

Encore Energy Partners Completes IPO

<i>Symbol</i>	ENP	<i>Ebitda Next Twelve Months ending 9/30/08 (US\$m)</i>	55
<i>Rating</i>		<i>North American Natural Gas/Ebitda (%)</i>	16
<i>Price (\$/sh)</i>	21.57	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	9/13/07	<i>Adjusted Reserves/Production NTM</i>	12.7
<i>Shares (mm)</i>	23	<i>EV/Ebitda</i>	10.3
<i>Market Capitalization (\$mm)</i>	500	<i>PV/Ebitda</i>	8.8
<i>Debt (\$mm)</i>	70	<i>Undeveloped Reserves (%)</i>	14
<i>Enterprise Value (EV) (\$mm)</i>	570	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	44.00
<i>Present Value (PV) (\$mm)</i>	490	<i>Present Value Proven Reserves(\$/boe)</i>	23.00
<i>Net Present Value (\$/share)</i>	18	<i>Present Value Proven Reserves(\$/mcf)</i>	3.80
<i>Debt/Present Value</i>	0.14	<i>Earnings Next Twelve Months (US\$/sh)</i>	0.54
<i>McDep Ratio - EV/PV</i>	1.17	<i>Price/Earnings Next Twelve Months</i>	40
<i>Distribution Yield (%/year)</i>	6.5	<i>Indicated Annual Distribution (US\$/sh)</i>	1.40

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.

Estimated present value presumes a long-term price for oil of US\$66 a barrel and natural gas, \$11 a million btu.

Encore Acquisition Company (EAC) owns about 61% of the units of ENP

Summary and Recommendation

After a successful initial public offering, **Encore Energy Partners (ENP)** advanced in unit price in its first two days of trading to a McDep Ratio more than 1.0. To put that in perspective while opening a new phase in oil and gas income investment, we add ENP as the third stock in a fresh category of U.S. Master Limited Partnerships (MLPs) (see tables [Rank by McDep Ratio](#), [Rank by EV/Ebitda](#) and [Rank by NTM Distribution Yield](#)). ENP's McDep Ratio is low by a wide margin compared to a popular transportation MLP in our coverage. ENP's McDep Ratio is high compared to 0.68 recently for buy-recommended **Encore Acquisition Company (EAC)**, the sponsor and majority owner of ENP (see *Meter Reader*, September 11, 2007). The difference provides the motivation for forming ENP which ought to be able to deliver a superior, risk-adjusted long-term return compared to the highly priced transportation MLP. We wish ENP continued success mainly because it demonstrates plainly the undervaluation of similar properties in EAC according to our analysis.

Oil Deal Well-Timed

After the first two days of trading for ENP, a partnership concentrated 85% on oil by cash flow, the price of light, sweet crude oil closed at a record \$80 a barrel as measured by near-month futures. Latest futures prices take projected cash flow (Ebitda) to about \$55 million for the twelve months ended September 30, 2008 (see table [Operating and Financial Estimates](#)). Net Present Value (NPV) of \$18 a share conforms to a link of cash flow and adjusted reserve life for operating companies including ENP's sponsor EAC (see table [Functional Cash Flow and Present Value](#)).

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Encore Energy Partners Next Twelve Months Operating and Financial Estimates

