Rating: Buy
S&P 500: 1122

Encana Corporation
Largest Independent Natural Gas Producer

Symbol	ECA	*Ebitda Next Twelve Months ending 3/31/05 (US$mm)*	6,700
Rating	Buy	*North American Natural Gas/Ebitda (%)*	68
Price (US$/sh)	40.21	*Natural Gas and Oil Production/Ebitda (%)*	97
Pricing Date	6/4/04	*Adjusted Reserves/Production NTM*	7.2
Shares (mm)	472	*EV/Ebitda*	3.9
Market Capitalization (US$mm)	19,000	*PV/Ebitda*	5.5
Debt (US$mm)	7,300	*Undeveloped Reserves (%)*	39
Enterprise Value (EV) (US$mm)	26,200	*Natural Gas and Oil Ebitda (US$/mcfe)*	4.25
Present Value (PV) (US$mm)	37,000	*Present Value Proven Reserves(US$/boe)*	15.25
Net Present Value (US$/share)	63	*Present Value Proven Reserves(US$/mcfe)*	2.54
Debt/Present Value	0.20	*Earnings Next Twelve Months (US$/sh)*	5.12
McDep Ratio - EV/PV	0.71	*Price/Earnings Next Twelve Months*	8
Dividend Yield (%/year)	1.0	*Indicated Annual Dividend (US$/sh)*	0.40

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

We continue to recommend current purchase of the common shares of **Encana Corporation (ECA)** for its concentrated, large cap participation in North American natural gas. The economic prospects for the cleanest primary energy source appear especially attractive in North America as supplemental supply is likely to be delayed and more expensive. Encana has been particularly effective in developing new sources of conventional production on a scale unequalled by any other company. We see about 57% appreciation potential to net present value of US$63 a share subject to the risk of low to moderate debt.

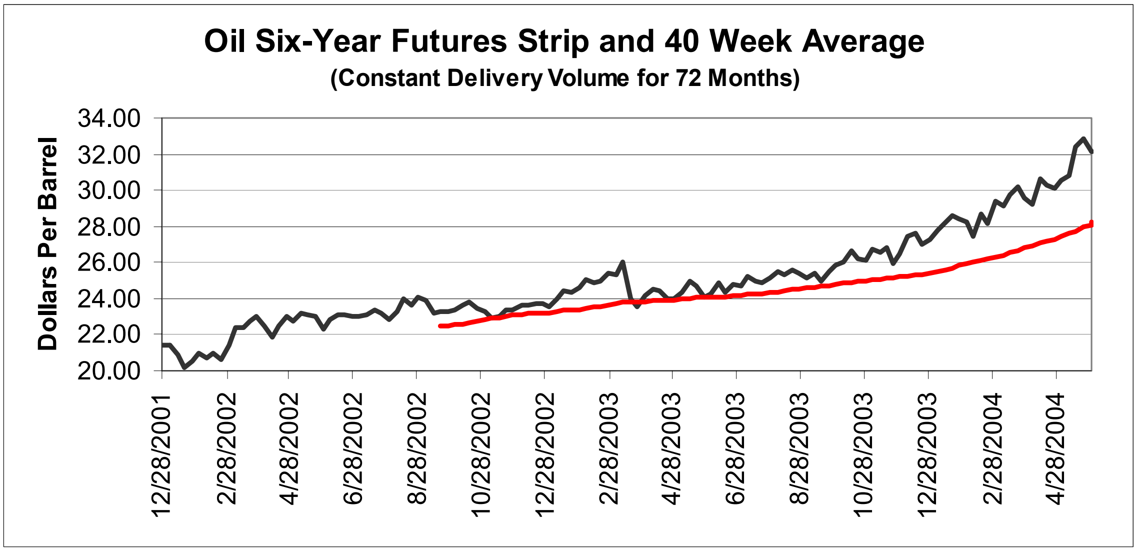
Oil Looks Up by the Charts, Fundamentals, Inflation and Security

Six-year futures describe the commodity price trends most relevant to estimating resource value. The longer time horizon better matches the period during which more of current resources will actually be produced. The longer term measure also smoothes the frantic near-month fluctuations and has the potential to keep climbing even if near-month quotes drop back temporarily.

The plots of weekly results since the beginning of 2002 trace a trend of six-year oil price rising 16% a year (see chart). We measure momentum with the 40-week moving average.
The chart looks good as long as the current six-year quote remains above the trailing average.

Fundamental factors support the price trends. Oil demand is strong with world economic growth paced by developing countries, especially China. Supply is tight as the Middle East is showing maturity with the workhorse giant fields on the verge of peaking.

Monetary factors also favor oil investment as interest rates below inflation drive investors to real assets for protection against currency debasement. Compared to Treasury Inflation Protected Securities that we also favor, oil price is likely to rise more than the official government determined inflation measure.



There appears to be little of the cost of maintaining global security reflected in the price of oil. Escalating violence in Saudi Arabia reminds us that the Iranian Revolution in 1979 was accompanied by a tripling in oil price after it had quadrupled earlier in the decade.

