McDep Associates
Independent Stock Idea
November 27, 2002

Rating: Buy
S&P 500: 913

Encana Corporation
Continue Buy on Natural Gas and Exceptional Prospects

Symbol	Price (US$/sh) 26-Nov 2002	Shares (mm)	Market Cap ($mm)	Net Present Value ($/sh)	Debt/ Present Value	McDep Ratio	EV/ Sales NTM	EV/ Ebitda NTM	P/E NTM	Div'd NTM (%)	PV/ Ebitda NTM
ECA	26.75	470	12,600	35	0.28	0.83	2.6	5.8	13.6	1.0	7.0

McDep Ratio = **M**arket **c**ap and **De**bt to **p**resent value of oil and gas and other businesses		
EV = Enterprise Value = Market Cap and Debt:	US$mm	19,000
Ebitda = Earnings before interest, tax, depreciation and amortization:	US$mm	3,300
NTM = Next Twelve Months Ended December 31, 2003; P/E = Stock Price to Earnings		
PV = Present Value of energy businesses:	US$mm	22,800

Summary and Recommendation

We continue our recommended purchase of the shares of the largest independent energy producer, Encana Corporation, on the basis of competitive valuation and exceptional prospects for future production of North American natural gas and international oil. Some two thirds of the value of the Canadian company is concentrated on Canadian and U.S. natural gas, the clean, premium fuel likely to be in short supply for the next several years. Encana has added impressive new sources in the U.S. Rockies, Western Canada and offshore Eastern Canada right under the noses of well-established competitors. The remaining third of the company includes a long life oil position in Canada enhanced with surprisingly large discoveries in the North Sea and the Gulf of Mexico, prizes snatched in playgrounds dominated by mega cap industry leaders. Equity and debt holders capitalize our estimate of Next Twelve Months cash flow at just 5.8 times, or years. That implies little recognition, if any, for stronger growth potential and concentration on clean fuel in politically secure areas. Notwithstanding our enthusiastic outlook, energy stocks are subject to political, economic, financial and business uncertainty.

Stock Price in Temporary Downtrend

We realize that the stock price chart pattern does not look like it is in a rising trend currently. While we would not recommend a stock if we thought it was going to decline further we have no control over that potential. We believe we have a reasonable basis for expecting that an investment in Encana stock will be rewarding over the next few years.

Management Projects 12% Volume Growth in 2003

Few companies have the prospects for volume gains that Encana seems to have. The possible increases are even more impressive considering that most natural gas and oil wells operate at a capacity limit that declines continuously. The company discussed its opportunities in detail in an all day presentation last week that is available on the Internet.

Yet we have learned over many years that one must be cautious about recognizing volume gains in stock price before they are in hand. Moreover, most oil and gas management projections of volume ultimately prove to be too optimistic from the largest to the smallest company. Thus, we do not think Encana's stock price has a lot of anticipation built into it and we will not be surprised if some of the expected volume gains get delayed.

Project Flat Volume for Valuation Purposes

Predecessor companies, PanCanadian and Alberta Energy, have long provided disclosures that enabled us to construct detailed financial models. Our current model is relatively simple by comparison although it may still look like it has a lot of numbers. The primary assumption in the volume section is that results for NTM ended December 31, 2003 are at the same level as for the quarter just ended. Also we have adjusted the volumes reported before royalties according to the Canadian custom to the volumes reported after royalties according to the U.S. custom.

In the price section of the model we take account of the latest expectations in the futures market for natural gas at the Henry Hub in Louisiana and for oil at Cushing in Oklahoma. For Encana's prices reported in Canadian dollars we have tried to eliminate any hedging effects so that projections reflect results before hedging. To the extent Encana has benefited from commodity price hedges and transportation cost hedges it is reflected in the company's latest balance sheet. We also freeze realized prices relative to futures prices. In the back of our minds we consider that Canada and Rocky Mountain natural gas prices were relatively depressed in the third quarter and are likely to show particularly strong gains in the winter quarters. On the other side, heavy oil prices have been reasonably good in Canada and could be weaker relative to the lighter commodity benchmark. About 30% of the company's oil production is sensitive to the light/heavy differential.

