McDep Associates

Independent Stock Idea

June 18, 2002

Buy/Sell Rating: 2 - Buy

S&P 500: 1036

Canadian Oil Sands Trust

Premier Growth, Inflation and Deflation Characteristics

Symbol		Price ($/sh) 18-Jun 2002	Shares (mm)	Market Cap (US$mm)	Net Present Value (US$/sh)	Debt/ Present Value	McDep Ratio	EV/ Sales 2002E	EV/ Ebitda NTM	P/E NTM	Div'd NTM (%)	PV/ Ebitda NTM
	US$	27.56	57	1,570	40.00	0.12	0.73	4.0	7.5	9	4.7	10.3
COS_u.TO	C$	42.40										

McDep Ratio = **M**arket **c**ap and **De**bt to **p**resent value of oil and gas and other businesses

EV = Enterprise Value = Market Cap and Debt:	US$mm	1,870
Ebitda = Earnings before interest, tax, depreciation and amortization:	US$mm	249
NTM = Next Twelve Months Ended June 30, 2003; P/E = Stock Price to Earnings		
PV = Present Value of oil and gas:	US$mm	2,570
Net Present Value	US$mm	2,270

Summary and Recommendation

We recommend current purchase of the units of Canadian Oil Sands Trust for investment growth, protection from inflation and resistance to deflation. The trust's sole asset is its 22% ownership of Syncrude, the joint venture with ExxonMobil, Encana, Conoco/Phillips, Petro-Canada, Murphy and Nexen that is producing growing volumes of high quality, semi-refined petroleum from the vast oil sands resources of northern Alberta. Oil, the giant of commodities, is one of our favorite sources of protection from the decline in the U.S. dollar. Rising political risk in the Middle East may also have unexpected consequences for oil price and inflation in general. With low debt, COS is not subject to the deflation of credit beginning to take place at high debt, high greed, corrupt companies. Unlike many U.S. counterparts among energy infrastructure partnerships and their sponsors, COS has apparently honest management who are paid reasonable compensation. With those overriding considerations strongly favoring strategic investment, we analyze in more detail oil volume and price, environmental considerations, absence of promoter greed, income taxation, distribution policy and do a discounted cash flow valuation.

Growth in Production Enhances Value

Currently producing more than 220,000 barrels daily, Syncrude is in the process of expanding capacity to 370,000 barrels daily by 2005. The joint venturers may expand the plant to 500,000 barrels daily by about 2015. At any oil price above US$ 20 per barrel, the economics of expansion are quite attractive. In fact operations would still generate positive cash flow down to about US$ 12 per barrel.

Those attractive economics were not always the case. Syncrude and the neighboring Suncor facility that we recently visited were not profitable until the last decade when new methods reduced costs. Those lower costs combined with six-year oil futures at more than US$ 22 a barrel imply prospects for future cash generation that are strongly positive.

The typical oil well in North America is produced continuously at capacity. As a result, its volume declines steadily as reserves are depleted. In contrast, oil sands production holds at a near constant level for the long life of the plant.

Obviously, the value of a rising production profile is much higher relative to current volume than is the value of a declining profile. That shows up in the cash flow multiple for COS stock. The market prices the stock at an EV/Ebitda multiple of around 7 times. We make the case that the multiple could move up to 10 times or more mainly because of the rising as opposed to declining production profile.

