Rating: Buy
S&P 500: 1203

# Imperial Oil Limited
## Raise Net Present Value to US$64 a Share

| | | | |
|---|---|---|---|
| *Symbol* | IMO | *Ebitda Next Twelve Months ending 3/31/06 (US$mm)* | 3,400 |
| *Rating* | Buy | *North American Natural Gas/Ebitda (%)* | 18 |
| *Price (US$/sh)* | 65.56 | *Natural Gas and Oil Production/Ebitda (%)* | 69 |
| *Pricing Date* | 2/4/05 | *Adjusted Reserves/Production NTM* | 10.6 |
| *Shares (mm)* | 352 | *EV/Ebitda* | 7.6 |
| *Market Capitalization (US$mm)* | 23,000 | *PV/Ebitda* | 7.5 |
| *Debt (US$mm)* | 2,600 | *Undeveloped Reserves (%)* | 30 |
| *Enterprise Value (EV) (US$mm)* | 25,700 | *Natural Gas and Oil Ebitda (US$/boe)* | 19.50 |
| *Present Value (PV) (US$mm)* | 25,100 | *Present Value Proven Reserves(US$/boe)* | 11.64 |
| *Net Present Value (US$/share)* | 64 | *Present Value Proven Reserves(US$/mcfe)* | 1.94 |
| *Debt/Present Value* | 0.11 | *Earnings Next Twelve Months (US$/sh)* | 4.70 |
| *McDep Ratio - EV/PV* | 1.02 | *Price/Earnings Next Twelve Months* | 14 |
| *Dividend Yield (%/year)* | 1.1 | *Indicated Annual Dividend (US$/sh)* | 0.70 |

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)**. We raised our estimate of net present value to $64 a share from $58 on January 26, 2005, when we revised our estimate of long-term oil price to $40 a barrel constant real from $35. Up some 50% in almost nine months, the stock price exceeds net present value, but not by enough yet to cause us to change our rating to hold. The company has attractive oil sands and Arctic natural gas projects that promise further potential while oil price shows no signs of reversing its upward trend. Succeeding for 125 years, Imperial will likely continue to profit despite economic, political, industry and financial risk.

**Syncrude May Be Most Valuable Asset**

We present separately the oil sands venture, Syncrude, where IMO's 25% is the largest position of the operating company partners (see table Functional Cash Flow and Present Value). Our value for the large oil sands facility is the same as the increased value we now carry for 35% Syncrude owner, **Canadian Oil Sands Trust (COSWF)**. 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. Imperial is the owner most responsible for the performance of Syncrude. An Imperial employee is the chief executive officer of the joint venture organization.

Oil Sands also account for much of the company's remaining oil exposure. Imperial's Cold Lake heavy oil production exceeds its share of Syncrude. While Syncrude recovers oil from sands mined on the surface, Cold Lake production is from sands too deep to be mined. The company has depended primarily on cyclic steam injection rather than SAGD, the Steam-Assisted Gravity

Drainage technique. Imperial is justly proud of a long, steady efficient expansion at Cold Lake that still has perhaps a doubling or more ahead of it.

**Frontier Potential in North American Natural Gas**

Proven reserves of natural gas account for 13% of our estimate of present value. Much of that gas may be consumed in heavy 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 months 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 is the most profitable in Canada. When it processes its own heavy oil production Imperial can earn the most value-added, as it does now with its share of Syncrude, and protect itself from potentially steep discounts for heavy oil.

**Imperial Oil Limited**
**Functional Cash Flow and Present Value**

| | *NTM Ebitda (US$mm)* | *Adjusted R/P* | *PV/ Ebitda* | *Present Value (US$mm)* | |
|---|---|---|---|---|---|
| North American Natural Gas | 597 | 5.2 | 5.4 | 3,200 | 13% |
| Syncrude | 648 | 20.0 | 11.0 | 7,100 | 28% |
| Oil | 1,098 | 10.1 | 7.6 | 8,300 | 33% |
| Downstream | 1,030 | | 6.3 | 6,500 | 26% |
| | 3,373 | 10.6 | 7.4 | 25,100 | 100% |
| Debt (US$mm) | | | | | 2,600 |
| Net Present Value (US$mm) | | | | | 22,500 |
| Shares (mm) | | | | | 352 |
| Net Present Value (US$/sh) | | | | | 64 |

**Light/Heavy Hedge Helped in the Latest Quarter**

Latest quarterly results were lower in oil production and higher in downstream than projected (see table Next Twelve Months Operating and Financial Estimates). The explanation lies in a widening of the price spread between benchmark Light, Sweet Crude oil and heavy oil.

