

Rating: Buy
S&P 500: 1191

Encore Acquisition Company **Long Life Oil Value**

<i>Symbol</i>	EAC	<i>Ebitda Next Twelve Months ending 9/30/06 (US\$m)</i>	509
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	43
<i>Price (\$/sh)</i>	33.76	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	10/26/05	<i>Adjusted Reserves/Production NTM</i>	14.3
<i>Shares (mm)</i>	50	<i>EV/Ebitda</i>	4.6
<i>Market Capitalization (\$mm)</i>	1,670	<i>PV/Ebitda</i>	6.2
<i>Debt (\$mm)</i>	670	<i>Undeveloped Reserves (%)</i>	29
<i>Enterprise Value (EV) (\$mm)</i>	2,340	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	45.40
<i>Present Value (PV) (\$mm)</i>	3,150	<i>Present Value Proven Reserves(\$/boe)</i>	16.80
<i>Net Present Value (\$/share)</i>	50	<i>Present Value Proven Reserves(\$/mcf)</i>	2.80
<i>Debt/Present Value</i>	0.21	<i>Earnings Next Twelve Months (US\$/sh)</i>	3.55
<i>McDep Ratio - EV/PV</i>	0.74	<i>Price/Earnings Next Twelve Months</i>	10
<i>Dividend Yield (%/year)</i>	0.0	<i>Indicated Annual Dividend (US\$/sh)</i>	0.00

Note: Estimated cash flow and earnings tied to one-year futures prices for oil and natural gas.

Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

Summary and Recommendation

Buy-recommended **Encore Acquisition (EAC)** offers 48% appreciation potential to estimated net present value of \$50 a share. Taking account of latest quarterly results, our correlation of 30 companies indicates net present value about \$12 a share higher than estimated. Acquisitions in recent months add about 8% to proven reserves. New purchases are financed with long-maturity debt and risk is reduced with price hedges. The company has a backlog of 100 to 250 million barrels it believes it can add to proven reserves currently of 187 million barrels equivalent of natural gas and oil. Tertiary recovery by air injection proceeding in the company's Cedar Creek Anticline oil field offers the greatest potential for adding to proven reserves.

Cash Flow and Reserve Life Point to Present Value

McDep analysis presumes that fundamental value is measured by the projection of cash flows far into the future and discounting them to the present at a rate of return, currently 7% a year before inflation. 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 combined correlation is about \$12 a share higher than our ongoing standard estimate for the company (see table Functional Cash Flow and Present Value). Long life might justify a higher multiple than in our present value estimate. At the same time we may be understating the cost of hedging as our cash flow estimates are before that deduction. We also estimate cash flow before allowing for compensation expense paid in stock.

Please see disclosures on the final page.

Encore Acquisition Company
Functional Cash Flow and Present Value

	<i>NTM Ebitda</i> <i>(US\$mm)</i>	<i>Adjusted</i> <i>R/P</i>	<i>PV/</i> <i>Ebitda</i>	<i>Present</i> <i>Value</i> <i>(US\$mm)</i>	
North American Natural Gas	220	8.8	3.6	800	25%
Oil	289	17.6	8.1	2,350	75%
	509	14.3	6.2	3,150	100%
Debt (US\$mm)				670	
Net Present Value (US\$mm)				2,480	
Shares (mm)				50	
Net Present Value (US\$/sh)				50	
Over (-)/ Under (+) Correlation (US\$/sh)				12	

Cash Flow by Quarter Depends on Latest Results and Futures Prices

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](#)). Company disclosures provide the clues for future volumes and costs as well as geographic and quality differences in price. Futures prices from the New York Mercantile Exchange determine industry benchmarks for the next year.

Latest acquisitions add to third quarter and fourth quarter 2005 volume gains. Prices tracked the industry benchmarks better recently.

A one-time charge to extinguish debt that was replaced on more advantageous terms reduced reported earnings by \$0.25 per share. We show earnings before that charge for the third quarter just reported.

Industry Conditions Support Long-Term Price Expectation

Present value estimates that form the denominator of the McDep Ratio and change only occasionally for all companies, most recently in early August, are tied to expected constant real long-term prices. Recent futures price for oil delivered over the next six years at \$58 a barrel exceeds our long-term expectation of \$50. One-year futures for natural gas exceed our long-term expectation while six-year futures for natural gas also have appreciation potential, in our opinion.

Oil and Gas Commodity and Stock Price
Wednesday, October 26, 2005

	<i>Units</i>	<i>Futures Price</i>		<i>McDep Ratio</i>
		<i>Six-Year</i>	<i>One-Year</i>	<i>Denominator</i>
Crude Oil	\$/barrel	57.67	61.81	50
Natural Gas	\$/million btu	8.59	12.09	10
	<i>Stocks</i>			<i>Median</i>
	Independent Producer - Small Cap			<i>McDep Ratio</i>
	EAC			0.73
				0.74

Source: McDep Associates, Bloomberg, New York Mercantile Exchange, Yahoo and company disclosures

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Encore Acquisition Company
Next Twelve Months Operating and Financial Estimates

