

Rating: Buy
S&P 500: 1431

Encore Acquisition Company Creating MLP for Income Investors

<i>Symbol</i>	EAC	<i>Ebitda Next Twelve Months ending 12/31/07 (US\$m)</i>	321
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	28
<i>Price (\$/sh)</i>	23.42	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	1/17/07	<i>Adjusted Reserves/Production NTM</i>	15.5
<i>Shares (mm)</i>	54	<i>EV/Ebitda</i>	6.1
<i>Market Capitalization (\$mm)</i>	1,260	<i>PV/Ebitda</i>	11.2
<i>Debt (\$mm)</i>	700	<i>Undeveloped Reserves (%)</i>	28
<i>Enterprise Value (EV) (\$mm)</i>	1,960	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	29.70
<i>Present Value (PV) (\$mm)</i>	3,600	<i>Present Value Proven Reserves(\$/boe)</i>	18.40
<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>	1.27
<i>McDep Ratio - EV/PV</i>	0.54	<i>Price/Earnings Next Twelve Months</i>	18
<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)** announces a potentially value-enhancing action to form a publicly-traded Master Limited Partnership to distribute high income from its oil and gas resources. No further information has been disclosed except that unspecified properties would be included with Wyoming reserves newly acquired for \$400 million from buy-recommended **Anadarko (APC)**. An initial public offering of units is expected, perhaps by mid-year. Today's median McDep Ratio of about 0.80 for royalty trusts, four of which Encore's chairman and founder had a hand in founding, suggests that the portion of Encore's present value transferred to the MLP could have unlevered market recognition 40% higher than that implied by Encore's low McDep Ratio of 0.54. Thus, if half of Encore were to be dedicated to an income distributing entity the enhancement would be some 20% to total unlevered value and a higher percentage to equity value. That would help reverse direction for an out-of-favor stock trading below its 200-day average price for almost a year. Small cap 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

Please see disclosures on the final page.

Encore Acquisition Company
Next Twelve Months Operating and Financial Estimates

	<i>Q4</i>	<i>Q3</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Next Twelve Months</i>
	<i>12/31/05</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>12/31/07</i>	<i>12/31/07</i>
Volume									
Natural Gas (mmcf)	67.2	59.5	59.5	63.1	59.5	59.5	59.5	59.5	59.5
Oil (mbd)	19.45	19.7	19.7	20.03	19.7	19.7	19.7	19.7	19.74
Total (mb)	2,820	2,728	2,728	11,147	2,669	2,698	2,728	2,728	10,822
Total (mbd)	30.7	29.7	29.7	30.5	29.7	29.7	29.7	29.7	29.7
Price									
Henry Hub (\$/mmbtu)	13.00	6.58	6.57	7.23	6.38	6.85	7.09	7.95	7.07
Differential (\$/mmbtu)	3.11	0.52	0.52	0.76	0.51	0.54	0.56	0.63	0.56
EAC (\$/mcf)	9.89	6.06	6.04	6.47	5.87	6.30	6.52	7.32	6.51
WTI Cushing (\$/bbl)	60.02	70.42	59.99	66.05	53.28	55.17	56.58	57.74	55.69
Differential	6.12	8.22	7.00	10.33	6.22	6.44	6.60	6.74	6.49
EAC (\$/bbl)	53.90	62.20	52.99	55.72	47.06	48.73	49.98	51.00	49.21
Total (\$/bbl)	55.89	53.56	47.40	49.91	43.11	45.08	46.36	48.63	45.81
Revenue (\$mm)									
Natural Gas	61	33	33	149	31	34	36	40	141
Oil	96	113	96	407	84	88	91	93	355
Total	158	146	129	556	115	122	126	133	496
Expense									
Lease operating	20	25	25	95	24	24	25	25	97
Production taxes	14	14	12	50	10	11	11	12	45
General and administrative	8	6	8	31	8	8	8	8	32
Total	42	44	44	176	42	43	44	45	174
Ebitda	116	102	85	381	73	78	82	88	321
Exploration	3	12	6	24	6	6	6	6	24
Deprec., Deplet., & Amort.	26	28	30	113	29	30	30	30	119
Hedging and other	19	5	14	58	11	13	14	16	54
Ebit	68	57	41	193	32	36	39	42	148
Interest	10	11	11	44	11	11	11	11	43
Ebt	58	46	30	149	21	25	28	32	105
Income Tax	21	25	10	61	7	9	10	11	37
Net Income (\$mm)	37	21	19	88	14	16	18	21	68
Per Share (\$)	0.75	0.39	0.36	1.66	0.25	0.30	0.33	0.38	1.27
Shares (millions)	50	54	54	53	54	54	54	54	54
Lease operating (\$/bbl)	7.05	8.98	9.00	8.51	9.00	9.00	9.00	9.00	9.00
Production taxes (%rev)	9.0	9.3	9.0	9.0	9.0	9.0	9.0	9.0	9.0
General and admin (\$/bbl)	2.75	2.31	3.00	2.74	3.00	3.00	3.00	3.00	3.00
Deprec., D,& A (\$/bbl)	9.11	10.08	11.00	10.09	11.00	11.00	11.00	11.00	11.00
Ebitda Margin	73%	70%	66%	68%	63%	64%	65%	66%	65%
Tax rate	36%	54%	35%	41%	35%	35%	35%	35%	35%

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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	92	11.8	9.8	900	25%
Oil	230	17.3	11.8	2,710	75%
	321	15.5	11.2	3,610	100%
Debt (US\$mm)					700
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)					50

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