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ENCORE ACQUISITION CO  
Form 10-Q  
May 06, 2002

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D. C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2002

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 1-16295

ENCORE ACQUISITION COMPANY  
(Exact name of Registrant as specified in its charter)

Delaware	75-2759650
-----	-----
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

777 Main Street, Suite 1400, Ft. Worth, Texas	76102
-----	-----
(Address of principal executive offices)	(Zip code)

Registrant's Telephone Number, including area code: (817) 877 - 9955

Not applicable  
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Number of shares of Common Stock outstanding as of May 3, 2002.....30,029,961

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ENCORE ACQUISITION COMPANY

CONSOLIDATED BALANCE SHEETS  
(in thousands except share data)

	MARCH 31, 2002 ----- (unaudited)	DECEMBER 2001 -----
ASSETS		
Current assets:		
Cash and cash equivalents .....	\$ 169	\$ 169
Accounts receivable (Net of allowance of \$7.0 million) .....	19,514	16,514
Deferred tax asset .....	4,438	4,438
Derivative assets .....	1,031	7,031
Other current assets .....	5,574	5,574

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Total current assets .....	30,726	28
Properties and equipment, at cost -- successful efforts method:		
Producing properties .....	493,247	422
Undeveloped properties .....	866	
Accumulated depletion, depreciation and amortization .....	(68,905)	(60)
	425,208	362
Other property and equipment .....	3,324	3
Accumulated depletion, depreciation, and amortization .....	(1,462)	(1)
	1,862	1
Other assets .....	3,232	8
Total assets .....	\$ 461,028	\$ 402
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable .....	\$ 5,389	\$ 10
Derivative liabilities .....	7,529	3
Current portion of note payable .....	--	1
Other current liabilities .....	15,131	12
Total current liabilities .....	28,049	27
Derivative liabilities .....	1,774	1
Long-term debt .....	133,000	78
Deferred income taxes .....	29,571	25
Total liabilities .....	192,394	132
Commitments and contingencies .....	--	
Stockholders' equity:		
Preferred stock, \$.01 par value, 5,000,000 shares authorized, none issued and outstanding .....	--	
Common stock, \$.01 par value, 60,000,000 authorized, 30,029,961 issued and outstanding .....	300	
Additional paid-in capital .....	248,786	248
Retained earnings .....	23,149	16
Accumulated other comprehensive income .....	(3,601)	4
Total stockholders' equity .....	268,634	269
Total liabilities and stockholders' equity .....	\$ 461,028	\$ 402

The accompanying notes are an integral part of these consolidated financial statements.

## ENCORE ACQUISITION COMPANY

CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands except per share data)

	THREE MONTHS ENDED MARCH 31,	
	2002	2001
	(unaudited)	
Revenues:		
Oil .....	\$ 26,686	\$ 27,377
Natural gas .....	5,611	8,844
	-----	-----
Total revenues .....	32,297	36,221
Expenses:		
Production --		
Direct lifting costs .....	6,817	6,355
Production, ad valorem, and severance taxes .....	3,013	4,270
General and administrative (excluding non-cash stock based compensation) .....	1,493	1,263
Non-cash stock based compensation .....	--	9,587
Depletion, depreciation, and amortization .....	8,559	7,563
Derivative fair value (gain) loss .....	(653)	102
Other operating expense .....	139	--
	-----	-----
Total expenses .....	19,368	29,140
Operating income .....	12,929	7,081
Other income (expenses):		
Interest .....	(1,492)	(2,537)
Other .....	30	52
	-----	-----
Total other income (expenses) .....	(1,462)	(2,485)
Income before income taxes .....	11,467	4,596
Provision for income taxes - current .....	(430)	(604)
Provision for income taxes - deferred .....	(3,927)	(4,785)
	-----	-----
Income (loss) before accounting change .....	7,110	(793)
Cumulative effect of accounting change (net of income taxes of \$0 and \$541, respectively) .....	--	(884)
	-----	-----
Net income (loss) .....	\$ 7,110	\$ (1,677)
	=====	=====
Income (loss) per common share before accounting change:		
Basic and diluted .....	\$ 0.24	\$ (0.03)

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Income (loss) per common share after accounting change:		
Basic and diluted .....	\$ 0.24	\$ (0.07)
Weighted average common shares outstanding:		
Basic .....	30,030	24,707
Diluted .....	30,052	24,707

The accompanying notes are an integral part of these consolidated financial statements.