Our latest projections have a greater discount for Cold Lake heavy oil relative to the Light, Sweet benchmark. Cold Lake was 53% of the company's oil volume in the fourth quarter 2004. Heavy oil requires more refining to convert it to environmentally qualified gasoline, heating oil and other products. The pricing dynamics can be complicated. The ratio of price of Cold Lake to Light Sweet dropped to a low point of 0.62 in the latest quarter (see table Oil Production and Revenue).

**Imperial Oil Limited**
**Next Twelve Months Operations**
(Canadian Dollars)

| | *Q3 9/30/04* | *Q4 12/31/04* | ***Year 2004*** | *Q1E 3/31/05* | *Q2E 6/30/05* | *Q3E 9/30/05* | *Q4E 12/31/05* | ***Year 2005E*** | *Q1E 3/31/06* | ***Next Twelve Months 3/31/06*** |
|---|---|---|---|---|---|---|---|---|---|---|
| **Volume** | | | | | | | | | | |
| Natural Gas (mmcfd) | 533 | 524 | **500** | 524 | 524 | 524 | 524 | **524** | 524 | **524** |
| Oil (mbd) | 219 | 242 | **230** | 242 | 242 | 242 | 242 | **242** | 242 | **242** |
| Total gas & oil (bcf) | 170 | 182 | **688** | 178 | 180 | 182 | 182 | **721** | 178 | **721** |
| Total gas & oil (mbd)) | 308 | 329 | **313** | 329 | 329 | 329 | 329 | **329** | 329 | **329** |
| **Price** | | | | | | | | | | |
| Natural gas ($/mcf) | | | | | | | | | | |
| Henry Hub ($/mmbtu) | 5.75 | 7.10 | **6.15** | 6.21 | 6.21 | 6.36 | 6.72 | **6.37** | 7.20 | **6.62** |
| Currency (US$/C$) | 0.77 | 0.82 | **0.77** | 0.80 | 0.80 | 0.80 | 0.80 | **0.80** | 0.80 | **0.80** |
| Henry Hub (C$/mmbtu) | 7.51 | 8.66 | **7.98** | 7.76 | 7.76 | 7.95 | 8.39 | **7.96** | 9.00 | **8.27** |
| Canada (C$/mcf) | 6.57 | 7.12 | **6.79** | 6.38 | 6.38 | 6.53 | 6.90 | **6.55** | 7.40 | **6.80** |
| Oil ($/bbl) | | | | | | | | | | |
| WTI Cushing | 43.89 | 48.30 | **41.44** | 46.56 | 47.32 | 46.67 | 45.83 | **46.60** | 45.35 | **46.29** |
| WTI Cushing (C$/bbl) | 57.30 | 58.92 | **53.68** | 58.18 | 59.13 | 58.31 | 57.27 | **58.22** | 56.66 | **57.84** |
| Worldwide | 46.97 | 43.85 | **42.85** | 43.30 | 44.01 | 43.40 | 42.62 | **43.33** | 42.17 | **43.05** |
| Total gas & oil ($/mcf) | 7.46 | 7.26 | **7.05** | 6.99 | 7.08 | 7.05 | 7.05 | **7.04** | 7.13 | **7.08** |
| NY Harbor 3-2-1 ($/bbl) | 7.83 | 5.28 | **8.24** | 6.43 | 8.10 | 7.50 | 6.38 | **7.10** | 7.15 | **7.28** |
| **Revenue** ($mm) | | | | | | | | | | |
| Natural Gas | 322 | 343 | **1,242** | 301 | 304 | 315 | 333 | **1,253** | 349 | **1,301** |
| Oil | 946 | 976 | **3,603** | 943 | 969 | 966 | 949 | **3,827** | 918 | **3,803** |
| Other | 4,546 | 4,793 | **17,615** | 4,793 | 4,793 | 4,793 | 4,793 | **19,174** | 4,793 | **19,174** |
| Total | 5,814 | 6,113 | **22,460** | 6,037 | 6,067 | 6,075 | 6,075 | **24,254** | 6,061 | **24,278** |
| **Expense** | | | | | | | | | | |
| Fixed | 227 | 305 | **975** | 305 | 305 | 230 | 230 | **1,071** | 230 | **909** |
| Variable | 227 | 305 | **975** | 288 | 295 | 296 | 297 | **1,176** | 293 | **891** |
| Other | 4,288 | 4,463 | **16,529** | 5,019 | 4,979 | 5,020 | 5,042 | **20,060** | 5,022 | **14,891** |
| **Ebitda** ($mm) | | | | | | | | | | |
| Exploration and Production | 815 | 709 | **2,895** | 651 | 673 | 755 | 755 | **2,834** | 744 | **2,927** |
| Other | 258 | 331 | **1,085** | 367 | 415 | 300 | 278 | **1,360** | 294 | **1,287** |
| Total Ebitda | 1,073 | 1,040 | **3,980** | 1,018 | 1,088 | 1,055 | 1,033 | **4,194** | 1,039 | **4,214** |
| Exploration | 21 | 7 | **59** | 7 | 7 | 7 | 7 | **28** | 7 | **28** |
| Deprec., Deplet., & Amort. | 220 | 252 | **904** | 252 | 252 | 252 | 252 | **1,008** | 252 | **1,008** |
| **Ebit** | 832 | 781 | **3,017** | 759 | 829 | 796 | 774 | **3,158** | 780 | **3,178** |
| Interest | 10 | 1 | **11** | 1 | 1 | 1 | 1 | **4** | 1 | **4** |
| **Ebt** | 822 | 780 | **3,006** | 758 | 828 | 795 | 773 | **3,154** | 779 | **3,174** |
| Income Tax | 281 | 242 | **968** | 265 | 290 | 278 | 270 | **1,104** | 273 | **1,111** |
| **Net Income ($mm)** | | | | | | | | | | |
| Exploration and Production | 411 | 389 | **1,487** | | | | | | | |
| Other | 130 | 186 | **600** | | | | | | | |
| Unallocated | 0 | (37) | **(49)** | | | | | | | |
| Total | 541 | 538 | **2,038** | 493 | 538 | 517 | 502 | **2,050** | 506 | **2,063** |
| **Shares** (millions) | 356 | 352 | **357** | 352 | 352 | 352 | 352 | **352** | 352 | **352** |
| Per share ($) | 1.52 | 1.53 | **5.71** | 1.40 | 1.53 | 1.47 | 1.43 | **5.83** | 1.44 | **5.87** |
| Ebitda Margin (E&P) | 64% | 54% | **60%** | 52% | 53% | 59% | 59% | **56%** | 59% | **57%** |
| Tax Rate | 34% | 31% | **32%** | 35% | 35% | 35% | 35% | **35%** | 35% | **35%** |

