

Rating: Buy
S&P 500: 1213

Encana Corporation **Canada's Largest Company**

<i>Symbol</i>	ECA	<i>Ebitda Next Twelve Months ending 9/30/06 (US\$m)</i>	10,800
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	85
<i>Price (US\$/sh)</i>	55.52	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	9/27/05	<i>Adjusted Reserves/Production NTM</i>	7.2
<i>Shares (mm)</i>	892	<i>EV/Ebitda</i>	5.4
<i>Market Capitalization (US\$m)</i>	49,500	<i>PV/Ebitda</i>	5.0
<i>Debt (US\$m)</i>	9,000	<i>Undeveloped Reserves (%)</i>	34
<i>Enterprise Value (EV) (US\$m)</i>	58,500	<i>Natural Gas and Oil Ebitda (US\$/mcfe)</i>	6.92
<i>Present Value (PV) (US\$m)</i>	54,500	<i>Present Value Proven Reserves(US\$/boe)</i>	24.01
<i>Net Present Value (US\$/share)</i>	51	<i>Present Value Proven Reserves(US\$/mcfe)</i>	4.00
<i>Debt/Present Value</i>	0.16	<i>Earnings Next Twelve Months (US\$/sh)</i>	5.48
<i>McDep Ratio - EV/PV</i>	1.07	<i>Price/Earnings Next Twelve Months</i>	10
<i>Dividend Yield (%/year)</i>	1.1	<i>Indicated Annual Dividend (US\$/sh)</i>	0.60

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

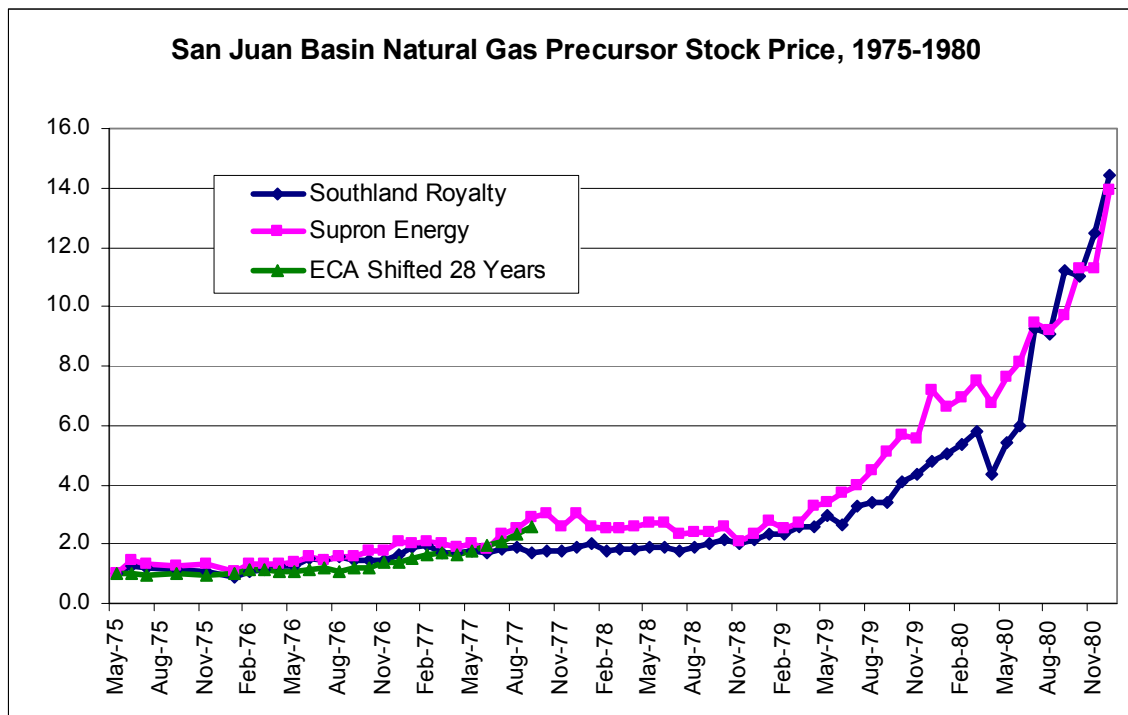
The most aggressive expansion of North American natural gas production that made buy-recommended **Encana (ECA)** the leading independent producer now makes it the largest of all companies in Canada by market capitalization. Chief Executive Officer Gwyn Morgan humbly admitted "I could never have imagined becoming the largest publicly traded company in Canada" according to Bloomberg. While such performance has carried stock price above estimated net present value, there may be further appreciation by analogy with past resource plays. In the natural gas price adjustment of 28 years ago we saw leading producers appreciate 14-fold in stock price in five and a half years. Illustrating the risk, there were pauses in the rise and ultimately a fall back from a peak.