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ENCORE ACQUISITION COMPANY

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
MARCH 31, 2002  
(in thousands)  
(unaudited)

	Retained Earnings	Common Stock	Additional Paid-In Capital
	-----	-----	-----
Balance at December 31, 2001 .....	\$ 16,039	\$ 300	\$ 248,786
Components of comprehensive income:			
Net income .....	7,110	--	--
Change in deferred hedge loss (net of income taxes of \$4,767) .....	--	--	--
Total comprehensive loss .....	-----	-----	-----
Balance at March 31, 2002 .....	\$ 23,149	\$ 300	\$ 248,786
	=====	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

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ENCORE ACQUISITION COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)

THREE MONTHS

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MARCH 31

-----  
2002  
-----

(unaudited)

Operating activities	
Net income (loss) .....	\$ 7,110
Adjustments to reconcile net income (loss) to net cash provided by operating activities:	
Depletion, depreciation, and amortization .....	8,559
Deferred taxes .....	3,927
Non-cash stock based compensation .....	--
Non-cash cumulative accounting change .....	--
Non-cash derivative fair value (gain) loss .....	(653)
Other non-cash items .....	(470)
Loss on disposition of assets .....	147
Changes in operating assets and liabilities:	
Accounts receivable .....	(3,228)
Other current assets .....	(700)
Other assets .....	4,855
Accounts payable and other current liabilities .....	(2,303)
	-----
Cash provided by operating activities .....	17,244
Investing activities	
Proceeds from disposition of assets .....	35
Purchases of other property and equipment .....	(323)
Acquisition of oil and gas properties .....	(50,438)
Development of oil and gas properties .....	(20,357)
	-----
Cash used by investing activities .....	(71,083)
Financing activities	
Proceeds from initial public offering .....	--
Offering costs paid .....	--
Proceeds from long-term debt .....	76,000
Payments on long-term debt .....	(21,000)
Payments on note payable .....	(1,107)
	-----
Cash provided (used) by financing activities .....	53,893
Increase (decrease) in cash and cash equivalents .....	54
Cash and cash equivalents, beginning of period .....	115
	-----
Cash and cash equivalents, end of period .....	\$ 169
	=====

The accompanying notes are an integral part of these consolidated financial statements.

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(unaudited)

## 1. FORMATION OF ENCORE

Encore Acquisition Company ("Encore"), a Delaware Corporation, is an independent (non-integrated) oil and natural gas company in the United States. We were organized in April 1998 and are engaged in the acquisition, development, exploitation and production of North American oil and natural gas reserves. Our oil and natural gas reserves are concentrated in fields located in the Williston Basin of Montana and North Dakota, the Permian Basin of Texas and New Mexico, the Anadarko Basin of Oklahoma and the Powder River Basin of Montana.

## 2. BASIS OF PRESENTATION

In the opinion of management, the accompanying unaudited consolidated financial statements of Encore include all adjustments necessary to present fairly our financial position as of March 31, 2002 and results of operations and cash flows for the three months ended March 31, 2002 and 2001. All adjustments are of a recurring nature. These interim results are not necessarily indicative of results for an entire year. Certain amounts of prior periods have been reclassified in order to conform to the current period presentation.

Certain disclosures have been condensed or omitted from these consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission. Therefore, these financial statements should be read in conjunction with Encore's 2001 consolidated financial statements and related notes thereto included in Encore's Annual Report filed on Form 10-K.

