



Independent Stock Idea

October 28, 2009

rating: buy
s&p 500: 1063

Encore Acquisition Company (EAC) Raise Net Present Value to \$50 a Share from \$44

<i>Symbol</i>	EAC	<i>Ebitda Next Twelve Months ending 9/30/10 (US\$m)</i>	539
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	21
<i>Price (\$/sh)</i>	42.43	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	10/27/09	<i>Adjusted Reserves/Production NTM</i>	11.7
<i>Shares (mm)</i>	52	<i>EV/Ebitda</i>	7.3
<i>Market Capitalization (\$mm)</i>	2,220	<i>PV/Ebitda</i>	8.0
<i>Debt (\$mm)</i>	1,700	<i>Undeveloped Reserves (%)</i>	18
<i>Enterprise Value (EV) (\$mm)</i>	3,920	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	32.90
<i>Present Value (PV) (\$mm)</i>	4,310	<i>Present Value Proven Reserves(\$/boe)</i>	20.40
<i>Net Present Value (\$/share)</i>	50	<i>Oil and Gas Ebitda Margin (%)</i>	60
<i>Debt/Present Value</i>	0.39	<i>Earnings Next Twelve Months (US\$/sh)</i>	0.76
<i>McDep Ratio - EV/PV</i>	0.91	<i>Price/Earnings Next Twelve Months</i>	56
<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\$75 a barrel and natural gas, \$8 a million btu.			
For historical research on Encore since 2003 see http://www.mcdep.com/4eac.htm			

Summary and Recommendation

Buy-recommended **Encore Acquisition Company (EAC)** offers unlevered appreciation potential of 10% to a McDep Ratio of 1.0 where stock price would equal Net Present Value (NPV) of \$50 a share. We raise NPV from \$44 a share on the basis of delayed cost reductions that now appear to have been achieved a few quarters after oil price declined. Released late October 27, third quarter results demonstrated strong recovery in unlevered cash flow (Ebitda) not only with lower than expected operating cost, but also higher volume and higher price (see table [Next Twelve Months Operating and Financial Estimates](#)). NPV is sensitive to expected performance in our valuation that capitalizes cash flow at unlevered multiples (PV/Ebitda) related to reserve life (Adjusted R/P) for natural gas and oil (see table [Functional Cash Flow and Present Value](#)). Work proceeds on long lead time enhanced recovery oil investment in Wyoming, Montana and North Dakota. Balancing the timing of new volumes, the company scored in the Bakken oil formation and the Haynesville natural gas formation testing high flow rate wells. While such shale formation wells decline rapidly their volumes can help the corporate trend until enhanced recovery projects contribute. Price is also in a rising trend with futures for oil and natural gas over the next six years quoted above the 40-week average (see chart [Six-Year Commodity Price Meter](#)).

