Rating: Buy
S&P 500: 1228

# Petro-Canada
## Approaching Par

| | | | |
|---|---|---|---|
| *Symbol* | PCZ | *Ebitda Next Twelve Months ending 6/30/06 (US$mm)* | 4,900 |
| *Rating* | Buy | *North American Natural Gas/Ebitda (%)* | 17 |
| *Price (US$/sh)* | 69.25 | *Natural Gas and Oil Production/Ebitda (%)* | 79 |
| *Pricing Date* | 7/22/05 | *Adjusted Reserves/Production NTM* | 6.7 |
| *Shares (mm)* | 263 | *EV/Ebitda* | 4.6 |
| *Market Capitalization (US$mm)* | 18,200 | *PV/Ebitda* | 4.7 |
| *Debt (US$mm)* | 4,500 | *Undeveloped Reserves (%)* | 19 |
| *Enterprise Value (EV) (US$mm)* | 22,700 | *Natural Gas and Oil Ebitda (US$/boe)* | 30.90 |
| *Present Value (PV) (US$mm)* | 22,900 | *Present Value Proven Reserves(US$/boe)* | 20.00 |
| *Net Present Value (US$/share)* | 70 | *Present Value Proven Reserves(US$/mcfe)* | 3.30 |
| *Debt/Present Value* | 0.20 | *Earnings Next Twelve Months (US$/sh)* | 8.02 |
| *McDep Ratio - EV/PV* | 0.99 | *Price/Earnings Next Twelve Months* | 9 |
| *Dividend Yield (%/year)* | 0.7 | *Indicated Annual Dividend (US$/sh)* | 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. McDep Ratio is approaching 1.00 implying that stock price is near net present value of $70 a share. Yet present value may be low because it is tied to $40 oil when the futures market is at more than $56 for the next six years. Accounting for about 15% of present value, the company's 12% ownership of the Syncrude oil sands facility is likely helping the sequential earnings trend for the quarter just ended to be reported on July 28. Syncrude expects to commission a 40% capacity expansion just a year from now. Present value includes no recognition for PCZ's 60% of the Fort Hills oil sands mining project that would produce more than 100,000 barrels daily after 2010. 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. Risks in the stock include operating reliability and oil price.

### Typical Weighting in Oil, Natural Gas and Downstream

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%.

### Cash Flow Trends May Continue

Oil and natural gas price increases that developed recently may be fully effective in future quarters (see table Next Twelve Months Operating and Financial Estimates). Similarly refining profit margin expectations that increased recently 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**
**Functional Cash Flow and Present Value**

| | *NTM Ebitda (US$mm)* | *Adjusted R/P* | *PV/ Ebitda* | *Present Value (US$mm)* | |
|---|---|---|---|---|---|
| North American Natural Gas | 846 | 8.2 | 5.9 | 5,000 | 22% |
| Rest of World Natural Gas | 224 | 5.0 | 3.6 | 800 | 3% |
| Oil | 2,817 | 6.3 | 4.3 | 12,100 | 53% |
| Downstream | 1,015 | | 4.9 | 5,000 | 22% |
| | 4,903 | 6.7 | 4.7 | 22,900 | 100% |
| Debt (US$mm) | | | | | 4,500 |
| Net Present Value (US$mm) | | | | | 18,400 |
| Shares (mm) | | | | | 263 |
| Net Present Value (US$/sh) | | | | | 70 |

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

Peer stocks appear priced at a median McDep Ratio of 0.92 (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 $37 a barrel, or less. The long-term commodity price in the futures market is currently about $57 a barrel.

More undervalued stocks have lower McDep Ratios. The rank with lowest on the bottom suggests buy low and sell high.

