

Rating: Buy  
S&P 500: 1367

## **Encore Acquisition Company** **Brown Bassett Wolfcamp**

<i>Symbol</i>	EAC	<i>Ebitda Next Twelve Months ending 9/30/07 (US\$m)</i>	365
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	28
<i>Price (\$/sh)</i>	24.19	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	11/2/06	<i>Adjusted Reserves/Production NTM</i>	15.5
<i>Shares (mm)</i>	54	<i>EV/Ebitda</i>	5.4
<i>Market Capitalization (\$mm)</i>	1,300	<i>PV/Ebitda</i>	9.8
<i>Debt (\$mm)</i>	670	<i>Undeveloped Reserves (%)</i>	28
<i>Enterprise Value (EV) (\$mm)</i>	1,980	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	33.80
<i>Present Value (PV) (\$mm)</i>	3,580	<i>Present Value Proven Reserves(\$/boe)</i>	18.30
<i>Net Present Value (\$/share)</i>	54	<i>Present Value Proven Reserves(\$/mcf)</i>	3.10
<i>Debt/Present Value</i>	0.19	<i>Earnings Next Twelve Months (US\$/sh)</i>	1.66
<i>McDep Ratio - EV/PV</i>	0.55	<i>Price/Earnings Next Twelve Months</i>	15
<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.

Estimated present value presumes a long-term price for oil of US\$60 a barrel and natural gas, \$10 a million btu.

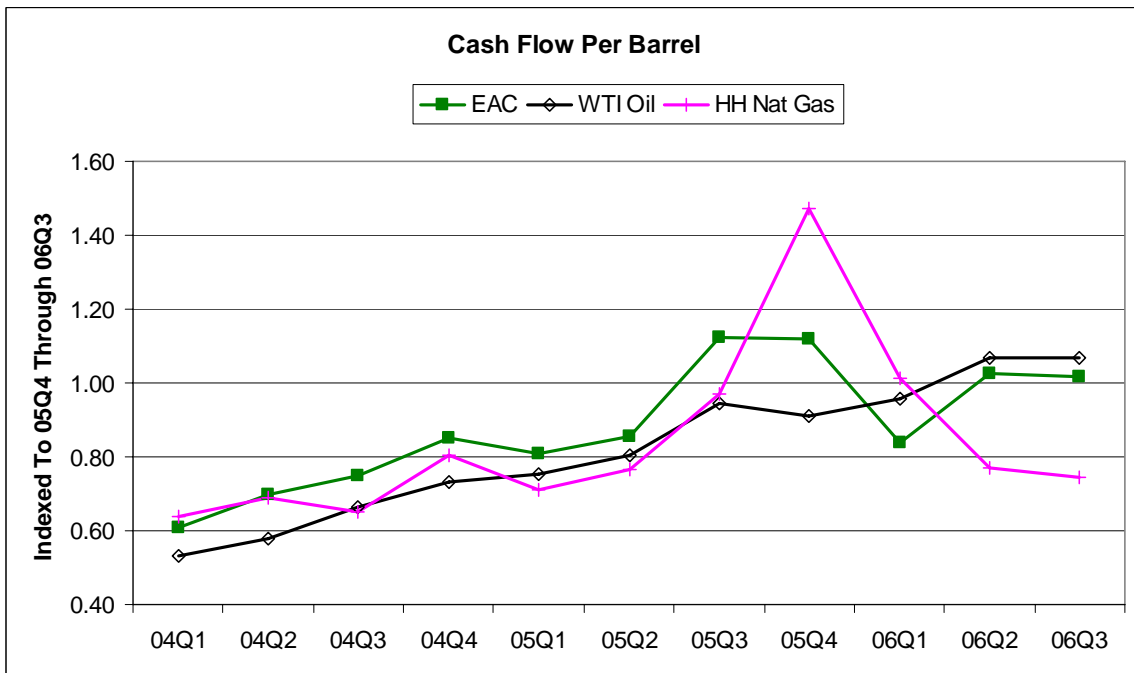
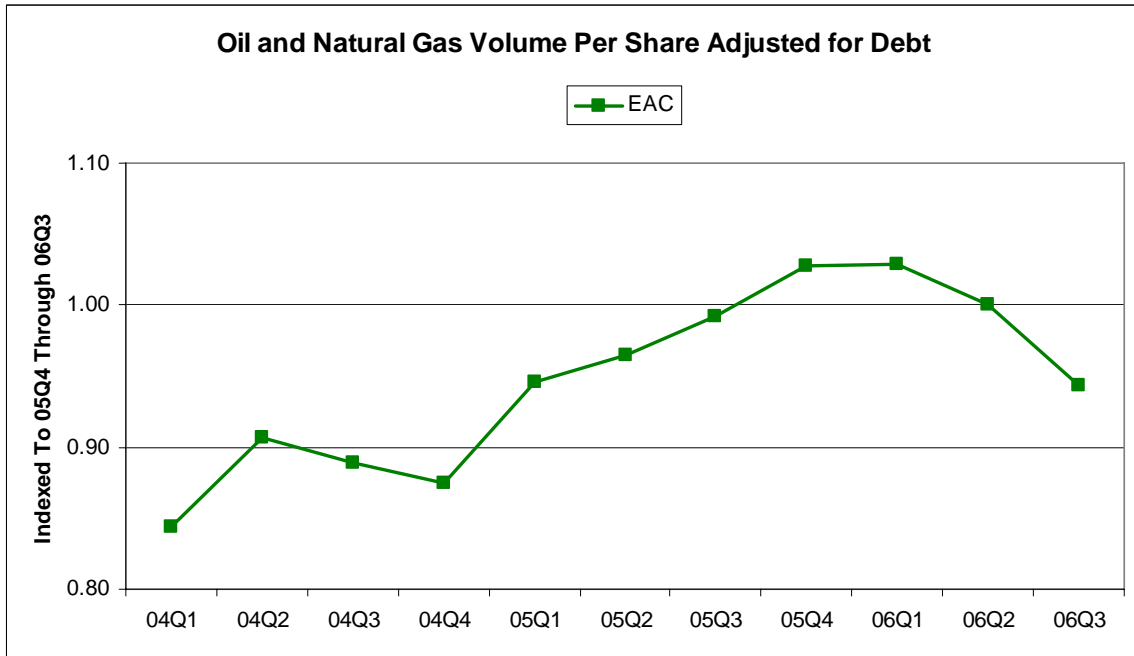
For historical research on Encore since 2003 see <http://www.mcdep.com/4eac.htm>

