

Rating: Buy
S&P 500: 1274

Petro-Canada

Favorable Relative Recognition

<i>Symbol</i>	PCZ	<i>Ebitda Next Twelve Months ending 12/31/06 (US\$m)</i>	5,300
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	17
<i>Price (US\$/sh)</i>	45.20	<i>Natural Gas and Oil Production/Ebitda (%)</i>	85
<i>Pricing Date</i>	1/26/06	<i>Adjusted Reserves/Production NTM</i>	6.0
<i>Shares (mm)</i>	523	<i>EV/Ebitda</i>	5.5
<i>Market Capitalization (US\$m)</i>	23,600	<i>PV/Ebitda</i>	5.1
<i>Debt (US\$m)</i>	5,200	<i>Undeveloped Reserves (%)</i>	22
<i>Enterprise Value (EV) (US\$m)</i>	28,800	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	39.20
<i>Present Value (PV) (US\$m)</i>	27,100	<i>Present Value Proven Reserves(US\$/boe)</i>	30.00
<i>Net Present Value (US\$/share)</i>	42	<i>Present Value Proven Reserves(US\$/mcf)</i>	5.00
<i>Debt/Present Value</i>	0.19	<i>Earnings Next Twelve Months (US\$/sh)</i>	4.77
<i>McDep Ratio - EV/PV</i>	1.06	<i>Price/Earnings Next Twelve Months</i>	9
<i>Dividend Yield (%/year)</i>	0.8	<i>Indicated Annual Dividend (US\$/sh)</i>	0.35

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.

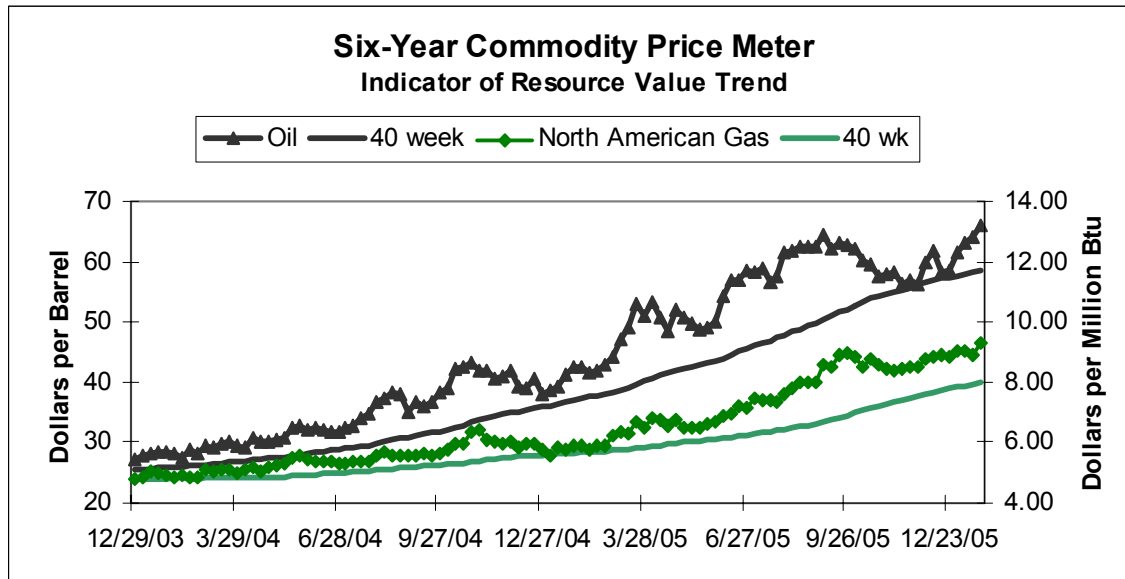
Summary and Recommendation

Stock price for buy-recommended **Petro-Canada (PCZ)** exceeds estimated net present value that we keep at \$42 a share after taking account of latest quarterly results. Our correlation of 30 companies indicates net present value about \$8 a share lower than estimated. The correlation is a statistical check that may overlook some of the company's oil sands projects. PCZ has a 12% interest in Syncrude whose capacity is expanding to 350,000 barrels daily. Last year the company acquired 60% of the Fort Hills oil sands project expected to be producing 100,000 barrels daily after 2010.

McDep Ratio Relates Oil Price to Opportunity

A McDep Ratio above 1.0 tells us that PCZ's market cap and debt, or enterprise value, is somewhat more than the estimated present value of its energy resources assuming a long-term real price of \$50 a barrel for Light, Sweet Crude Oil. Meanwhile six-year oil futures are about \$66 a barrel. Momentum has been positive for more than three years as the current quote stays above the 40-week average (see chart [Six-Year Commodity Price Meter](#)). Six-year oil has tripled in the four years we have been calculating it on a weekly basis. We do not need further gains in oil price to make money in buy recommendations. Yet our vision of \$150 oil in 2010 implies additional scope to exceed common expectations.

