McDep Associates
Stock Idea
August 13, 2001

Buy/Sell Rating: 2 - Buy

PanCanadian Petroleum Limited
Exceptional Old and New Value

Symbol	*Price (US$/sh) 10-Aug 2001*	*Shares (mm)*	*Market Cap ($mm)*	*Net Present Value (US$/sh)*	*Debt/ Present Value*	*McDep Ratio*	*EV/ Sales NTM*	*EV/ Ebitda NTM*	*P/E NTM*	*Div'd NTM (%)*	*PV/ Ebitda NTM*
PCP.TO	27.86	262	7,300	37.50	0.06	0.76	1.1	4.2	7.4	1.0	5.5

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$mm 7,960
Ebitda = Earnings before interest, tax, depreciation and amortization: US$mm 1,910
NTM = Next Twelve Months Ended June 30, 2002; P/E = Stock Price to Earnings
PV = Present Value of energy businesses: US$mm 10,480

Summary and Recommendation

We recommend that investors buy shares of PanCanadian Petroleum Limited, soon to be traded on the New York Stock Exchange, because the company's high quality resource foundation of a billion barrels equivalent, 60% natural gas, may be doubled by new discoveries. Trading will begin about August 21 on a "when issued" basis referring to the 85% of current shares that will be distributed to the shareholders of Canadian Pacific Ltd. by early October. Most of the company's existing reserves underlie 12 million acres largely granted to the railroad a century ago; half of which are exempt from provincial royalty. Remarkably, just two years ago, the old-line company discovered a trillion cubic feet natural gas field offshore Nova Scotia, owned 100% that may be replicated in new drilling that began last month. Only weeks ago, the company announced a 300 million barrel oil discovery offshore Scotland, owned 45% that may be expanded to a billion barrels in drilling to be resumed in the fall. As if that is not enough upside, testing of a 20 trillion cubic feet coal bed methane resource on old railroad lands appears highly promising. Trading in the shares may be volatile as the publicly traded float expands from US$ 1 billion to US$ 7 billion in the next two months.

PanCanadian Shares Owned by Canadian Pacific to be Freely Traded

In a long awaited, historic action, Canadian Pacific, the conglomerate, will reorganize itself out of existence. Shares of PanCanadian owned by Canadian Pacific will be distributed to the shareholders of CP. Increased trading because of more shares in public hands along with a listing of the shares for trading in the U.S. should lead to greatly expanded investor interest in PCP.

Taxation of Special Dividend May Inhibit Buyers Temporarily

In the process, PanCanadian will pay a special dividend of about US$ 3 per share. CP will retain its share of the dividend ultimately to be included in the value of other newly independent companies. Investors who buy PCP stock before the record date, expected to be before the end of August, will be entitled to that payment and will be subject to the tax consequences. Investors who buy the "when issued" shares after they begin trading on about August 21, will not receive the dividend and, of course, would not be liable to pay tax because of the dividend.

Facing an immediate tax of about US$ 1 per share, a taxable U.S. investor would be at a disadvantage in purchasing PCP stock before the dividend. A tax-exempt U.S. investor may be able to avoid a Canadian withholding tax. Thus our purchase recommendation is most suitable today for those investors who would not be penalized by tax on the special dividend. We expect that our buy recommendation will still be effective when U.S. investors can buy NYSE shares, but we will be watchful of any changes that justify revising our recommendation.

We notice that the custodian for our New York listed shares of **Petro-Canada** held in a retirement account does not withhold Canadian tax. In the past, the same custodian withheld Canadian tax on Toronto listed shares of the same company. European stocks held in the same account do have tax withheld on distributions. As a result for the time being we are unsure whether Canadian tax would be withheld in a retirement account that holds Toronto listed shares of PCP.

Old Assets Have Exceptional Value

The company's proven reserves of 3.7 trillion cubic feet of natural gas and 400 million barrels of conventional oil and liquids under its 12 million acres in Western Canada are more valuable than normal. Unit wellhead revenue is higher because the company has the lowest natural gas transportation costs in Alberta. Because of its size and closer location to the U.S. border, PCP has a preferential contract with the provincial pipeline. Contiguous, rather than scattered, land holdings allow further efficiencies. The greatest advantage is that half of the company's land is owned in fee and therefore production is free of royalty. That means PCP gets more of the upside in price because provincial royalties paid by most producers increase in percentage terms as price goes up. As a result PanCanadian's cash flow is not only higher per unit, but it has more upside than average. Efficient operations also offer downside protection because PCP can still generate cash flow when other producers may have to shut in. Stated another way, whatever cash flow PCP generates should be valued at a higher multiple than usual for typical production by peer companies.

