Rating: Buy
S&P 500: 1065

Imperial Oil Limited
Choice Piece of ExxonMobil

Symbol	IMO	*Ebitda Next Twelve Months ending 6/30/05 (US$mm)*	3,200
Rating	Buy	*North American Natural Gas/Ebitda (%)*	17
Price (US$/sh)	47.41	*Natural Gas and Oil Production/Ebitda (%)*	72
Pricing Date	8/13/04	*Adjusted Reserves/Production NTM*	10.9
Shares (mm)	359	*EV/Ebitda*	5.9
Market Capitalization (US$mm)	17,000	*PV/Ebitda*	6.4
Debt (US$mm)	2,200	*Undeveloped Reserves (%)*	36
Enterprise Value (EV) (US$mm)	19,200	*Natural Gas and Oil Ebitda (US$/boe)*	20.10
Present Value (PV) (US$mm)	20,800	*Present Value Proven Reserves(US$/boe)*	9.77
Net Present Value (US$/share)	52	*Present Value Proven Reserves(US$/mcfe)*	1.63
Debt/Present Value	0.10	*Earnings Next Twelve Months (US$/sh)*	4.57
McDep Ratio - EV/PV	0.92	*Price/Earnings Next Twelve Months*	10
Dividend Yield (%/year)	1.4	*Indicated Annual Dividend (US$/sh)*	0.67

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

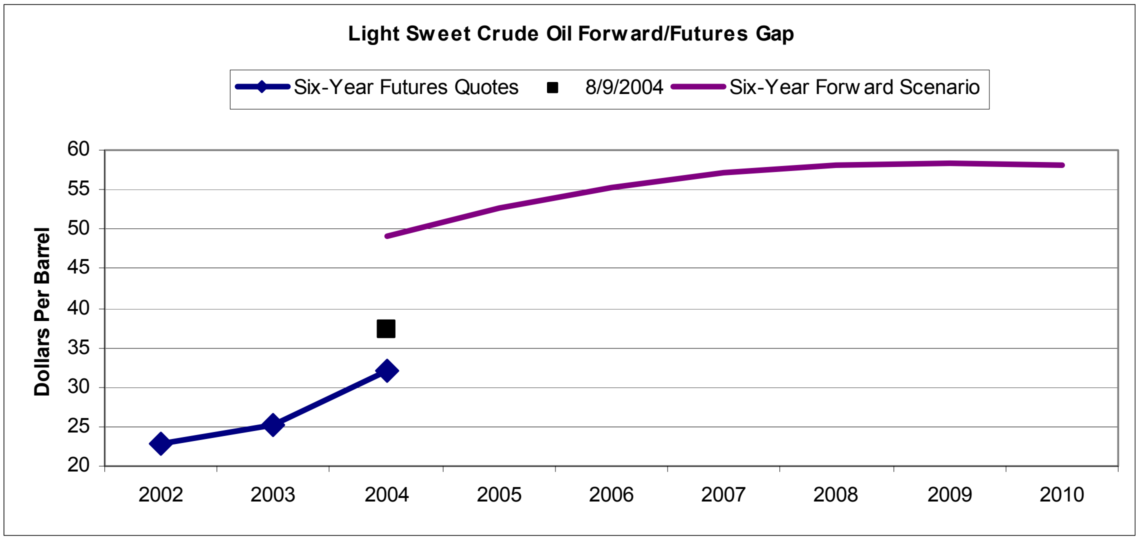
We continue a Buy rating on the common shares of **Imperial Oil Limited (IMO)** as a direct participation in Canadian operations of 70% owner **ExxonMobil (XOM)**. Oil sands representation in 25% ownership of Syncrude, heavy oil production at Cold Lake, frontier natural gas potential in the Mackenzie Delta and a leading refining/marketing position highlight the company's promise. The stock remains priced below our estimate of present value that assumes a constant real oil price of US$35 a barrel of Light, Sweet Oil and a return of 7% a year above inflation. We see some risk in the price of heavy oil relative to light oil and product price margins can be volatile.

Moderate Oil Price Scenario

The value of the company depends in large part on the future price of crude oil. Publicly traded in the commodity markets, futures contracts for delivery over the next six years continue in a steep uptrend. Whether the trend will slow for awhile we cannot know. Our scenario is that a move that began in the low $20 and is now in the mid $30 could reach $50 (see chart).

To construct the scenario we assumed oil would peak in 2010 at $50 in 2003 dollars. That is more moderate than the peak in early 1981 at more than $80 in 2003 dollars. Then we applied 3% per year inflation and calculated six-year averages to build a forward curve.