## 3. NEW ACCOUNTING STANDARDS

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 143 ("SFAS 143"), Accounting for Asset Retirement Obligations, which the Company will be required to adopt as of January 1, 2003. This statement requires us to record a liability in the period in which an asset retirement obligation ("ARO") is incurred, based upon the discounted estimated fair value of the obligation. Also, upon initial recognition of the liability, we must capitalize additional asset cost equal to the amount of the liability. In addition to any obligations that arise after the effective date of SFAS 143, upon initial adoption we must recognize (1) a liability for any existing AROs, (2) capitalized cost related to the liability, and (3) accumulated depletion, depreciation, and amortization on that capitalized cost. We are currently reviewing the provisions of the statement and assessing their impact on our financial statements. We do not currently know the effect, if any, the adoption of SFAS 143 will have on our financial statements.

## 4. INDEBTEDNESS

The Company's overall debt has increased by \$53.9 million since December 31, 2001. The Company closed the Central Permian acquisition for \$50.1 million in January 2002. The remaining borrowings were used to fund ordinary operating and capital requirements under the 2002 budget.

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## 5. EARNINGS (LOSS) PER SHARE (EPS)

The following table reflects earnings (loss) per share data for the three months ended March 31 (in thousands, except per share data):

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THREE MONTHS  
MARCH 31,  
2002  
-----

NUMERATOR:  
-----

Income (loss) before accounting change .....	\$ 7,110
	=====
Net income (loss) .....	\$ 7,110
	=====

DENOMINATOR:  
-----

Denominator for basic earnings per share -- weighted average shares outstanding .....	30,030
Effect of dilutive securities: Dilutive options .....	22
	-----
Denominator for diluted earnings per share .....	30,052
	=====
Basic income (loss) per common share before accounting change .....	\$ 0.24
Cumulative effect of accounting change, net of tax .....	--
	-----
Basic income (loss) per common share after accounting change .....	\$ 0.24
	=====
Diluted income (loss) per common share before accounting change .....	\$ 0.24
Cumulative effect of accounting change, net of tax .....	--
	-----
Diluted income (loss) per common share after accounting change .....	\$ 0.24
	=====

For the quarters ended March 31, 2002 and 2001, outstanding employee stock options of 500,000 and 602,000, respectively, were excluded from the calculation of diluted earnings per share because their effect would have been antidilutive.

6. DERIVATIVE FINANCIAL INSTRUMENTS

During the quarter ended March 31, 2002, current derivative assets decreased \$6.0 million and long term derivative assets decreased \$0.2 million, while current derivative liabilities increased \$4.0 million and long-term derivative liabilities increased \$0.5 million. These changes were due primarily to an increase in the futures price of oil and natural gas. Also, during the quarter we recorded a \$0.7 million derivative fair value gain, resulting primarily from a decrease in the market value of our 2,000 Bbls per day short oil put contracts.

With the adoption of SFAS 133 on January 1, 2001, Encore began recording deferred hedging gains and losses as other comprehensive income. For the quarter ended March 31, 2002, we had a comprehensive loss of \$0.7 million, while net income totaled \$7.1 million. The difference between net income and comprehensive loss is due to a \$7.8 million change in deferred hedging gain/loss in other comprehensive income. Due to an increase in the futures price of oil and natural gas, we went from a deferred hedging gain of \$4.2 million, net of tax, at December 31, 2001 to a deferred hedging loss of \$3.6 million, net of tax, at



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March 31, 2002.

At December 31, 2001, we had \$4.8 million in gross unrecognized gains in other comprehensive income related to the termination of hedging contracts with Enron that will be amortized into earnings during 2002 and 2003. The following table illustrates the current and future amortization of this amount to revenue (in thousands):

PERIOD -----	OIL -----	GAS -----	TOTAL -----
Q1 2002 .....	\$ 705	\$ 399	\$ 1,104
Q2 2002 .....	705	399	1,104
Q3 2002 .....	706	398	1,104
Q4 2002 .....	706	398	1,104
Q1 2003 .....	100	5	105
Q2 2003 .....	100	5	105
Q3 2003 .....	100	4	104
Q4 2003 .....	101	4	105
	-----	-----	-----
Total .....	\$ 3,223	\$ 1,612	\$ 4,835
	=====	=====	=====