	Year 2006	H2 6/30/07	Q3E 9/30/07	Q4E 12/31/07	Year 2007E	Q1E 3/31/08	Q2E 6/30/08	Q3E 9/30/08	Next Twelve Months 9/30/08
Volume									
Natural Gas (bcf)	2.16	0.90	0.46	0.46	1.82	0.45	0.45	0.46	1.82
Natural Gas (mmcf)	5.9	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Days	365	181	92	92	365	91	91	92	366
Oil (mb)	1,273	617	314	315	1,246	312	312	315	1,255
Oil (mbd)	3.5	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4
Total (mb)	1,273	617	314	316	1,246	312	312	316	1,255
Total (mbd)	3.5	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4
Price									
Henry Hub (\$/mmbtu)	7.23	7.18	6.16	6.86	6.85	7.99	7.53	7.74	7.53
Differential (\$/mmbtu)	0.40	0.40	0.34	0.38	0.39	0.45	0.42	0.43	0.42
ENP (\$/mcf)	6.83	6.78	5.81	6.47	6.46	7.54	7.11	7.30	7.11
WTI Cushing (\$/bbl)	66.05	61.49	75.15	73.86	68.00	73.14	72.56	72.04	72.90
Differential	15.69	14.61	17.85	17.55	16.11	17.38	17.24	17.11	17.32
ENP (\$/bbl)	50.36	46.88	57.29	56.32	51.89	55.77	55.32	54.93	55.58
Total (\$/bbl)	61.92	56.77	65.77	65.70	61.29	66.70	65.63	65.51	65.88
Revenue (\$mm)									
Natural Gas	15	6	3	3	12	3	3	3	13
Oil	64	29	18	18	65	17	17	17	70
Total	79	35	21	21	76	21	20	21	83
Expense									
Lease operating	9	7	3	3	14	3	3	3	14
Production taxes	9	5	2	2	9	2	2	2	10
General and administrative	3	1	1	1	3	1	1	1	4
Total	21	13	7	7	26	7	7	7	27
Ebitda	58	22	14	14	50	14	14	14	55
Deprec., Deplet., & Amort.	31	15	8	8	30	7	7	8	30
Hedging and other	3	4	2	2	8	2	2	2	8
Ebit	24	3	4	4	12	4	4	4	17
Interest	4	2	1	1	4	1	1	1	4
Ebt	20	1	3	3	7	3	3	3	13
Income Tax									
Net Income (\$mm)	20	1	3	3	7	3	3	3	13
Per Unit (\$)	0.85	0.04	0.14	0.14	0.31	0.15	0.13	0.13	0.54
Units (millions)	23	23	23	23	23	23	24	24	23
Lease operating (\$/bbl)	7.15	11.18	11.00	11.00	11.09	11.00	11.00	11.00	11.00
Production taxes (%rev)	11.5	12.8	12.0	12.0	12.4	12.0	12.0	12.0	12.0
General and admin (\$/bbl)	2.28	2.11	3.00	3.00	2.56	3.00	3.00	3.00	3.00
Deprec., D, & A (\$/bbl)	24.26	24.14	24.00	24.00	24.07	24.00	24.00	24.00	24.00
Ebitda Margin	73%	64%	67%	67%	65%	67%	67%	67%	67%

Present Value Exceptions

While NPV for ENP fits our correlation for operating companies there are exceptions among other income stocks that affect relative valuation by the McDep Ratio. Among the Canadian stocks, the long, long life of buy-recommended **Canadian Oil Sands Trust (COSWF)** is unmatched. McDep Ratios for buy-recommended **Penn West Energy Trust (PWE)** as well as for unrated **Enerplus (ERF)** and **Pengrowth (PGH)** are about 0.15 lower than the normal relationship would indicate as we allow for additional value in oil sands and enhanced recovery.

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**Encore Energy Partners
Functional Cash Flow and Present Value**

	<i>NTM Ebitda</i> <i>(US\$mm)</i>	<i>Adjusted</i> <i>R/P</i>	<i>PV/</i> <i>Ebitda</i>	<i>Present</i> <i>Value</i> <i>(US\$mm)</i>	
North American Natural Gas	9	20.9	11.6	100	20%
Oil	47	10.7	8.4	390	80%
	55	12.7	8.9	490	100%
Debt (US\$mm)					70
Net Present Value (US\$mm)					420
Shares (mm)					23
Net Present Value - Standard Estimate (US\$/sh)					18
Net Present Value - Approximation by Correlation (US\$/sh)					18