At some point oil price could be too strong and economic activity would be adversely affected. Six times in the past thirty years the annual gain in monthly price exceeded 70% briefly. July futures near $40 a barrel for Light, Sweet Crude Oil would have to exceed $52 a barrel to trigger a 70% warning.

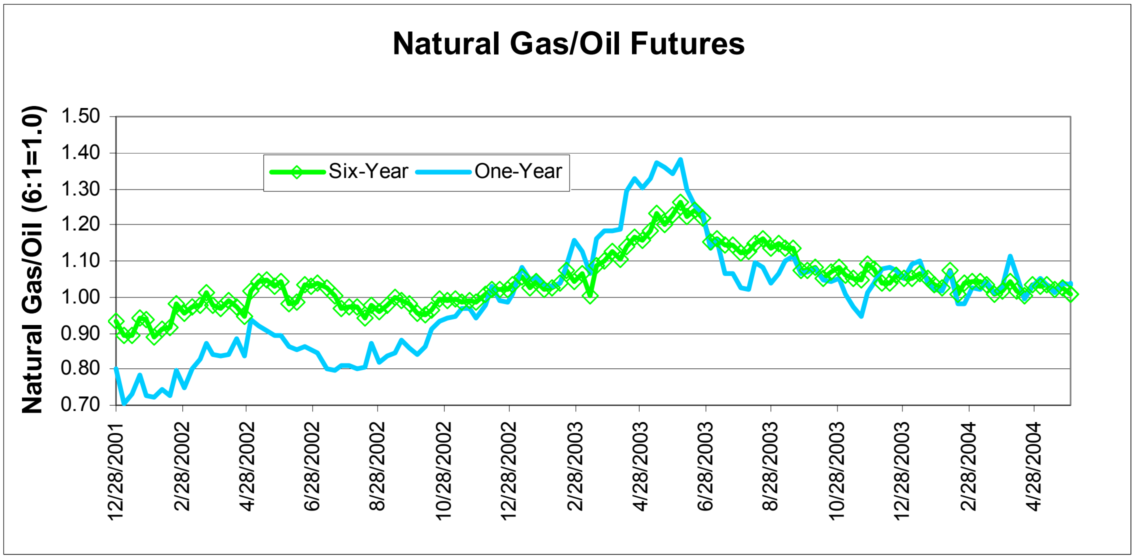
Natural Gas Outlook Stronger than Oil

Natural gas prices are advancing faster than oil. The ratio of natural gas to oil on a heating content basis advanced from 0.2 times oil in 1970 to 1.0 times oil today. That trend points to a ratio of perhaps 1.3 in 2010. We find that easy to believe in part because the ratio exceeded that for one-year futures for most of the spring of 2003 (see chart). As the cleanest fuel, natural gas should continue to advance in price relative to oil as the world increasingly desires a cleaner environment.

Volume, Price and Costs Translate to Attractive Cash Flow

Our process of estimating company-specific present value begins with an estimate of next twelve months cash flow. Current projections lead to a healthy level of unlevered cash flow, also known as Ebitda, short for earnings before interest, tax, depreciation and amortization (see table). We choose the next twelve months ending March 31, 2005 as the relevant time period.

For the next twelve months we project natural gas and oil volume near the first quarter 2004 level. That is sufficient for our valuation calculation. Management provides rich detail in conference calls, presentations and copious regulatory disclosures to put more color on a projection of growth for the rest of the decade.



We take the futures market at face value in projecting price for the next twelve months. Henry Hub quotes guide our projection of natural gas revenue. Light Sweet Crude quotes guide our projections of oil revenue. Because futures are constantly changing, our projection is adjusted accordingly. As a result, the specific amounts we project today may not be the amounts realized when the company next reports.

The company actively hedges oil and gas price at levels that justify its capital program. That takes some of the sizzle out of current prospects while it also limits the downside risk. The company still should derive most of the long-term benefit from the higher price we expect. We use unhedged prices for our cash flow projection that becomes a comparative benchmark for valuation. We make an allowance for hedging losses in estimating earnings.

Assess Present Value Multiple Depending on Reserve Life

The important variables in the valuation of future production are captured in base year cash flow and a multiple of that cash flow that depends on reserve life. Indeed investors do differentiate on that basis as reflected in a high correlation of unlevered cash flow multiple with adjusted reserve life. We convert the market relationship to a formula that produces an anticipatory value with somewhat more sensitivity to reserve life.

The adjusted reserve life index is the sum of developed and half undeveloped reserves divided by next twelve months production. When we last did an industry-wide upward revaluation on March 23, we estimated cash flow multiple equal to 2.5 plus 0.5 times reserve life. That approximates present value assuming constant commodity price near the one-year quotes at that time, about $35 a barrel for crude oil. Higher commodity prices since then imply higher cash flow and lower multiple.

Encana's shorter-than-average adjusted reserve life of 7.2 years suggested, on March 23, an assessed multiple of present value to annual cash flow of 6.1 times, or years. The current multiple of cash flow implied by our estimate of present value is only 5.5 times. Meanwhile, Encana's stock is priced at only 3.9 times unlevered cash flow.

