

Rating: Buy
 S&P 500: 1152

Petro-Canada Oil Sands Strategy

<i>Symbol</i>	PCZ	<i>Ebitda Next Twelve Months ending 3/31/06 (US\$mm)</i>	4,600
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	18
<i>Price (US\$/sh)</i>	57.26	<i>Natural Gas and Oil Production/Ebitda (%)</i>	82
<i>Pricing Date</i>	4/26/05	<i>Adjusted Reserves/Production NTM</i>	6.7
<i>Shares (mm)</i>	263	<i>EV/Ebitda</i>	4.2
<i>Market Capitalization (US\$mm)</i>	15,100	<i>PV/Ebitda</i>	4.9
<i>Debt (US\$mm)</i>	4,400	<i>Undeveloped Reserves (%)</i>	19
<i>Enterprise Value (EV) (US\$mm)</i>	19,500	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	30.20
<i>Present Value (PV) (US\$mm)</i>	22,900	<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>	0.19	<i>Earnings Next Twelve Months (US\$/sh)</i>	7.60
<i>McDep Ratio - EV/PV</i>	0.85	<i>Price/Earnings Next Twelve Months</i>	8
<i>Dividend Yield (%/year)</i>	0.8	<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 the company generates a high rate of cash flow currently and develops longer-life assets. During the past quarter PCZ committed to 60% of the Fort Hills oil sands mining project that would produce more than 100,000 barrels daily after 2010. Meanwhile production has resumed at the capacity rate of 250,000 barrels daily for Syncrude, the oil sands mining and upgrading project owned 12% by PCZ. Steep price discounts for the output of an *in situ* oil sands project prove the value of PCZ's C\$2.6 billion program to equip its Edmonton refinery to upgrade heavy oil. Oil sands forms just part of the resource potential for which we estimate a net present value of US\$70 a share for Petro-Canada stock. Risks include operating reliability and oil price.

Four "Oil Sands" Projects

When Sun Oil Company built the first plant 40 years ago to extract oil from the Athabasca Tar Sands the facility was named Great Canadian Oil Sands. When the investment became profitable about 20 years ago, the cleaner sounding "oil sands" connoted a commercially valuable resource and became the preferred descriptor for the "tar sands". Along the way Great Canadian Oil Sands became Suncor and was joined by Syncrude as the second profit making plant. Once a larger percentage holder, Petro-Canada now has 12% of Syncrude worth about US\$3.5 billion in present value.

Suncor and Syncrude are both mining/upgrading projects. The oil sands lie near the surface and are scooped up by giant shovels and loaded into large trucks for processing. A third oil sands mining project owned by Shell, Chevron and Western Oil Sands is operating and several are in the planning or early construction stages. On March 1, Petro-Canada announced that it was assuming operating responsibility and 60% ownership of the Fort Hills oil sands project. The

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second mining project for PCZ would be adjacent to the Syncrude Aurora mine. Fort Hill would not be producing until after 2010.

The same oil sands that are mined by Suncor and Syncrude are deposited deeper over a wide area where mining is uneconomic. Also called oil sands now, the deeper deposits can be produced *in situ* by heating the formation with steam. Petro-Canada has such a project it calls MacKay River where it uses the SAGD (Steam Assisted Gravity Drainage) technique. As evident by a well head price of only C\$10 a barrel recently, there appears to be a temporary oversupply of heavy oil produced from deeper oil sands.

Fortunately PCZ has anticipated such conditions and is investing C\$2.6 billion to equip its Edmonton refinery to take heavy oil feedstock and turn it into light, sweet crude oil or refined products. We might say that the refinery project is Petro-Canada's fourth "oil sands" profit center. In a broader sense the growing supply of oil from oil sands creates demand for more refining in Canada and the U.S. The company also contemplates investing in a coker to break up heavy oil in its other refining center in Montreal.

Oil sands along with East Coast Oil and International make up the oil production segment that accounts for 53% of the value of the company (see table Functional Cash Flow and Present Value). Downstream, becoming increasingly linked to oil sands, accounts for 22%.

Petro-Canada					
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	851	8.1	5.9	5,000	22%
Overseas Natural Gas	216	5.0	3.7	800	4%
Oil	2,740	6.4	4.4	12,000	53%
Downstream	831		6.0	5,000	22%
	4,639	6.7	4.9	22,800	100%
Debt (US\$mm)					4,400
Net Present Value (US\$mm)					18,400
Shares (mm)					263
Net Present Value (US\$/sh)					70

Further Gains Anticipated

Oil and natural gas price increases that developed during the first quarter of 2005 may be fully effective in future quarters (see table Next Twelve Months Operating and Financial Estimates). Similarly refining profit margin expectations that increased only in the past month may be fully effective in future quarters. While expectations can change quickly the current futures prices point to continuing gains in cash flow.