Natural Gas Stock Precursors Southland Royalty and Supron Energy

Encana's natural gas strategy emphasizes resource plays that have identifiable sources of future reserves and production. The prominent historical analogy is the San Juan Basin of New Mexico, the mother lode of natural gas in our experience. To refresh our perspective we check our old DLJ research. Southland Royalty owned the properties that became San Juan Basin Royalty Trust in November 1980. Supron Energy was essentially a pure play on San Juan Basin natural gas. From May 1975 to December 1980 the stocks appreciated 14 times (see chart [San Juan Basin Natural Gas Precursor Stock Price, 1975-1980](#)).

Superimposed on the chart we add the indexed price of Encana from May 2003 to September 2005. We plot the Encana price as though May 2003 was May 1975. The 28 year time difference matches the period from the stock market low of 1974 to the stock market low of 2002. Thus, by the pattern of past price advances for two premier resource plays, Encana stock may have a several fold gain ahead.

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No one can promise a repeat of history. Moreover if Encana stock continues to appreciate, other natural gas producers are likely to do so as well.

Unbooked Resources

When those San Juan Basin stocks were rising 28 years ago the driving forces were commodity price and infill drilling that expanded reserves and production. Encana also has both today. Management details more drilling potential on existing properties. We take into account some extra potential in our present value estimates. The present value multiple of cash flow (PV/Ebitda) is about one year higher than the correlation with reserve life (Adjusted R/P) would imply (see table Functional Cash Flow and Present Value).

Encana Corporation Functional Cash Flow and Present Value

	<i>NTM</i> <u>Ebitda</u>	<i>Adjusted</i> <u>R/P</u>	<i>PV/</i> <u>Ebitda</u>	<i>Present</i> <u>Value</u>	
North American Natural Gas	9,230	7.1	5.0	46,000	84%
Oil	1,610	7.6	5.3	8,500	16%
	10,840	7.2	5.0	54,500	100%
Debt				9,000	
Net Present Value (\$mm)				45,500	
Shares				892	
Net Present Value (\$/sh)				51	

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Cash Flow Gains Signaled by Futures

Natural gas futures prices point to cash flow and earnings advances in the next few quarters (see table [Next Twelve Months Operating and Financial Estimates](#)). Next we look further at trends in futures prices.

