

Rating: Buy
 S&P 500: 1173

Imperial Oil Limited Oil Sands Strategy

<i>Symbol</i>	IMO	<i>Ebitda Next Twelve Months ending 3/31/06 (US\$m)</i>	3,500
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	19
<i>Price (US\$/sh)</i>	70.47	<i>Natural Gas and Oil Production/Ebitda (%)</i>	73
<i>Pricing Date</i>	5/5/05	<i>Adjusted Reserves/Production NTM</i>	9.9
<i>Shares (mm)</i>	350	<i>EV/Ebitda</i>	7.8
<i>Market Capitalization (US\$m)</i>	24,600	<i>PV/Ebitda</i>	7.1
<i>Debt (US\$m)</i>	2,600	<i>Undeveloped Reserves (%)</i>	23
<i>Enterprise Value (EV) (US\$m)</i>	27,200	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	20.70
<i>Present Value (PV) (US\$m)</i>	25,000	<i>Present Value Proven Reserves(US\$/boe)</i>	13.26
<i>Net Present Value (US\$/share)</i>	64	<i>Present Value Proven Reserves(US\$/mcf)</i>	2.21
<i>Debt/Present Value</i>	0.10	<i>Earnings Next Twelve Months (US\$/sh)</i>	4.87
<i>McDep Ratio - EV/PV</i>	1.09	<i>Price/Earnings Next Twelve Months</i>	14
<i>Dividend Yield (%/year)</i>	1.0	<i>Indicated Annual Dividend (US\$/sh)</i>	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)**. Just as oil sands are Canada's most important energy resource, oil sands may be more than half the future potential of Imperial. Holding 25%, the company is the owner most responsible for the performance of Syncrude, Canada's largest oil sands project with current capacity of about 250,000 barrels daily. Imperial may file for regulatory approval this year to build a nearby 300,000 bd facility at Kearl where its share would be 70%. At its 100% owned Cold Lake oil sands project the company has boosted volume to 139,000 bd. Meanwhile the stock sports an unlevered cash flow multiple near 8 times that is high relative to producer/refiner peers, but still fundamentally low, in our opinion. Succeeding for 125 years, Canada's only AAA-rated industrial corporation will likely continue to reward investors 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 value we now carry for 35% Syncrude owner, **Canadian Oil Sands Trust (COSWF)**. An Imperial employee is the chief executive officer of the joint venture organization.

New Mine and Upgrader Contemplated at Kearl

Management confirms that the company's oil sands leases just north of Syncrude have enough resource to support a large mine and upgrader operation similar to that at Syncrude. Considering all the similar projects in more advanced planning by other companies, the Kearl facility would not likely start operation until the end of the next decade.

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Imperial Oil Limited
Functional Cash Flow and Present Value

	<i>NTM Ebitda</i> <i>(US\$mm)</i>	<i>Adjusted</i> <i>R/P</i>	<i>PV/</i> <i>Ebitda</i>	<i>Present</i> <i>Value</i> <i>(US\$mm)</i>	
North American Natural Gas	649	3.9	4.9	3,200	13%
Syncrude	880	20.0	8.3	7,300	29%
Oil	1,030	5.7	7.8	8,000	32%
Downstream	938		6.9	6,500	26%
	3,497	9.9	7.1	25,000	100%
Debt (US\$mm)					2,600
Net Present Value (US\$mm)					22,400
Shares (mm)					350
Net Present Value (US\$/sh)					64

Cold Lake Needs Upgrading

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.

The challenge at Cold Lake and for most of Canada's heavy oil producers is the availability of refining capacity to upgrade the raw material. A higher quality crude oil can be more readily turned into clean gasoline, jet and diesel fuel and heating oil. Again in the first quarter of 2005, the price of Cold Lake oil was low at a ratio of 0.65 to Light, Sweet Crude (see table [Oil Production and Revenue](#)).

Frontier Potential in North American Natural Gas Postponed

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 timing of construction continues to be delayed over land disputes involving the Canadian government and Arctic natives.

Cash Flow Gains Projected

Cash flow in future quarters seems likely to benefit from the continuing upward trend in oil price and a widening profit margin for refiners (see table [Next Twelve Months Operating and Financial Estimates](#)). Oil volumes reflect a recovery from the first quarter at Syncrude.

