

Rating: Buy
S&P 500: 1455

Encore Acquisition Company Reduce Net Present Value to \$48 a Share

<i>Symbol</i>	EAC	<i>Ebitda Next Twelve Months ending 12/31/07 (US\$m)</i>	329
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	32
<i>Price (\$/sh)</i>	24.90	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	2/14/07	<i>Adjusted Reserves/Production NTM</i>	15.0
<i>Shares (mm)</i>	54	<i>EV/Ebitda</i>	6.4
<i>Market Capitalization (\$mm)</i>	1,340	<i>PV/Ebitda</i>	10.2
<i>Debt (\$mm)</i>	780	<i>Undeveloped Reserves (%)</i>	28
<i>Enterprise Value (EV) (\$mm)</i>	2,120	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	29.40
<i>Present Value (PV) (\$mm)</i>	3,360	<i>Present Value Proven Reserves(\$/boe)</i>	17.20
<i>Net Present Value (\$/share)</i>	48	<i>Present Value Proven Reserves(\$/mcf)</i>	2.90
<i>Debt/Present Value</i>	0.23	<i>Earnings Next Twelve Months (US\$/sh)</i>	0.93
<i>McDep Ratio - EV/PV</i>	0.63	<i>Price/Earnings Next Twelve Months</i>	27
<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

We reduce estimated net present value (NPV) for buy-rated **Encore Acquisition (EAC)** to \$48 a share from \$54 to bring NPV more in line with our correlation with some thirty companies that takes account of cash flow and reserve life (see table Functional Cash Flow and Present Value). Encore remains a strong asset value, while investors await improved performance. In the words of Jonny Brumley, who just completed his first year as chief executive “2006 was a pretty rough year”. In the conference call discussing fourth quarter 2006 results on February 14, Mr. Brumley disclosed that volume response from high pressure air injection in the company’s main field, the Cedar Creek Anticline in Montana and North Dakota, has been less than expected. The project appears justified at today’s oil prices, but possibly not at the lower levels when the project was begun a few years ago. In 2007 the company has committed to \$800 million of acquisitions to be financed by debt and the sale of \$200 million in a new income stock. Because the ratio of debt to present value would increase to 0.38 from 0.23, investors would need 20% less Encore stock to maintain the normal unlevered weighting we suggest in our illustrative energy portfolio.

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Please see disclosures on the final page.

Encore Acquisition Company
Next Twelve Months Operating and Financial Estimates

	<i>Q4</i>	<i>Q3</i>	<i>Q4</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>2006</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	64.1	64.3	64.1	64.1	64.1	64.1	64.1
Oil (mbd)	19.45	19.7	20.0	20.10	20.0	20.0	20.0	20.0	20.01
Total (mb)	2,820	2,728	2,825	11,244	2,763	2,794	2,825	2,825	11,207
Total (mbd)	30.7	29.7	30.7	30.8	30.7	30.7	30.7	30.7	30.7
Price									
Henry Hub (\$/mmbtu)	13.00	6.58	6.57	7.23	6.70	7.42	7.71	8.46	7.57
Differential (\$/mmbtu)	3.11	0.52	0.25	0.70	0.25	0.28	0.29	0.32	0.28
EAC (\$/mcf)	9.89	6.06	6.32	6.54	6.45	7.14	7.42	8.14	7.29
WTI Cushing (\$/bbl)	60.02	70.42	59.99	66.05	56.73	59.33	60.97	62.13	59.79
Differential	6.12	8.22	10.06	11.11	9.52	9.95	10.23	10.42	10.01
EAC (\$/bbl)	53.90	62.20	49.93	54.95	47.21	49.38	50.75	51.71	49.78
Total (\$/bbl)	55.89	53.56	45.75	49.48	44.25	47.11	48.58	50.71	47.68
Revenue (\$mm)									
Natural Gas	61	33	37	153	37	42	44	48	171
Oil	96	113	92	403	85	90	93	95	364
Total	158	146	129	556	122	132	137	143	534
Expense									
Lease operating	20	25	28	98	30	31	31	31	123
Production taxes	14	14	11	50	11	12	12	13	48
General and administrative	8	6	10	32	8	8	8	8	34
Total	42	44	49	180	50	51	52	52	205
Ebitda	116	102	80	376	73	81	85	91	329
Exploration	3	12	14	32	14	14	14	6	49
Deprec., Deplet., & Amort.	26	28	31	114	33	34	34	34	134
Hedging and other	19	5	10	54	12	18	20	24	75
Ebit	68	57	25	177	27	30	31	32	120
Interest	10	11	11	44	11	11	11	11	44
Ebt	58	46	14	133	16	19	20	22	77
Income Tax	21	25	4	55	6	7	7	8	27
Net Income (\$mm)	37	21	10	79	11	12	13	14	50
Per Share (\$)	0.75	0.39	0.19	1.49	0.20	0.22	0.24	0.26	0.93
Shares (millions)	50	54	54	53	54	54	54	54	54
Lease operating (\$/bbl)	7.05	8.98	9.86	8.73	11.00	11.00	11.00	11.00	11.00
Production taxes (%rev)	9.0	9.3	8.8	9.0	9.0	9.0	9.0	9.0	9.0
General and admin (\$/bbl)	2.75	2.31	3.36	2.83	3.00	3.00	3.00	3.00	3.00
Deprec., D,& A (\$/bbl)	9.11	10.08	10.97	10.09	12.00	12.00	12.00	12.00	12.00
Ebitda Margin	73%	70%	62%	68%	59%	61%	62%	63%	62%
Tax rate	36%	54%	28%	41%	35%	35%	35%	35%	35%

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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	105	11.0	8.6	900	27%
Oil	224	17.1	11.0	2,460	73%
	329	15.0	10.2	3,360	100%
Debt (US\$mm)					780
Net Present Value (US\$mm)					2,580
Shares (mm)					54
Net Present Value - Standard Estimate (US\$/sh)					48
Net Present Value - Approximation by Correlation (US\$/sh)					48

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