	<i>Q4</i>	<i>Year</i>	<i>Q1</i>	<i>Q2</i>	<i>Q3</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Next Twelve Months</i>
	<i>12/31/04</i>	<i>2004</i>	<i>3/31/05</i>	<i>6/30/05</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>2005E</i>	<i>3/31/06</i>	<i>6/30/06</i>	<i>9/30/06</i>	<i>9/30/06</i>
Volume											
Natural Gas (mmcf)	46.7	38.5	49.5	54.2	59.7	70.0	58.4	70.0	70.0	70.0	70.0
Oil (mbd)	18.32	18.25	18.97	18.66	18.26	18.6	18.62	19.6	19.6	18.5	19.07
Total (mbd)	26.1	24.7	27.2	27.7	28.2	30.3	28.4	31.3	31.3	30.2	30.7
Price											
Henry Hub (\$/mmbtu)	7.10	6.15	6.27	6.76	8.56	13.38	8.74	13.36	10.43	10.40	11.89
Differential (\$/mmbtu)	0.41	0.39	0.41	0.19	0.09	0.15	(0.16)	0.15	0.11	0.11	0.13
EAC (\$/mcf)	6.69	5.76	5.77	6.57	8.47	13.23	8.91	13.22	10.31	10.28	11.76
WTI Cushing (\$/bbl)	48.31	41.44	49.65	53.05	62.52	61.00	56.56	60.75	61.06	61.09	60.97
Differential	4.46	3.19	4.64	5.84	4.43	4.32	4.83	4.32	4.33	4.33	4.32
EAC (\$/bbl)	43.85	38.25	45.01	47.21	58.09	56.68	51.73	56.45	56.73	56.76	56.65
Total (\$/bbl)	42.74	37.29	41.86	44.67	55.53	65.44	52.32	64.97	58.65	58.67	61.93
Revenue (\$mm)											
Natural Gas	29	81	26	32	46	85	190	83	66	66	300
Oil	74	255	77	80	98	97	352	100	101	97	394
Total	103	336	103	113	144	182	541	183	167	163	695
Expense											
Lease operating	13	47	15	16	18	22	71	23	23	22	90
Production taxes	9	30	9	10	13	16	48	16	15	15	63
General and administrative	5	17	6	8	7	8	29	8	9	8	34
Total	28	94	30	34	37	47	147	47	46	45	186
Ebitda	75	242	73	79	107	135	394	135	121	118	509
Exploration	2	4	3	4	5	5	16	5	5	5	19
Deprec., Deplet., & Amort.	15	49	17	19	24	28	88	28	28	28	112
Hedging and other	11	39	13	13	27	26	79	25	21	20	92
Ebit	47	150	40	44	51	81	216	82	72	69	304
Interest	7	23	7	7	9	9	32	9	8	8	33
Ebt	40	126	33	36	43	72	184	73	64	61	271
Income Tax	14	44	12	12	9	25	59	26	22	21	95
Net Income (\$mm)	26	82	22	24	33	47	126	48	41	40	176
Per Share (\$)	0.53	1.71	0.44	0.48	0.67	0.95	2.54	0.96	0.83	0.80	3.55
Shares (millions)											
Lease operating (\$/bbl)	5.58	5.24	6.07	6.24	6.90	8.00	6.84	8.00	8.00	8.00	8.00
Production taxes (%rev)	9.0	9.0	8.9	8.7	8.7	9.0	8.8	9.0	9.0	9.0	9.0
General and admin (\$/bbl)	2.20	1.87	2.45	3.16	2.52	3.00	2.79	3.00	3.00	3.00	3.00
Deprec., D, & A (\$/bbl)	6.36	5.39	6.81	7.55	9.34	10.00	8.48	10.00	10.00	10.00	10.00
Ebitda Margin	73%	72%	71%	70%	74%	74%	73%	74%	72%	72%	73%
Tax rate	35%	35%	35%	34%	22%	35%	32%	35%	35%	35%	35%

Buy Independent Natural Gas and Oil Producers

Energy is necessary for world economic growth and clean energy provides a better quality of life. Independent natural gas and oil producers are among the leading global suppliers of clean energy. McDep Ratios that compare Enterprise Value with Present Value of energy and other businesses imply that the stock market undervalues the fundamental prospects. Stocks are ranked in descending order of McDep Ratio connoting “buy low, sell high” (see table Rank by McDep Ratio).

Kurt H. Wulff, CFA

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

	<i>Symbol/</i>	<i>Rating</i>	<i>Price</i> <i>(\$/sh)</i>	<i>Shares</i>	<i>Market</i>	<i>Net</i>	<i>Debt/</i>	<i>McDep</i>
			<i>26-Oct</i>	<i>(mm)</i>	<i>Cap</i>	<i>Present</i>	<i>Present</i>	<i>Ratio</i>
			<i>2005</i>		<i>(\$mm)</i>	<i>Value</i>	<i>Value</i>	
Independent Natural Gas and Oil - Large Cap and Mid Cap								
Encana Corporation	ECA	B	47.95	876	42,000	51.00	0.20	0.95
XTO Energy Inc.	XTO	B	43.72	370	16,180	48.00	0.20	0.93
Burlington Resources	BR	B	70.98	385	27,300	86.00	0.09	0.84
CNOOC Limited (29%)	CEO	B	63.64	119	7,590	84.00	0.01	0.76
Devon Energy Corporation	DVN	B	60.75	471	28,600	86.00	0.15	0.75
Anadarko Petroleum Corp.	APC	B	90.21	238	21,500	140.00	0.11	0.69
Occidental Petroleum Corp.	OXY	B	75.60	406	30,700	120.00	0.11	0.67
<i>Total or Median</i>					<i>174,000</i>		<i>0.11</i>	<i>0.76</i>
Independent Natural Gas and Oil - Small Cap								
Berry Petroleum Company	BRY	B	57.59	23	1,300	65.00	0.10	0.90
Encore Acquisition Company	EAC	B	33.76	50	1,670	50.00	0.21	0.74
Energy Partners Ltd.	EPL	B	25.11	41	1,020	38.00	0.17	0.72
Cimarex Energy Company	XEC	B	38.78	85	3,300	64.00	0.12	0.65
<i>Total or Median</i>					<i>7,300</i>		<i>0.15</i>	<i>0.73</i>

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