Rating: Buy
S&P 500: 1089

Suncor Energy
Oil Sands Growth Stock

Symbol	SU	*Ebitda Next Twelve Months ending 3/31/05 (US$mm)*	1,900
Rating	Buy	*North American Natural Gas/Ebitda (%)*	11
Price (US$/sh)	23.71	*Natural Gas and Oil Production/Ebitda (%)*	91
Pricing Date	5/20/04	*Adjusted Reserves/Production NTM*	18.4
Shares (mm)	465	*EV/Ebitda*	7.2
Market Capitalization (US$mm)	11,000	*PV/Ebitda*	10.7
Debt (US$mm)	2,800	*Undeveloped Reserves (%)*	1
Enterprise Value (EV) (US$mm)	13,900	*Natural Gas and Oil Ebitda (US$/boe)*	19.20
Present Value (PV) (US$mm)	20,500	*Present Value Proven Reserves(US$/boe)*	11.13
Net Present Value (US$/share)	38	*Present Value Proven Reserves(US$/mcfe)*	1.86
Debt/Present Value	0.14	*Earnings Next Twelve Months (US$/sh)*	1.78
McDep Ratio - EV/PV	0.68	*Price/Earnings Next Twelve Months*	13
Dividend Yield (%/year)	0.7	*Indicated Annual Dividend (US$/sh)*	0.17

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

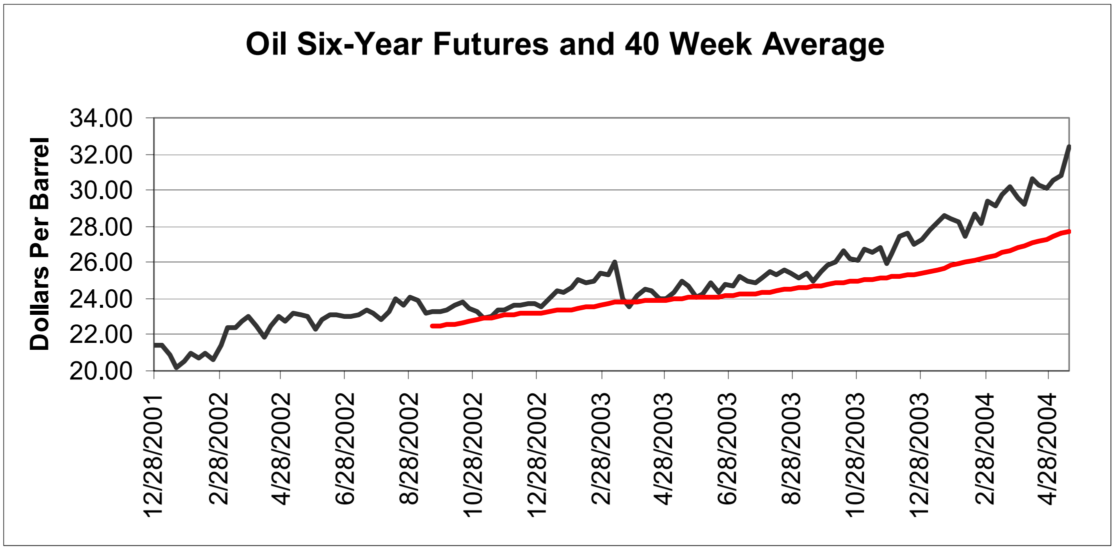
We initiate a "Buy" rating on the common shares of **Suncor Energy (SU)** for Canadian oil sands growth as the company reinvests its cash flow from long-life oil production. The vision of legendary oilman, J. Howard Pew, Suncor was the first and is still the largest equity producer of synthetic crude oil from the vast, politically safe energy resources of Alberta, Canada. Mr. Pew initiated the Great Canadian Oil Sands project forty years ago anticipating the peaking of many of the largest U.S. oil fields. Not until about 1991 did a new chief executive officer, Rick George, with the help of dedicated engineers, turn oil sands into a profit machine. In the next few years of the current century we see possible appreciation in stock price of some 60% to reach our estimate of net present value. While there is stock market risk in Suncor, oil sands represent a reduction in energy supply risk for North Americans.

