



# Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

July 3, 2009

## **Raise NPV for Encore on Timely Deals (EAC, ENP)**

### **Summary and Recommendation**

Value-enhancing transactions justify an increase in estimated Net Present Value (NPV) to \$48 a share from \$44 for buy-recommended **Encore Acquisition Company (EAC)** and to \$18 a unit from \$17 for 52% publicly-held **Encore Energy Partners (ENP)**, in our opinion. Announced June 29, EAC entered a deal to acquire \$375 million of oil properties in Oklahoma and natural gas properties in East Texas. Also announced on June 29 and earlier in May, EAC transferred \$244 million of oil and gas properties to ENP. On June 29 and earlier in June, ENP sold in two public offerings a total of about 11 million units for about \$160 million. Earlier in March, EAC cashed in oil hedges for almost \$200 million and essentially redeployed the proceeds in the latest acquisition. A buyer's market for deals in 2009 makes acquisition terms favorable. Moreover properties appear to be valued higher by investors in ENP (McDep Ratio, 0.85) than in EAC (McDep Ratio, 0.76). Monetizing hedges in March when oil prices and stock prices were low has proved to be well timed. Now natural gas price is low thereby giving Chief Executive Jon S. Brumley the confidence to include natural gas properties in the latest acquisition. Commenting on the analyst call on July 1, Mr. Brumley, the younger, declares "You never really know what part of the [natural gas] cycle you are buying in, but it feels like this is definitely in the lower half."

### **Deals Boost Volume Trend**

At a time when industry volumes are in price-induced decline as a result of reduced drilling, EAC and ENP may report increases with the latest deals (see tables, page 2 and 3, Next Twelve Months Operating and Financial Estimates). As well as enhancing NPV, the new deals are likely to increase debt-adjusted volume per share (unit). At the same time, our estimate of NPV for EAC may be conservative relative to an approximation by cash flow multiple depending on reserve life. NPV for ENP appears in line (see tables, page 4, Functional Cash Flow and Present Value). To avoid double counting, we classify the publicly-held units of ENP as debt for EAC, which also may overstate EAC's fixed obligations from a credit point of view. Represented 74% and 77% respectively in oil, EAC and ENP are among the most concentrated stocks on liquid energy (see Table 1, page 5). Willingness to use debt is part of management's call on the business outlook (see Table 2, page 6). ENP's distribution yield at a high 15% a year, reinforced with currently favorable hedging, contributes to a higher unlevered market cash flow multiple (EV/Ebitda) compared to EAC (see Table 3, page 7). In a difficult environment, EAC and ENP appear to be making positive progress toward delivering favorable investment returns, subject to the usual risks.

