

Rating: Buy  
S&P 500: 1280

## **Encore Acquisition Company** **Abundant Appreciation Potential**

|                                     |        |  |       |
|-------------------------------------|--------|--|-------|
| <i>Symbol</i>                       | EAC    | <i>Ebitda Next Twelve Months ending 6/30/07 (US\$mm)</i> | 521   |
| <i>Rating</i>                       | Buy    | <i>North American Natural Gas/Ebitda (%)</i>             | 31    |
| <i>Price (\$/sh)</i>                | 29.61  | <i>Natural Gas and Oil Production/Ebitda (%)</i>         | 100   |
| <i>Pricing Date</i>                 | 8/3/06 | <i>Adjusted Reserves/Production NTM</i>                  | 14.9  |
| <i>Shares (mm)</i>                  | 54     | <i>EV/Ebitda</i>   | 4.3   |
| <i>Market Capitalization (\$mm)</i> | 1,580  | <i>PV/Ebitda</i>   | 6.8   |
| <i>Debt (\$mm)</i>                  | 660    | <i>Undeveloped Reserves (%)</i>                          | 28    |
| <i>Enterprise Value (EV) (\$mm)</i> | 2,240  | <i>Natural Gas and Oil Ebitda (\$/boe)</i>               | 46.20 |
| <i>Present Value (PV) (\$mm)</i>    | 3,550  | <i>Present Value Proven Reserves(\$/boe)</i>             | 18.20 |
| <i>Net Present Value (\$/share)</i> | 54     | <i>Present Value Proven Reserves(\$/mcf)</i>             | 3.00  |
| <i>Debt/Present Value</i>           | 0.19   | <i>Earnings Next Twelve Months (US\$/sh)</i>             | 3.27  |
| <i>McDep Ratio - EV/PV</i>          | 0.63   | <i>Price/Earnings Next Twelve Months</i>                 | 9     |
| <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.

### **Summary and Recommendation**

Buy-recommended **Encore Acquisition (EAC)** offers 58% unlevered possible appreciation to a McDep Ratio of 1.0 where stock price would equal net present value (NPV) estimated at \$54 a share presuming a long-term oil price of \$60 a barrel. We raised our estimate of NPV from \$45 a share when we revised our oil price from \$50 a barrel on June 6. Though NPV may seem high, some understandable factors might explain it. Starting at 0.63 the McDep Ratio would be 0.73 if the stock price recognized the modest credit we include in present value for Encore's long adjusted reserve life at 14.9 years compared to the median buy recommendation at 10.0 years. EAC might rise further to 0.83 if the median small cap buy would be priced the same as the median buy. Finally, it might rise to 0.96 if it were to appreciate as much as the median buy recommendation rising to 1.0. Otherwise most of the commodity price opportunity and operating challenges that Encore President Jonny Brumley discussed in the August 3 conference call could be priced in the stock in similar fashion as for other buy recommendations. Finally, looking past the statistics to the people behind the numbers, we believe Encore stock is a solid investment in long life, small cap oil and gas production.

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**Encore Acquisition Company**  
**Next Twelve Months Operating and Financial Estimates**