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 did in the latest quarter. Building more upgrading capacity is an obvious antidote, but the capital requirements are high and the lead time long.

**Imperial Oil Limited**
**Oil Production and Revenue**
(Canadian Dollars)

| | *Q1 3/31/03* | *Q2 6/30/03* | *Q3 9/30/03* | *Q4 12/31/03* | ***Year 2003*** | *Q1 3/31/04* | *Q2 6/30/04* | *Q3 9/30/04* | *Q4 12/31/04* | ***Year 2004*** |
|---|---|---|---|---|---|---|---|---|---|---|
| **Volume** | | | | | | | | | | |
| Oil (mbd) | | | | | | | | | | |
| Conventional | 36 | 36 | 35 | 35 | **35** | 34 | 34 | 32 | 32 | **33** |
| Cold Lake | 106 | 122 | 121 | 117 | **117** | 112 | 105 | 101 | 128 | **112** |
| Syncrude | 47 | 52 | 60 | 50 | **52** | 62 | 57 | 60 | 56 | **59** |
| Natural Gas Liquids | 21 | 19 | 23 | 26 | **22** | 28 | 26 | 26 | 26 | **26** |
| Total Oil | 210 | 229 | 239 | 228 | **227** | 236 | 222 | 219 | 242 | **230** |
| **Price** | | | | | | | | | | |
| Currency (US$/C$) | 0.66 | 0.72 | 0.72 | 0.76 | **0.71** | 0.76 | 0.74 | 0.77 | 0.82 | **0.77** |
| Oil (C$/bbl) | | | | | | | | | | |
| Light, Sweet (US$/bbl) | 34.03 | 29.07 | 30.22 | 31.19 | **31.13** | 35.23 | 38.34 | 43.89 | 48.30 | **41.44** |
| Light, Sweet (C$/bbl) | 51.37 | 40.65 | 41.97 | 41.04 | **43.76** | 46.41 | 52.09 | 57.30 | 58.92 | **53.68** |
| Conventional | 47.86 | 38.53 | 36.68 | 36.47 | **39.89** | 42.70 | 47.45 | 52.86 | 53.22 | **48.96** |
| Cold Lake (Hardisty) | 40.12 | 31.80 | 31.16 | 28.92 | **32.77** | 35.50 | 37.66 | 42.36 | 36.42 | **37.83** |
| Syncrude (Par Edmonton) | 51.68 | 42.39 | 41.53 | 40.09 | **43.65** | 46.81 | 51.35 | 56.99 | 58.19 | **53.25** |
| Natural Gas Liquids | 39.26 | 29.68 | 28.25 | 29.39 | **31.45** | 31.87 | 28.79 | 34.47 | 38.01 | **33.27** |
| Total Oil | 43.95 | 35.09 | 34.29 | 32.58 | **36.27** | 39.08 | 41.64 | 46.97 | 43.85 | **42.85** |
| Ratio: Cold Lake/Light Swt | 0.78 | 0.78 | 0.74 | 0.70 | 0.75 | 0.76 | 0.72 | 0.74 | 0.62 | 0.70 |
| **Revenue** (C$mm) | | | | | | | | | | |
| Conventional | 155 | 126 | 118 | 117 | **517** | 132 | 147 | 156 | 157 | **591** |
| Cold Lake | 383 | 353 | 347 | 311 | **1,394** | 362 | 360 | 394 | 429 | **1,544** |
| Syncrude | 219 | 201 | 229 | 184 | **833** | 264 | 266 | 315 | 300 | **1,145** |
| Natural Gas Liquids | 74 | 51 | 60 | 70 | **256** | 81 | 68 | 82 | 91 | **323** |
| Total Oil | 831 | 731 | 754 | 683 | **2,999** | 839 | 841 | 946 | 976 | **3,603** |

