

Rating: Buy  
 S&P 500: 1227

## Imperial Oil Limited Syncrude Boost

<i>Symbol</i>	IMO	<i>Ebitda Next Twelve Months ending 6/30/06 (US\$mm)</i>	4,300
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	19
<i>Price (US\$/sh)</i>	83.00	<i>Natural Gas and Oil Production/Ebitda (%)</i>	73
<i>Pricing Date</i>	7/21/05	<i>Adjusted Reserves/Production NTM</i>	10.5
<i>Shares (mm)</i>	345	<i>EV/Ebitda</i>	7.3
<i>Market Capitalization (US\$mm)</i>	28,700	<i>PV/Ebitda</i>	5.8
<i>Debt (US\$mm)</i>	2,800	<i>Undeveloped Reserves (%)</i>	24
<i>Enterprise Value (EV) (US\$mm)</i>	31,500	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	26.80
<i>Present Value (PV) (US\$mm)</i>	24,900	<i>Present Value Proven Reserves(US\$/boe)</i>	13.04
<i>Net Present Value (US\$/share)</i>	64	<i>Present Value Proven Reserves(US\$/mcf)</i>	2.17
<i>Debt/Present Value</i>	0.11	<i>Earnings Next Twelve Months (US\$/sh)</i>	6.65
<i>McDep Ratio - EV/PV</i>	1.26	<i>Price/Earnings Next Twelve Months</i>	12
<i>Dividend Yield (%/year)</i>	0.9	<i>Indicated Annual Dividend (US\$/sh)</i>	0.79

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)**. Holding 25%, IMO 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 (bd) undergoing expansion to 350,000 bd.. Near-capacity production at Syncrude in the latest quarter contributed mightily to record results for the company as a whole. Meanwhile, Imperial's McDep Ratio has reached the high end of the range for buy recommendations. Yet present value, the denominator of the McDep Ratio, may be low because it is tied to \$40 oil when the futures market is at more than \$56 for the next six years. Nor does present value reflect anything for a new oil sands plant and Arctic natural gas. 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 Single 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 has applied for provincial government approval to develop oil sands leases just north of Syncrude with a large mine and upgrader operation similar to that at Syncrude. While we thought initially that the Kearl facility would not likely start operation until the end of the next decade, management expects it to startup at the end of 2010.

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

	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>(US\$mm)</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
				<i>(US\$mm)</i>	
North American Natural Gas	821	4.2	3.9	3,200	13%
Syncrude	859	20.0	8.5	7,300	29%
Oil - Conventional and Cold Lake	1,459	10.3	5.4	7,900	32%
Downstream	1,149		5.7	6,500	26%
	4,289	10.5	5.8	24,900	100%
Debt (US\$mm)				2,800	
Net Present Value (US\$mm)				22,100	
Shares (mm)				345	
Net Present Value (US\$/sh)				64	

**Cold Lake Needs Upgrading**

Imperial's Cold Lake heavy oil production is from sands too deep to be mined. Syncrude recovers oil from sands mined on the surface. 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 second 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](#)).

In contrast, Syncrude output is valued at a premium to Light, Sweet. At expanded volumes, Syncrude revenues may exceed Cold Lake late next year.

**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 proven reserves could triple with the completion of a pipeline to the Arctic. The timing of construction continues to be delayed over the division of revenue between 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](#)). Refinery maintenance limited cash flow in the second quarter just completed.