### **Summary and Recommendation**

Buy-recommended **Encore Acquisition (EAC)** at a McDep Ratio of 0.55 offers unlevered appreciation potential of 81% to estimated present value. Reported on November 1, third quarter operations trace a rising trend in oil and gas production volume with some mild decline recently (see chart). Concentrated 75% on oil by value, EAC earns a cash flow margin that tracks mostly with oil price rather than natural gas price (see chart). Though it seems high relative to stock price, Net Present Value matches that from correlating the rate of production relative to reserves with present value as a multiple of cash flow for some thirty natural gas and oil producers (see table on page 4). Besides a slowly building response from high pressure injection in the Cedar Creek Anticline in Montana, Encore looks to a joint venture with buy-rated **ExxonMobil (XOM)** in West Texas for growth. Recent success in the Wolfcamp formation in XOM's Brown Bassett field may help fourth quarter volume and contribute to 5% of EAC's total corporate volume in 2007. Below the 200-day average price signifying an out-of-favor stock, EAC has a full weighting in our illustrative energy portfolio concentrated on real assets that promise a high return providing clean fuel for global growth.

Kurt H. Wulff, CFA

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**Encore Acquisition Company**  
**Next Twelve Months Operating and Financial Estimates**

	<i>Q3</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>9/30/05</i>	<i>6/30/06</i>	<i>9/30/06</i>	<i>12/31/06</i>	<i>2006E</i>	<i>3/31/07</i>	<i>6/30/07</i>	<i>9/30/07</i>	<i>9/30/07</i>
<b>Volume</b>									
Natural Gas (mmcf)	59.7	65.7	59.5	59.5	<b>63.1</b>	59.5	59.5	59.5	<b>59.5</b>
Oil (mbd)	18.26	19.9	19.7	19.7	<b>20.03</b>	19.7	19.7	19.7	<b>19.74</b>
Total (mb)	2,595	2,809	2,728	2,728	<b>11,147</b>	2,669	2,698	2,728	<b>10,822</b>
Total (mbd)	28.2	30.9	29.7	29.7	<b>30.5</b>	29.7	29.7	29.7	<b>29.7</b>
<b>Price</b>									
Henry Hub (\$/mmbtu)	8.56	6.81	6.58	6.30	<b>7.17</b>	8.30	7.74	7.94	<b>7.57</b>
Differential (\$/mmbtu)	0.09	(0.01)	0.52	0.50	<b>0.75</b>	0.66	0.61	0.63	<b>0.61</b>
EAC (\$/mcf)	8.47	6.82	6.06	5.80	<b>6.42</b>	7.64	7.12	7.31	<b>6.97</b>
WTI Cushing (\$/bbl)	62.52	70.47	70.42	58.20	<b>65.60</b>	60.80	63.32	64.77	<b>61.77</b>
Differential	4.43	11.19	8.22	6.79	<b>10.27</b>	7.10	7.39	7.56	<b>7.21</b>
EAC (\$/bbl)	58.09	59.28	62.20	51.40	<b>55.33</b>	53.70	55.93	57.21	<b>54.56</b>
Total (\$/bbl)	55.53	52.77	53.56	45.86	<b>49.53</b>	51.08	51.51	52.75	<b>50.29</b>
<b>Revenue (\$mm)</b>									
Natural Gas	46	41	33	32	<b>148</b>	41	39	40	<b>151</b>
Oil	98	107	113	93	<b>404</b>	95	100	104	<b>393</b>
Total	144	148	146	125	<b>552</b>	136	139	144	<b>544</b>
<b>Expense</b>									
Lease operating	18	23	25	25	<b>95</b>	24	24	25	<b>97</b>
Production taxes	13	13	14	11	<b>50</b>	12	13	13	<b>49</b>
General and administrative	7	7	6	8	<b>31</b>	8	8	8	<b>32</b>
Total	37	43	44	44	<b>175</b>	44	45	46	<b>179</b>
<b>Ebitda</b>	107	106	102	81	<b>377</b>	92	94	98	<b>365</b>
Exploration	5	4	12	6	<b>24</b>	6	6	6	<b>24</b>
Deprec., Deplet., & Amort.	24	28	28	30	<b>113</b>	29	30	30	<b>119</b>
Hedging and other	27	19	5	13	<b>57</b>	17	17	18	<b>66</b>
<b>Ebit</b>	51	55	57	38	<b>190</b>	45	47	50	<b>180</b>
Interest	9	10	11	11	<b>44</b>	11	11	11	<b>43</b>
<b>Ebt</b>	43	44	46	27	<b>146</b>	35	36	39	<b>137</b>
Income Tax	9	15	25	10	<b>60</b>	12	13	14	<b>48</b>
<b>Net Income (\$mm)</b>	33	29	21	18	<b>86</b>	22	24	25	<b>89</b>
Per Share (\$)	0.67	0.55	0.39	0.33	<b>1.63</b>	0.42	0.44	0.47	<b>1.66</b>
<b>Shares (millions)</b>	50	54	54	54	<b>53</b>	54	54	54	<b>54</b>
Lease operating (\$/bbl)	6.90	8.23	8.98	9.00	<b>8.51</b>	9.00	9.00	9.00	<b>9.00</b>
Production taxes (%rev)	8.7	8.5	9.3	9.0	<b>9.0</b>	9.0	9.0	9.0	<b>9.0</b>
General and admin (\$/bbl)	2.52	2.49	2.31	3.00	<b>2.74</b>	3.00	3.00	3.00	<b>3.00</b>
Deprec., D.& A (\$/bbl)	9.34	9.97	10.08	11.00	<b>10.09</b>	11.00	11.00	11.00	<b>11.00</b>
Ebitda Margin	74%	71%	70%	65%	<b>68%</b>	68%	68%	68%	<b>67%</b>
Tax rate	22%	34%	54%	35%	<b>41%</b>	35%	35%	35%	<b>35%</b>

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**Encore Acquisition Company**  
**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	101	11.8	8.9	900	25%
Oil	264	17.3	10.2	2,680	75%
	365	15.5	9.8	3,580	100%
Debt (US\$mm)					670
Net Present Value (US\$mm)					2,910
Shares (mm)					54
Net Present Value - Standard Estimate (US\$/sh)					54
Net Present Value - Approximation by Correlation (US\$/sh)					52

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