



Independent Stock Idea

August 6, 2008

rating: buy
s&p 500: 1289

Encore Acquisition Company (EAC) Sale Called Off

<i>Symbol</i>	EAC	<i>Ebitda Next Twelve Months ending 6/30/09 (US\$m)</i>	738
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	17
<i>Price (\$/sh)</i>	50.26	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	8/6/08	<i>Adjusted Reserves/Production NTM</i>	13.9
<i>Shares (mm)</i>	52	<i>EV/Ebitda</i>	5.4
<i>Market Capitalization (\$mm)</i>	2,630	<i>PV/Ebitda</i>	7.2
<i>Debt (\$mm)</i>	1,370	<i>Undeveloped Reserves (%)</i>	32
<i>Enterprise Value (EV) (\$mm)</i>	4,000	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	52.90
<i>Present Value (PV) (\$mm)</i>	5,300	<i>Present Value Proven Reserves(\$/boe)</i>	22.90
<i>Net Present Value (\$/share)</i>	75	<i>Present Value Proven Reserves(\$/mcf)</i>	3.80
<i>Debt/Present Value</i>	0.26	<i>Earnings Next Twelve Months (US\$/sh)</i>	5.11
<i>McDep Ratio - EV/PV</i>	0.76	<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.			
Estimated present value presumes a long-term price for oil of US\$100 a barrel and natural gas, \$14 a million btu.			
For historical research on Encore since 2003 see http://www.mcdep.com/4eac.htm			

Summary and Recommendation

Rapidly changing market conditions caused management of buy-recommended **Encore Acquisition Company (EAC)** to end the process it had announced that might have resulted in the sale of the company. In anticipation, stock price reached estimated net present value (NPV) of \$75 a share, but has since declined sharply along with prices of peer companies. Released late in the evening of August 5 combined with the announcement of discontinued strategic efforts, second quarter results met or exceeded our expectations. Projected volumes along with August 4 futures prices promise a high level of unlevered cash flow (Ebitda) (see table [Next Twelve Months Operating and Financial Estimates](#)). Projected cash flow capitalized at unlevered multiples (PV/Ebitda) related to reserve life (Adjusted R/P) supports NPV (see table [Functional Cash Flow and Present Value](#)). Though down a few dollars in the past few days, long-term crude oil price remains in an uptrend where today's settlement of \$116 a barrel for delivery over the next six years is above the 40-week average of \$104 (see chart [Six-Year Commodity Price Meter](#)). In the earnings release, EAC announced its highest single well flow rate in corporate history, 12.7 million cubic feet equivalent daily, in a well in its West Texas Joint Venture with buy-recommended **Exxon Mobil (XOM)**.