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The following tables summarize our open commodity hedging positions as of March 31, 2002:

### OIL HEDGES AT MARCH 31, 2002

PERIOD -----	DAILY FLOOR VOLUME (Bbl) -----	FLOOR PRICE (PER Bbl) -----	DAILY CAP VOLUME (Bbl) -----	CAP PRICE (PER Bbl) -----	DAILY SWAP VOLUME (Bbl) -----
Jan -- June 2002	5,000	\$ 23.14	2,500	\$ 26.31	2,500
July -- Dec 2002	4,000	\$ 22.93	2,500	\$ 26.31	2,000
Jan -- Dec 2003	3,000	\$ 19.17	3,000	\$ 25.33	--

### NATURAL GAS HEDGES AT MARCH 31, 2002

PERIOD -----	DAILY FLOOR VOLUME (Mcf) -----	FLOOR PRICE (PER Mcf) -----	DAILY CAP VOLUME (Mcf) -----	CAP PRICE (PER Mcf) -----	DAILY SWAP VOLUME (Mcf) -----
2002	5,000	\$ 3.13	2,500	\$ 8.05	5,000
2003	2,500	\$ 3.00	--	\$ --	2,500

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### INTEREST RATE HEDGES AT MARCH 31, 2002

PERIOD	FIXED SWAP INTEREST RATE	SWAP NOTIONAL
2002	5.48%	\$ 60,000,000
2003	5.48%	\$ 60,000,000
2004	5.48%	\$ 60,000,000
2005	5.48%	\$ 60,000,000

The actual gains or losses we realize from our hedge transactions may vary significantly from the amounts recorded in the March 31, 2002 balance sheet due to the fluctuation of prices in the commodity markets and/or fluctuations in the floating LIBOR interest rate.

Additionally, as of March 31, 2002, we had short oil put contracts in place covering 2,000 Bbls per day at an average strike price of \$19.25 which do not qualify for hedge accounting. Accordingly, these contracts are marked to market through earnings each period.

#### 7. INCOME TAXES

During the first quarter of 2002, Encore incurred \$4.4 million in income tax expense. Of this, \$3.9 million is deferred income tax expense and relates primarily to intangible drilling costs incurred during the quarter, which are deductible for income tax purposes, but have been capitalized as Properties and Equipment under generally accepted accounting principles. These amounts will be depleted and transferred to earnings over the production life of the wells.

Primarily as a result of the net deferred hedge loss recorded in other comprehensive income during the first quarter of 2002, Encore has a deferred tax asset in the amount of \$5.1 million at March 31, 2002; \$4.4 million of which is current. The remaining \$0.7 million has been netted with our deferred tax liability on the balance sheet.

#### 8. ACQUISITION

On January 4, 2002, we completed the acquisition of interests in oil and natural gas properties in the Permian Basin for \$50.1 million from Conoco. The two principal operated properties are the East Cowden Grayburg and Fuhrman Nix fields; the non-operated properties are primarily in the North Cowden and Yates fields. Production from the acquired properties averaged 1,638 BOE per day in the first quarter of 2002. Over 40 development wells have been identified, and the drilling program may be initiated in the second half of this year. The acquisition was funded by additional borrowings under the Company's existing credit agreement.

#### 9. SUBSEQUENT EVENTS

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On April 1, 2002, the Board of Directors of the Company upon recommendation by its Audit Committee, approved the engagement of Ernst & Young LLP as the Company's independent auditors for the fiscal year 2002, dismissing the firm of Arthur Andersen LLP. The determination to change independent auditors followed the Board of Director's decision to seek proposals from independent public accountants to audit the Company's financial statements for the fiscal year ending December 31, 2002.