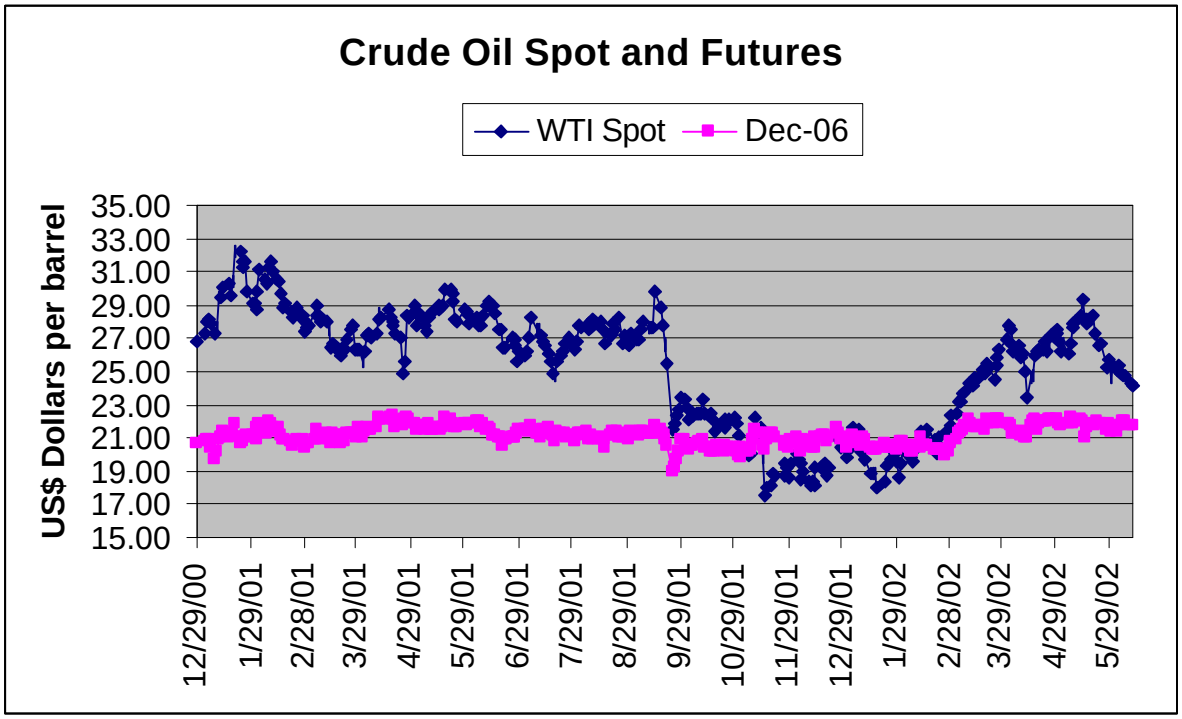
Long Term Oil Price More Stable Than Might Be Perceived

The main concern investors may have in buying units of COS is that the price of oil may drop or even collapse. Those fears may be overdone, but it is not hard to understand how the concerns have developed. The daily price fluctuates much more widely than the distant futures price. Yet it is the distant futures price that is more indicative of the value of future production. We think investors in oil get unduly nervous when the daily price changes. We have felt those pangs in our stomach as well.

Compound that with regular stories of the imminent collapse of the oil producing country cartel, or the arrival of a hyper-efficient automobile or a newly discovered unlimited cheap energy source and oil investors have to reassure themselves that their investments remain solid.

Go back thirty years and the only oil price widely quoted was the daily price. Twenty years ago, or so, futures started trading on the New York Mercantile Exchange. Initially futures were quoted for only a few months ahead. Now futures are quoted six years out.

We take some comfort in the availability of futures quotes that lend more stability to the outlook. During the past two years, for example, the daily quote ranged from US$ 17 to 32. At the same time the futures quote for December 2006 stayed in a tighter range of only US$ 19 to 22 (see Chart).



North American Oil Has Strategic Value

More than offsetting investor concern about lower oil price may be the risk of higher oil price. Political conditions in oil producing countries, particularly in the Middle East, have rarely been more threatening than now. Fanatics feed the flames of hatred.

Consuming countries have declared a war on terrorism. The Iranian revolution caught the world by surprise twenty years ago. What surprise lies ahead? Might we force a change of control in Iraq? Might Saudi Arabia see political upheaval?

As a result of our susceptibility to surprise adverse developments, a steady source of oil supply in North America may have more value than we contemplate now. Owning future production is a sound way for investors to participate, both opportunistically and defensively. Next we attempt to quantify the value of long life oil under neutral to cautious assumptions.

Projections Allow Generous Cushion for Surprise

A discounted cash flow valuation leads to a present value that seems too good to be true if we take all the variables at face value (see tables at the end). While the calculation supports a value above US$ 40 a share, we use that round number as our estimate for purposes of comparison with other stocks by the McDep Ratio.

The case for caution is that problems do come up. From time to time equipment is down and production volume falls short of design capacity. Construction costs have magnified beyond some expectations.

Projected volume expands in line with expectations for the expansion now in progress through 2004. We ignore any later expansion even though the operators outline projects through 2015. Arbitrarily we end our calculation at a thirty-year life even though the Suncor plant has already been operating for more than thirty years.