Oil Looks Up by the Charts, Fundamentals, Inflation and Security

Six-year futures describe the commodity price trends most relevant to estimating resource value. The longer time horizon better matches the period during which more of current resources will actually be produced. The longer term measure also smoothes the frantic near-month fluctuations and has the potential to keep climbing even if near-month quotes drop back temporarily.

The plots of weekly results since the beginning of 2002 trace a trend of six-year oil price rising 16% a year (see chart). We measure momentum with the 40-week moving average.
The charts look good as long as the current six-year quote remains above the trailing average.

Fundamental factors support the price trends. Oil demand is strong with world economic growth paced by developing countries, especially China. Supply is tight as the Middle East is showing maturity with the workhorse giant fields on the verge of peaking.



Monetary factors also favor oil investment as interest rates below inflation drive investors to real assets for protection against currency debasement. Compared to Treasury Inflation Protected Securities that we also favor, oil price is likely to rise more than the official government determined inflation measure.

There appears to be little of the cost of maintaining global security reflected in the price of oil. As a result oil from safe areas like Canada has greater value than might appear in today's price.

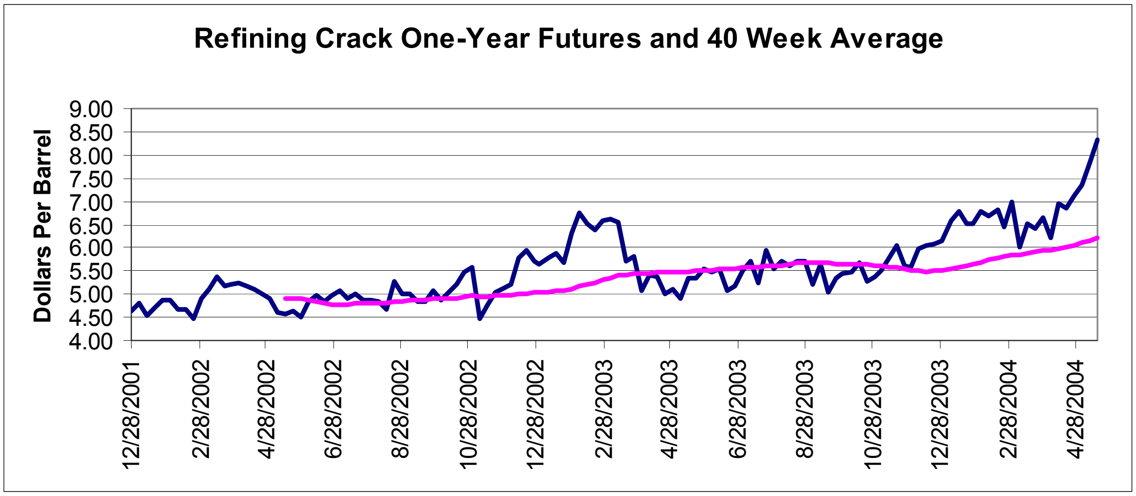
At some point oil price could be too strong and economic activity would be adversely affected. Six times in the past thirty years the annual gain in monthly price exceeded 70% briefly. June futures near $40 a barrel for Light, Sweet Crude Oil would have to exceed $52 a barrel to trigger a 70% warning.

Downstream Trends Also Strong

Industry people like to refer to the oil producing business as upstream and the oil refining/marketing business as downstream. Strong upstream business prospects captured in the rising trend of six-year futures are complemented by improving downstream prospects captured in the trend of one-year refining crack futures (see chart).

Compared to the two previous years, there has been no sign yet of a temporary peak in the trend. Perhaps there will be some falloff this year as in the past, but it would occur from a higher level.

