

Rating: Buy
 S&P 500: 1189

Petro-Canada

Raise Net Present Value to \$70 a Share

<i>Symbol</i>	PCZ	<i>Ebitda Next Twelve Months ending 3/31/06 (US\$m)</i>	3,700
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	19
<i>Price (US\$/sh)</i>	51.80	<i>Natural Gas and Oil Production/Ebitda (%)</i>	83
<i>Pricing Date</i>	2/1/05	<i>Adjusted Reserves/Production NTM</i>	7.6
<i>Shares (mm)</i>	264	<i>EV/Ebitda</i>	4.8
<i>Market Capitalization (US\$m)</i>	13,700	<i>PV/Ebitda</i>	6.1
<i>Debt (US\$m)</i>	3,900	<i>Undeveloped Reserves (%)</i>	23
<i>Enterprise Value (EV) (US\$m)</i>	17,600	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	24.80
<i>Present Value (PV) (US\$m)</i>	22,400	<i>Present Value Proven Reserves(US\$/boe)</i>	20.00
<i>Net Present Value (US\$/share)</i>	70	<i>Present Value Proven Reserves(US\$/mcf)</i>	3.30
<i>Debt/Present Value</i>	0.17	<i>Earnings Next Twelve Months (US\$/sh)</i>	5.29
<i>McDep Ratio - EV/PV</i>	0.79	<i>Price/Earnings Next Twelve Months</i>	10
<i>Dividend Yield (%/year)</i>	0.9	<i>Indicated Annual Dividend (US\$/sh)</i>	0.49

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 **Petro-Canada (PCZ)** as we raise our estimate of net present value for the producer/refiner to \$70 a share from \$68. Though well above current stock price, present value is up less than expected considering we revised our estimate of long-term oil price on January 26, 2005 to \$40 a barrel constant real, up from \$35. Some of the company's natural gas and oil production seemed to get less price gain in the last quarter than suggested by the benchmark grades traded in the futures market. We see 35% stock price appreciation potential to net present value where the stock would then offer a continuing unlevered real return of some 7% per year at normal risk.

Five Core Areas in Four Businesses

The company defines itself and reports financial results in five core areas, North American Natural Gas, Canada East Coast Oil, International, Downstream and Oil Sands. North American Natural Gas and Downstream match our functional distinctions while we look at the remaining three areas as two functional distinctions, oil and overseas natural gas (see table Functional Cash Flow and Present Value).

The recent acquisition of Prima Energy, the U.S. Rocky Mountain producer, lengthened the reserve life for the premium gas business (see column headed "Adjusted R/P"). Discoveries in the MacKenzie Delta would also lengthen life when transformed to reserves as a proposed Arctic pipeline project proceeds after imminent approval. Liquefied Natural Gas plans for Overseas Natural Gas would also involve more sustainable production.

In oil production, Petro-Canada is reaping the reward from East Coast oil where it erected the "Eighth Wonder of the World", the Hibernia concrete platform built to withstand collision with an iceberg. A second field, Terra Nova, is producing at normal rates again after suffering some

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downtime in the fourth quarter. International oil prospects were strengthened last year with the acquisition of the Buzzard discovery in the North Sea from Encana.

Petro-Canada
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	686	8.9	7.3	5,000	22%
Overseas Natural Gas	200	5.5	5.0	1,000	4%
Oil	2,133	7.3	5.9	12,500	56%
Downstream	639		6.1	3,900	17%
	3,658	7.6	6.1	22,400	100%
Debt (US\$mm)				3,900	
Net Present Value (US\$mm)				18,500	
Shares (mm)				264	
Net Present Value (US\$/sh)				70	

Oil Sands include Petro-Canada's twelve percent ownership of Syncrude, a valuable long-life asset that recovers oil from sands mined on the surface. In addition, the company has some current production and ambitious plans to recover oil from sands too deep to be mined. Those resources are susceptible to in-situ production by the SAGD, Steam-Assisted Gravity Drainage technique. Ironically there was a brief period during the last quarter when the price of heavy oil in Canada was so much below light oil that SAGD projects operated at a cash loss.

Downstream is linked to oil sands in a billion dollar effort to upgrade the company's Edmonton refinery. By providing processing for its future heavy oil production Petro-Canada 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. That happened to a degree in the last quarter as downstream profits were better than projected.

A Year of Building in 2005

Our normal projection of flat volume may be slightly optimistic for PetroCanada in 2005 (see table [Next Twelve Months Operating and Financial Estimates](#)). Management prepares investors for a slight decline before stronger gains in 2006.

Buy Oil and Gas Producers at Mid Decade

PetroCanada stock appears to offer competitive value in an attractive group for investment (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.