Encana Corporation
Next Twelve Months Operating and Financial Estimates

	Q1 3/31/04	*Q2E 6/30/04*	*Q3E 9/30/04*	*Q4E 12/31/04*	***Year 2004E***	*Q1E 3/31/05*	***Next Twelve Months 3/31/05***
Volume							
Natural Gas (mmcfd)	2,712	2,712	2,712	2,712	**2,712**	2,712	**2,712**
Oil (mbd)	265	265	265	265	**265**	265	**265**
Total (bcf)	391	391	396	396	**1,575**	387	**1,570**
Total (mmcfd)	4,302	4,302	4,302	4,302	**4,302**	4,302	**4,302**
Price							
Henry Hub (US$/mmbtu)	5.64	6.13	6.30	6.54	**6.15**	6.78	**6.44**
Differential	0.38	0.41	0.43	0.44	**0.41**	0.46	**0.44**
Encana ($/mcf)	5.26	5.72	5.87	6.10	**5.74**	6.33	**6.00**
WTI Cushing (US$/bbl)	35.23	38.61	38.47	37.61	**37.48**	36.34	**37.76**
Differential	10.00	10.96	10.92	10.67	**10.63**	10.31	**10.71**
Encana ($/bbl)	25.23	27.66	27.55	26.94	**26.85**	26.02	**27.05**
Revenue ($mm)							
Natural Gas	1,298	1,412	1,465	1,522	**5,697**	1,544	**5,943**
Oil	608	667	672	657	**2,604**	621	**2,616**
Hedging	(149)				**(149)**		**-**
Other	1,093	1,093	1,093	1,093	**4,371**	1,093	**4,371**
Total	2,850	3,171	3,230	3,272	**12,523**	3,258	**12,930**
Expense							
Natural Gas and Oil	471	506	517	526	**2,020**	523	**2,071**
Other	1,047	1,047	1,047	1,047	**4,187**	1,047	**4,187**
Total	1,518	1,552	1,552	1,552	**6,175**	1,570	**6,227**
Ebitda ($mm)							
Natural Gas and Oil	1,286	1,573	1,620	1,653	**6,132**	1,642	**6,488**
Other	46	46	46	46	**184**	46	**184**
Total	1,332	1,619	1,666	1,699	**6,316**	1,688	**6,672**
Deprec., Deplet., & Amort.	624	624	624	624	**2,496**	624	**2,496**
Hedging		198	178	154	**529**	109	**638**
Interest	79	79	79	79	**316**	79	**316**
Ebt	629	718	785	842	**2,974**	876	**3,222**
Income tax	157	180	196	211	**744**	219	**805**
Net Income ($mm)	472	539	589	632	**2,231**	657	**2,416**
Per share ($)	1.00	1.14	1.25	1.34	**4.73**	1.39	**5.12**
Shares (millions)	472	472	472	472	**472**	472	**472**
Ebitda margin (ng + o)	67%	76%	76%	76%	**74%**	76%	**76%**
Tax rate	25%	25%	25%	25%	**25%**	25%	**25%**

Acquisition Foretells Higher Resource Value

The company's recent acquisition of Rocky Mountain producer, Tom Brown, is not included in the projection of cash flow, or in reserves. The new production and reserves would likely be offset by divestitures. Management expects the net effect to be accretive to value. When the deal was announced in late April, we expressed thoughts that still seem valid.

The price paid was in cash, not stock, and was at a sharp 24% premium to recent stock price. Yet the premium was less than the 40% appreciation potential implied by our anticipatory estimate of present value for the target's small cap peers.

Encana's purchase of Tom Brown may be a telltale transaction pointing to future profits for oil and gas investors. A knowledgeable purchaser has paid a large premium to current stock price, in cold cash, after oil and gas prices already had a good run.

One apparent justification for the deal price is that the buyer is not going to wait for someone else to build a pipeline to tap land-locked natural gas. Encana proposes to build the Entrega line to connect the Piceance Basin of western Colorado to the interstate grid. Management suggests lightheartedly that "Entrega" is Spanish for "higher netback", a reference to the greater value that the new line would add to new natural gas production.

That makes sense, but we think there is also a broader dynamic. The buyer is demonstrating a greater conviction about the future value of natural gas and oil resources than are stock market and commodity traders. We have also been trying to express that greater conviction since we moved our present value estimates ahead of the level implied by six-year futures earlier this year.

Kurt H. Wulff, CFA

Research Methodology/Ratings Description: McDep Associates is an independent research originator focused on oil and gas stocks exclusively. The firm applies the thirty years of experience of its analyst to estimate a present value of the oil and gas resources and other businesses of covered companies. That value is compared with a company's stock market capitalization and debt. Stocks with low market cap and debt relative to present value tend to outperform stocks with high market cap and debt relative to present value. Buy recommendations are expected to deliver a total return better than 7% per year above inflation. Hold recommendations assume the attributes of the underlying business are more than fully reflected in the current price of the stock. Sell recommendations are expected to deliver a negative total return less than 7% per year including the effects of inflation.