McDep Associates
Stock Idea
November 16, 2001

Buy/Sell Rating: 2 - Buy

Purcell Energy Ltd.
Micro Cap Natural Gas Producer in the Northwest Territories

Symbol	*Price (C$/sh) 16-Nov 2001*	*Price (US$/sh) 16-Nov 2001*	*Shares (mm)*	*Market Cap (US$mm)*	*Net Present Value (US$/sh)*	*Debt/ Present Value*	*McDep Ratio*	*EV/ Sales 2001E*	*EV/ Ebitda NTM*	*P/E NTM*	*Div'd NTM (%)*	*PV/ Ebitda NTM*
PEL.TO	3.00	1.89	27	52	3.46	0.09	0.59	2.6	3.5	8	-	6.0

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$mm*	61
Ebitda = Earnings before interest, tax, depreciation and amortization:	*US$mm*	17
NTM = Next Twelve Months Ended September 30, 2002; P/E = Stock Price to Earnings		
PV = Present Value of oil and gas:	*US$mm*	104

Summary and Recommendation

We recommend current purchase of the common stock of Purcell Energy Ltd. because it owns a major interest in Liard, a large natural gas field in the Northwest Territories of Canada. Chevron is the operator and largest interest owner in the Fort Liard Project followed by Purcell and Anadarko. Talisman Energy is a partner with Purcell in an exploratory venture in the same promising area. Some of the cash flow from Fort Liard is being returned to shareholders through stock repurchase and some is being redeployed in diversified oil and gas projects elsewhere in Western Canada. The main risk in the stock, aside from the price of natural gas, is the short operating history of the wells in the field that accounts for two-thirds of the company's value. Yet the company's low debt balance sheet is reassuring at a time of industry volatility. The stock has appreciation potential of some 70% to present value of equity. Beyond that, possible gains in the value of natural gas as a commodity and good luck in exploration could multiply the stock's appeal.

Fort Liard at the Leading Edge of Onshore North American Natural Gas

In recent years the Mother Lode of onshore natural gas in North America has been the San Juan Basin of New Mexico. From there exploration and exploitation is gradually making its way north and west along the mountainous spine of the North American continent. The trend runs through the U.S. Rockies, through Alberta and British Columbia, into the Northwest Territories, and eventually to the Arctic Ocean and its islands. The immaturity and hence prospectivity of exploration and development increases as we go northwest, but pipelines do not yet reach to all the discoveries.

The North American pipeline grid extends a little way into the Northwest Territories today. Thus, a company active in the Fort Liard area at the southern border of NWT has the leading edge combination of lightly exploited geology and access to the end of the pipeline grid.

A predecessor of Purcell held exploration rights in NWT. Chevron partnered with the small company to conduct further drilling and then the development of a large discovery. The Fort Liard properties were recently producing at the rate of 130 million cubic feet per day from only three wells. Two of the wells rank in a handful of the top producers ever drilled in western Canada. A mid year estimate put proven reserves in place at 580 billion cubic feet of raw gas, twelve times the recent rate of production annualized. Not all of the gas in place is recoverable and not all of it is the methane that we know as pipeline quality natural gas.

Strategic Exploration With A Respected Partner

While Liard is the largest discovery in the southern NWT, most of the prospective acreage in the area has yet to be leased. A land sale is expected in 2002 to be conducted on behalf of the native people descended from the indigenous residents of the region. The sale will be competitive, with participation expected from other companies active nearby including Anadarko/Forest, Chevron and Devon/Anderson.

Micro Cap Purcell has a partner with greater financial strength and strong technological expertise, Talisman Energy, to pursue targets in a regional Area of Mutual Interest. As is often the case, small companies have disproportionate interests in projects developed by larger companies. Purcell has the right to a 40% share of any specific project Talisman undertakes in the area.

The Purcell/Talisman Joint Venture completed a seismic program this past summer. The results are being interpreted. Before the survey, Talisman identified 3 to 7 prospects that could each potentially reproduce the Liard field.

Stock Repurchase Returns Capital

Meanwhile, management seems sensitive to the historical risk that after a company scores a big discovery it reinvests all the cash flow to find another without success. At the same time Purcell's stock price at C$ 3.00 is just half management's net asset value of C$ 6.05 using a commodity price forecast as of July 1, 2001. That is too tempting to pass up and the company has repurchased almost a million shares in the two months leading up to August 3. More shares may have been reacquired since then under a 2.2 million-share authorization, or about 8% of shares out.