Kurt H. Wulff, CFA



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Encore Acquisition Company									
Next Twelve Months Operating and Financial Estimates									
									<i>Next</i>
	<i>Q2</i>	<i>Q1</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Months</i>
	<i>6/30/08</i>	<i>3/31/09</i>	<i>6/30/09</i>	<i>9/30/09</i>	<i>12/31/09</i>	<i>2009E</i>	<i>3/31/10</i>	<i>6/30/10</i>	<i>6/30/10</i>
<b>Volume</b>									
Natural Gas (mmcf)	67.1	85.5	84.7	108.8	107.7	<b>96.8</b>	106.7	105.6	<b>107.2</b>
Days	91	90	91	92	92	<b>365</b>	90	91	<b>365</b>
Oil (mbd)	27.0	27.6	27.4	28.7	28.4	<b>28.03</b>	28.1	27.8	<b>28.27</b>
Total (mb)	3,477	3,771	3,775	4,309	4,266	<b>16,120</b>	4,131	4,135	<b>16,840</b>
Total (mbd)	38.2	41.9	41.5	46.8	46.4	<b>44.2</b>	45.9	45.4	<b>46.1</b>
<b>Price</b>									
Henry Hub (\$/mmbtu)	10.93	4.90	3.50	4.00	4.99	<b>4.34</b>	5.96	5.87	<b>5.20</b>
Differential (\$/mmbtu)	(0.19)	1.62	0.52	0.60	0.75	<b>0.83</b>	1.14	0.88	<b>0.85</b>
EAC (\$/mcf)	11.12	3.28	2.97	3.40	4.24	<b>3.51</b>	4.82	4.99	<b>4.35</b>
WTI Cushing (\$/bbl)	123.97	42.96	59.54	71.79	73.62	<b>61.98</b>	74.84	75.76	<b>74.00</b>
Differential	7.33	7.48	7.15	8.61	8.83	<b>7.75</b>	8.98	9.09	<b>8.90</b>
EAC (\$/bbl)	116.64	35.48	52.40	63.17	64.79	<b>54.23</b>	65.86	66.67	<b>65.10</b>
Total (\$/bbl)	102.03	30.10	40.64	46.60	49.54	<b>42.12</b>	51.55	52.45	<b>50.00</b>
<b>Revenue (\$mm)</b>									
Natural Gas	68	25	23	34	42	<b>124</b>	46	48	<b>170</b>
Oil	287	88	130	167	169	<b>555</b>	167	169	<b>672</b>
Total	355	114	153	201	211	<b>679</b>	213	217	<b>842</b>
<b>Expense</b>									
Lease operating	41	44	49	56	55	<b>205</b>	54	54	<b>219</b>
Production taxes	35	12	15	20	21	<b>69</b>	21	22	<b>84</b>
General and administrative	15	14	19	22	21	<b>76</b>	21	21	<b>84</b>
<b>Expense</b>	143	70	83	98	98	<b>349</b>	96	96	<b>387</b>
<b>Ebitda</b>	212	44	70	103	113	<b>330</b>	117	121	<b>455</b>
Exploration	12	11	11	11	11	<b>44</b>	11	11	<b>44</b>
Deprec., Deplet., & Amort.	51	70	60	69	68	<b>268</b>	66	66	<b>269</b>
Partnership, hedging, other		(72)				<b>(72)</b>			<b>-</b>
<b>Ebit</b>	149	35	10	34	45	<b>124</b>	51	55	<b>185</b>
Interest	16	16	16	19	19	<b>69</b>	19	19	<b>74</b>
<b>Ebt</b>	133	19	(6)	16	27	<b>55</b>	33	36	<b>111</b>
Income Tax	46	7	(2)	5	9	<b>19</b>	11	13	<b>39</b>
<b>Net Income (\$mm)</b>	86	12	(4)	10	17	<b>36</b>	21	23	<b>72</b>
Per Share (\$)	1.65	0.23	(0.08)	0.19	0.32	<b>0.67</b>	0.40	0.44	<b>1.35</b>
<b>Shares (millions)</b>	52	53	53	53	53	<b>53</b>	53	53	<b>53</b>
Lease operating (\$/bbl)	11.79	11.67	13.00	13.00	13.00	<b>12.69</b>	13.00	13.00	<b>13.00</b>
Production taxes (%rev)	9.9	10.6	10.0	10.0	10.0	<b>10.1</b>	10.0	10.0	<b>10.0</b>
General and admin (\$/bbl)	4.31	3.71	5.00	5.00	5.00	<b>4.70</b>	5.00	5.00	<b>5.00</b>
Deprec., D, & A (\$/bbl)	14.67	18.56	16.00	16.00	16.00	<b>16.60</b>	16.00	16.00	<b>16.00</b>
Ebitda Margin	60%	38%	46%	51%	54%	<b>49%</b>	55%	56%	<b>54%</b>
Tax rate	35%	35%	35%	35%	35%	<b>35%</b>	35%	35%	<b>35%</b>