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Imperial Oil Limited
Oil Production and Revenue
 (Canadian Dollars)

	<i>Q2</i>	<i>Q3</i>	<i>Q4</i>	<i>Year</i>	<i>Q1</i>	<i>Q2</i>	<i>Q3</i>	<i>Q4</i>	<i>Year</i>	<i>Q1</i>
	<i>6/30/03</i>	<i>9/30/03</i>	<i>12/31/03</i>	<i>2003</i>	<i>3/31/04</i>	<i>6/30/04</i>	<i>9/30/04</i>	<i>12/31/04</i>	<i>2004</i>	<i>3/31/05</i>
Volume										
Oil (mbd)										
Conventional	36	35	35	35	34	34	32	32	33	31
Cold Lake	122	121	117	117	112	105	101	128	112	139
Syncrude	52	60	50	52	62	57	60	56	59	39
Natural Gas Liquids	19	23	26	22	28	26	26	26	26	24
Total Oil	229	239	228	227	236	222	219	242	230	233
Price										
Currency (US\$/C\$)	0.72	0.72	0.76	0.71	0.76	0.74	0.77	0.82	0.77	0.82
Oil (C\$/bbl)										
Light, Sweet (US\$/bbl)	29.07	30.22	31.19	31.13	35.23	38.34	43.89	48.31	41.44	49.65
Light, Sweet (C\$/bbl)	40.65	41.97	41.04	43.76	46.41	52.09	57.29	58.94	53.68	60.85
Conventional	38.53	36.68	36.47	39.89	42.70	47.45	52.86	53.22	48.96	58.28
Cold Lake (Hardisty)	31.80	31.16	28.92	32.77	35.50	37.66	42.36	36.42	37.83	39.49
Syncrude (Par Edmonton)	42.39	41.53	40.09	43.65	46.81	51.35	56.99	58.19	53.25	62.63
Natural Gas Liquids	29.68	28.25	29.39	31.45	31.87	28.79	34.47	38.01	33.27	35.27
Total Oil	35.09	34.29	32.58	36.27	39.08	41.64	46.97	43.85	42.85	45.43
Ratio: Cold Lake/Light Swt	0.78	0.74	0.70	0.75	0.76	0.72	0.74	0.62	0.70	0.65
Revenue (C\$m)										
Conventional	126	118	117	517	132	147	156	157	591	163
Cold Lake	353	347	311	1,394	362	360	394	429	1,544	494
Syncrude	201	229	184	833	264	266	315	300	1,145	220
Natural Gas Liquids	51	60	70	256	81	68	82	91	323	76
Total Oil	731	754	683	2,999	839	841	946	976	3,603	953

Buy Oil and Gas Producers at Mid Decade

Multi-fold gain potential for oil and gas price over the years ahead justifies investment in recommended oil and gas producers, in our opinion. A McDep Ratio of 1.0 implies that a stock is valued at present value assuming a constant real oil price of US\$40 (see table Rank by McDep Ratio). That is lower than the current benchmark oil average futures price for the next six years of about US\$50 a barrel. Moreover the average 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 of about \$42 a barrel.

Kurt H. Wulff, CFA

Imperial Oil Limited
Next Twelve Months Operations
 (Canadian Dollars)