Kurt H. Wulff, CFA

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

| | *Q4* *12/31/04* | ***Year*** ***2004*** | *Q1* *3/31/05* | *Q2E* *6/30/05* | *Q3E* *9/30/05* | *Q4E* *12/31/05* | ***Year*** ***2005E*** | *Q1E* *3/31/06* | *Q2E* *6/30/06* | ***Next Twelve Months*** ***6/30/06*** |
|---|---|---|---|---|---|---|---|---|---|---|
| **Volume** | | | | | | | | | | |
| Natural gas (bcf) | | | | | | | | | | |
| U.S. (or North America) | 51 | **194** | 48 | 48 | 48 | 48 | **192** | 46 | 46 | **188** |
| Overseas | 11 | **51** | 14 | 14 | 14 | 14 | **57** | 14 | 14 | **57** |
| Total | 62 | **244** | 62 | 62 | 62 | 62 | **249** | 60 | 60 | **245** |
| Natural Gas (mmcfd) | | | | | | | | | | |
| U.S. (or North America) | 556 | **529** | 534 | 529 | 523 | 518 | **526** | 513 | 508 | **516** |
| Overseas | 119 | **139** | 158 | 156 | 155 | 153 | **156** | 158 | 156 | **156** |
| Total | 675 | **669** | 692 | 685 | 678 | 671 | **682** | 671 | 664 | **671** |
| Days | 92 | **366** | 90 | 91 | 92 | 92 | **365** | 90 | 91 | **365** |
| Oil (mmb) | 20.9 | **87.5** | 20.3 | 21.5 | 21.5 | 21.3 | **84.5** | 20.6 | 21.7 | **85.0** |
| Oil (mbd) | 227 | **239** | 226 | 236 | 233 | 231 | **232** | 229 | 238 | **233** |
| Total gas & oil (mmb) | 31.2 | **128.3** | 30.7 | 31.8 | 31.9 | 31.6 | **126.0** | 30.7 | 31.8 | **125.8** |
| Total gas & oil (mbd) | 340 | **351** | 341 | 350 | 346 | 343 | **345** | 341 | 349 | **345** |
| **Price** | | | | | | | | | | |
| Natural gas ($/mcf) | | | | | | | | | | |
| Henry Hub (US$/mmbtu) | 7.10 | **6.15** | 6.27 | 6.76 | 7.21 | 7.99 | **7.05** | 8.82 | 7.62 | **7.91** |
| Currency (US$/C$) | 0.82 | **0.77** | 0.82 | 0.82 | 0.82 | 0.82 | **0.82** | 0.82 | 0.82 | **0.82** |
| Henry Hub (C$/mmbtu) | 8.65 | **7.98** | 7.68 | 8.23 | 8.78 | 9.73 | **8.61** | 10.74 | 9.28 | **9.63** |
| U.S. (or North America) | 6.89 | **6.72** | 6.67 | 7.15 | 7.63 | 8.45 | **7.47** | 9.33 | 8.06 | **8.36** |
| Overseas | 5.83 | **5.30** | 6.25 | 6.68 | 7.14 | 7.35 | **6.85** | 7.42 | 7.46 | **7.34** |
| Total | 6.70 | **6.43** | 6.57 | 7.04 | 7.52 | 8.20 | **7.33** | 8.88 | 7.92 | **8.12** |
| Oil ($/bbl) | | | | | | | | | | |
| WTI Cushing (US$/bbl) | 48.31 | **41.44** | 49.65 | 53.05 | 56.73 | 58.35 | **54.45** | 58.97 | 59.28 | **58.33** |
| WTI Cushing (C$/bbl) | 58.91 | **53.70** | 60.85 | 64.62 | 69.10 | 71.07 | **66.41** | 71.82 | 72.20 | **71.05** |
| Worldwide | 48.41 | **46.92** | 52.76 | 56.03 | 59.92 | 61.63 | **57.64** | 62.28 | 62.61 | **61.60** |
| Total gas & oil ($/bbl) | 43.65 | **42.17** | 45.37 | 48.55 | 51.89 | 54.28 | **50.05** | 55.88 | 54.48 | **54.11** |
| NY Harbor 3-2-1 ($/bbl) | 5.72 | **7.74** | 6.17 | 10.59 | 12.43 | 7.81 | **9.25** | 9.12 | 11.49 | **10.21** |
| **Revenue** ($mm) | | | | | | | | | | |
| Natural Gas | | | | | | | | | | |
| U.S. (or North America) | 352 | **1,301** | 321 | 344 | 367 | 403 | **1,434** | 431 | 373 | **1,573** |
| Overseas | 64 | **269** | 89 | 95 | 102 | 104 | **389** | 106 | 106 | **417** |
| Total | 416 | **1,570** | 409 | 439 | 469 | 506 | **1,824** | 536 | 479 | **1,990** |
| Oil | 1,011 | **4,107** | 1,073 | 1,202 | 1,287 | 1,310 | **4,872** | 1,282 | 1,358 | **5,237** |
| Downstream | 2,506 | **9,434** | 2,488 | 2,488 | 2,488 | 2,488 | **9,952** | 2,488 | 2,488 | **9,952** |
| Other | (216) | **(734)** | (589) | (589) | (589) | (589) | **(2,354)** | (589) | (589) | **(2,354)** |
| Total | 3,717 | **14,377** | 3,382 | 3,540 | 3,655 | 3,716 | **14,293** | 3,718 | 3,737 | **14,825** |
| **Expense** | | | | | | | | | | |
| Upstream | 442 | **1,661** | 536 | 579 | 610 | 625 | **2,350** | 626 | 631 | **2,492** |
| Downstream | 2,294 | **8,680** | 2,261 | 2,180 | 2,153 | 2,215 | **8,810** | 2,193 | 2,154 | **8,716** |
| Other | (216) | **(734)** | (589) | (589) | (589) | (589) | **(2,354)** | (589) | (589) | **(2,354)** |
| Total | 2,520 | **9,607** | 2,209 | 2,171 | 2,174 | 2,252 | **8,806** | 2,230 | 2,196 | **8,853** |
| **Ebitda** ($mm) | | | | | | | | | | |
| Upstream | 985 | **4,016** | 946 | 1,062 | 1,146 | 1,191 | **4,345** | 1,192 | 1,206 | **4,736** |
| Downstream | 212 | **754** | 227 | 308 | 335 | 273 | **1,142** | 295 | 334 | **1,236** |
| Total | 1,197 | **4,770** | 1,173 | 1,370 | 1,481 | 1,463 | **5,487** | 1,488 | 1,540 | $\boxed{\textbf{5,972}}$ |
| Exploration | 76 | **235** | 82 | 100 | 100 | 100 | **382** | 100 | 100 | **400** |
| Deprec., Deplet., & Amort. | | | | | | | | | | |
| Upstream | 280 | **1,125** | 295 | 300 | 300 | 300 | **1,195** | 300 | 300 | **1,200** |
| Downstream | 72 | **277** | 53 | 70 | 70 | 70 | **263** | 70 | 70 | **280** |
| Other | 40 | | | | | | | | | |
| Total | 392 | **1,442** | 348 | 370 | 370 | 370 | **1,458** | 370 | 370 | **1,480** |
| **Ebit** | 729 | **3,093** | 743 | 900 | 1,011 | 993 | **3,647** | 1,018 | 1,070 | **4,092** |
| Interest | 34 | **142** | 34 | 34 | 34 | 34 | **136** | 34 | 34 | **136** |
| **Ebt** | 695 | **2,951** | 709 | 866 | 977 | 959 | **3,511** | 984 | 1,036 | **3,956** |
| Income Tax | 243 | **1,033** | 248 | 303 | 342 | 336 | **1,229** | 344 | 363 | **1,385** |
| **Net Income ($mm)** | | | | | | | | | | |
| Upstream | 378 | | 53 | | | | | | | |
| Downstream | 91 | | 113 | | | | | | | |
| Other | (17) | | 295 | | | | | | | |
| Total | 452 | **1,918** | 461 | 563 | 635 | 624 | **2,282** | 639 | 674 | **2,571** |
| **Shares** (millions) | 264 | **266** | 263 | 263 | 263 | 263 | **263** | 263 | 263 | **263** |
| Per share ($) | 1.71 | **7.20** | 1.75 | 2.14 | 2.41 | 2.37 | **8.66** | 2.43 | 2.56 | **9.76** |
| Ebitda Margin (E&P) | 72% | **74%** | 68% | 69% | 69% | 70% | **69%** | 70% | 70% | **70%** |
| Tax Rate | 35% | **35%** | 35% | 35% | 35% | 35% | **35%** | 35% | 35% | **35%** |