Oil price is projected in line with the futures market through 2008 and escalated thereafter with the rate implied by inflation indexed U.S. government securities. Our own opinion is that the actual price is likely to be higher than the projection and that the chance that it will be lower is quite slim.

Projected costs at 50% of revenue are higher than current experience. The operators aim for lower costs than we project. A favorable feature of the royalty regime is that the rate is only nominal until new investment is recovered. Continued expansion would imply a lower royalty.

Capital expenditures are projected in line with disclosures for the current program. Suncor acknowledges that costs were higher than expected. Syncrude is making extra effort to complete more detailed engineering design in advance in order to avoid potentially costly changes in the field. Mathematically, somewhat higher construction costs would not dilute calculated present value by much though common sense suggests that careful attention to costs is always good discipline.

Unlike U.S. royalty trusts in our coverage, COS does have some debt that among other uses allows payment of a distribution while large capital investments are being made. The calculation assumes that all cash flow is distributed after debt service. Further expansion may consume cash flow, but presumably would also add present value.

Finally the calculation uses a higher discount rate than we use for U.S. royalty trusts. One justification could be that oil sands production is more analogous to a thirty-year bond because we project a rising volume profile while long life natural gas production is more analogous to a ten-year bond because we project a declining profile. Interest rates for a thirty-year bond are usually higher than for a ten-year bond, perhaps because the

present value is more volatile for a given change in interest. Investors might require a higher return to offset higher volatility.

Carbon Dioxide Emissions Arouse Environmental Concern

Reducing environmental pollution may require more expenditure in the future. If energy prices are higher than expected there will be more room to make energy cleaner. Much is already being done and we expect the oil sands producers to take further steps. Let's take potential pollutants in turn. Large quantities of coke are a byproduct. Because the carbon fuel also contains sulfur and metals it is not suitable for burning on site. As a result coke apparently is stored outdoors in a manner that would allow future recovery for possible commercial use.

Water used in separating oil from sands and to transport slurry is treated in settling ponds to deal with metal and minerals contaminant. The open ponds have an oil slick that is a potential threat to birds that are kept at a distance by scarecrows and loud noise.

Sulfur dioxide is scrubbed from gas emissions as in power plants. Oxides of nitrogen that interact to cause smog in populated areas do not seem to be a problem in the remote region.

The main question about air pollution concerns carbon dioxide, the potential contributor to global warming and the target of the "Kyoto" protocol. Canadians would like to do their part as world citizens, but there is a debate as to whether the treaty as it now stands makes sense for Canada. Carbon dioxide emissions can be controlled at a price and there may be room to do so eventually.

Our opinion is that it is not in the interest of Canada to spend much now on reducing carbon dioxide emissions from oil sands production until worse sources of pollution are curtailed. The carbon dioxide emissions from coal burning in China and elsewhere dwarf the emissions from oil production and refining. Natural gas is apparently wasted in Russia and other less pristine producing countries. Pure methane is many times more damaging to the ozone layer, an apparent cause of global warming, than carbon dioxide and wasteful burning also emits carbon dioxide. When carbon dioxide is a byproduct of natural gas production, it apparently is usually vented to the atmosphere.

Promoter Greed Appears Almost Non-Existent

Everything is relative and perhaps active environmentalists might not be as sanguine about that issue as we are. Similarly short-term oil price will continue to be volatile at the same time we believe that long-term investment in the commodity, especially in North America, is attractive. There is a final area where the Canadian Oil Sands Trust shines with unwavering and unchallengeable brightness – it is a comparatively fair deal

for investors. In contrast to the high greed limited partnerships in the U.S. there is no general partner tax that would siphon away practically half of cash flow without fully disclosing the potential dilution. Critical of the deceptive partnerships, we feel strongly that Canadian Oil Sands Trust offers a better energy income investment than practically any of the highly leveraged, misleading promotions inspired by Enron and its competitors and partners.

Last year we had the impression that COS would be traded on the New York Stock Exchange. Apparently the trustee reconsidered that the effort might be too successful and U.S. investors would soon reach a 49% limit.

Tax Issues Need Attention

Our understanding of the taxation of income paid to U.S. holders may not be reliable. Apparently the trust is treated as a corporation, not as a limited partnership and not as a royalty trust for U.S. income tax purposes.