Latest quarterly cost relationships also form the basis for projected items. On balance we see that strong futures prices carry cash flow (Ebitda) up for the next few quarters and modest erosion in futures prices trim it back thereafter (see table). Projected NTM cash flow is a little more than C$5 billion closely matching the company's expected capital program. While doing our analysis of Encana in its home currency, we convert to U.S. dollars in valuation comparisons with other stocks.

Encana Corporation
Next Twelve Months Operating and Financial Estimates
(Canadian dollars)

	Q3 9/30/02	*Q4E 12/31/02*	*Q1E 3/31/03*	*Q2E 6/30/03*	*Q3E 9/30/03*	*Q4E 12/31/02*	*Next Twelve Months 12/31/02*
Volume							
Natural Gas (bcf)	212	212	208	210	212	212	**842**
Natural Gas (mmcfd)	2,307	2,307	2,307	2,307	2,307	2,307	**2,307**
Days	92	92	90	91	92	92	**365**
Oil (mmb)	20.9	20.9	20.4	20.6	20.9	20.9	**83**
Oil (mbd)	227	227	227	227	227	227	**227**
Total (bcf)	337	337	330	334	337	337	**1,339**
Total (mmcfd)	3,667	3,667	3,667	3,667	3,667	3,667	**3,667**
Price							
Henry Hub (US$/mmbtu)	3.21	4.17	4.33	3.77	3.94	4.06	**4.07**
Differential	(0.01)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	**0.03**
Encana ($/mcf)	3.22	4.18	4.35	3.78	3.95	4.08	**4.04**
WTI Cushing (US$/bbl)	28.33	27.32	24.95	24.57	24.67	24.14	**25.08**
Differential	(4.94)	(4.76)	(4.35)	(4.28)	(4.30)	(4.21)	**(3.78)**
Encana ($/bbl)	34.28	32.08	29.29	28.85	28.97	28.35	**28.86**
Total ($/bbl)							
Revenue ($mm)							
Natural Gas	684	888	903	794	839	866	**3,402**
Oil	715	669	598	595	604	591	**2,389**
Other	1,483	1,586	1,528	1,415	1,470	1,484	**5,897**
Total	2,882	3,143	3,029	2,804	2,913	2,942	**11,688**
Expense							
Natural Gas and Oil	234	265	254	232	243	245	**973**
Other	1,400	1,503	1,445	1,332	1,387	1,401	**5,565**
Total	1,633	1,633	1,699	1,563	1,563	1,563	**6,389**
Ebitda ($mm)							
Natural Gas and Oil	1,166	1,292	1,247	1,158	1,201	1,212	**4,818**
Other	83	83	83	83	83	83	**332**
Total	1,249	1,375	1,330	1,241	1,284	1,295	**5,150**
Deprec., Deplet., & Amort.	616	616	616	616	616	616	**2,464**
Interest	112	112	112	112	112	112	**448**
Ebt	521	647	602	513	556	567	**2,238**
Income tax	182	226	211	179	195	199	**783**
Net Income ($mm)	338	421	391	333	361	369	**1,454**
Per share ($)	0.72	0.89	0.83	0.71	0.77	0.78	**3.09**
Shares (millions)	470	470	470	470	470	470	**470**
Ebitda margin (ng + o)	83%	83%	83%	83%	83%	83%	**83%**
Tax rate	35%	35%	35%	35%	35%	35%	**35%**

McDep Ratio Implies Moderate Valuation

The McDep Ratio is the most important single valuation measure for energy stocks, in our experience. The numerator, "McDe" in McDep, is Market Cap and Debt, also known as Enterprise Value. The denominator, "p" in McDep, is Present Value of future cash flow from natural gas and oil production and other businesses. Stocks with high McDep Ratios, especially those above 1.20, have high valuation risk and are likely to underperform. Stocks with low McDep Ratios, especially those below 0.8 have extra appreciation potential. The McDep Ratio for Encana falls at a low 0.83.