Reinvestment Diversifies Asset Mix

Cash flow from Liard is also being reinvested in other oil and gas prospects in Canada. During the first half of 2001 proven reserves elsewhere increased from 23% to 32% of the total according to management.

Unavoidably, reinvestment success depends in large part on the quality of management. We have met several times with Mr. Jan Alston, President and Chief Executive Officer. Mr. Alston appears forthright and truthful and we are impressed by his apparent past contributions to the company's success. Purcell has credible partners in Chevron and Talisman as well as other companies it deals with outside of Fort Liard.

Value Concentrated in Single New Field

While the reward we see in Purcell stock starts with a minimum 24% ownership of a large field, the newness of that asset also poses a risk for the stock. Investors remember high expectations for nearby Pointed Mountain field, discovered by Amoco, that were washed away when natural gas turned to water. Yet Chevron is aware of the problem that limited production at Pointed Mountain and has taken great care to avoid its repetition. So far the Liard wells are not showing any susceptibility to unexpected decline. Moreover Purcell's independent engineer, the respected Gilbert Laustsen Jung Associates Ltd., has taken extra care in its estimates also.

Opportunity Loss in Natural Gas Contracts

Management has warned investors to expect a shortfall in third quarter cash flow, soon to be reported, because of the cost of a mistimed natural gas contract change. The opportunity cost ended on November 1st. Popularized by traders like Enron along with banks and Wall Street houses, financial engineering with hedges options and futures is increasingly applied by most oil and gas producers. Our view is that most companies are losers when they engage in unnecessary contracting practices that attempt to outguess the market. While we use the futures market for information we do not give companies credit for price realizations other than what the market determines. Financial engineering profits, if any, are not predictable on a continuing basis and therefore are not reliable for use in valuation of stocks.

Valuation Attractive on Cautious Projections

Except in a few cases where we attempt a complete discounted cash flow calculation we compare stocks on the basis of a cash flow projection for the next twelve months and an assessment of present value as a multiple of that cash flow. While commodity price is the greatest uncertainty in future cash flow, the same supply and demand factors affect the whole industry. We neutralize the issue further by taking at face value the commodity price assumptions embedded in the commodity futures market.

While we adhere strictly to the futures market in our calculations, we don't accept the results blindly. We know there is vulnerability at any time. We also believe in long-term global economic growth and a value of energy greater than in today's futures market.

The next greatest source of uncertainty in cash flow projections is production volume. Here we take a cautious tack on Purcell. Even though management projects volume for 2002 at 7000 barrels equivalent daily, we use only the 5.3 mbd recently achieved (see Table). As a result we project Ebitda for the next twelve months at C$ 27.5 million compared to management's recent estimate of C$ 32 million cash flow for 2002.

Next we assess a multiple of 6.0 for present value to Ebitda. That multiple looks reasonable compared to the median of 7.5 for a dozen peers among natural gas producers. The main differentiating factor among companies is expectations for future cash flow beyond one year. Much of that is already predetermined by each company's existing reserve position. On a proven only basis, Purcell's reserve life index of 6.2 years on projected production compared to a median 8 years largely explains our lower assessed multiple.

Cash flow times a multiple minus debt and divided by shares leads to present value of equity of US$ 3.46 per share compared to management's estimate of C$ 6.05 that translates to about US$ 3.80. Knowing that such estimates are sensitive to commodity price we are reassured that Purcell has little debt meaning that the company is well positioned to weather a downturn should one arrive before the upturn we look for in the future.

Volatile Times May Reward the Patient

Few energy stocks were as exciting as Enron. Yet in the end Enron collapsed. Enron believed in high financial leverage and paper assets. With Enron discredited, the anti-Enron companies are those with low debt and real assets. Such companies are likely to be among those left standing and in a position to prosper. Purcell has low debt and attractive real assets.

From today's price of US$ 1.87 (C$ 3.00) we see appreciation to US$ 3.46 (C$ 5.49) perhaps over the next year. At that point Purcell's McDep Ratio would be 1.00 on today's calculation, our measure of normal value. There are many companies below 1.00 currently, but few as low as Purcell at 0.59. While that is an indicator of potential we think the return can be even greater over several years subject to political, economic, business and financial risk.