**Please see disclosures on the final page.**

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

| | Symbol/ | Rating | Price ($/sh) 22-Jul 2005 | Shares (mm) | Market Cap ($mm) | Net Present Value ($/sh) | Debt/ Present Value | McDep Ratio |
|---|---|---|---|---|---|---|---|---|
| **Producer/Refiners - Large Cap and Mid Cap** | | | | | | | | |
| Kinder Morgan, Inc. | KMI | S2 | 88.62 | 123 | 10,910 | 20.00 | 0.76 | 1.83 |
| Imperial Oil Limited (30%) | IMO | B | 83.39 | 104 | 8,640 | 64.00 | 0.11 | 1.27 |
| Marathon Oil Corporation | MRO | B | 57.18 | 367 | 20,990 | 45.00 | 0.33 | 1.18 |
| Petro-Canada | PCZ | B | 69.25 | 263 | 18,240 | 70.00 | 0.20 | 0.99 |
| Suncor Energy | SU | B | 49.12 | 461 | 22,650 | 54.00 | 0.11 | 0.92 |
| ConocoPhillips | COP | B | 61.16 | 1,420 | 86,800 | 70.00 | 0.21 | 0.90 |
| Norsk Hydro ASA | NHY | B | 95.77 | 251 | 24,030 | 110.00 | 0.13 | 0.89 |
| PetroChina Company Ltd (10%) | PTR | B | 82.94 | 176 | 14,580 | 94.00 | 0.05 | 0.89 |
| Lukoil Oil Company | LUKOY | B | 39.55 | 830 | 33,000 | 52.00 | 0.02 | 0.77 |
| *Total or Median* | | | | | *240,000* | | *0.13* | *0.92* |

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