Nova Scotia Natural Gas Discovery Has Exceptional Value

A second reason that PanCanadian's cash flow should be valued at a higher multiple is that it doesn't include anything for a large natural gas discovery off Canada's East Coast. Acquiring a small oil field near Sable Island from the formerly independent UK producer, Lasmo, PanCanadian drilled deeper and found the Deep Panuke gas field. At the time, 1999, PanCanadian could not induce a partner to share the risk. As a result, it has 100% of the discovery, which was a surprise to everyone except perhaps an optimistic company geoscientist. Now that a billion dollar present value field has been found, PanCanadian does not need or want a partner.

Deep Panuke is expected to be ready to produce natural gas for the Boston and vicinity market in 2005. That will be good timing ahead of Arctic gas and liquefied natural gas imports. At 400 million cubic feet per day (mmcfd), annual revenue could be more than a billion dollars at a gas price of $7 per thousand cubic feet (mcf).

A $7 gas price is not as far fetched, as it might seem. PanCanadian management buys the same rationale we do that a reasonable price today might be in the range of US$ 4 to US$ 6 per mcf, around the equivalent for heating oil. Moreover natural gas is cleaner than heating oil.

For further excitement, PanCanadian is one of the two largest leaseholders along the reef edge. Drilling has begun on the first of four additional structures that look like Deep Panuke.

Scotland Oil Discovery Has Exceptional Value

We are surprised that PanCanadian stock has not reacted more obviously to the announcement on July 4 of results from the sidetrack well on the Buzzard prospect in the North Sea. Management states that the well indicates recoverable reserves of 200-300 million barrels. Moreover the limits of the structure have not been defined implying that the discovery could turn into a billion barrel field. In any event it appears to be one of the best of the decade for the area. After a pause for environmental reasons, drilling will resume in the fall in a location that attempts to extend the size of recoverable reserves.

Thinking to ourselves when we saw PCP's press release on July 4 our reaction was "Here is a fairly large old-line company that actually has a pretty exciting new oil discovery." Now we can still get in on it at the practically the same stock price as at midyear. Yet as we will discuss below, PCP's stock has already outperformed for the past two years.

Coal Bed Methane May Also Have Exceptional Value

We were further impressed to hear management hint that recent results of a pilot project to develop natural gas production from coal seams on PCP land had turned strongly positive. PCP Chief Executive, David Tuer, likes to point out that Canada, by some estimates, has more CBM potential than the U.S. although it has no noticeable commercial production yet. Productive U.S. areas include the San Juan Basin, the Powder River Basin, Appalachia, the Black Warrior Basin, the Raton Basin, and **Devon Energy's** latest development, the Cherokee Basin.

Disappointing initially, the first eight wells are now flowing at attractive rates. PCP expects full cycle costs of only US$ 1 per mcf. We'll assume that it will take a lot of wells to develop meaningful production. Yet it could be profitable for an efficient operator like PCP. Total resource potential is a huge 20-30 trillion cubic feet on PCP lands.

The surprising aspect of PCP's CBM is that a small cap company, **Quicksilver Resources (KWK)** would have about a 25% participation in all of PCP's CBM. Priding itself on applying the best people to solve problems, PCP engaged geoscientists and engineers organized in an affiliate of KWK. We can remember first hearing from KWK last April that it had a deal to develop CBM under PCP lands on terms that seemed quite favorable to KWK. While KWK stock, too, has performed well, its valuation does not yet imply much for CBM. Being highly leveraged, KWK may be hard pressed to finance its share of CBM. That may be an opening for PCP to finance KWK in return for a lesser interest for KWK.