On April 18, 2002, the company agreed to acquire oil and natural gas properties in the Paradox Basin in Utah from a privately held oil and gas company. The purchase price for the Paradox Basin acquisition is \$23.4 million, prior to closing adjustments. The Utah properties are the Ratherford Unit operated by Exxon Mobil and the Aneth Unit operated by ChevronTexaco. The working and net revenue interest in the Ratherford Unit is 19.3% and 16.8% respectively, and the working interest and the net revenue interest in the Aneth Unit are 12.0% and 10.3% respectively. Approximately 78% of the value of the acquisition is subject to preferential rights held by the Navajo Nation. The units produce from the Desert Creek zone at about 5,700 feet. The expected closing date is August 31, 2002.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This document contains forward-looking statements that involve risks and uncertainties that are made pursuant to the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those anticipated in our forward-looking statements due to many factors, including, but not limited to, those set forth under "SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS" contained in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, in Encore's 2001 Annual Report filed on Form 10-K. The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included in this document and Encore's 2001 Form 10-K.

RESULTS OF OPERATIONS

The following table sets forth operating information of Encore for the periods presented.

	THREE MONTHS MARCH 31
	-----
	2002
	-----
Operating Results (in thousands):	
Oil and natural gas revenues .....	\$ 32,297
Direct lifting costs .....	6,817
Production, ad valorem and severance taxes .....	3,013

Daily production:

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Oil volumes (Bbls) .....	15,674
Natural gas volumes (Mcf) .....	24,009
Combined volumes (BOE) .....	19,676
Average prices (net of hedging and net profits):	
Oil (per Bbl) .....	\$ 18.92
Natural gas (per Mcf) .....	2.60
Combined volumes (per BOE) .....	18.24
Average costs (per BOE):	
Direct lifting costs .....	\$ 3.85
Production, ad valorem and severance taxes .....	1.70
G&A (excluding non-cash stock based compensation) .....	0.84
DD&A .....	4.83

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COMPARISON OF QUARTER ENDED MARCH 31, 2002 TO QUARTER ENDED MARCH 31, 2001

Set forth below is our comparison of operations during the first quarter of 2002 with the first quarter of 2001.

REVENUES AND PRODUCTION. Oil and natural gas revenues of Encore for the first quarter of 2002 decreased as compared to 2001 by \$3.9 million, from \$36.2 million to \$32.3 million. The following table illustrates the primary components of oil and natural gas revenue for the quarters ended March 31, 2002 and 2001, as well as each quarter's respective oil and natural gas volumes (in thousands except per unit amounts):

REVENUES:	THREE MONTHS ENDED MARCH 31,			
	2002		2001	
	Revenue	\$/Unit	Revenue	\$/Unit
Oil wellhead .....	\$ 26,543	\$ 18.82	\$ 31,768	\$ 26.67
Net profits oil .....	(328)	(0.23)	(1,090)	(0.92)
Oil hedges .....	(235)	(0.17)	(3,301)	(2.77)
Enron hedges .....	706	0.50	--	--
Total Oil Revenues .....	<u>\$ 26,686</u>	<u>\$ 18.92</u>	<u>\$ 27,377</u>	<u>\$ 22.98</u>
Natural gas wellhead .....	\$ 4,768	\$ 2.21	\$ 12,410	\$ 6.51
Net profits gas .....	(7)	--	(47)	(0.02)
Gas hedges .....	452	0.21	(3,519)	(1.85)
Enron hedges .....	398	0.18	--	--
Total Gas Revenues .....	<u>\$ 5,611</u>	<u>\$ 2.60</u>	<u>\$ 8,844</u>	<u>\$ 4.64</u>

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OTHER DATA:	Production -----	NYMEX \$/Unit -----	Production -----	NYMEX \$/Unit -----
Oil (Bbls) .....	1,411	\$ 21.64	1,191	\$ 28.73
Gas (Mcf) .....	2,161	2.49	1,906	6.30

Although oil volumes increased, total oil revenue was down due to lower prices, offset by lower hedging and net profits payments. Oil volumes increased 220 MBbls due to the Company's successful development drilling program and the Central Permian acquisition completed this quarter. Wellhead oil revenues decreased \$7.85 per Bbl primarily from a decrease in the overall market price for oil as reflected in the \$7.09 per Bbl decrease in the average NYMEX price over the same period. The decrease in wellhead oil revenues was offset by a decrease in payments made for net profits and hedging, which decreased \$0.8 million and \$3.1 million, respectively. The decrease in net profits was primarily due to lower prices and higher capital expenditures in the first quarter of 2002. The Company's hedging activities are not a component of the expenses deducted in calculating net profits interest payments. The decrease in hedging payments is a direct result of the decrease in the average NYMEX price for oil.