Kurt H. Wulff, CFA

Purcell Energy Ltd.
Operating and Financial Results

	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*	*Q3E 9/30/02*	***Next Twelve** Months 9/30/02*
Volume									
Natural Gas (bcf)	1.90	1.95	2.62	2.62	**9.09**	2.57	2.62	2.62	**10.43**
Natural Gas (mmcfd)	21.1	21.4	28.5	28.5	**24.9**	28.5	28.5	28.5	**28.5**
Days	90	91	92	92	**365**	90	92	92	**366**
Oil (mb)	48	44	51	51	**192**	50	51	51	**201**
Oil (mbd)	0.53	0.48	0.55	0.55	**0.53**	0.55	0.55	0.55	**0.55**
Total (mb)	364	368	488	488	**1,707**	477	488	488	**1,940**
Total (mbd)	4.0	4.0	5.3	5.3	**4.7**	5.3	5.3	5.3	**5.3**
Price									
Henry Hub ($/mmbtu)	6.31	4.36	2.75	2.69	**4.03**	3.11	3.10	3.21	**3.03**
Differential ($/mmbtu)	0.66	(0.29)	(0.29)	(0.29)	**0.11**	(0.29)	(0.29)	(0.29)	**(0.29)**
PEL (C$/mcf)	5.65	4.65	3.04	2.98	**3.91**	3.40	3.39	3.50	**3.32**
WTI Cushing ($/bbl)	28.81	27.90	26.69	22.02	**26.35**	22.48	22.35	22.20	**22.26**
Differential	(1.92)	(4.36)	(4.36)	(4.36)	**(3.67)**	(4.36)	(4.36)	(4.36)	**(4.36)**
PEL (C$/bbl)	30.73	32.26	31.05	26.38	**30.02**	26.85	26.72	26.56	**26.63**
Revenue (C$mm)									
Natural Gas	10.7	9.1	8.0	7.8	**35.5**	8.7	8.9	9.2	**34.6**
Oil	1.5	1.4	1.6	1.3	**5.8**	1.3	1.4	1.3	**5.4**
Other	(0.8)	(2.7)	(3.5)	(0.6)	**(7.6)**	(0.7)	(0.7)	(0.7)	**(2.8)**
Total	11.4	7.7	6.0	8.5	**33.7**	9.4	9.5	9.8	**37.2**
Expense									
Production	1.4	1.6	2.0	2.0	**6.9**	1.9	2.0	2.0	**7.8**
General and administrative	0.4	0.4	0.5	0.5	**1.8**	0.5	0.5	0.5	**1.9**
Other	0.8	(0.2)							
Total	2.6	1.8	2.4	2.4	**9.3**	2.4	2.4	2.4	**9.7**
Ebitda	8.8	6.0	3.6	6.1	**24.4**	7.0	7.1	7.4	**27.5**
Exploration									
Deprec., Deplet., & Amort.	2.1	2.0	2.9	2.9	**10.0**	2.9	2.9	2.9	**11.6**
Other Non Cash									
Ebit	6.7	3.9	0.7	3.1	**14.4**	4.1	4.2	4.4	**15.8**
Interest	0.2	0.2	0.2	0.2	**0.7**	0.2	0.2	0.2	**0.7**
Ebt	6.5	3.8	0.5	3.0	**13.7**	3.9	4.0	4.3	**15.1**
Income Tax	2.3	1.3	0.2	1.0	**4.8**	1.4	1.4	1.5	**5.3**
Net Income ($mm)	4.2	2.4	0.3	1.9	**8.9**	2.6	2.6	2.8	**9.8**
Per Share (C$)	0.16	0.09	0.01	0.07	**0.33**	0.09	0.09	0.10	**0.36**
Shares (millions)	26	27	27	27	**27**	27	27	27	**27**
Production (C$/bbl)	3.96	4.22	4.00	4.00	**4.04**	4.00	4.00	4.00	**4.00**
General and admin (C$/bbl)	0.99	1.18	1.00	1.00	**1.04**	1.00	1.00	1.00	**1.00**
Deprec., D,& A (C$/bbl)	5.83	5.50	6.00	6.00	**5.86**	6.00	6.00	6.00	**6.00**
Ebitda Margin	77%	77%	60%	71%	**72%**	74%	74%	75%	**74%**
Tax rate	35%	35%	35%	35%	**35%**	35%	35%	35%	**35%**

Commodity prices above are current with the futures market of November 9, 2001. Futures have changed since then, but Purcell's relative appeal has probably not changed much.