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

	<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>Q2</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>	<i>6/30/05</i>
<b>Volume</b>										
Oil (mbd)										
Conventional	35	35	<b>35</b>	34	34	32	32	<b>33</b>	31	31
Cold Lake	121	117	<b>117</b>	112	105	101	128	<b>112</b>	139	121
Syncrude	60	50	<b>52</b>	62	57	60	56	<b>59</b>	39	58
Natural Gas Liquids	23	26	<b>22</b>	28	26	26	26	<b>26</b>	24	25
Total Oil	239	228	<b>227</b>	236	222	219	242	<b>230</b>	233	235
<b>Price</b>										
Currency (US\$/C\$)	0.72	0.76	<b>0.71</b>	0.76	0.74	0.77	0.82	<b>0.77</b>	0.82	0.82
Oil (C\$/bbl)										
Light, Sweet (US\$/bbl)	30.22	31.19	<b>31.13</b>	35.23	38.34	43.89	48.31	<b>41.44</b>	49.65	53.05
Light, Sweet (C\$/bbl)	41.97	41.04	<b>43.76</b>	46.41	52.09	57.29	58.94	<b>53.68</b>	60.85	64.62
Conventional	36.68	36.47	<b>39.89</b>	42.70	47.45	52.86	53.22	<b>48.96</b>	58.28	61.46
Cold Lake (Hardisty)	31.16	28.92	<b>32.77</b>	35.50	37.66	42.36	36.42	<b>37.83</b>	39.49	42.23
Syncrude (Par Edmonton)	41.53	40.09	<b>43.65</b>	46.81	51.35	56.99	58.19	<b>53.25</b>	62.63	66.56
Natural Gas Liquids	28.25	29.39	<b>31.45</b>	31.87	28.79	34.47	38.01	<b>33.27</b>	35.27	33.57
Total Oil	34.29	32.58	<b>36.27</b>	39.08	41.64	46.97	43.85	<b>42.85</b>	45.43	49.85
Ratio: Cold Lake/Light Swt	0.74	0.70	<b>0.75</b>	0.76	0.72	0.74	0.62	<b>0.70</b>	0.65	0.65
<b>Revenue (C\$m)</b>										
Conventional	118	117	<b>517</b>	132	147	156	157	<b>591</b>	163	173
Cold Lake	347	311	<b>1,394</b>	362	360	394	429	<b>1,544</b>	494	465
Syncrude	229	184	<b>833</b>	264	266	315	300	<b>1,145</b>	220	351
Natural Gas Liquids	60	70	<b>256</b>	81	68	82	91	<b>323</b>	76	76
Total Oil	754	683	<b>2,999</b>	839	841	946	976	<b>3,603</b>	953	1,066

**Buy Natural Gas and Oil Producer/Refiners**

Peer stocks appear priced at a median McDep Ratio of 0.90 (see table [Rank by McDep Ratio](#)). Since a McDep Ratio of 1.00 represents present value assuming a long-term oil price of US\$40 a barrel, the group appears to be valued at \$36 a barrel, or less. The long-term commodity price in the futures market is currently about \$56 a barrel.

More undervalued stocks have lower McDep Ratios. The rank with lowest on the bottom suggests buy low and sell high. Any temptation to think that Imperial's McDep Ratio is high is quickly dispelled considering the least undervalued peer has a McDep Ratio half again as high as Imperial.