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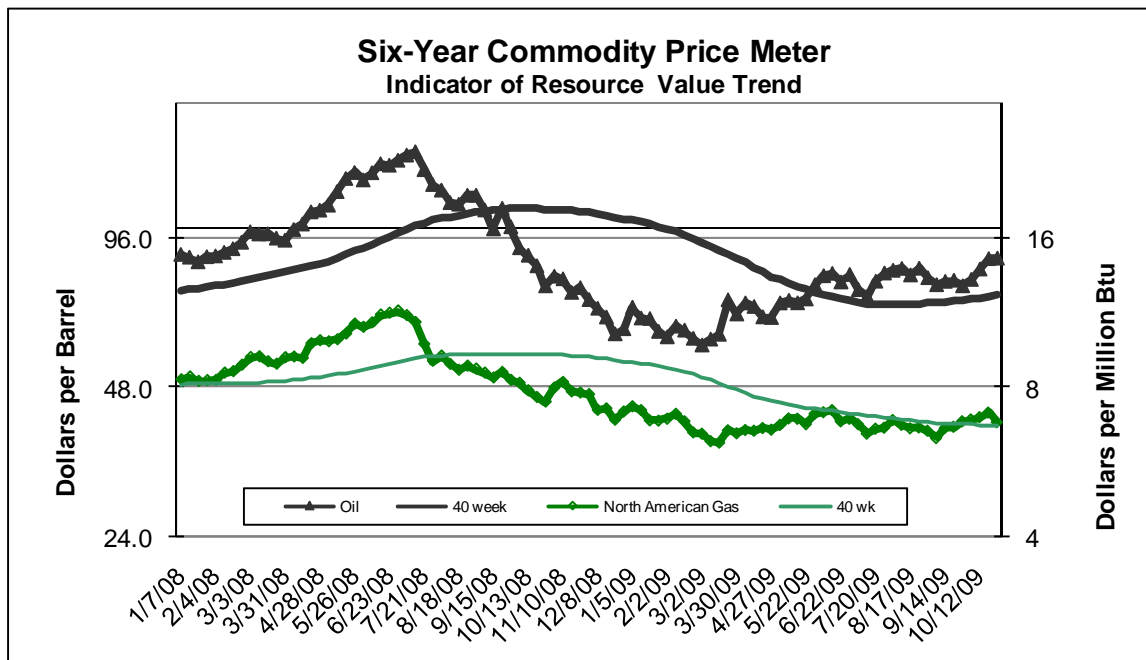
Encore Acquisition Company									
Next Twelve Months Operating and Financial Estimates									
									<i>Next Twelve Months</i>
	<i>Q3</i>	<i>Q2</i>	<i>Q3</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	
	<i>9/30/08</i>	<i>6/30/09</i>	<i>9/30/09</i>	<i>12/31/09</i>	<i>2009E</i>	<i>3/31/10</i>	<i>6/30/10</i>	<i>9/30/10</i>	<i>9/30/10</i>
Volume									
Natural Gas (mmcf)	75.8	88.2	94.4	105.0	93.3	104.0	102.9	101.9	103.4
Days	92	91	92	92	365	90	91	92	365
Oil (mbd)	27.0	26.7	27.5	28.0	27.46	27.7	27.4	27.2	27.58
Total (mb)	3,645	3,768	3,977	4,186	15,702	4,054	4,058	4,062	16,360
Total (mbd)	39.6	41.4	43.2	45.5	43.0	45.0	44.6	44.1	44.8
Price									
Henry Hub (\$/mmbtu)	10.25	3.50	3.39	4.48	4.07	5.58	5.61	5.84	5.38
Differential (\$/mmbtu)	0.68	(0.17)	(0.32)	(0.09)	0.22	0.30	0.84	0.23	0.33
EAC (\$/mcf)	9.57	3.67	3.71	4.57	3.85	5.28	4.77	5.61	5.05
WTI Cushing (\$/bbl)	117.99	59.52	68.22	77.69	62.10	80.00	81.52	82.60	80.45
Differential	9.78	4.50	7.77	8.85	7.00	9.11	9.78	12.39	10.05
EAC (\$/bbl)	108.21	55.02	60.45	68.84	55.09	70.89	71.74	70.21	70.40
Total (\$/bbl)	92.00	43.30	46.56	52.91	43.52	55.80	55.16	56.15	54.99
Revenue (\$mm)									
Natural Gas	67	29	32	44	131	49	45	53	191
Oil	269	134	153	177	552	177	179	175	709
Total	335	163	185	221	683	226	224	228	900
Expense									
Lease operating	64	41	38	46	169	45	45	45	180
Production taxes	33	17	19	24	72	25	25	25	99
General and administrative	28	19	13	21	67	20	20	20	82
Expense	126	77	70	91	308	90	90	90	361
Ebitda	210	87	115	130	375	136	134	138	539
Exploration	13	16	17	17	61	17	17	17	68
Deprec., Deplet., & Amort.	58	74	73	84	301	81	81	81	327
Partnership, hedging, other	26	(19)	11	14	(66)	16	16	16	62
Ebit	113	16	14	32	97	40	37	41	149
Interest	18	19	22	22	79	22	22	22	88
Ebt	95	(3)	(8)	10	18	18	15	19	61
Income Tax	33	(1)	(3)	3	6	6	5	7	21
Net Income (\$mm)	62	(2)	(5)	6	11	12	10	12	40
Per Share (\$)	1.15	(0.04)	(0.10)	0.12	0.21	0.22	0.19	0.23	0.76
Shares (millions)									
Lease operating (\$/bbl)	17.60	10.88	9.56	11.00	10.77	11.00	11.00	11.00	11.00
Production taxes (%rev)	10.0	10.4	10.3	11.0	10.6	11.0	11.0	11.0	11.0
General and admin (\$/bbl)	7.69	4.94	3.27	5.00	4.24	5.00	5.00	5.00	5.00
Deprec., D, & A (\$/bbl)	15.91	19.64	18.36	20.00	19.15	20.00	20.00	20.00	20.00
Ebitda Margin	63%	53%	62%	59%	55%	60%	60%	61%	60%
Tax rate	35%	35%	35%	35%	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	114	10.0	8.2	940	22%
Oil	425	12.9	8.0	3,380	78%
	539	11.7	8.0	4,320	100%
Debt (US\$mm)					1,700
Net Present Value (US\$mm)					2,620
Shares (mm)					52
Net Present Value - Standard Estimate (US\$/sh)					50
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					56





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