PanCanadian Valued at Low Multiple of Cash Flow

By our cash flow projection taking energy prices from the futures market, PCP stock is valued at an EV/Ebitda multiple of only 4.2 years (see table on page 6). Other mid cap oil and gas producers also appear to be valued at similarly low multiples implying that investors may be even more pessimistic on energy prices than are commodity traders (see Tables S-1 and S-2)). Thus valuation appears quite attractive to us for justifying new investment.

Despite expectations for continuing growth we project volumes flat on a daily basis for the next twelve months, hold price differentials constant, and project costs and margins near recent levels. Our projections serve well the purpose of comparing with other companies. In assessing present value as a multiple of cash flow we take little account of the superior growth prospects and better downside protection the company appears to face. Thus if the stock looks attractive on the basis of our next twelve months projections, it should be more attractive on the basis of longer term considerations.

Financial Risk is Low

A Debt/PV ratio of only 0.06 places PCP among the lowest risk energy stocks in terms of financial leverage. When the special dividend is paid, the Debt/PV ratio will increase to a still modest 0.13. On that basis investors can own more of PCP stock compared to a normal position without taking on extra financial risk. For example, $0.65 controls $1.00 of PV in a stock with a typical debt ratio of 0.35. After the dividend, $0.87 would control $1.00 of PV in PCP. As a result one could own a third more PCP on a risk-adjusted basis.

Even with low financial risk the company has sold some of its natural gas forward. At mid year PCP had an unrecognized gain of about US$ 200 million on natural gas hedging contracts.

Better than hedging in our mind is stock repurchase. Why hedge to keep cash flow steadier if temporary weakness might lower stock price for repurchase? Hedging gains are temporary; repurchase gains are permanent. We were encouraged as we saw Mr. Tuer's eyes light up when we asked about whether PCP might repurchase its own shares once it is free of CP.

PCP Stock Has Already Performed Well

Among peer companies, PCP stock has outperformed for the past two years. Yet on a five-year basis, the stock is behind Alberta Energy, **Anadarko** and Devon. At the same time management has been getting the story out to help its six-fold addition to publicly held shares go smoothly. As a result the points we are making in the company's favor are known to anyone who has been paying attention to the stock.

Exceptional Assets Point to Positive Reward/Risk

In an industry where most companies try to tell their story well, we think that PCP does have more to talk about. Larger companies would love to be able to claim Deep Panuke and Buzzard as their successes. Further favorable news would have to help the stock. At the same time how badly could investors suffer in PCP? Perhaps further appreciation may be postponed. Perhaps there will be surprising volatility when all the shares distributed to CP holders come out. Perhaps the industry takes a down turn. In that case low financial leverage and low operating costs will offer relative support.

Kurt H. Wulff, CFA

PanCanadian Petroleum Limited
Next Twelve Months Operating and Financial Estimates
(Canadian dollars)