Encana Corporation Next Twelve Months Operating and Financial Estimates											
	<i>Q4</i>	<i>Year</i>	<i>Q1</i>	<i>Q2</i>	<i>Q3E</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)	3,087	2,992	3,146	3,212	3,400	3,400	3,290	3,400	3,200	3,400	3,350
Oil (mbd)	159	238	157	157	157	157	157	157	157	157	157
Total (bcf)	372	1,618	368	378	399	399	1,545	391	377	399	1,567
Total (mmcfed)	4,041	4,420	4,088	4,154	4,342	4,342	4,232	4,342	4,142	4,342	4,292
Price											
Henry Hub (US\$/mmbtu)	7.10	6.15	6.27	6.76	8.56	13.05	8.66	13.63	10.41	10.28	11.84
Differential	1.02	0.57	0.46	0.51	0.64	0.98	0.56	1.02	0.78	0.77	0.87
Encana (\$/mcf)	6.08	5.58	5.81	6.25	7.92	12.07	8.10	12.61	9.63	9.51	10.97
WTI Cushing (US\$/bbl)	48.31	41.44	49.65	53.05	62.46	65.90	57.77	66.72	66.48	66.25	66.34
Differential	17.57	6.51	19.88	21.25	25.02	26.40	23.10	26.73	26.63	26.54	26.58
Encana (\$/bbl)	30.74	34.93	29.77	31.80	37.44	39.50	34.66	39.99	39.85	39.71	39.76
Total (\$/bbl)	35.12	33.96	33.69	36.21	45.34	65.30	45.49	67.93	53.70	53.28	60.10
Revenue (\$mm)											
Natural Gas	1,727	6,112	1,645	1,827	2,478	3,777	9,727	3,859	2,804	2,973	13,413
Oil	450	3,044	421	454	541	571	1,986	565	569	574	2,279
Total	2,176	10,276	2,066	2,281	3,019	4,347	11,713	4,424	3,373	3,547	15,692
Expense (\$mm)											
	317	3,646	460	391	760	1,424	3,036	1,463	937	1,024	4,849
Ebitda (\$mm)											
	1,860	6,630	1,605	1,890	2,259	2,923	8,677	2,961	2,436	2,523	10,843
Deprec., Deplet., & Amort.	641	2,692	686	675	675	675	2,711	675	675	675	2,700
Hedging	226	873	22	112	57	57	248	43	56	57	213
Interest	113	391	100	101	101	101	403	101	101	101	404
Ebt											
	880	2,675	797	1,002	1,426	2,090	5,315	2,143	1,604	1,690	7,526
Income tax	308	699	279	351	499	732	1,860	750	561	591	2,634
Net Income (\$mm)											
	572	1,975	518	651	927	1,359	3,455	1,393	1,042	1,098	4,892
Per share (\$)	0.62	2.12	0.57	0.73	1.04	1.52	3.86	1.56	1.17	1.23	5.48
Shares (millions)											
	930	932	909	892	892	892	895	892	892	892	892
Ebitda margin	85%	65%	78%	83%	75%	67%	74%	67%	72%	71%	69%
Tax rate	35%	26%	35%	35%	35%	35%	35%	35%	35%	35%	35%

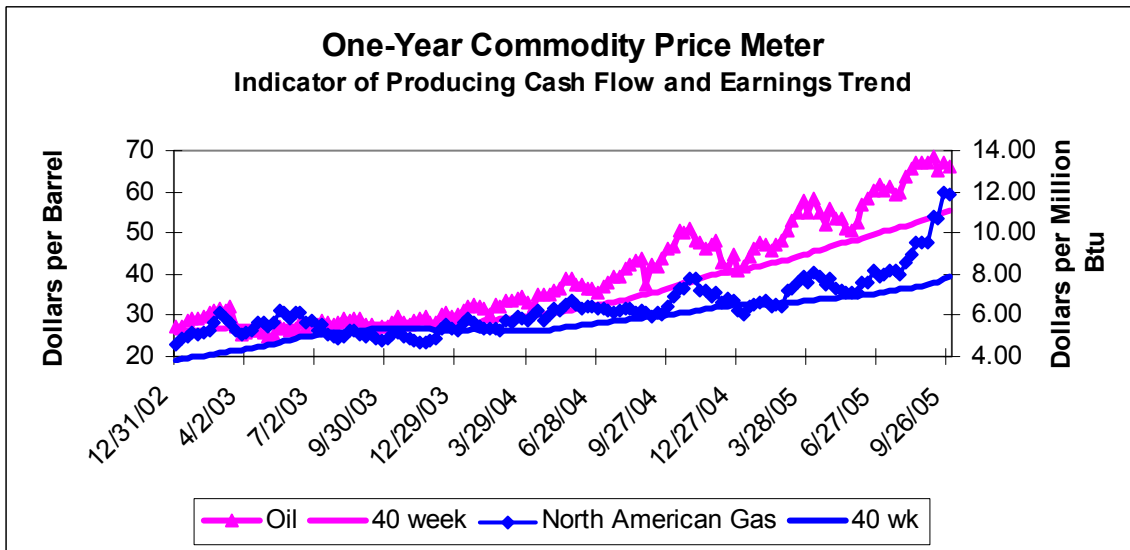
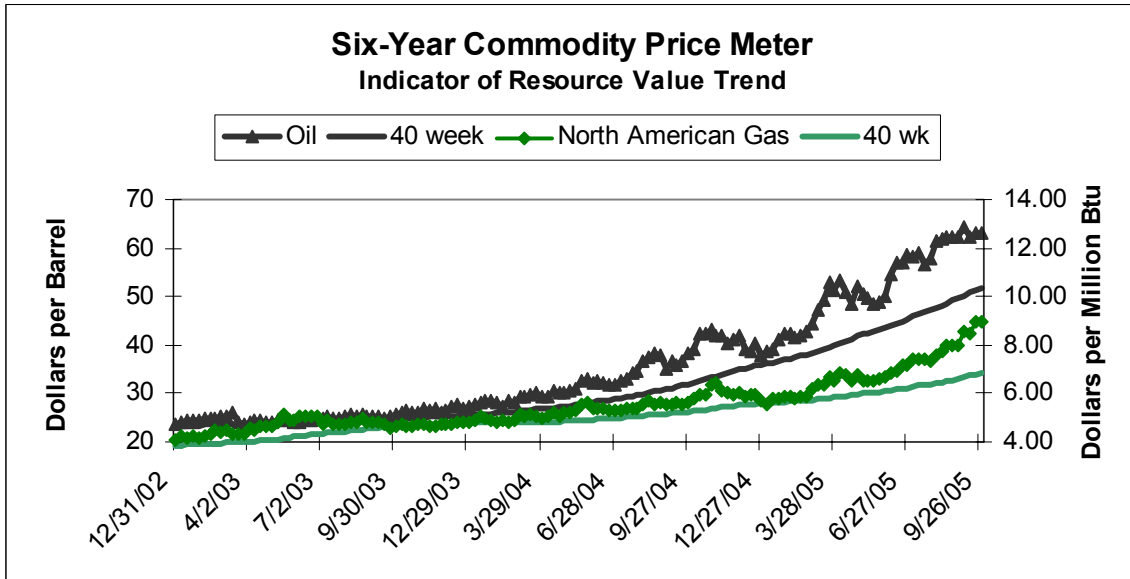
No Strategic Storage for Natural Gas