Kurt H. Wulff, CFA

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

	<i>Q4</i>	<i>Year</i>	<i>Q1</i>	<i>Q2</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Next</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>6/30/06</i>	<i>Twelve</i>
										<i>Months</i>
										<i>6/30/06</i>
<b>Volume</b>										
Natural Gas (mmcf)	524	<b>500</b>	522	514	514	514	<b>516</b>	514	514	<b>514</b>
Oil (mbd)	242	<b>230</b>	233	235	236	236	<b>235</b>	235	235	<b>235</b>
Total gas & oil (bcf)	182	<b>688</b>	173	175	178	177	<b>703</b>	173	175	<b>703</b>
Total gas & oil (mbd))	329	<b>313</b>	320	321	322	321	<b>321</b>	321	320	<b>321</b>
<b>Price</b>										
Natural gas (\$/mcf)										
Henry Hub (\$/mmbtu)	7.10	<b>6.15</b>	6.27	6.76	7.21	7.99	<b>7.05</b>	8.82	7.62	<b>7.91</b>
Currency (US\$/C\$)	0.82	<b>0.77</b>	0.82	0.80	0.82	0.82	<b>0.82</b>	0.82	0.82	<b>0.82</b>
Henry Hub (C\$/mmbtu)	8.66	<b>7.98</b>	7.68	8.40	8.78	9.73	<b>8.65</b>	10.74	9.28	<b>9.63</b>
Canada (C\$/mcf)	7.12	<b>6.79</b>	7.02	7.71	8.05	8.92	<b>7.93</b>	9.85	8.51	<b>8.83</b>
Oil (\$/bbl)										
WTI Cushing	48.31	<b>41.44</b>	49.65	53.05	56.73	58.35	<b>54.45</b>	58.97	59.28	<b>58.33</b>
WTI Cushing (C\$/bbl)	58.94	<b>53.68</b>	60.85	65.99	69.10	71.07	<b>66.75</b>	71.82	72.20	<b>71.05</b>
Worldwide	43.85	<b>42.85</b>	45.43	49.85	53.43	54.92	<b>50.96</b>	55.64	55.91	<b>54.96</b>
Total gas & oil (\$/mcf)	7.26	<b>7.05</b>	7.43	8.15	8.68	9.09	<b>8.34</b>	9.43	9.10	<b>9.07</b>
NY Harbor 3-2-1 (\$/bbl)	5.72	<b>7.74</b>	6.17	10.59	12.43	7.81	<b>9.25</b>	9.12	11.49	<b>10.21</b>
<b>Revenue (\$mm)</b>										
Natural Gas	343	<b>1,242</b>	331	361	381	422	<b>1,495</b>	456	398	<b>1,657</b>
Oil	976	<b>3,603</b>	953	1,066	1,162	1,191	<b>4,372</b>	1,178	1,193	<b>4,724</b>
Other	4,793	<b>17,615</b>	4,674	5,375	5,375	5,375	<b>20,800</b>	5,375	5,375	<b>21,501</b>
Total	6,113	<b>22,460</b>	5,958	6,802	6,918	6,989	<b>26,667</b>	7,009	6,967	<b>27,882</b>
<b>Expense (\$mm)</b>										
Fixed	305	<b>975</b>	360	293	293	293	<b>1,239</b>	293	330	<b>972</b>
Variable	305	<b>975</b>	360	293	317	331	<b>1,301</b>	335	327	<b>912</b>
Other	4,463	<b>16,529</b>	4,390	5,172	5,635	5,650	<b>20,848</b>	5,654	5,682	<b>15,507</b>
<b>Ebitda (\$mm)</b>										
Exploration and Production	709	<b>2,895</b>	564	841	933	989	<b>3,326</b>	1,005	935	<b>3,861</b>
Other	331	<b>1,085</b>	284	203	350	350	<b>1,187</b>	350	350	<b>1,400</b>
Total Ebitda	1,040	<b>3,980</b>	847	1,044	1,283	1,339	<b>4,513</b>	1,355	1,285	<b>5,261</b>
Exploration	7	<b>59</b>	21	6	15	15	<b>57</b>	15	15	<b>60</b>
Deprec., Deplet., & Amort.	252	<b>904</b>	238	219	219	219	<b>895</b>	219	219	<b>876</b>
<b>Ebit</b>	781	<b>3,017</b>	588	819	1,049	1,105	<b>3,561</b>	1,121	1,051	<b>4,325</b>
Interest	1	<b>11</b>	2	6	6	6	<b>20</b>	6	6	<b>24</b>
<b>Ebt</b>	780	<b>3,006</b>	586	813	1,043	1,099	<b>3,541</b>	1,115	1,045	<b>4,301</b>
Income Tax	242	<b>968</b>	195	274	365	385	<b>1,219</b>	390	366	<b>1,506</b>
<b>Net Income (\$mm)</b>										
Exploration and Production	389	<b>1,487</b>	242	449						
Other	186	<b>600</b>	146	93						
Unallocated	(37)	<b>(49)</b>	3	(3)						
Total	538	<b>2,038</b>	391	539	678	714	<b>2,322</b>	725	679	<b>2,796</b>
<b>Shares (millions)</b>	352	<b>357</b>	350	345	345	345	<b>346</b>	345	345	<b>345</b>
Earnings per share (\$)	1.53	<b>5.71</b>	1.12	1.56	1.96	2.07	<b>6.71</b>	2.10	1.97	<b>8.10</b>
Ebitda Margin (E&P)	54%	<b>60%</b>	44%	59%	60%	61%	<b>57%</b>	62%	59%	<b>61%</b>
Tax Rate	31%	<b>32%</b>	33%	34%	35%	35%	<b>34%</b>	35%	35%	<b>35%</b>

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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>Rating</i>		<i>(\$/sh)</i>	<i>Shares</i>	<i>Cap</i>	<i>Present</i>	<i>Debt/</i>	<i>McDep</i>
			<i>21-Jul</i>	<i>(mm)</i>	<i>(\$mm)</i>	<i>Value</i>	<i>Present</i>	<i>Ratio</i>
			<i>2005</i>			<i>(\$/sh)</i>	<i>Value</i>	
<b>Producer/Refiners - Large Cap and Mid Cap</b>								
Kinder Morgan, Inc.	KMI	S2	88.00	123	10,830	20.00	0.76	1.83
Imperial Oil Limited (30%)	IMO	B	83.00	104	8,600	64.00	0.11	1.26
Marathon Oil Corporation	MRO	B	55.92	367	20,520	42.00	0.29	1.23
Petro-Canada	PCZ	B	68.27	263	17,980	70.00	0.20	0.98
Suncor Energy	SU	B	47.75	461	22,020	54.00	0.11	0.90
ConocoPhillips	COP	B	60.03	1,420	85,200	70.00	0.21	0.89
Norsk Hydro ASA	NHY	B	95.71	251	24,010	110.00	0.13	0.89
PetroChina Company Ltd (10%)	PTR	B	82.90	176	14,570	94.00	0.05	0.89
Lukoil Oil Company	LUKOY	B	39.65	830	33,000	52.00	0.02	0.77
	<i>Total or Median</i>					<i>237,000</i>	<i>0.13</i>	<i>0.90</i>

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