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Petro-Canada
Next Twelve Months Operating and Financial Estimates
(Canadian Dollars)

	<i>Q3</i>	<i>Q4</i>	<i>Year</i>	<i>Q1E</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)										
U.S. (or North America)	521	556	529	530	525	519	514	522	509	517
Overseas	130	119	139	174	172	171	169	171	174	171
Total	651	675	669	704	697	690	683	693	683	688
Oil (mbd)	227	227	239	225	222	220	218	221	216	219
Total gas & oil (mbd)	336	340	351	342	339	335	332	337	330	334
Price										
Natural gas (\$/mcf)										
Henry Hub (US\$/mmbtu)	5.75	7.10	6.15	6.28	6.33	6.44	6.77	6.46	7.24	6.70
Currency (US\$/C\$)	0.77	0.82	0.77	0.82	0.82	0.82	0.82	0.82	0.82	0.82
Henry Hub (C\$/mmbtu)	7.52	8.65	7.98	7.69	7.75	7.88	8.29	7.90	8.86	8.20
U.S. (or North America)	6.60	6.89	6.72	6.12	6.17	6.27	6.60	6.29	7.05	6.52
Overseas	5.00	5.83	5.30	5.80	5.91	5.80	5.67	5.79	5.54	5.73
Total	6.28	6.70	6.43	6.04	6.11	6.16	6.37	6.17	6.67	6.32
Oil (\$/bbl)										
WTI Cushing (US\$/bbl)	43.89	48.30	41.44	48.02	48.95	48.09	47.00	48.02	45.93	47.49
WTI Cushing (C\$/bbl)	57.38	58.90	53.69	58.79	59.92	58.87	57.53	58.78	56.22	58.14
Worldwide	52.43	48.41	46.92	48.32	49.25	48.39	47.29	48.31	46.21	47.80
Total gas & oil (\$/bbl)	45.72	43.65	42.17	41.22	41.92	41.51	41.30	41.49	41.15	41.47
NY Harbor 3-2-1 (\$/bbl)	7.83	5.44	8.31	7.89	9.40	8.46	7.36	8.28	9.60	8.71
Revenue (\$mm)										
Natural Gas										
U.S. (or North America)	316	352	1,301	292	295	300	312	1,199	323	1,230
Overseas	60	64	269	91	93	91	88	363	87	359
Total	376	416	1,570	383	387	391	400	1,561	410	1,589
Oil	1,095	1,011	4,107	977	997	980	949	3,904	898	3,824
Downstream	2,459	2,506	9,434	2,506	2,506	2,506	2,506	10,024	2,506	10,024
Other	(308)	(216)	(734)	(216)	(216)	(216)	(216)	(865)	(216)	(865)
Total	3,622	3,717	14,377	3,650	3,674	3,661	3,639	14,624	3,598	14,572
Expense (\$mm)										
Upstream	434	442	1,661	432	436	434	427	1,729	420	1,717
Downstream	2,328	2,294	8,680	2,316	2,298	2,298	2,336	9,247	2,310	9,242
Other	(308)	(216)	(734)	(216)	(216)	(216)	(216)	(865)	(216)	(865)
Total	2,454	2,520	9,607	2,532	2,517	2,515	2,547	10,111	2,514	10,094
Ebitda (\$mm)										
Upstream	1,037	985	4,016	928	949	937	922	3,736	888	3,696
Downstream	131	212	754	190	208	208	170	777	196	782
Total	1,168	1,197	4,770	1,118	1,157	1,146	1,092	4,513	1,083	4,478
Exploration	49	76	235	76	76	76	76	304	76	304
Deprec., Deplet., & Amort.										
Upstream	283	280	1,125	280	280	280	280	1,120	280	1,120
Downstream	69	72	277	72	72	72	72	288	72	288
Other		40								
Total	352	392	1,442	352	352	352	352	1,408	352	1,408
Ebit	767	729	3,093	690	729	718	664	2,801	655	2,766
Interest	33	34	142	34	34	34	34	136	34	136
Ebt	734	695	2,951	656	695	684	630	2,665	621	2,630
Income Tax	257	243	1,033	230	243	239	221	933	217	921
Net Income (\$mm)										
Upstream	451	378								
Downstream	40	91								
Other	(14)	(17)								
Total	477	452	1,918	426	452	444	410	1,732	404	1,710
Shares (millions)	269	264	266	264	264	264	264	264	264	264
Per share (\$)	1.77	1.71	7.20	1.61	1.71	1.68	1.55	6.56	1.53	6.47
Ebitda Margin (E&P)	73%	72%	74%	73%	73%	73%	73%	73%	73%	73%
Tax Rate	35%	35%	35%	35%	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>Rating</i>	<i>Price</i> <i>(\$/sh)</i>	<i>Shares</i>	<i>Market</i>	<i>Net</i>	<i>Debt/</i>	<i>McDep</i>
			<i>1-Feb</i>	<i>(mm)</i>	<i>Cap</i>	<i>Present</i>	<i>Present</i>	<i>Ratio</i>
			<i>2005</i>		<i>(\$mm)</i>	<i>Value</i>	<i>Value</i>	
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	75.18	125	9,400	20.00	0.74	1.72
Imperial Oil Limited (30%)	IMO	B3	62.99	105	6,640	64.00	0.11	0.99
Marathon Oil Corporation	MRO	B3	39.18	347	13,610	42.00	0.30	0.95
Norsk Hydro ASA	NHY	B1	78.10	254	19,850	101.00	0.16	0.81
ConocoPhillips	COP	B1	94.61	706	66,800	128.00	0.22	0.80
Petro-Canada	PCZ	B3	51.80	264	13,680	70.00	0.17	0.79
Suncor Energy	SU	B3	33.37	460	15,350	54.00	0.10	0.65
PetroChina Company Ltd (10%)	PTR	B2	55.76	176	9,800	94.00	0.05	0.61
Lukoil Oil Company	LUKOY	B2	124.75	209	26,000	208.00	0.03	0.61
<i>Total or Median</i>					<i>181,000</i>		<i>0.16</i>	<i>0.80</i>

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 = Market cap and Debt to present value of oil and gas and other businesses

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