The availability of government-owned emergency inventories keeps crude oil within its normal price band despite the loss of all Gulf of Mexico oil production temporarily. Natural gas production has also been lost and can be made up only by substitution with oil at higher price. As a result the natural gas price trend has accelerated while the crude oil price trend continues at the same pace (see charts [Six-Year Commodity Price Meter](#) and [One-Year Commodity Price Meter](#)).

Buy Independent Producers

Current stock prices for natural gas and oil producers approximate a median McDep Ratio of 0.86 (see table [Rank by McDep Ratio](#)). A McDep Ratio of 1.0 presumes a 7% per year real return on constant real prices for oil of \$50 a barrel, and natural gas of \$10 a million btu. At a slightly higher McDep Ratio, Encana may be challenged to continue to outperform peers. Yet the differences may be slight compared to the outlook for the industry.

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

	<i>Symbol/</i>	<i>Rating</i>	<i>Price</i> <i>(\$/sh)</i> <i>27-Sep</i> <i>2005</i>	<i>Shares</i> <i>(mm)</i>	<i>Market</i> <i>Cap</i> <i>(\$mm)</i>	<i>Net</i> <i>Present</i> <i>Value</i> <i>(\$/sh)</i>	<i>Debt/</i> <i>Present</i> <i>Value</i>	<i>McDep</i> <i>Ratio</i>
Independent Natural Gas and Oil - Large Cap and Mid Cap								
Encana Corporation	ECA	B	55.52	892	49,500	51.00	0.16	1.07
Burlington Resources	BR	B	78.66	385	30,300	86.00	0.09	0.92
XTO Energy Inc.	XTO	B	43.40	372	16,150	48.00	0.17	0.92
CNOOC Limited (29%)	CEO	B	70.57	119	8,420	84.00	0.01	0.84
Devon Energy Corporation	DVN	B	66.45	471	31,300	86.00	0.15	0.81
Occidental Petroleum Corp.	OXY	B	86.84	406	35,300	120.00	0.11	0.75
Anadarko Petroleum Corp.	APC	B	95.10	238	22,600	140.00	0.11	0.71
<i>Total or Median</i>					<i>545,000</i>		<i>0.11</i>	<i>0.86</i>

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