	Q1 3/31/01	*Q2 6/30/01*	*Q3E 9/30/01*	*Q4E 12/31/01*	*Year 2001E*	*Q1E 3/31/02*	*Q2E 6/30/02*	*Next Twelve Months 6/30/02*
Volume								
Natural Gas (bcf)	92.6	96.1	97.2	97.2	**383.0**	95.0	96.1	**385.4**
Natural Gas (mmcfd)	1,029	1,056	1,056	1,056	**1,049**	1,056	1,056	**1,056**
Days	90	91	92	92	**365**	90	91	**365**
Oil (mmb)	10.5	10.2	10.3	10.3	**41**	10.1	10.2	**41**
Oil (mbd)	117	112	112	112	**113**	112	112	**112**
Total (bcf)	156	157	159	159	**630**	155	157	**630**
Total (mmcfd)	1,731	1,726	1,726	1,726	**1,727**	1,726	1,726	**1,726**
Price								
Henry Hub (US$/mmbtu)	6.31	4.36	3.16	3.70	**4.38**	4.01	3.67	**3.63**
Differential ($/mmbtu)	(2.52)	(2.02)	(2.02)	(2.02)	**(2.12)**	(2.02)	(2.02)	**(2.02)**
PCP ($/mcf)	8.83	6.38	5.18	5.72	**6.50**	6.03	5.69	**5.65**
WTI Cushing (US$/bbl)	28.81	27.90	27.96	27.17	**27.96**	26.58	25.92	**26.90**
Differential	1.74	(2.04)	(2.04)	(2.04)	**(1.08)**	(2.04)	(2.04)	**(2.04)**
PCP ($/bbl)	27.07	29.93	29.99	29.20	**29.04**	28.61	27.96	**28.95**
Total ($/bbl)								
Revenue ($mm)								
Natural Gas	818	613	504	556	**2,490**	573	546	**2,178**
Oil	285	304	308	300	**1,198**	288	284	**1,180**
Other	2,062	1,819	1,924	1,880	**7,685**	1,876	1,905	**7,585**
Total	3,165	2,736	2,736	2,736	**11,373**	2,736	2,736	**10,944**
Expense								
Natural Gas and Oil	209	176	144	158	**687**	159	150	**611**
Other	1,992	1,773	1,878	1,834	**7,477**	1,830	1,859	**7,401**
Total	2,201	1,949	1,949	1,949	**8,048**	1,989	2,009	**7,895**
Ebitda ($mm)								
Natural Gas and Oil	894	741	667	698	**3,001**	701	681	**2,748**
Other	70	46	46	46	**208**	46	46	**184**
Total	964	787	713	744	**3,209**	747	727	**2,932**
Exploration								
Deprec., Deplet., & Amort.	176	214	214	214	**818**	214	214	**856**
Interest	23	20	20	20	**83**	20	20	**80**
Ebt	765	553	479	510	**2,308**	513	493	**1,996**
Income tax	283	121	168	179	**750**	180	172	**698**
Net Income ($mm)	482	432	312	332	**1,557**	334	320	**1,297**
Per share ($)	1.89	1.65	1.19	1.27	**6.00**	1.27	1.22	**4.95**
Shares (millions)	255	262	262	262	**260**	262	262	**262**
Ebitda margin	30%	29%	26%	27%	**28%**	27%	27%	**27%**
Tax rate - current	37%	22%	35%	35%	**33%**	35%	35%	**35%**

Table S-1

Mid Cap and Small Cap Energy Companies

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

	Symbol/	Rating	Price ($/sh) 10-Aug 2001	Shares (mm)	Market Cap ($mm)	Net Present Value ($/sh)	Debt/ Present Value	McDep Ratio
Power								
Consol Energy Inc.	CNX		23.30	79	1,800	19.70	0.65	1.06
Sempra Energy	SRE		26.62	203	5,400	23.10	0.65	1.05
CMS Energy Corporation	CMS		24.59	128	3,200	19.80	0.80	1.05
Constellation Energy Group	CEG		30.01	152	4,600	37.10	0.45	0.89
Total or Median					*15,000*		*0.65*	*1.05*
Natural Gas and Oil								
Triton Energy Limited	OIL		44.92	59	2,700	24.50	0.24	1.64
TEPPCO Partners, L.P.	TPP		31.30	38	1,190	13.20	0.65	1.48
Valero Energy Corp.(with UDS)	VLO		34.68	110	3,800	30.80	0.63	1.05
Ocean Energy, Inc.	OEI		19.39	177	3,400	21.90	0.27	0.92
Marathon Oil Corporation	MRO	1	30.00	310	9,300	42.60	0.26	0.78
Petro-Canada	PCZ		25.17	267	6,700	33.00	0.08	0.78
Unocal Corporation	UCL		35.20	256	9,000	51.90	0.27	0.77
PanCanadian Petroleum (US$)	PCP.TO	2	27.86	262	7,300	37.50	0.06	0.76
Norsk Hydro ASA (49%)	NHY		42.30	128	5,400	61.60	0.16	0.74
Devon Energy Corporation	DVN		49.79	135	6,700	80.10	0.16	0.68
PetroChina Company Ltd (10%)	PTR	2	20.24	176	3,600	32.50	0.15	0.68
Total or Median					*59,100*		*0.24*	*0.78*
Small Cap								
Quicksilver Resources Inc.	KWK		16.65	19.3	320	10.80	0.59	1.22
Dorchester Hugoton, Ltd.*	DHULZ		14.50	10.7	156	12.10	-	1.20
Swift Energy Company	SFY		29.04	25.7	750	27.70	0.24	1.04
Cross Timbers Royalty Tr*	CRT		17.05	6.0	102	16.70	-	1.02
Encore Acquisition Corporation	EAC		14.75	30.0	440	16.40	0.15	0.91
San Juan Basin Royalty Tr*	SJT		13.29	46.6	620	14.80	-	0.90
Penn Virginia Corporation	PVA		36.00	8.8	320	44.20	0.00	0.82
Hugoton RoyaltyTrust*	HGT		12.11	40.0	480	15.30	-	0.79
Energy Partners Ltd.*	EPL	2	10.94	27.0	300	15.70	0.08	0.72
Total or Median					*3,490*		*0.00*	*0.91*
Micro Cap								
Purcell Energy, Ltd. (US$)	PEL.TO		2.27	26.0	59	3.70	0.07	0.65