Economics support the price trends. Oil demand is strong with world economic growth paced by developing countries, especially China. Supply growth is limited as spare capacity has virtually disappeared. The largest producing fields in the Middle East are now mature. It will take time, large amounts of capital and a secure political climate to boost producing rates.



Monetary factors favor oil investment as interest rates below inflation drive investors to real assets for protection against the dollar losing value. If similar past periods are any guide, the authorities may not raise interest rates above inflation for the rest of the decade.

Environmental factors favor higher oil and gas price. Coal is still a quarter of world primary energy supply. Cleaner oil and gas are undervalued as long as we tolerate environmentally disadvantageous coal.

Political factors favor higher oil price in consuming countries and producing countries. Consuming governments often resort to artificial forces to hold down oil price that can appear to work temporarily. Military force could fall into that category though we would like to believe the objectives for deployment would be more worthy. Thirty years ago some of the same political leaders now directing military force directed price controls in a failed attempt to hold oil price artificially low.

In producing countries we have seen time and again that oil production goes down when international oil companies are not welcome. After Iran, Iraq and Venezuela, now Saudi Arabia appears vulnerable to political change that may bring about production decline.

Oil stock price can decline even if oil price remains firm. That happened in 1974 when economic activity and the stock market declined severely. It seemed to occur again in 2002 and we hope that is now behind us. Nonetheless the stock market may have begun a new moderate downward phase of its cycle. While oil stocks may not be entirely immune to surprise declines, we believe the fundamental outlook can carry the stocks higher over the next several years.

One-Year Futures Point to Higher Cash Flow and Profits

As our next twelve months (NTM) cash flow model moves ahead to the period ending June 30, 2005 expectations also advance mainly because of advancing one-year futures. We relate natural gas and oil price to the quotes for commodities traded on the New York Mercantile Exchange (see table Next Twelve Months Operating and Financial Estimates).

Imperial Oil Limited
Next Twelve Months Operations
(Canadian Dollars)

	Q1 3/31/04	*Q2 6/30/04*	*Q3E 9/30/04*	*Q4E 12/31/04*	***Year 2004E***	*Q1E 3/31/05*	*Q2E 6/30/05*	***Next Twelve Months 6/30/05***
Volume								
Natural Gas (mmcfd)	449	493	493	493	**483**	493	493	**493**
Days	91	91	92	92	**366**	90	91	**365**
Oil (mmb)	21	20	22	22	**85**	21	21	**86**
Oil (mbd)	236	222	236	236	**233**	236	236	**236**
Total gas & oil (bcf)	170	166	176	176	**687**	172	174	**697**
Total gas & oil (mbd))	311	304	318	318	**313**	318	318	**318**
Price								
Natural gas ($/mcf)								
Henry Hub ($/mmbtu)	5.64	6.10	5.74	6.28	**5.94**	6.88	6.13	**6.26**
Currency (US$/C$)	0.76	0.74	0.76	0.76	**0.76**	0.76	0.76	**0.76**
Henry Hub (C$/mmbtu)	7.43	8.29	7.51	8.22	**7.86**	9.01	8.03	**8.19**
U.S. (or North America)	6.58	6.87	6.23	6.82	**6.62**	7.47	6.66	**6.79**
Oil ($/bbl)								
WTI Cushing	35.23	38.34	43.19	43.93	**40.17**	42.25	40.88	**42.56**
WTI Cushing (C$/bbl)	46.41	52.09	56.55	57.52	**53.14**	55.32	53.53	**55.73**
Worldwide	39.08	41.64	45.20	45.97	**43.01**	44.22	42.79	**44.55**
Total gas & oil ($/mcf)	6.53	6.92	7.20	7.44	**7.03**	7.40	7.01	**7.26**
NY Harbor 3-2-1 ($/bbl)	6.98	11.45	8.04	6.98	**8.36**	7.83	7.78	**7.66**
Revenue ($mm)								
Natural Gas	269	308	283	309	**1,169**	331	299	**1,222**
Oil	839	841	981	998	**3,660**	939	919	**3,838**
Other	3,959	4,317	4,317	4,317	**16,909**	4,317	4,317	**17,267**
Total	5,067	5,466	5,581	5,624	**21,738**	5,587	5,534	**22,326**
Expense								
Fixed	224	245	230	230	**929**	230	230	**909**
Variable	224	245	269	279	**1,016**	271	259	**864**
Other	3,678	4,051	4,516	4,545	**16,790**	4,520	4,510	**14,387**
Ebitda ($mm)								
Exploration and Production	661	660	765	799	**2,884**	770	728	**3,061**
Other	281	266	300	280	**1,127**	297	296	**1,173**
Total Ebitda	942	925	1,065	1,079	**4,011**	1,067	1,024	**4,235**
Exploration	16	15	15	15	**61**	15	15	**60**
Deprec., Deplet., & Amort.	215	217	217	217	**866**	217	217	**868**
Ebit	711	693	833	847	**3,084**	835	792	**3,307**
Interest			-	-	**-**	-	-	**-**
Ebt	711	693	833	847	**3,084**	835	792	**3,307**
Income Tax	204	241	291	296	**1,033**	292	277	**1,157**
Net Income ($mm)								**-**
Exploration and Production	366	321						
Other	147	137						
Unallocated	(6)	(6)						
Total	507	452	541	550	**2,051**	543	515	**2,150**
Shares (millions)	362	359	359	359	**360**	359	359	**359**
Per share ($)	1.40	1.26	1.51	1.53	**5.70**	1.51	1.43	**5.99**
Ebitda Margin (E&P)	60%	57%	60%	61%	**60%**	61%	60%	**61%**
Tax Rate	29%	35%	35%	35%	**33%**	35%	35%	**35%**