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									Next
	Q2	Q1	Q2E	Q3E	Q4E	Year	Q1E	Q2E	Twelve
	6/30/08	3/31/09	6/30/09	9/30/09	9/30/09	2009E	3/31/10	6/30/10	Months
									6/30/10
<b>Volume</b>									
Natural Gas (bcf)	1.07	1.11	1.27	1.61	1.59	5.59	1.54	1.55	6.29
Natural Gas (mmcf)	11.7	12.3	14.0	17.5	17.3	15.3	17.2	17.0	17.2
Days	91	90	91	92	92	365	90	91	365
Oil (mb)	423	395	419	589	583	1,985	565	565	2,301
Oil (mbd)	4.6	4.4	4.6	6.4	6.3	5.4	6.3	6.2	6.3
Total (mb)	601	580	631	857	849	2,916	822	823	3,350
Total (mbd)	6.6	6.4	6.9	9.3	9.2	8.0	9.1	9.0	9.2
<b>Price</b>									
Henry Hub (\$/mmbtu)	10.93	4.90	3.50	4.00	4.99	4.34	5.96	5.87	5.20
Differential (\$/mmbtu)	(0.13)	1.49	0.56	0.80	1.00	0.94	1.29	1.27	1.10
ENP (\$/mcf)	11.06	3.41	2.94	3.20	3.99	3.41	4.67	4.60	4.10
WTI Cushing (\$/bbl)	123.97	42.96	59.54	71.79	73.62	61.98	74.84	75.76	74.00
Differential	12.44	5.73	5.95	7.18	7.36	4.65	5.62	5.69	6.50
ENP (\$/bbl)	111.53	37.23	53.59	64.61	66.26	57.32	69.22	70.07	67.50
Total (\$/bbl)	98.15	31.88	41.49	50.39	53.01	45.55	56.32	56.78	54.08
<b>Revenue (\$mm)</b>									
Natural Gas	12	4	4	5	6	19	7	7	26
Oil	47	15	22	38	39	114	39	40	155
Total	59	18	26	43	45	133	46	47	181
<b>Expense</b>									
Lease operating	7	7	8	10	10	35	10	10	40
Production taxes	6	2	3	5	5	16	5	5	21
General and administrative	3	2	3	4	4	14	4	4	17
Total	16	12	14	20	20	65	19	19	78
<b>Ebitda</b>	43	7	12	23	25	68	27	27	103
Deprec., Deplet., & Amort.	9	10	11	15	15	52	15	15	60
Hedging and other	78	(10)	(7)	(5)	(5)	(27)			(10)
<b>Ebit</b>	(43)	7	8	13	15	42	12	13	52
Interest	2	2	2	3	3	10	3	3	12
<b>Ebt</b>	(45)	5	6	10	12	32	9	10	40
Income Tax									
<b>Net Income (\$mm)</b>	(45)	5	6	10	12	32	9	10	40
Per Unit (\$)	(1.45)	0.14	0.18	0.23	0.26	0.81	0.21	0.22	0.92
<b>Units (millions)</b>	31	33	34	44	44	40	44	44	44
<b>Distribution (\$mm)</b>	22	17	17	24	24	81	24	24	95
Per Unit (\$)	0.69	0.50	0.51	0.54	0.54	2.09	0.54	0.54	2.15
<b>Ratios</b>									
Distribution/Ebitda	0.50	2.36	1.41	1.01	0.94	1.19	0.88	0.87	0.92
Lease operating (\$/bbl)	11.49	12.59	12.00	12.00	12.00	12.12	12.00	12.00	12.00
Production taxes (% rev)	9.8	11.9	11.9	11.9	11.9	11.9	11.6	11.6	11.7
General and admin (\$/bbl)	4.83	3.45	5.00	5.00	5.00	4.69	5.00	5.00	5.00
Deprec., D, & A (\$/bbl)	15.32	17.94	18.00	18.00	18.00	17.99	18.00	18.00	18.00
Ebitda Margin	74%	38%	47%	54%	56%	51%	58%	58%	57%
Tax rate	0%	0%	0%	0%	0%	0%	0%	0%	0%

Please see disclosures on the final page.

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<b>Encore Acquisition Company</b>					
<b>Functional Cash Flow and Present Value</b>					
				<i>Present</i>	
	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Value</i>	
	<u>(US\$mm)</u>	<u>R/P</u>	<u>Ebitda</u>	<u>(US\$mm)</u>	
North American Natural Gas	92	9.6	12.0	1,100	26%
Oil	363	12.6	8.5	3,100	74%
	455	11.4	9.2	4,200	100%
Debt (US\$mm)					1,640
Net Present Value (US\$mm)					2,560
Shares (mm)					53
Net Present Value - Standard Estimate (US\$/sh)					48
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					54

<b>Encore Energy Partners</b>					
<b>Functional Cash Flow and Present Value</b>					
				<i>Present</i>	
	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Value</i>	
	<u>(US\$mm)</u>	<u>R/P</u>	<u>Ebitda</u>	<u>(US\$mm)</u>	
North American Natural Gas	15	14.8	16.3	240	23%
Oil	88	12.0	8.9	790	77%
	103	12.9	10.0	1,030	100%
Debt (US\$mm)					240
Net Present Value (US\$mm)					790
Shares (mm)					44
Net Present Value - Standard Estimate (US\$/sh)					18
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					19