U.S. holders may have some 20% of COS with most of the remainder held by Canadians. Apparently institutions dominate U.S. holders. Possibly units held in tax-exempt accounts can apply for exemption from the Canadian withholding tax. Institutions or individuals holding the units might claim a return of capital to reduce taxation. In fact, the trust publishes an estimate of the amount of distribution that represents return of capital specifically for U.S. taxpayers.

The fail-safe tax treatment for individuals is to hold the units in a taxable account, pay tax on the full amount of distribution and claim a foreign tax credit for the Canadian tax withheld. Perhaps the units could be held in an individual tax-deferred account. In that case, taxation of all of the distribution would be deferred. Partial Canadian tax is likely to be withheld that individuals might not recover. By the time the trust pays the much higher distributions that appear ahead, we expect to be more confident of the tax implications.

Distribution Has High Upside

The classic problem of U.S. royalty trusts has been the two-edged impact of investing in expanded capacity. The investment usually enhances the long-term value of the asset. At the same time it reduces the current distribution because investment is usually financed first from the cash flow that would otherwise pay the distribution. Stock price is usually more negatively impacted by the reduction in current distribution than positively impacted by the enhancement of long-term value.

COS has the flexibility to take a compromise approach. The trust can borrow in the capital markets and need not rely on advances from the operator of the asset. In fact COS

maintains some borrowing because it believes the return on oil sands is likely to exceed the interest on debt. The likely policy in a few years will be to pay down debt in advance of another round of expansion. At the same time COS continue to make distributions of C$ 0.50 per unit quarterly. That rate was reduced late last year when oil price was temporarily lower, but has not been increased this year when oil price has advanced.

A relatively low current distribution probably has a dampening effect on stock price. If so, that is a reason, in our opinion, for investors to be more interested now. At the same time, the current expansion will take a few years to complete and it may be that long before the distribution is increased materially. During that time we think the stock has appreciation potential as investors become more confident of underlying value.

Kurt H. Wulff, CFA

Table COS-1
Canadian Oil Sands Trust
Present Value
(Canadian dollars)

Volume Decline (%/yr):	0	Price Escalation Post 2008 (%/yr):	1.9
Volume Enhancement (%/yr):	13	Discount rate (%/yr):	8.0
Royalty/Cash Flow (%):	25	U.S. TIPS Inflation (%/yr):	1.9
Operating Cost (%):	50	U.S. 10 Year Yield (%/yr):	5.0
PV/Volume ($/bbl):	4.73	Present Value (US$/unit):	46.30

Year	Basic (mmb)	Volume Enhanced (mmb)	Total (mmb)	Price ($/bbl)	Revenue ($mm)	Oper Cost ($mm)	Royalty ($mm)	Capital & Debt ($mm)	Distribution ($mm)	Distribution ($/unit)	Disc Factor	Present Value ($/unit)
Total 2003 through 2032; years ending on 6/30												
C$	544	313	856	41.53	35568	17757	4037	612	12681	223	0.32	71.30
2003	18.1	0.0	18.1	40.01	725	336		-124	114	2.00	0.96	1.92
2004	18.1	2.4	20.5	37.58	770	385		-129	114	2.00	0.89	1.78
2005	18.1	5.0	23.1	36.42	843	422		108	114	2.00	0.82	1.65
2006	18.1	8.0	26.2	35.57	930	465		238	227	4.00	0.76	3.06
2007	18.1	11.4	29.6	34.92	1032	516	129	20	387	6.81	0.71	4.81
2008	18.1	11.4	29.6	34.55	1021	511	128	20	383	6.74	0.65	4.41
2009	18.1	11.4	29.6	34.25	1013	506	127	20	380	6.68	0.61	4.05
2010	18.1	11.4	29.6	34.89	1031	516	129	20	387	6.80	0.56	3.82
2011	18.1	11.4	29.6	35.53	1050	525	131	20	394	6.93	0.52	3.60
2012	18.1	11.4	29.6	36.19	1070	535	134	20	401	7.06	0.48	3.40
2013	18.1	11.4	29.6	36.86	1090	545	136	20	409	7.19	0.45	3.20
2014	18.1	11.4	29.6	37.54	1110	555	139	20	416	7.32	0.41	3.02
2015	18.1	11.4	29.6	38.24	1130	565	141	20	424	7.45	0.38	2.85
2016	18.1	11.4	29.6	38.94	1151	576	144	20	432	7.59	0.35	2.69
2017	18.1	11.4	29.6	39.66	1172	586	147	20	440	7.73	0.33	2.53
2018	18.1	11.4	29.6	40.40	1194	597	149	20	448	7.88	0.30	2.39
2019	18.1	11.4	29.6	41.15	1216	608	152	20	456	8.02	0.28	2.25
2020	18.1	11.4	29.6	41.91	1239	619	155	20	465	8.17	0.26	2.12
2021	18.1	11.4	29.6	42.68	1262	631	158	20	473	8.32	0.24	2.00
2022	18.1	11.4	29.6	43.47	1285	642	161	20	482	8.48	0.22	1.89
2023	18.1	11.4	29.6	44.28	1309	654	164	20	491	8.63	0.21	1.78
2024	18.1	11.4	29.6	45.10	1333	666	167	20	500	8.79	0.19	1.68
2025	18.1	11.4	29.6	45.93	1358	679	170	20	509	8.95	0.18	1.58
2026	18.1	11.4	29.6	46.78	1383	691	173	20	519	9.12	0.16	1.49
2027	18.1	11.4	29.6	47.64	1408	704	176	20	528	9.29	0.15	1.41
2028	18.1	11.4	29.6	48.53	1434	717	179	20	538	9.46	0.14	1.33
2029	18.1	11.4	29.6	49.42	1461	730	183	20	548	9.64	0.13	1.25
2030	18.1	11.4	29.6	50.34	1488	744	186	20	558	9.81	0.12	1.18
2031	18.1	11.4	29.6	51.27	1515	758	189	20	568	10.00	0.11	1.11
2032	18.1	11.4	29.6	52.22	1544	772	193	20	579	10.18	0.10	1.05