|                            | <i>Q2</i>      | <i>Year</i>  | <i>Q1</i>      | <i>Q2</i>      | <i>Q3E</i>     | <i>Q4E</i>      | <i>Year</i>  | <i>Q1E</i>     | <i>Next<br/>Twelve<br/>Months</i> |
|----------------------------|----------------|--------------|----------------|----------------|----------------|-----------------|--------------|----------------|-----------------------------------|
|                            | <i>6/30/05</i> | <i>2005</i>  | <i>3/31/06</i> | <i>6/30/06</i> | <i>9/30/06</i> | <i>12/31/06</i> | <i>2006E</i> | <i>3/31/07</i> | <i>6/30/07</i>                    |
| <b>Volume</b>              |                |              |                |                |                |                 |              |                |                                   |
| Natural Gas (mmcf)         | 54.2           | <b>57.7</b>  | 67.9           | 65.7           | 65.7           | 65.7            | <b>66.2</b>  | 65.7           | <b>65.7</b>                       |
| Oil (mbd)                  | 18.66          | <b>18.83</b> | 20.7           | 19.9           | 19.9           | 19.9            | <b>20.12</b> | 19.9           | <b>19.92</b>                      |
| Total (mbd)                | 27.7           | <b>28.4</b>  | 32.0           | 30.9           | 30.9           | 30.9            | <b>31.2</b>  | 30.9           | <b>30.9</b>                       |
| <b>Price</b>               |                |              |                |                |                |                 |              |                |                                   |
| Henry Hub (\$/mmbtu)       | 6.76           | <b>8.65</b>  | 8.97           | 6.81           | 7.44           | 9.79            | <b>8.25</b>  | 11.62          | <b>9.40</b>                       |
| Differential (\$/mmbtu)    | 0.19           | <b>0.78</b>  | 2.08           | (0.01)         | (0.01)         | (0.01)          | <b>0.51</b>  | (0.02)         | <b>(0.00)</b>                     |
| EAC (\$/mcf)               | 6.57           | <b>7.87</b>  | 6.89           | 6.82           | 7.45           | 9.81            | <b>7.74</b>  | 11.63          | <b>9.40</b>                       |
| WTI Cushing (\$/bbl)       | 53.05          | <b>56.31</b> | 63.33          | 70.47          | 74.40          | 76.40           | <b>71.15</b> | 77.82          | <b>76.74</b>                      |
| Differential               | 5.84           | <b>5.25</b>  | 14.71          | 11.19          | 9.81           | 8.07            | <b>10.99</b> | 8.22           | <b>8.61</b>                       |
| EAC (\$/bbl)               | 47.21          | <b>51.06</b> | 48.62          | 59.28          | 64.59          | 68.32           | <b>60.15</b> | 69.60          | <b>68.13</b>                      |
| Total (\$/bbl)             | 44.67          | <b>49.77</b> | 46.05          | 52.77          | 57.53          | 64.96           | <b>55.30</b> | 69.67          | <b>63.98</b>                      |
| <b>Revenue (\$mm)</b>      |                |              |                |                |                |                 |              |                |                                   |
| Natural Gas                | 32             | <b>166</b>   | 42             | 41             | 45             | 59              | <b>187</b>   | 69             | <b>225</b>                        |
| Oil                        | 80             | <b>351</b>   | 91             | 107            | 118            | 125             | <b>442</b>   | 125            | <b>495</b>                        |
| Total                      | 113            | <b>517</b>   | 133            | 148            | 163            | 184             | <b>629</b>   | 194            | <b>721</b>                        |
| <b>Expense</b>             |                |              |                |                |                |                 |              |                |                                   |
| Lease operating            | 16             | <b>68</b>    | 23             | 23             | 26             | 26              | <b>97</b>    | 25             | <b>101</b>                        |
| Production taxes           | 10             | <b>46</b>    | 12             | 13             | 15             | 17              | <b>56</b>    | 17             | <b>65</b>                         |
| General and administrative | 8              | <b>28</b>    | 9              | 7              | 9              | 9               | <b>33</b>    | 8              | <b>34</b>                         |
| Total                      | 34             | <b>142</b>   | 44             | 43             | 49             | 51              | <b>186</b>   | 51             | <b>200</b>                        |
| <b>Ebitda</b>              | 79             | <b>375</b>   | 89             | 106            | 115            | 134             | <b>443</b>   | 143            | <b>521</b>                        |
| Exploration                | 4              | <b>14</b>    | 2              | 4              | 4              | 4               | <b>14</b>    | 4              | <b>16</b>                         |
| Deprec., Deplet., & Amort. | 19             | <b>86</b>    | 27             | 28             | 28             | 28              | <b>112</b>   | 28             | <b>113</b>                        |
| Hedging and other          | 13             | <b>71</b>    | 19             | 19             | 21             | 25              | <b>85</b>    | 29             | <b>100</b>                        |
| <b>Ebit</b>                | 44             | <b>203</b>   | 40             | 55             | 65             | 80              | <b>240</b>   | 86             | <b>308</b>                        |
| Interest                   | 7              | <b>33</b>    | 12             | 10             | 10             | 10              | <b>43</b>    | 10             | <b>39</b>                         |
| <b>Ebt</b>                 | 36             | <b>170</b>   | 29             | 44             | 55             | 70              | <b>198</b>   | 76             | <b>269</b>                        |
| Income Tax                 | 12             | <b>54</b>    | 11             | 15             | 19             | 24              | <b>69</b>    | 27             | <b>94</b>                         |
| <b>Net Income (\$mm)</b>   | 24             | <b>116</b>   | 18             | 29             | 36             | 45              | <b>128</b>   | 49             | <b>175</b>                        |
| Per Share (\$)             | 0.48           | <b>2.34</b>  | 0.36           | 0.55           | 0.67           | 0.85            | <b>2.42</b>  | 0.92           | <b>3.27</b>                       |
| <b>Shares (millions)</b>   | 49             | <b>50</b>    | 50             | 54             | 54             | 54              | <b>53</b>    | 54             | <b>54</b>                         |
| Lease operating (\$/bbl)   | 6.24           | <b>6.59</b>  | 7.89           | 8.23           | 9.00           | 9.00            | <b>8.53</b>  | 9.00           | <b>9.00</b>                       |
| Production taxes (%rev)    | 8.7            | <b>8.8</b>   | 9.2            | 8.5            | 9.0            | 9.0             | <b>8.9</b>   | 9.0            | <b>9.0</b>                        |
| General and admin (\$/bbl) | 3.16           | <b>2.72</b>  | 3.14           | 2.49           | 3.00           | 3.00            | <b>2.91</b>  | 3.00           | <b>3.00</b>                       |
| Deprec., D, & A (\$/bbl)   | 7.55           | <b>8.25</b>  | 9.37           | 9.97           | 10.00          | 10.00           | <b>9.83</b>  | 10.00          | <b>10.00</b>                      |
| Ebitda Margin              | 70%            | <b>72%</b>   | 67%            | 71%            | 70%            | 73%             | <b>70%</b>   | 74%            | <b>72%</b>                        |
| Tax rate                   | 34%            | <b>32%</b>   | 37%            | 34%            | 35%            | 35%             | <b>35%</b>   | 35%            | <b>35%</b>                        |

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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                                 | 163               | 10.7            | 5.5           | 900             | 25%   |
| Oil  | 358               | 17.2            | 7.4           | 2,650           | 75%   |
|  | 521               | 14.9            | 6.8           | 3,550           | 100%  |
| Debt (US\$mm)  |                   |                 |               |                 | 660   |
| Net Present Value (US\$mm)                                 |                   |                 |               |                 | 2,890 |
| Shares (mm)  |                   |                 |               |                 | 54    |
| Net Present Value - Standard Estimate (US\$/sh)            |                   |                 |               |                 | 54    |
| Net Present Value - Approximation by Correlation (US\$/sh) |                   |                 |               |                 | 56    |

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