The crack spread we measure is the price of two/thirds barrel of gasoline plus one/third barrel of heating oil minus a barrel of crude oil. While there are innumerable varieties of crude oil and products quoted around the world there is only one source of transparent, public quotes of futures prices for the next year, the New York Mercantile Exchange. As a result we use the Nymex quotes as an indicator of future downstream profitability globally, recognizing that markets are linked meaningfully, if not perfectly. Finally, the crack spread should be seasonally neutral because it always includes twelve months.



Volume, Price and Costs Translate to Attractive Cash Flow

Our process of estimating company-specific present value begins with an estimate of next twelve months cash flow. Current projections lead to a healthy level of unlevered cash flow, also known as Ebitda, short for earnings before interest, tax, depreciation and amortization (see table). We choose the next twelve months ending March 31, 2005 as the relevant time period.

For the next twelve months we project constant natural gas and oil volume at the first quarter 2004 level. That is sufficient for our valuation calculation. Management provides rich detail in conference calls, presentations and copious regulatory disclosures to put more color on a projection of growth for the rest of the decade.

We take the futures market at face value in projecting price for the next twelve months. Henry Hub quotes guide our projection of natural gas revenue. Light Sweet Crude quotes guide our projections of oil revenue. The refinery crack futures guide our projections of downstream cash flow. Because futures are constantly changing, our projection is adjusted accordingly. As a result, the specific amounts we project today may not be the amounts realized when the company next reports.

Assess Present Value Multiple Depending on Reserve Life

The important variables in the valuation of future production are captured in base year cash flow and a multiple of that cash flow that depends on reserve life. Indeed investors do differentiate on that basis as reflected in a high correlation of unlevered cash flow multiple with adjusted reserve life. We convert the market relationship to a formula that produces an anticipatory value with somewhat more sensitivity to reserve life.

Suncor
Next Twelve Months Operations
(Canadian Dollars)

	Q1 3/31/04	*Q2E 6/30/03*	*Q3E 9/30/04*	*Q4E 12/31/04*	***Year 2004E***	*Q1E 3/31/05*	***Next Twelve Months 3/31/05***
Volume							
Natural Gas (mmcfd)	197	197	197	197	**197**	197	**197**
Oil (mbd)	217	217	217	217	**217**	217	**217**
Total gas & oil (bcf)	135	136	138	138	**547**	135	**547**
Total gas & oil (mbd))	250	250	250	250	**250**	250	**250**
Price							
Natural gas ($/mcf)							
Henry Hub ($/mmbtu)	5.64	6.14	6.52	6.69	**6.25**	6.88	**6.55**
Currency (US$/C$)	0.76	0.72	0.72	0.72	**0.73**	0.72	**0.72**
Henry Hub (C$/mmbtu)	7.43	8.57	9.11	9.34	**8.61**	9.61	**9.16**
U.S. (or North America)	6.54	7.55	8.02	8.22	**7.59**	8.46	**8.06**
Oil ($/bbl)							
WTI Cushing	35.23	39.60	40.90	39.00	**38.68**	37.26	**39.19**
WTI Cushing (C$/bbl)	46.41	55.34	57.15	54.49	**53.35**	52.07	**54.76**
Company	43.28	51.60	53.29	50.81	**49.78**	48.55	**51.08**
Total gas & oil ($/mcf)	7.12	8.46	8.77	8.44	**14.30**	8.14	**14.55**
NY Harbor 3-2-1 ($/bbl)	6.98	11.95	9.90	7.07	**8.98**	7.01	**8.98**
Revenue ($mm)							
Natural Gas	116	135	145	149	**545**	150	**579**
Oil	845	1,019	1,064	1,014	**3,943**	948	**4,045**
Other	834	834	834	834	**3,335**	834	**3,335**
Total	1,795	1,988	2,043	1,997	**7,823**	1,932	**7,960**
Expense							
Fixed	248	248	248	248	**992**	248	**819**
Variable	248	298	312	300	**1,158**	283	**856**
Other	784	1,312	1,332	1,329	**4,756**	1,312	**6,616**
Ebitda ($mm)							
Exploration and Production	465	609	649	615	**2,339**	567	**2,440**
Other	50	68	62	53	**233**	53	**236**
Total Ebitda	515	676	711	669	**2,572**	620	$\boxed{\textbf{2,676}}$
Exploration	33	10	10	10	**63**	10	**40**
Deprec., Deplet., & Amort.	174	174	174	174	**696**	174	**696**
Ebit	308	492	527	485	**1,813**	436	**1,940**
Interest	39	39	39	39	**158**	39	**158**
Ebt	269	453	488	445	**1,655**	396	**1,782**
Income Tax	55	159	171	156	**540**	139	**624**
Net Income ($mm)							**-**
Exploration and Production	260	355	388	357	**1,361**	316	**1,417**
Other	27	40	37	31	**135**	30	**137**
Unallocated	(73)	(101)	(108)	(99)	**(381)**	(88)	**(396)**
Total	214	294	317	289	**1,115**	258	**1,158**
Shares (millions)	465	465	465	465	**465**	465	**465**
Per share ($)	0.46	0.63	0.68	0.62	**2.40**	0.55	**2.49**
Ebitda Margin	29%	34%	35%	33%	**33%**	32%	**34%**
Tax Rate	20%	35%	35%	35%	**33%**	35%	**35%**