Buy/Sell rating after symbol: 1 - Strong Buy, 2 - Buy
McDep Ratio = **M**arket **c**ap and **De**bt to **p**resent value of oil and gas and other businesses
* For small cap stocks marked with asterisk, estimated present value recalculated weekly.

Table S-2

Mid Cap and Small Cap Energy Companies

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

	Symbol/ Rating		Price ($/sh) 10-Aug 2001	EV/ Sales 2001E	EV/ Ebitda NTM	P/E NTM	Dividend or Distribution NTM (%)	PV/ Ebitda NTM
Power								
Consol Energy Inc.	CNX		23.30	2.0	7.4	8	4.8	7.0
Sempra Energy	SRE		26.62	1.2	7.4	10	3.8	7.0
CMS Energy Corporation	CMS		24.59	0.9	7.3	9	5.9	7.0
Constellation Energy Group	CEG		30.01	1.8	6.3	9	1.6	7.0
Median				*1.5*	*7.4*	*9*	*4.3*	*7.0*
Natural Gas and Oil								
TEPPCO Partners, L.P.	TPP		31.30	0.7	11.8	16	6.7	8.0
Triton Energy Limited	OIL		44.92	6.3	9.8	24	-	6.0
Valero Energy Corp.(with UDS)	VLO		34.68	0.3	6.3	5	0.9	6.0
Ocean Energy, Inc.	OEI		19.39	3.5	5.5	12	0.8	6.0
Petro-Canada	PCZ		25.17	1.3	4.7	10	1.1	6.0
Unocal Corporation	UCL		35.20	1.7	4.6	13	2.3	6.0
PanCanadian Petroleum (US$)	PCP.TO	2	27.86	1.1	4.2	7	1.0	5.5
Marathon Oil Corporation	MRO	1	30.00	0.4	3.9	7	3.1	5.0
Norsk Hydro ASA (49%)	NHY		42.30	0.8	3.7	8	2.5	5.0
Devon Energy Corporation	DVN		49.79	2.6	3.4	7	0.4	5.0
PetroChina Company Ltd (10%)	PTR	2	20.24	1.4	2.7	5	8.4	4.0
Median				*1.3*	*4.6*	*8*	*1.1*	*6.0*
Small Cap								
Dorchester Hugoton, Ltd.*	DHULZ		14.50	7.7	11.0	13	7.4	9.2
Quicksilver Resources Inc.	KWK		16.65	4.9	11.0		-	9.0
Cross Timbers Royalty Tr*	CRT		17.05	6.1	9.7	10	9.7	9.6
San Juan Basin Royalty Tr*	SJT		13.29	6.4	8.2	11	9.1	9.1
Hugoton RoyaltyTrust*	HGT		12.11	4.9	7.2	10	10.1	9.1
Swift Energy Company	SFY		29.04	4.7	6.2	15	-	6.0
Encore Acquisition Corporation	EAC		14.75	3.7	5.5	13	-	6.0
Penn Virginia Corporation	PVA		36.00	3.5	4.9	11	2.5	6.0
Energy Partners Ltd.*	EPL	2	10.94	2.2	3.9	28	-	5.4
Median				*4.9*	*7.2*	*12*	*2.5*	*9.0*
Micro Cap								
Purcell Energy, Ltd. (US$)	PEL.TO		2.27	3.0	3.9	13	-	6.0

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended June 30, 2002; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses
* For small cap stocks marked with asterisk, estimated present value recalculated weekly.