Natural Gas and Oil Income Stocks - Rank by McDep Ratio

	<i>Symbol/</i> <i>Rating</i>	<i>Price</i> <i>(\$/sh)</i> <i>13-Sep</i> <i>2007</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>(\$/un)</i>	<i>Debt/</i> <i>Present</i> <i>Value</i>	<i>McDep</i> <i>Ratio</i>
U.S. Royalty Trusts							
Sabine Royalty Trust	SBR	42.91	14.6	630	45.00	-	0.95
Cross Timbers Royalty Trust	CRT	43.26	6.0	260	46.00	-	0.94
Permian Basin RT	PBT	14.26	46.6	670	16.50	-	0.86
Mesa RoyaltyTrust	MTR	60.01	1.9	110	70.00	-	0.86
San Juan Basin Royalty Trust	SJT	B 32.79	46.6	1,530	40.00	-	0.82
Hugoton RoyaltyTrust	HGT	B 24.48	40.0	980	34.00	-	0.72
	<i>Total or Median</i>			4,200			0.86
Canadian Income Trusts (US\$)							
Pengrowth Energy Trust	PGH	17.28	246.0	4,250	17.00	0.27	1.01
Enerplus Resources Fund	ERF	44.76	128.0	5,730	52.00	0.12	0.88
Penn West Energy Trust	PWE	B 29.96	241.5	7,240	36.00	0.19	0.87
Canadian Oil Sands Trust	COSWF	B 32.75	479.0	15,690	39.00	0.07	0.85
	<i>Total or Median</i>			32,900		0.16	0.87
U.S. Master Limited Partnerships (MLPs)							
Kinder Morgan Energy Partners, L.P.	KMP	S 49.80	178.6	8,900	17.00	0.53	1.91
Encore Energy Partners, L.P. (39%)	ENP	21.57	9.0	190	18.00	0.14	1.17
Dorchester Minerals, L.P.	DMLP	20.47	28.2	580	27.00	-	0.76
	<i>Total or Median</i>			9,700		0.14	1.17

B = Buy, S = Sell

McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses

Among U.S. royalty trusts, NPV for buy-recommended **Hugoton Royalty Trust (HGT)** fits the correlation in part because reserves for HGT are estimated by the same engineer and on the same basis as for ENP. NPV for buy-recommended **San Juan Basin Royalty Trust (SJT)** is higher than the correlation in part because reserve estimates for SJT became more understated when SJT switched to a more conservative engineer and an estimate of reserves on a comparable underlying

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properties basis is not available. Finally, three of the U.S royalty trusts hold “revenue royalties” as opposed to “profits royalties” that have higher present value for the same cash flow.

The lower McDep Ratio MLP, **Dorchester Minerals (DMLP)**, shares characteristics with the U.S. royalty trusts that we try to recognize as we estimate a present value higher than indicated by the typical connection of cash flow and reserve life. DMLP’s stock price may also be depressed by an overhang of systematic selling by early pension fund investors.

Natural Gas and Oil Income Stocks - Rank by EV/Ebitda

	Symbol/ Rating	Price (\$/sh) 13-Sep 2007	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
U.S. Royalty Trusts							
Cross Timbers Royalty Trust	CRT	43.26	12.0	12.2	11.5	12.2	8.2
San Juan Basin Royalty Trust	SJT B	32.79	10.0	13.4	11.0	13.7	7.3
Sabine Royalty Trust	SBR	42.91	9.6	10.5	10.0	10.0	10.0
Mesa RoyaltyTrust	MTR	60.01	21.9	11.4	9.8	11.1	9.0
Hugoton RoyaltyTrust	HGT B	24.48	14.1	12.4	9.0	13.0	7.7
Permian Basin RT	PBT	14.26	8.1	9.3	8.1	10.2	9.8
	<i>Median</i>		<i>11.0</i>	<i>11.8</i>	<i>9.9</i>	<i>11.7</i>	<i>8.6</i>
Canadian Income Trusts (US\$)							
Canadian Oil Sands Trust	COSWF B	32.75	20.9	10.2	8.7	10.6	9.3
Enerplus Resources Fund	ERF	44.76	9.4	9.0	7.9	16.1	10.7
Pengrowth Energy Trust	PGH	17.28	7.1	7.7	7.8	43.9	16.5
Penn West Energy Trust	PWE B	29.96	7.7	7.9	6.8	13.7	12.9
	<i>Median</i>		<i>8.5</i>	<i>8.4</i>	<i>7.8</i>	<i>14.9</i>	<i>11.8</i>
U.S. Master Limited Partnerships (MLPs)							
Kinder Morgan Energy Partners, L.P.	KMP S	49.80	7.6	8.0	15.3	34.3	6.8
Encore Energy Partners, L.P.	ENP	21.57	12.7	8.8	10.3	40.0	6.5
Dorchester Minerals, L.P.	DMLP	20.47	9.1	12.4	9.4	14.9	10.6
	<i>Median</i>		<i>9.1</i>	<i>8.8</i>	<i>10.3</i>	<i>34.3</i>	<i>6.8</i>