The adjusted reserve life index is the sum of developed and half undeveloped reserves divided by next twelve months production. When we last did an industry-wide upward revaluation on March 23, we estimated cash flow multiple equal to 2.5 plus 0.5 times reserve life. That approximates present value assuming constant commodity price near the one-year quotes at that time, about $35 a barrel for crude oil. Higher commodity prices since then imply higher cash flow and lower multiple by about 10%. Estimated present value provides a measure of appreciation potential should the market move toward that level as we expect.

Oil Sands an Immense North American Asset

Practically all the value in Suncor is in oil sands. Natural gas production essentially serves to hedge the cost of natural gas consumed in oil production. Downstream to a large extent adds further value to oil sands production and serves as a hedge to any surprise discount for heavier grades of oil. Nonetheless we assess lower multiples on cash flow from natural gas production and downstream operations to reflect shorter expected life.

Some like to say that there is more oil in place in oil sands in Canada than under the desert sands in Saudi Arabia. Finding the resource is not the critical step. Building capacity and operating it consistently is the challenge. We visited the Suncor facility in 2002 when the latest expansion was near completion.

The company has in place the capacity to deliver somewhat more than the 217 thousand barrels daily it produced in the first quarter of 2004. Volume may expand 9% per year through 2007. Moreover, once capacity is established it can be sustained practically indefinitely. In other words volume is not subject to the normal decline of a conventional oil field.

For valuation purposes we project volume at the most recent level for the next twelve months. Our use of the first quarter 2004 as a volume base should be quite conservative. Management has a goal of higher volume as early as the second half of 2004.

We arbitrarily limit the adjusted life index of oil sands production to 20 years. A 20 year life, if it is believable and conservatively stated, is worth a multiple of a little more than 11 times in our current framework. Scale that back a bit for the 11% of cash flow from natural gas and 9% of cash flow from downstream and we estimate present value at 10.7 times next twelve months cash flow.

Kurt H. Wulff, CFA

Research Methodology/Ratings Description: McDep Associates is an independent research originator focused on oil and gas stocks exclusively. The firm applies the thirty years of experience of its analyst to estimate a present value of the oil and gas resources and other businesses of covered companies. That value is compared with a company's stock market capitalization and debt. Stocks with low market cap and debt relative to present value tend to outperform stocks with high market cap and debt relative to present value. Buy recommendations are expected to deliver a total return better than 7% per year above inflation. Hold recommendations assume the attributes of the underlying business are more than fully reflected in the current price of the stock. Sell recommendations are expected to deliver a negative total return less than 7% per year including the effects of inflation.

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