	<i>Q3</i>	<i>Q4</i>	<i>Year</i>	<i>Q1</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Next Twelve Months</i>
	<i>9/30/04</i>	<i>12/31/04</i>	<i>2004</i>	<i>3/31/05</i>	<i>6/30/05</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>2005E</i>	<i>3/31/06</i>	<i>3/31/06</i>
Volume										
Natural Gas (mmcf)	533	524	500	522	522	522	522	522	522	522
Oil (mbd)	219	242	230	233	249	253	252	247	252	251
Total gas & oil (bcf)	170	182	688	173	184	188	187	731	183	741
Total gas & oil (mbd)	308	329	313	320	336	340	339	334	339	338
Price										
Natural gas (\$/mcf)										
Henry Hub (\$/mmbtu)	5.75	7.10	6.15	6.27	6.95	6.86	7.40	6.87	8.03	7.31
Currency (US\$/C\$)	0.77	0.82	0.77	0.82	0.80	0.80	0.80	0.80	0.80	0.80
Henry Hub (C\$/mmbtu)	7.51	8.66	7.98	7.68	8.72	8.61	9.29	8.57	10.08	9.18
Canada (C\$/mcf)	6.57	7.12	6.79	7.02	7.97	7.87	8.49	7.84	9.21	8.38
Oil (\$/bbl)										
WTI Cushing	43.89	48.31	41.44	49.65	51.72	53.22	53.86	52.11	53.61	53.10
WTI Cushing (C\$/bbl)	57.29	58.94	53.68	60.85	64.92	66.80	67.60	65.04	67.29	66.65
Worldwide	46.97	43.85	42.85	45.43	49.69	51.38	51.96	49.72	51.80	51.21
Total gas & oil (\$/mcf)	7.46	7.26	7.05	7.43	8.20	8.39	8.62	8.17	8.78	8.50
NY Harbor 3-2-1 (\$/bbl)	7.78	5.72	7.74	6.17	10.80	9.50	7.65	8.53	8.41	9.09
Revenue (\$mm)										
Natural Gas	322	343	1,242	331	379	378	408	1,496	433	1,597
Oil	946	976	3,603	953	1,128	1,195	1,205	4,480	1,173	4,701
Other	4,546	4,793	17,615	4,674	4,674	4,674	4,674	18,697	4,674	18,697
Total	5,814	6,113	22,460	5,958	6,181	6,247	6,288	24,673	6,280	24,995
Expense (\$mm)										
Fixed	227	305	975	360	330	330	330	1,350	330	1,009
Variable	227	305	975	360	422	441	452	1,676	450	1,036
Other	4,288	4,463	16,529	4,390	5,132	5,151	5,162	19,836	5,160	15,022
Ebitda (\$mm)										
Exploration and Production	815	709	2,895	564	754	802	831	2,950	825	3,212
Other	258	331	1,085	284	294	294	294	1,167	294	1,178
Total Ebitda	1,073	1,040	3,980	847	1,048	1,096	1,125	4,117	1,120	4,390
Exploration	21	7	59	21	21	21	21	84	21	84
Deprec., Deplet., & Amort.	220	252	904	238	252	252	252	994	252	1,008
Ebit										
	832	781	3,017	588	775	823	852	3,039	847	3,298
Interest	10	1	11	2	2	2	2	8	2	8
Ebt										
	822	780	3,006	586	773	821	850	3,031	845	3,290
Income Tax	281	242	968	195	271	287	298	1,051	296	1,151
Net Income (\$mm)										
Exploration and Production	411	389	1,487	242						
Other	130	186	600	146						
Unallocated	0	(37)	(49)	3						
Total	541	538	2,038	391	503	534	553	1,981	549	2,138
Shares (millions)										
Earnings per share (\$)	356	352	357	350	350	350	350	350	350	350
Ebitda Margin (E&P)	1.52	1.53	5.71	1.12	1.44	1.53	1.58	5.67	1.57	6.12
Ebitda Margin (E&P)	64%	54%	60%	44%	50%	51%	51%	49%	51%	51%
Tax Rate	34%	31%	32%	33%	35%	35%	35%	35%	35%	35%

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Rank by McDep Ratio: Market Cap and Debt to Present Value

	<i>Symbol/</i>		<i>Price</i>		<i>Market</i>	<i>Net</i>	<i>Debt/</i>	
	<i>Rating</i>		<i>(\$/sh)</i>	<i>Shares</i>	<i>Cap</i>	<i>Present</i>	<i>Present</i>	<i>McDep</i>
			<i>5-May</i>	<i>(mm)</i>	<i>(\$mm)</i>	<i>Value</i>	<i>Value</i>	<i>Ratio</i>
			<i>2005</i>			<i>(\$/sh)</i>		
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	76.30	125	9,540	20.00	0.74	1.74
Marathon Oil Corporation	MRO	B	48.09	349	16,760	42.00	0.30	1.10
Imperial Oil Limited (30%)	IMO	B	70.47	105	7,390	64.00	0.10	1.09
ConocoPhillips	COP	B	105.01	706	74,100	128.00	0.23	0.86
Petro-Canada	PCZ	B	57.03	263	15,020	70.00	0.19	0.85
Norsk Hydro ASA	NHY	B	79.20	252	19,980	101.00	0.16	0.82
Suncor Energy	SU	B	39.54	460	18,190	54.00	0.09	0.76
PetroChina Company Ltd (10%)	PTR	B	61.45	176	10,800	94.00	0.05	0.67
Lukoil Oil Company	LUKOY	B	33.90	834	28,000	52.00	0.03	0.66
<i>Total or Median</i>					<i>200,000</i>		<i>0.16</i>	<i>0.85</i>

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