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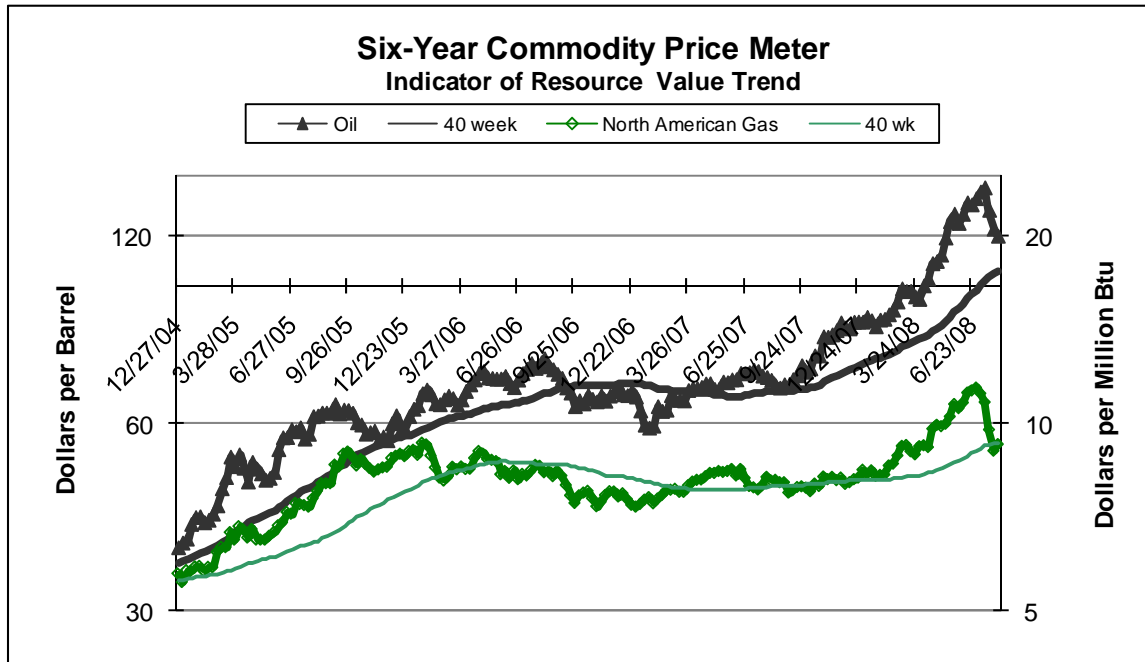
Encore Acquisition Company									
Next Twelve Months Operating and Financial Estimates									
									<i>Next</i>
	<i>Q2</i>	<i>Q1</i>	<i>Q2</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Months</i>
	<i>6/30/07</i>	<i>3/31/08</i>	<i>6/30/08</i>	<i>9/30/08</i>	<i>12/31/08</i>	<i>2008E</i>	<i>3/31/09</i>	<i>6/30/09</i>	<i>6/30/09</i>
Volume									
Natural Gas (mmcf)	76.1	64.1	67.1	67.1	67.1	66.3	67.1	67.1	67.1
Days	91	91	91	92	92	366	90	91	365
Oil (mbd)	28.7	27.5	27.0	27.0	27.0	27.15	27.0	27.0	27.03
Total (mb)	3,766	3,476	3,477	3,516	3,516	13,985	3,439	3,477	13,948
Total (mbd)	41.4	38.2	38.2	38.2	38.2	38.2	38.2	38.2	38.2
Price									
Henry Hub (\$/mmbtu)	7.56	8.02	10.93	10.36	9.25	9.64	9.87	8.94	9.60
Differential (\$/mmbtu)	1.04	(0.26)	(0.19)	(0.18)	(0.16)	(0.21)	0.99	0.89	0.38
EAC (\$/mcf)	6.52	8.28	11.12	10.53	9.41	9.85	8.88	8.04	9.22
WTI Cushing (\$/bbl)	64.91	97.94	123.97	125.40	122.05	117.34	122.70	121.73	122.97
Differential	7.90	8.81	7.33	7.42	7.22	7.75	7.26	7.20	7.27
EAC (\$/bbl)	57.01	89.13	116.64	117.98	114.83	109.59	115.44	114.53	115.70
Total (\$/bbl)	51.53	78.10	102.03	101.95	97.76	94.99	97.25	95.14	98.04
Revenue (\$mm)									
Natural Gas	45	48	68	65	58	239	54	49	226
Oil	149	223	287	293	286	1,089	281	282	1,142
Total	194	271	355	358	344	1,328	334	331	1,367
Expense	65	119	143	165	158	585	154	152	629
Ebitda	129	153	212	194	186	744	181	179	738
Exploration	3	5	12	12	12	41	12	12	48
Deprec., Deplet., & Amort.	52	50	51	56	56	214	55	56	223
Partnership, hedging, other	9	2		10	10	22	10	10	40
Ebit	64	96	149	127	119	492	116	113	475
Interest	27	19	16	16	16	67	16	16	64
Ebt	37	77	133	111	103	425	100	97	411
Income Tax	13	19	46	39	36	141	35	34	144
Net Income (\$mm)	24	58	86	72	67	284	65	63	267
Per Share (\$)	0.44	1.08	1.65	1.38	1.28	5.40	1.24	1.21	5.11
Shares (millions)	54	54	52	52	52	53	52	52	52
Ebitda Margin	66%	56%	60%	54%	54%	56%	54%	54%	54%
Tax rate	35%	25%	35%	35%	35%	33%	35%	35%	35%

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	122	9.1	7.4	900
Oil	616	15.9	7.1	4,390
	738	13.9	7.2	5,290
Debt (US\$mm)				1,370
Net Present Value (US\$mm)				3,920
Shares (mm)				52
Net Present Value - Standard Estimate (US\$/sh)				75
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)				85



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