## Buy Oil and Gas Producers at Mid Decade

With the company's distinguished history and quality reputation, Imperial Oil stock ranks near the high end of our buy recommendations in a group that has appreciation potential (see table Rank by McDep Ratio). Three to five-fold gain potential for oil and gas price over the next 5 to 13 years justifies investment in recommended oil and gas producers, in our opinion. Supporting improving prospects, the average futures price of oil for continuous delivery over the next six years is in a multi-year uptrend as defined by the current quotes above the 40-week average. The current benchmark oil average futures price for the next six years is about $42 a barrel.

Kurt H. Wulff, CFA

**Oil and Gas Producers**
**Rank by McDep Ratio: Market Cap and Debt to Present Value**

| | Symbol/ | Rating | Price ($/sh) 4-Feb 2005 | Shares (mm) | Market Cap ($mm) | Net Present Value ($/sh) | Debt/ Present Value | McDep Ratio |
|---|---|---|---|---|---|---|---|---|
| **Producer/Refiners - Large Cap and Mid Cap** | | | | | | | | |
| Kinder Morgan, Inc. | KMI | S2 | 76.91 | 125 | 9,610 | 20.00 | 0.74 | 1.75 |
| Imperial Oil Limited (30%) | IMO | B3 | 65.56 | 105 | 6,910 | 64.00 | 0.11 | 1.02 |
| Marathon Oil Corporation | MRO | B3 | 40.50 | 347 | 14,070 | 42.00 | 0.30 | 0.98 |
| Norsk Hydro ASA | NHY | B1 | 78.30 | 254 | 19,900 | 101.00 | 0.16 | 0.81 |
| ConocoPhillips | COP | B1 | 96.22 | 706 | 67,900 | 128.00 | 0.22 | 0.81 |
| Petro-Canada | PCZ | B3 | 52.11 | 264 | 13,760 | 70.00 | 0.17 | 0.79 |
| Suncor Energy | SU | B3 | 33.82 | 460 | 15,560 | 54.00 | 0.10 | 0.66 |
| PetroChina Company Ltd (10%) | PTR | B2 | 56.65 | 176 | 9,960 | 94.00 | 0.05 | 0.62 |
| Lukoil Oil Company | LUKOY | B2 | 126.50 | 209 | 26,000 | 208.00 | 0.03 | 0.62 |
| *Total or Median* | | | | | *184,000* | | *0.16* | *0.81* |

B1 = Buy full unlevered position, B2 = Buy half unlevered position, B3 = Alternative buy, H = Hold
S2 = Short half unlevered position, S3 = Short quarter unlevered position
McDep Ratio = **M**arket **c**ap and **De**bt to **p**resent value of oil and gas and other businesses



**Certification:** I, Kurt H. Wulff, certify that the views expressed in this research analysis accurately reflect my personal views about the subject securities and issuers. No part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this research analysis.

**Research Methodology/Ratings Description:** McDep Associates is an independent research originator focused on oil and gas stocks exclusively. The firm applies the thirty 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 is compared with a company's stock market capitalization and debt. Stocks with low market cap and debt relative to present value tend to outperform stocks with high market cap and debt relative to present value. Buy recommendations are expected to deliver a total return better than 7% per year above inflation. Hold recommendations assume the attributes of the underlying business are reflected in the current price of the stock. Sell recommendations are expected to deliver a negative total return less than 7% per year including the effects of inflation.