McDep Ratio Numerator Neutralizes Financial Leverage

Promoting value without disclosing or simply ignoring leverage has long been done to deceive investors well before Enron came along. By combining market cap and debt in the numerator of the McDep Ratio we look at value before leverage. Admittedly we can still be fooled when leverage is not fully disclosed.

McDep Ratio Denominator Measures Fundamental or Business Value

While we say our technique is tied to discounted cash flow analysis we necessarily shorten the process when applying it to more companies. The simple model is that present value equals next twelve months cash flow (Ebitda) times a multiple that reflects reserve life primarily. It is simple logic that the longer an asset lasts, the longer cash flow lasts. We make a modification to reserve life that counts undeveloped reserves at lower weight because development costs yet to be spent subtract from present value of future cash flow. Factors to consider in assessing a multiple could be anything that would affect the present value calculation.

Adjusted Reserve Life Exceeds 9 Years

Our calculation of reserve life for Encana takes royalties out of the numerator and the denominator (see table). It does not matter for the ratio whether royalties are included or not as long as the treatment is consistent for reserves and production.

A nine year life index is longer than average. While some peer companies may report reserve life a year or two longer, Encana's basis may be more conservative in the sense that it has been fully verified by respected independent engineers.

Ultra long-life Syncrude accounts for about 16% of reserves and about 6% of production. Take out Syncrude and adjusted reserve life becomes 8.3 years. Syncrude is particularly valuable, but the market does not seem to fully recognize the ultra long life.

Natural Gas and Oil Reserves

	Natural Gas	Oil	Total	
	(bcf)	(mmb)	(bcf)	(mmb)
Reserves (bcf or mmb)				
Proven (P)	7038	1127	13800	2300
Proven Developed (PD)	5630	902	11040	1840
Proven Undeveloped (PUD)	1408	225	2760	460
Production, NTM	842	83	1339	223
Reserve Life Index (years)				
R/P P	8.4	13.6	10.3	10.3
R/P PD	6.7	10.9	8.2	8.2
R/P PUD	1.7	2.7	2.1	2.1
R/P PD+.5PUD	7.5	12.3	9.3	9.3

Moderate Debt Being Reduced

The next most important valuation consideration is the ratio of Debt/Present Value. Stocks with ratios of debt above 0.50 have a high probability of financial failure and are to be avoided, in our opinion, regardless of McDep Ratio. Of eleven stocks in our coverage a year ago with debt above 0.50, eight have essentially failed or gone bankrupt.

Investors can add their own leverage by adjusting amounts owned of high and low debt stocks, or if possible, sell short or buy on margin. Where investors have some flexibility it makes little sense to invest in a stock with excessive debt. In the McDep Energy Portfolio we recommend weightings that neutralize debt and we include no stocks as buys that have excessive debt.

Encana's ratio of debt near average for peer companies is of little concern. The company recently announced the sale of C$2 billion of pipeline assets. When the transaction closes next year it could reduce debt by some 20%.

Management Gets High Marks

We have known both the Chairman and the Chief Executive Officer of Encana for more than a decade. Neither has ever disappointed us with a questionable move. There were times when one needed patience with their respective stocks, but the overall progress both have been able to generate has been exceptional.

Encana Probably Underweighted in U.S. Portfolios

A technical factor that might help Encana stock could be that it is not yet well known by U.S. investors. The merged company has been trading for less than a year. One of the predecessors, PanCanadian, started trading in the U.S. only in the second half of last year. Alberta Energy had been trading in the U.S. for a few years. Liquidity should not be a problem for most U.S. investors as the stock trades about 300,000 shares a day on the New York Stock Exchange and more in Toronto.

Kurt H. Wulff, CFA