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	Symbol/Rating	Price (US\$/sh)	EV/ Market	Enterprise Value (\$mm)	Present Value by Segment (%)			Dist. NTM (\$/un)	Dist. Yield (%)	McDep Ratio
					NAmer. Natural Gas	Oil Prod'n				
	B = Buy H = Hold	2-Jul 2009	Cap							
<b>Canadian Income Trusts (US\$)</b>										
Pengrowth Energy Trust	PGH	7.70	1.89	3,700	39	61	1.03	13.4	0.64	
Penn West Energy Trust	PWE H	12.33	1.76	8,900	32	68	1.55	12.6	0.63	
Peyto Energy Trust	PEYUF	7.82	1.48	1,230	79	21	1.24	15.9	0.59	
Enerplus Resources Fund	ERF	21.17	1.24	4,300	50	50	1.86	8.8	0.58	
Canadian Oil Sands Trust	COSWF B	22.80	1.11	12,200		100	1.99	8.7	0.57	
<i>Total or Median</i>				30,300					0.59	
<b>Small Cap Independent Producers</b>										
Encore Acquisition Company	EAC B	29.18	2.05	3,200	26	74	-	-	0.76	
Berry Petroleum Company	BRY H	18.43	2.18	1,790	38	62	0.30	1.6	0.65	
Birchcliff Energy Ltd. (US\$)	BIREF	5.08	1.38	850	72	28	-	-	0.59	
Cimarex Energy Company	XEC B	27.88	1.38	3,150	67	33	0.24	0.9	0.59	
<i>Total or Median</i>				8,990					0.62	
<b>Top Line Cash Payers</b>										
Cross Timbers Royalty Trust	CRT	24.50	1.00	150	69	31	1.66	6.8	0.77	
Sabine Royalty Trust	SBR	45.07	1.00	660	43	57	2.84	6.3	0.75	
Dorchester Minerals, L.P.	DMLP B	23.31	1.00	660	69	31	1.62	7.0	0.73	
Freehold Royalty Trust (US\$)	FRHLF	11.97	1.23	730	29	67	1.03	8.6	0.71	
Permian Basin RT	PBT	10.48	1.00	490	33	67	0.94	9.0	0.55	
<i>Total or Median</i>				2,690					0.73	
<b>Bottom Line Cash Payers</b>										
Linn Energy, LLC	LINE	19.27	1.64	3,610	53	47	2.52	13.1	1.20	
Encore Energy Partners, L.P. (52%)	ENP	14.36	1.38	450	23	77	2.15	15.0	0.85	
San Juan Basin Royalty Trust	SJT H	14.05	1.00	660	100	-	1.17	8.3	0.54	
Hugoton Royalty Trust	HGT B	13.99	1.00	560	91	9	1.13	8.1	0.50	
Mesa Royalty Trust	MTR	27.07	1.00	50	75	25	2.61	9.6	0.40	
<i>Total or Median</i>				5,330					0.54	
<b>Composite (excl COSWF)</b>										
<i>Enterprise Value Weighting</i>				35,100	46	54			0.66	
<i>Equal Weighting</i>					55	45			0.67	
<i>Equal Weighted Buys</i>					52	48			0.64	

\* Percentages in Symbol column refer to current market Enterprise Value weightings; Rating column, equal weightings.  
\* Percentages in Price column refer to equal weighted buys.