Investors who want calendar year estimates can find 2004 in the table. For 2005 we suggest using the next twelve months as a rough estimate. Estimates can change frequently along with oil markets.

Present Value at Real Price and Real Return

NTM estimates determine to a large extent the first year of projected cash flow that we discount to present value (see table Present Value of Oil and Gas Reserves). The calculation is set up on the basis of one barrel equivalent of reported proven reserves with the proportions developed and undeveloped matching the company's characteristics. As a result, total present value, the number in the box, is also present value per barrel of proven reserves.

Imperial Oil Limited
Present Value of Oil and Gas Reserves
(U.S. dollars)

Volume Decline (%/yr):	10	Nymex Oil Price Post 2005 ($/bbl)	35
Volume Enhancement (%/yr):	9	Real Discount Rate (%/yr):	7.0
Capex/Cash Flow (%):	20	Variable Cost (%):	30

Year	Basic (bbl)	Volume Enhanced (bbl)	Total (bbl)	Price ($/bbl)	Revenue ($)	Fixed Cost ($)	Var. Cost ($)	Cash Flow ($)	Cap Ex ($)	Free CF ($)	Disc Factor	Present Value ($)
Total 2005 through 2024; years ending on 6/30												
	0.640	0.360	1.000	28.38	28.38	4.76	8.51	15.11	1.70	13.41	0.64	$\boxed{8.60}$
2005	0.075	0.000	0.075	33.27	2.51	0.24	0.75	1.52	0.30	1.21	0.97	1.17
2006	0.067	0.007	0.074	27.98	2.08	0.24	0.62	1.22	0.24	0.97	0.90	0.88
2007	0.060	0.013	0.073	27.98	2.05	0.24	0.61	1.19	0.24	0.96	0.84	0.81
2008	0.054	0.018	0.072	27.98	2.02	0.24	0.61	1.17	0.23	0.94	0.79	0.74
2009	0.048	0.023	0.071	27.98	1.99	0.24	0.60	1.15	0.23	0.92	0.74	0.68
2010	0.043	0.027	0.070	27.98	1.96	0.24	0.59	1.13	0.23	0.91	0.69	0.63
2011	0.039	0.030	0.069	27.98	1.93	0.24	0.58	1.11	0.22	0.89	0.64	0.57
2012	0.035	0.033	0.068	27.98	1.90	0.24	0.57	1.09	0.00	1.09	0.60	0.66
2013	0.031	0.030	0.061	27.98	1.70	0.24	0.51	0.95	0.00	0.95	0.56	0.54
2014	0.028	0.027	0.055	27.98	1.53	0.24	0.46	0.83	0.00	0.83	0.53	0.44
2015	0.025	0.024	0.049	27.98	1.37	0.24	0.41	0.72	0.00	0.72	0.49	0.35
2016	0.022	0.021	0.044	27.98	1.22	0.24	0.37	0.62	0.00	0.62	0.46	0.28
2017	0.020	0.019	0.039	27.98	1.09	0.24	0.33	0.53	0.00	0.53	0.43	0.23
2018	0.018	0.017	0.035	27.98	0.98	0.24	0.29	0.45	0.00	0.45	0.40	0.18
2019	0.016	0.015	0.031	27.98	0.88	0.24	0.26	0.38	0.00	0.38	0.37	0.14
2020	0.014	0.014	0.028	27.98	0.78	0.24	0.24	0.31	0.00	0.31	0.35	0.11
2021	0.013	0.012	0.025	27.98	0.70	0.24	0.21	0.25	0.00	0.25	0.33	0.08
2022	0.011	0.011	0.022	27.98	0.63	0.24	0.19	0.20	0.00	0.20	0.31	0.06
2023	0.010	0.010	0.020	27.98	0.56	0.24	0.17	0.16	0.00	0.16	0.29	0.04
2024	0.009	0.009	0.018	27.98	0.50	0.24	0.15	0.11	0.00	0.11	0.27	0.03

While there are many assumptions that could be discussed, discount rate and oil price are especially important. Price escalation and discount rate interact. In this case we make the simplification of dealing in constant dollars. That assumes price escalation, cost escalation and discount rate are all net of inflation.