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended September 30, 2008; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses

Kinder Morgan Energy Partners Makes All Other Covered Stocks Look Undervalued

The high valuation of sell-recommended Kinder Morgan Energy Partners (KMP) has inspired a host of energy transportation MLPs and now the new wave of oil and gas production MLPs. Though KMP stays afloat with the benefit of fallacious practices, in our view, we are relieved that production MLPs are different. First, KMP’s accounting for general partner compensation tricks public research sources into calculating an unlevered cash flow multiple that makes KMP look half as expensive as it really is. Thankfully, our production MLPs have more realistic compensation accounted for reasonably without the “incentive distribution rights” that scoop “off-the-books” tribute for the KMP general partner. Second, with the complicity of debt rating agencies that are paid by KMP, the partnership has an understated amount of over-rated debt as

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we see it. Thankfully again, among our production MLPs, DMLP has no debt and ENP has low debt.

Income investors also appear to overlook the fact that KMP's distribution is financed by borrowed money as indicated by a Distribution/Equity Ebitda ratio above 1.0 (see column *Dist./Equity Ebitda* in the table below, Rank by NTM Distribution Yield). By the same measure, ENP has scope to increase its distribution.

Natural Gas and Oil Income Stocks - Rank by NTM Distribution Yield

	<i>Symbol</i>	<i>Revenue Royalty (%)</i>	<i>Natural Gas/ Ebitda (%)</i>	<i>Dist/ Ebitda</i>	<i>Dist/ Equity Ebitda</i>	<i>NTM Distribution (\$mm)</i>	<i>(\$/un)</i>	<i>Dist. Yield (%)</i>
U.S. Royalty Trusts								
San Juan Basin Royalty Trust	SJT	-	98	0.80	0.80	112	2.40	7.3
Hugoton RoyaltyTrust	HGT	-	88	0.69	0.69	75	1.88	7.7
Cross Timbers Royalty Trust	CRT	84	67	0.94	0.94	21	3.54	8.2
Mesa RoyaltyTrust	MTR	-	70	0.88	0.88	10	5.39	9.0
Permian Basin RT	PBT	35	36	0.79	0.79	65	1.40	9.8
Sabine Royalty Trust	SBR	100	56	1.00	1.00	63	4.30	10.0
	<i>Total or Median</i>		68	0.84	0.84	300		8.6
Canadian Income Trusts (US\$)								
Canadian Oil Sands Trust	COSWF	-	(7)	0.74	0.80	1,456	3.04	9.3
Enerplus Resources Fund	ERF	-	41	0.72	0.82	613	4.79	10.7
Penn West Energy Trust	PWE	-	35	0.68	0.85	936	3.88	12.9
Pengrowth Energy Trust	PGH	-	41	0.94	1.28	701	2.85	16.5
	<i>Total or Median</i>		38	0.73	0.84	3,700		11.8
U.S. Master Limited Partnerships (MLPs)								
Encore Energy Partners, L.P.	ENP		16	0.59	0.68	13	1.40	6.5
Kinder Morgan Energy Partners, lKMP			-	0.76	1.60	607	3.40	6.8
Dorchester Minerals, L.P.	DMLP	64	72	1.00	1.00	61	2.17	10.6
	<i>Total or Median</i>							

NTM = Next Twelve Months Ended September 30, 2008

Ebitda = Earnings before interest, tax, depreciation and amortization

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