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PCZ's McDep Ratio ranks above the median of peer companies (see table [Rank by McDep Ratio](#)). Aside from fundamental value, a McDep Ratio of 1.0 is an indication of takeover value. The McDep Ratio of buy-recommended **Burlington Resources (BR)**, increased to 1.0 immediately after buy-recommended **ConocoPhillips (COP)** announced its takeover offer.

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

	Symbol/ Rating	Price (\$/sh) 26-Jan 2006	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	97.85	139	13,640	33.00	0.74	1.51
Imperial Oil Limited (30%)	IMO B	102.56	102	10,480	84.00	0.10	1.20
Petro-Canada	PCZ B	45.20	523	23,640	42.00	0.19	1.06
Suncor Energy	SU B	76.40	461	35,230	75.00	0.10	1.02
Marathon Oil Corporation	MRO B	72.50	368	26,670	75.00	0.25	0.97
Norsk Hydro ASA	NHY B	116.50	251	29,230	130.00	0.17	0.91
PetroChina Company Ltd (10%)	PTR B	94.56	176	16,620	120.00	0.01	0.79
Lukoil Oil Company	LUKOY B	77.80	830	65,000	100.00	0.01	0.78
Gazprom (50%)	OGZPF B	91.00	1,013	92,200	120.00	0.03	0.77
	<i>Total or Median</i>			<i>313,000</i>		<i>0.10</i>	<i>0.97</i>

Low Cash Flow Multiple

Petro-Canada has an adjusted reserve life index of 6.0 years, lowest among peers (see table [Rank by EV/Ebitda](#)). Petro-Canada's unlevered multiple, EV/Ebitda, is not the lowest of peers.

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Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.

	Symbol/ Rating		Price (\$/sh) 26-Jan 2006	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	97.85		8.2	12.4	20	3.6
Gazprom (50%)	OGZPF	B	91.00	20.0	10.7	8.2	14	0.5
Imperial Oil Limited (30%)	IMO	B	102.56	11.5	6.7	8.1	14	0.8
Suncor Energy	SU	B	76.40	17.7	7.4	7.5	15	0.3
Petro-Canada	PCZ	B	45.20	6.0	5.1	5.5	9	0.8
Norsk Hydro ASA	NHY	B	116.50	7.9	5.1	4.7	9	2.6
PetroChina Company Ltd (10%)	PTR	B	94.56	13.8	5.8	4.6	9	4.0
Marathon Oil Corporation	MRO	B	72.50	6.5	4.6	4.5	7	1.8
Lukoil Oil Company	LUKOY	B	77.80	19.7	5.5	4.3	6	1.3
	<i>Median</i>			<i>12.7</i>	<i>5.8</i>	<i>5.5</i>	<i>9</i>	<i>1.3</i>

More Concentration on Natural Gas

Each oil and gas stock has its own unique mix of energy resources (see table Business Segments). Petro-Canada's concentration on North American natural gas is the highest among peers at 23%.

Home Country and Business Segments

	Symbol/ Rating		Non- U.S. Domicile	North Amer. Natural Gas (%)	Rest of World Natural Gas (%)	Oil Prod'n (%)	Down- stream (%)	Total Present Value (US\$mm)
Producer/Refiners - Large Cap and Mid Cap								
Gazprom	OGZPF	B	Russia		100			251,000
PetroChina Company Ltd.	PTR	B	China	-	9	71	20	213,000
Lukoil Oil Company	LUKOY	B	Russia	-	-	75	25	83,600
Norsk Hydro ASA	NHY	B	Norway	-	29	38	33	39,400
Suncor Energy	SU	B	Canada	4	-	89	7	38,200
Marathon Oil Corporation	MRO	B		13	7	40	41	36,600
Imperial Oil Limited	IMO	B	Canada	13	-	62	25	31,900
Petro-Canada	PCZ	B	Canada	23	4	53	20	27,200
	<i>Median</i>			<i>4</i>	<i>5</i>	<i>62</i>	<i>25</i>	<i>721,000</i>

Static Present Value Justified by Dynamic Cash Flow

Next Twelve Months (NTM) cash flow represents the volumes and costs that form the base for future projections. Reserve life index tells how long cash flow will last. NTM cash flow and reserve life are the two main variables in our correlation by function for about 30 companies. Net present value indicated by the current relationship is about \$7 a share lower than our steady estimate for the company (see table Functional Cash Flow and Present Value). That is a wide gap that we will examine more closely in the next few months.

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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	905	8.9	6.8	6,200	23%
Rest of World Natural Gas	296	6.3	3.4	1,000	4%
Oil	3,305	5.0	4.4	14,500	53%
Downstream	771		7.1	5,500	20%
	5,277	6.0	5.2	27,200	100%
Debt (US\$mm)					5,200
Net Present Value (US\$mm)					22,000
Shares (mm)					523
Net Present Value (US\$/sh)					42
Over (-)/ Under (+) Correlation (US\$/sh)					(7)

Futures Prices Propel Estimated Cash Flow by Quarter

Cash flow for the next year is projected from a base through the latest reported quarter (see table Next Twelve Months Operating and Financial Estimates). Futures prices from the New York Mercantile Exchange determine industry benchmarks for the next year.