Natural gas revenues decreased by \$3.2 million due to a decrease in the net sales price per Mcf, which was somewhat offset by a 255 MMcf increase in production and net hedging receipts in the first quarter of 2002 versus net hedging payments in the first quarter of 2001. The increase in volumes is due to increased production in the Cedar Creek Anticline and Crockett County properties due to successful development drilling. Wellhead price received decreased \$4.30 per Mcf, consistent with the average NYMEX price decrease of \$3.81 per Mcf for the three months ended March 31, 2001 to the three months ended March 31, 2002, while hedging payments decreased \$2.06 per Mcf due to lower natural gas prices.

DIRECT LIFTING COSTS. Direct lifting costs of Encore for the first quarter of 2002 increased as compared to the first quarter of 2001 by \$0.5 million. The increase in direct lifting costs is primarily attributable to increased production in 2002 offset by a decrease in per BOE costs. On a per BOE basis, direct lifting costs decreased from \$4.21 to \$3.85, primarily as a result of the company deferring a portion of first quarter scheduled maintenance until the second quarter. As a result, second quarter 2001 direct lifting costs will rise from the first quarter and move direct lifting costs for the year more in line with our 2002 expected amount of \$4.25 per BOE.

PRODUCTION, AD VALOREM AND SEVERANCE TAXES. Production, ad valorem and severance taxes for the first quarter of 2002 decreased as compared to the first quarter of 2001 by approximately \$1.3 million, from \$4.3 million to \$3.0 million. The decrease in production, ad valorem and severance taxes was a result of the substantially lower prices as compared to the first quarter of 2001. The decrease was partially offset by increased taxes as a result of the Central Permian acquisition. As a percent of oil and natural gas revenues (excluding the effects of hedges), production, ad valorem and severance taxes remained fairly constant, down to 9.7% from 9.9%.

DEPLETION, DEPRECIATION AND AMORTIZATION (DD&A) EXPENSE. DD&A expense for the first quarter of 2002 increased by \$1.0 million, reflecting the increase in

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our asset base resulting from the Central Permian acquisition and development drilling and the corresponding increase in production. The average DD&A rate of \$4.83 per BOE of production during the first quarter of 2002 represents a decrease of \$0.18 per BOE from the \$5.01 per BOE recorded in the first quarter of 2001. The decrease was attributable to normal production declines in the Lodgepole properties, which have relatively high DD&A rates as compared to our other producing properties.

GENERAL AND ADMINISTRATIVE (G&A) EXPENSE. G&A expense increased \$0.2 million for the first quarter of 2002 as compared to the first quarter of 2001, from \$1.3 million to \$1.5 million (excluding non-cash stock based \$9.6 million in the first quarter of 2001). The increase in G&A was a result of the hiring of additional staff after the Central Permian acquisition to analyze and exploit our drilling inventory and evaluate potential future acquisitions. On a per BOE basis, G&A remained constant at \$0.84 from the first quarter of 2001.

NON-CASH STOCK BASED COMPENSATION EXPENSE. Non-cash stock based compensation expense decreased from \$9.6 million in the first quarter of 2001 to zero in the first quarter of 2002. This stock based compensation is associated with the purchase by our management stockholders of Class A common stock under our management stock plan adopted in August 1998. This amount represents the vested portion of the shares purchased and is recorded as compensation, calculated in accordance with variable plan accounting under APB 25. The amount recorded in the first quarter of 2001 represented the final amount of expense to be recorded related to the Class A stock.

INTEREST EXPENSE. Interest expense for the quarter ended March 31, 2002 was \$1.5 million compared to \$2.5 million for the quarter ended March 31, 2001. The decrease in interest expense is directly attributable to lower interest rates. The weighted average interest rate, net of hedges, for the first quarter of 2002 was 4.7% compared to 7.1% for the first quarter of 2001.

