Year*** ***2004E***	*Q1E* *3/31/05*	***Next Twelve*** *Months* *3/31/05*
Volume							
Natural Gas (mmcfd)	449	449	449	449	**449**	449	**449**
Oil (mbd)	236	236	236	236	**236**	236	**236**
Total gas & oil (bcf)	168	170	172	172	**681**	168	**681**
Total gas & oil (mbd))	311	311	311	311	**311**	311	**311**
Price							
Natural gas ($/mcf)							
Henry Hub ($/mmbtu)	5.64	6.14	6.52	6.69	**6.25**	6.88	**6.55**
Currency (US$/C$)	0.76	0.72	0.72	0.72	**0.73**	0.72	**0.72**
Henry Hub (C$/mmbtu)	7.43	8.57	9.11	9.34	**8.60**	9.61	**9.16**
U.S. (or North America)	6.58	7.59	8.06	8.27	**7.63**	8.51	**8.11**
Oil ($/bbl)							
WTI Cushing	35.23	39.60	40.90	39.00	**38.68**	37.26	**39.19**
WTI Cushing (C$/bbl)	46.41	55.34	57.15	54.49	**53.35**	52.07	**54.76**
Worldwide	39.08	46.59	48.12	45.88	**44.94**	43.84	**46.12**
Total gas & oil ($/mcf)	6.53	7.72	8.03	7.80	**30.86**	7.60	**31.12**
NY Harbor 3-2-1 ($/bbl)	6.98	11.95	9.90	7.07	**8.98**	7.01	**8.98**
Revenue ($mm)							
Natural Gas	266	310	333	342	**1,251**	344	**1,329**
Oil	830	1,001	1,045	996	**3,871**	931	**3,973**
Other	3,971	3,971	3,971	3,971	**15,884**	3,971	**15,884**
Total	5,067	5,282	5,349	5,309	**21,007**	5,246	**21,186**
Expense							
Fixed	218	218	218	218	**871**	218	**896**
Variable	218	260	274	266	**1,017**	253	**868**
Other	3,690	4,068	4,114	4,156	**16,027**	4,144	**13,985**
Ebitda ($mm)							
Exploration and Production	661	833	887	854	**3,234**	804	**3,378**
Other	281	381	349	299	**1,310**	297	**1,326**
Total Ebitda	942	1,214	1,235	1,153	**4,544**	1,102	**4,704**
Exploration	16	16	16	16	**64**	16	**64**
Deprec., Deplet., & Amort.	215	215	215	215	**860**	215	**860**
Ebit	711	983	1,004	922	**3,620**	871	**3,780**
Interest		-	-	-	**-**	-	**-**
Ebt	711	983	1,004	922	**3,620**	871	**3,780**
Income Tax	204	344	351	323	**1,222**	305	**1,323**
Net Income ($mm)							**-**
Exploration and Production	366						
Other	147						
Unallocated	(6)						
Total	507	639	653	599	**2,398**	566	**2,457**
Shares (millions)	362	362	362	362	**362**	362	**362**
Per share ($)	1.40	1.77	1.80	1.66	**6.62**	1.56	**6.79**
Ebitda Margin (E&P)	60%	64%	64%	64%	**63%**	63%	**64%**
Tax Rate	29%	35%	35%	35%	**34%**	35%	**35%**

The adjusted reserve life index is the sum of developed and half undeveloped reserves divided by next twelve months production. When we last did an industry-wide upward revaluation on March 23, we estimated cash flow multiple equal to 2.5 plus 0.5 times reserve life. That approximates present value assuming constant commodity price near the one-year quotes at that time, about $35 a barrel for crude oil. Higher commodity prices since then imply higher cash flow and lower multiple by about 10%. Estimated present value provides a measure of appreciation potential should the market move toward that level as we expect.

Long-Life Oil Majority of Value for Imperial

At 54% of next twelve months cash flow, oil production accounts for an even higher proportion of value. Long-life oil accounts for most of Imperial's reserves and we assess a higher multiple for long-life.

The company reports 31% of its oil and gas as undeveloped despite its conservative approach to estimating reserves. Most of that is associated with the Cold Lake heavy oil resource. Imperial is justly proud of a long, steady efficient expansion that still has perhaps a doubling or more ahead of it. The realistic reporting of undeveloped reserves helps us make a better estimate of value.

Imperial also owns 25% of the Syncrude Oil Sands plant and is the owner most responsible for the performance of the facility. An Imperial employee is the chief executive officer of the joint venture organization. We arbitrarily limit the life of Syncrude reserves to 20 times in our calculation of present value thereby implying a multiple of about 11 times for that portion of the company's cash flow.

Frontier Potential in North American Natural Gas

Proven reserves of natural gas account for 18% of our cash flow estimate. Much of that gas may be consumed in oil production. What is not counted yet is that the volumes could triple with the completion of a pipeline to the Arctic. The prospects of actual construction seem high, but it may be a few more years to be sure.

Number One in Refined Products

One can still see the "Esso" sign in Canada. Rights to the Standard Oil brand in the U.S. were regionalized after the breakup of the Rockefeller trust nearly a hundred years ago. True to its tradition, the sign speaks of a profitable operation despite bouts of intense competition. Downstream cash flow accounts for 28% of our projection. That is higher than for the typical integrated company.

Kurt H. Wulff, CFA

Research Methodology: McDep Associates ("the firm") applies the thirty plus years of experience of its analyst to estimate a present value of the oil and gas resources and other businesses of covered companies. That value becomes the denominator of the McDep Ratio while market capitalization and debt are the numerator. Stocks with low McDep Ratios tend to outperform stocks with high McDep Ratios on an unlevered basis. The firm emphasizes quantitative tools in deriving estimates while applying a final qualitative refinement.

Ratings Description: Stocks are rated by expected risk-adjusted return over one to three years compared to Treasury Inflation Protected Securities. Buy, Hold and Sell ratings imply expectations better than, equal to and inferior to those of TIPS. The McDep Ratio for a Buy may range up to 1.2; for a Hold**,** 1.0 to 1.4; and for a Sell, above 1.2.

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