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

	<i>Q4</i>	<i>Q3</i>	<i>Q4</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Next Twelve Months</i>
	<i>12/31/04</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>2005</i>	<i>3/31/06</i>	<i>6/30/06</i>	<i>9/30/06</i>	<i>12/31/06</i>	<i>12/31/06</i>
Volume									
Natural Gas (mmcf)									
U.S. (or North America)	556	527	488	513	483	478	474	469	476
Overseas	119	113	118	126	126	124	123	122	124
Total	675	640	606	639	609	603	597	591	600
Oil (mbd)	227	223	211	220	209	219	217	214	215
Total gas & oil (mbd)	340	330	312	326	310	319	316	313	315
Price									
Natural gas (\$/mcf)									
Henry Hub (US\$/mmbtu)	7.10	8.56	13.00	8.65	9.56	8.95	9.20	10.11	9.45
Currency (US\$/C\$)	0.82	0.83	0.85	0.83	0.87	0.87	0.87	0.87	0.87
Henry Hub (C\$/mmbtu)	8.65	10.29	15.30	10.48	11.00	10.29	10.58	11.63	10.88
U.S. (or North America)	6.89	8.22	11.83	8.46	8.50	7.96	8.18	8.99	8.41
Overseas	5.83	6.58	9.19	6.97	10.31	10.57	10.67	10.71	10.57
Total	6.70	7.93	11.32	8.17	8.88	8.50	8.70	9.35	8.85
Oil (\$/bbl)									
WTI Cushing (US\$/bbl)	48.31	62.52	60.02	56.31	67.34	69.02	69.68	69.95	69.00
WTI Cushing (C\$/bbl)	58.91	75.14	70.61	68.15	77.46	79.40	80.16	80.47	79.37
Worldwide	48.41	69.01	60.50	60.55	66.38	68.03	68.68	68.95	68.03
Total gas & oil (\$/bbl)	43.65	59.82	59.42	54.10	57.92	58.55	59.33	60.73	59.14
NY Harbor 3-2-1 (\$/bbl)	5.72	16.70	9.05	10.63	8.04	11.92	12.44	10.23	10.66
Revenue (\$mm)									
Natural Gas									
U.S. (or North America)	352	399	531	1,584	370	346	357	388	1,461
Overseas	64	68	100	319	117	120	121	120	477
Total	416	467	631	1,903	486	466	477	508	1,938
Oil	1,011	1,416	1,174	4,862	1,248	1,355	1,369	1,360	5,331
Downstream	2,506	3,144	3,038	11,353	3,038	3,038	3,038	3,038	12,152
Other	(216)	(182)	(5)	(993)	(5)	(5)	(5)	(5)	(21)
Total	3,717	4,845	4,838	17,125	4,767	4,853	4,879	4,901	19,400
Expense (\$mm)									
Upstream	442	611	519	2,172	504	522	528	533	2,086
Downstream	2,294	2,927	2,816	10,512	2,816	2,816	2,816	2,816	11,265
Other	(216)	(182)	(5)	(993)	(5)	(5)	(5)	(5)	(21)
Total	2,520	3,356	3,330	11,692	3,314	3,333	3,339	3,343	13,330
Ebitda (\$mm)									
Upstream	985	1,272	1,287	4,593	1,231	1,298	1,318	1,336	5,183
Downstream	212	217	222	841	222	222	222	222	887
Total	1,197	1,489	1,508	5,433	1,453	1,520	1,540	1,558	6,070
Exploration	76	54	77	271	77	77	77	77	308
Deprec., Deplet., & Amort.									
Upstream	280	309	234	1,135	234	234	234	234	936
Downstream	72	60	51	216	51	51	51	51	204
Other	40								
Total	392	369	285	1,351	285	285	285	285	1,140
Ebit	729	1,066	1,146	3,811	1,091	1,158	1,178	1,196	4,622
Interest	34	39	52	164	52	52	52	52	208
Ebt	695	1,027	1,094	3,647	1,039	1,106	1,126	1,144	4,414
Income Tax	243	359	383	1,277	363	387	394	400	1,545
Net Income (\$mm)									
Upstream	378	499	651						
Downstream	91	102	111						
Other	(17)	66	(51)						
Total	452	667	711	2,371	675	719	732	743	2,869
Shares (millions)	528	525	523	525	523	523	523	523	523
Per share (\$)	0.86	1.27	1.36	4.52	1.29	1.37	1.40	1.42	5.49
Ebitda Margin (E&P)	72%	70%	75%	71%	76%	76%	76%	76%	76%
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%

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