Petro-Canada
Next Twelve Months Operating and Financial Estimates
 (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)										
U.S. (or North America)	521	556	529	534	529	523	518	526	513	521
Overseas	130	119	139	158	156	155	153	156	158	156
Total	651	675	669	692	685	678	671	682	671	676
Oil (mbd)	227	227	239	226	236	233	231	232	229	232
Total gas & oil (mbd)	336	340	351	341	350	346	343	345	341	345
Price										
Natural gas (\$/mcf)										
Henry Hub (US\$/mmbtu)	5.75	7.10	6.15	6.27	7.23	7.37	7.86	7.18	8.53	7.75
Currency (US\$/C\$)	0.77	0.82	0.77	0.82	0.81	0.81	0.81	0.81	0.81	0.81
Henry Hub (C\$/mmbtu)	7.52	8.65	7.98	7.68	8.92	9.08	9.70	8.84	10.52	9.55
U.S. (or North America)	6.60	6.89	6.72	6.67	7.75	7.89	8.42	7.68	9.13	8.29
Overseas	5.00	5.83	5.30	6.25	6.82	7.09	7.17	6.83	7.10	7.04
Total	6.28	6.70	6.43	6.57	7.54	7.71	8.13	7.49	8.65	8.00
Oil (\$/bbl)										
WTI Cushing (US\$/bbl)	43.89	48.31	41.44	49.65	54.19	56.35	56.92	54.28	56.38	55.96
WTI Cushing (C\$/bbl)	57.37	58.91	53.70	60.85	66.84	69.50	70.21	66.85	69.53	69.02
Worldwide	52.43	48.41	46.92	52.76	57.96	60.26	60.88	58.03	60.29	59.84
Total gas & oil (\$/bbl)	45.72	43.65	42.17	45.37	50.75	52.52	53.74	50.63	54.25	52.80
NY Harbor 3-2-1 (\$/bbl)	7.78	5.72	7.74	6.17	12.35	10.59	8.75	9.47	9.23	10.23
Revenue (\$mm)										
Natural Gas										
U.S. (or North America)	316	352	1,301	321	373	380	401	1,475	422	1,576
Overseas	60	64	269	89	97	101	101	388	101	400
Total	376	416	1,570	409	470	481	503	1,863	523	1,976
Oil	1,095	1,011	4,107	1,073	1,243	1,294	1,294	4,904	1,241	5,072
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)	(607)	(607)	(607)	(607)	(2,426)	(607)	(2,426)
Total	3,622	3,717	14,377	3,382	3,612	3,674	3,696	14,365	3,663	14,646
Expense (\$mm)										
Upstream	434	442	1,661	536	578	588	596	2,298	590	2,352
Downstream	2,328	2,294	8,680	2,279	2,166	2,166	2,336	8,946	2,331	8,999
Other	(308)	(216)	(734)	(607)	(607)	(607)	(607)	(2,426)	(607)	(2,426)
Total	2,454	2,520	9,607	2,209	2,137	2,147	2,325	8,818	2,315	8,924
Ebitda (\$mm)										
Upstream	1,037	985	4,016	946	1,135	1,186	1,201	4,469	1,174	4,696
Downstream	131	212	754	227	340	340	170	1,078	175	1,025
Total	1,168	1,197	4,770	1,173	1,475	1,527	1,371	5,546	1,348	5,722
Exploration	49	76	235	82	82	82	82	328	82	328
Deprec., Deplet., & Amort.										
Upstream	283	280	1,125	295	295	295	295	1,180	295	1,180
Downstream	69	72	277	53	53	53	53	212	53	212
Other		40								
Total	352	392	1,442	348	348	348	348	1,392	348	1,392
Ebit (\$mm)										
Upstream	767	729	3,093	743	1,045	1,097	941	3,826	918	4,002
Interest	33	34	142	34	34	34	34	136	34	136
Ebt (\$mm)										
Upstream	734	695	2,951	709	1,011	1,063	907	3,690	884	3,866
Income Tax	257	243	1,033	248	354	372	317	1,292	309	1,353
Net Income (\$mm)										
Upstream	451	378		53						
Downstream	40	91		113						
Other	(14)	(17)		295						
Total	477	452	1,918	461	657	691	590	2,399	575	2,513
Shares (millions)										
Upstream	269	264	266	263	263	263	263	263	263	263
Per share (\$)	1.77	1.71	7.20	1.75	2.50	2.62	2.24	9.11	2.18	9.54
Ebitda Margin (E&P)	73%	72%	74%	68%	70%	71%	71%	70%	71%	71%
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%

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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](#)). Multi-fold gain potential for oil and gas price over the years ahead 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 US\$52 a barrel. A McDep Ratio of 1.0 implies that a stock is valued at present value assuming a constant real oil price of US\$40.

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>McDep</i>		
	<i>Rating</i>	<i>(\$/sh)</i>	<i>Cap</i>	<i>Present</i>	<i>Present</i>	<i>Ratio</i>		
		<i>26-Apr</i>	<i>(\$mm)</i>	<i>Value</i>	<i>Value</i>			
		<i>2005</i>	<i>(mm)</i>	<i>(\$/sh)</i>				
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	77.00	125	9,630	20.00	0.74	1.75
Imperial Oil Limited (30%)	IMO	B	73.84	105	7,790	64.00	0.11	1.14
Marathon Oil Corporation	MRO	B	47.88	347	16,630	42.00	0.30	1.10
ConocoPhillips	COP	B	106.75	706	75,400	128.00	0.23	0.87
Norsk Hydro ASA	NHY	B	84.10	252	21,220	101.00	0.16	0.86
Petro-Canada	PCZ	B	57.26	263	15,080	70.00	0.19	0.85
Suncor Energy	SU	B	37.40	460	17,200	54.00	0.10	0.72
Lukoil Oil Company	LUKOY	B	140.00	209	29,000	208.00	0.03	0.68
PetroChina Company Ltd (10%)	PTR	B	62.11	176	10,920	94.00	0.05	0.68
<i>Total or Median</i>					<i>203,000</i>		<i>0.16</i>	<i>0.86</i>

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