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Table 2								
Oil and Gas Income and Small Cap Stocks								
Net Present Value and McDep Ratio								
			Price (\$/sh)	Shares	Market Cap (\$mm)	Net Present Value (\$/un)	Debt/ Present Value	McDep Ratio
	Symbol/ Rating		2-Jul 2009	(mm)				
<b>Canadian Income Trusts (US\$)</b>								
Pengrowth Energy Trust	PGH		7.70	257.0	1,980	16.00	0.30	0.64
Penn West Energy Trust	PWE	H	12.33	410.0	5,060	25.00	0.27	0.63
Peyto Energy Trust	PEYUF		7.82	105.9	830	16.00	0.19	0.59
Enerplus Resources Fund	ERF		21.17	165.7	3,510	40.00	0.11	0.58
Canadian Oil Sands Trust	COSWF	B	22.80	482.2	10,990	42.00	0.06	0.57
<i>Total or Median</i>					22,400		0.19	0.59
<b>Small Cap Independent Producers</b>								
Encore Acquisition Company	EAC	B	29.18	53.3	1,560	48.00	0.39	0.76
Berry Petroleum Company	BRY	H	18.43	44.6	820	40.00	0.35	0.65
Birchcliff Energy Ltd. (US\$)	BIREF		5.08	122.0	620	10.00	0.16	0.59
Cimarex Energy Company	XEC	B	27.88	81.7	2,280	55.00	0.16	0.59
<i>Total or Median</i>					5,280		0.26	0.62
<b>Top Line Cash Payers</b>								
Cross Timbers Royalty Trust	CRT		24.50	6.0	150	32.00	-	0.77
Sabine Royalty Trust	SBR		45.07	14.6	660	60.00	-	0.75
Dorchester Minerals, L.P.	DMLP	B	23.31	28.2	660	32.00	-	0.73
Freehold Royalty Trust (US\$)	FRHLF		11.97	49.5	590	18.00	0.14	0.71
Permian Basin RT	PBT		10.48	46.6	490	19.00	-	0.55
<i>Total or Median</i>					2,550			0.73
<b>Bottom Line Cash Payers</b>								
Linn Energy, LLC	LINE		19.27	114.0	2,200	14.00	0.47	1.20
Encore Energy Partners, L.P. (52%)	ENP		14.36	22.9	330	18.00	0.23	0.85
San Juan Basin Royalty Trust	SJT	H	14.05	46.6	660	26.00	-	0.54
Hugoton Royalty Trust	HGT	B	13.99	40.0	560	28.00	-	0.50
Mesa Royalty Trust	MTR		27.07	1.9	50	67.00	-	0.40
<i>Total or Median</i>					3,800			0.54
B = Buy, H = Hold								
McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses								
Present Value presumes long-term prices of \$75 a barrel for oil and \$10 a million btu for natural gas.								



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Table 3								
Oil and Gas Income and Small Cap Stocks								
Value Multiples - Rank by EV/Ebitda								
			Price (\$/sh)	Revenue	Dist/ Equity	Adjstd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda
	Symbol/ Rating		2-Jul 2009	Royalty (%)	Ebitda	NTM	NTM	NTM
<b>Canadian Income Trusts (US\$)</b>								
	PEYUF		7.82		0.96	17.1	12.4	7.3
	COSWF	B	22.80		0.59	21.5	12.4	7.1
	ERF		21.17		0.50	9.3	10.7	6.2
	PWE	H	12.33		0.58	8.3	9.4	6.0
	PGH		7.70		0.60	8.1	9.4	6.0
	<i>Median</i>					9.3	10.7	6.2
<b>Small Cap Independent Producers</b>								
	BIREF		5.08		-	9.9	22.1	13.0
	BRY	H	18.43		-	11.7	10.9	7.1
	EAC	B	29.18		-	11.4	9.2	7.0
	XEC	B	27.88		-	7.2	7.5	4.4
	<i>Median</i>					10.7	10.1	7.1
<b>Top Line Cash Payers</b>								
	SBR		45.07	100	1.00	10.0	21.1	15.9
	CRT		24.50	84	0.91	13.0	17.6	13.5
	DMLP	B	23.31	64	0.92	8.1	18.2	13.2
	PBT		10.48	32	0.87	10.9	17.6	9.7
	FRHLF		11.97	71	0.57	6.3	10.0	7.1
	<i>Median</i>					10.0	17.6	13.2
<b>Bottom Line Cash Payers</b>								
	LINE		19.27		3.13	18.3	17.4	20.9
	MTR		27.07		0.92	14.4	23.5	9.4
	SJT	H	14.05		0.80	9.2	17.7	9.6
	HGT	B	13.99		0.75	13.3	18.5	9.3
	ENP		14.36		1.19	12.9	10.0	8.5
	<i>Median</i>					13.3	17.7	9.4
EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended June 30, 2010; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses								



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