Table COS-1
Canadian Oil Sands Trust
Next Twelve Months Operating and Financial Estimates

	Q1 3/31/02	*Q2E 6/30/02*	*Q3E 9/30/02*	*Q4E 12/31/02*	***Year 2002E***	*Q1E 3/31/03*	*Q2E 6/30/03*	***Next Twelve** Months 6/30/03*
Volume								
Days	90	91	92	92	**365**	90	91	**365**
Oil (mb)	4,470	4,520	4,570	4,570	**18,129**	4,470	4,520	**18,129**
Oil (mbd)	49.7	49.7	49.7	49.7	**49.7**	49.7	49.7	**49.7**
Price								
WTI Cushing ($/bbl)	21.60	25.80	25.73	25.59	**24.68**	25.14	24.69	**25.29**
Differential	12.58	15.02	14.98	14.90	**(14.39)**	14.63	14.37	**(14.72)**
Company	34.18	40.82	40.71	40.49	**39.07**	39.77	39.06	**40.01**
Revenue ($mm)								
Oil	153	185	186	185	**708**	178	177	**725**
Other	5	-	-	-	**5**	-	-	-
Total	158	185	186	185	**714**	178	177	**725**
Expense								
Operating	79	79	79	79	**316**	79	79	**316**
Other	3	5	5	5	**18**	5	5	**20**
Total	82	84	84	84	**334**	84	84	**336**
Ebitda	76	101	102	101	**380**	94	93	**389**
Exploration								
Deprec., Deplet., & Amort.	14	14	14	14	**56**	14	14	**56**
Other Non Cash	(0)				**(0)**			-
Ebit	62	86	88	87	**323**	80	79	**333**
Interest	12	12	12	12	**48**	12	12	**48**
Ebt	50	74	76	75	**275**	68	67	**285**
Income Tax								
Net Income ($mm)	50	74	76	75	**275**	68	67	**285**
Per Share ($)	0.88	1.31	1.33	1.32	**4.84**	1.19	1.17	**5.02**
Shares (millions)	56.9	56.9	56.9	56.9	**56.9**	56.9	56.9	**56.9**
Operating ($/bbl)	17.67	17.48	17.29	17.29	**17.43**	17.67	17.48	**17.43**
General and admin ($/bbl)	0.67	1.11	1.09	1.09	**0.99**	1.12	1.11	**1.10**
Ebitda Margin	48%	54%	55%	55%	**53%**	53%	52%	**54%**
Deprec., D,& A ($/bbl)	3.13	3.10	3.10	3.10	**3.11**	3.10	3.10	**3.10**
Interest Rate (%/yr)	10	10						
Tax rate	0%	0%	0%	0%	**0%**	0%	0%	**0%**