For discount rate we use a 7% real return per year on an unlevered basis. That means a buyer who pays present value would earn 7% per year above inflation if all the projections were to materialize as stated.

While first year oil price is from the futures market we hold it constant at an arbitrary level thereafter. The assumed price listed in the upper right hand corner is the commonly quoted benchmark Light, Sweet Crude.

Present Value per Barrel Leads to Present Value per Share

We illustrate the calculation of Net Present Value (NPV) in a sensitivity table where each column is headed by a different oil price (see table Net Present Value Calculation). The price of $35 a barrel corresponds to our standardized present value of $52 a share.

Imperial Oil Limited
Net Present Value Calculation
(U.S. dollars)

Constant Oil Price ($/bbl):	30	35	40	50
Present Value per Barrel ($):	7.30	8.60	10.00	12.70
Oil and Gas Reserves (million barrels equivalent):	1,539	1,539	1,539	1,539
Present Value of Oil and Gas Reserves ($mm):	11,200	13,200	15,400	19,500
Frontier and Oil Sands Incremental	1,700	1,700	1,700	1,700
Present Value of Other Businesses ($mm):	5,800	5,800	5,800	5,800
Total	18,700	20,700	22,900	27,000
Debt ($mm):	2,200	2,200	2,200	2,200
Present Value of Equity ($mm):	16,500	18,500	20,700	24,800
Shares (mm):	359	359	359	359
Net Present Value ($/sh):	46	52	58	69

Reported reserves that we use in the calculation understate likely future volumes. Contrary to our projection of volume decline in calculating the value of proven reserves, the company historically has added new reserves and slowed decline.

In addition to the value of proven reserves to be produced over the next twenty years, Imperial has long life resources that add more value that we include on the line labeled "Frontier and Oil Sands Incremental". Frontier refers to natural gas resources in northern Canada awaiting a pipeline that is well along in the planning stage. Not only oil sands, but also heavy oil resources are expected to be producing beyond the twenty years in the cash flow projection.

(Though twenty years may seem far out, we can remember making a presentation on the energy outlook, including tar sands as we called them then, to the predecessor of a Syncrude partner 35 years ago. The company was Cities Service and the location was the research facility, now occupied by another company, alongside the New Jersey Turnpike near Cranbury.)

Light/Heavy Uncertainty Hedged Naturally

Our latest projections have a greater discount for Cold Lake heavy oil relative to the Light, Sweet benchmark compared to three months ago. Cold Lake was 47% of the company's oil volume in the second quarter 2004, oil sands was 26% with the remainder conventional oil and natural gas liquids. Heavy oil requires more refining to convert it to environmentally qualified gasoline, heating oil and other products. The pricing dynamics can be complicated. We have a sense that when refining margins are wide as they are now, the light/heavy price spread, or discount can widen. From January to June 2004 the ratio of heavy oil price to light oil price decreased by about 5% as we measure by prices posted on Imperial's web site.

Imperial has two natural hedges against a widening light/heavy spread. First, Imperial is in the refining business and can thus offset a wider spread with wider refining margin. Second, oil sands production does not have the same exposure because it is upgraded on site to light, sweet quality. When the 40% expansion is completed between June 2005 and June 2006, Syncrude will produce a premium product to Light, Sweet.

We have wondered in the past why Imperial did not expand more rapidly at Cold Lake. The resources are there even beyond quantities reported as proven. The explanation appears to lie in how fast the market can take more heavy oil without the price spread widening inordinately as it has on occasion. Building more upgrading capacity is an obvious antidote, but the capital requirements are high.

Stock Priced for $30 to $35 Oil

Cutting through the details, assumptions, projections and qualifications, we think Imperial Oil stock is priced for about a 7% per year return above inflation as though the long term benchmark price of crude oil were to be $30 to $35 a barrel. With spot oil quoted at $46 and 6-year futures averaging almost $38 we believe $30 to $35 will prove to be a low expectation. Those who talk of $100 to $200 a barrel strike us as somewhat alarmist, but more realistic than those who talk the popular number of $25. We would not dismiss out of hand the temporary realization of either. The important point is that we move beyond agonizing over oil price and act to make money owning Imperial Oil stock and that of other well-positioned natural gas and oil producers.

Kurt H. Wulff, CFA