### LIQUIDITY AND CAPITAL RESOURCES

Principal uses of capital have been for the acquisition and development of oil and natural gas properties.

During the quarter ended March 31, 2002, net cash provided by operations was \$17.2 million, a decrease of \$2.3 million compared to the quarter ended March 31, 2001. This decrease is a result of lower oil and natural gas prices.

We anticipate that our capital expenditures will total approximately \$22.0 million for the second quarter of 2002. The level of these and other future expenditures is largely discretionary, and the amount of funds devoted to any particular activity may increase or decrease significantly, depending on available opportunities and market conditions. We plan to finance our ongoing development and acquisition expenditures using internally generated cash flow, available cash and our existing credit agreement. As previously announced, Encore plans to invest \$81.0 million in capital expenditures in 2002.

At March 31, 2002, Encore had total assets of \$461.0 million. Total capitalization was \$401.6 million, of which 66.9% was represented by stockholders' equity and 33.1% by debt under the Company's existing senior credit facility.

Encore's operating subsidiary currently maintains a credit agreement with a group of banks that matures in May 2004. Encore has guaranteed the subsidiary's obligations under the credit agreement and has pledged the stock and other equity interests of its subsidiaries to secure the guaranty. Borrowings under the credit agreement totaled \$133.0 million as of March 31, 2002. The borrowing base, as established in the credit agreement, was \$180.0 million as of March 31, 2002. During the first quarter of 2002, the weighted average interest rate under

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the facility, net of hedges, was 4.7%. The remaining borrowing base available under the credit agreement at March 31, 2002, was \$47.0 million. Encore pays certain fees based on the unused portion of the borrowing base. The credit agreement contains a number of negative and financial covenants. Encore was in compliance with the covenants as of March 31, 2002.

In March 2000, the Company issued a \$35.2 million note payable to Burlington Resources in connection with the Lodgepole acquisition in North Dakota. The note required monthly principal payments over the 22 month period ending January 31, 2002. The note bore monthly compounded interest at the rate of 4% per annum on the outstanding principal plus accrued interest. The final principal payment of \$1.1 million along with accrued interest of \$1.3 million was paid on January 31, 2002.

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The Company believes that its capital resources are adequate to meet the requirements of its business. Based on our anticipated capital investment programs, we expect to invest our internally generated cash flow to replace production and enhance our waterflood programs. Additional capital may be required to pursue acquisitions and longer-term capital projects, such as our proposed high pressure air injection tertiary recovery project in the Cedar Creek Anticline, to increase our reserve base. Substantially all of these expenditures are discretionary and will be undertaken only if funds are available and the projected rates of return are satisfactory. Future cash flows are subject to a number of variables including the level of oil and natural gas production and prices. Operations and other capital resources may not provide cash in sufficient amounts to maintain planned levels of capital expenditures.

### INFLATION AND CHANGES IN PRICES

While the general level of inflation affects certain of our costs, factors unique to the petroleum industry result in independent price fluctuations. Historically, significant fluctuations have occurred in oil and natural gas prices. In addition, changing prices often cause costs of equipment and supplies to vary as industry activity levels increase and decrease to reflect perceptions of future price levels. Although it is difficult to estimate future prices of oil and natural gas, price fluctuations have had, and will continue to have, a material effect on us.

The following table indicates the average oil and natural gas prices received for the quarter ended March 31, 2002 and 2001. Average equivalent prices for 2002 and 2001 were increased by \$0.75 and decreased by \$4.52 per BOE, respectively, as a result of our hedging activities. Average prices per equivalent barrel indicate the composite impact of changes in oil and natural gas prices. Natural gas production is converted to oil equivalents at the conversion rate of six Mcf per Bbl. Average prices shown in the following table are net of net profits interests.

	OIL (PER Bbl)	NATURAL GAS (PER Mcf)	EQUIV. OIL (PER BOE)
	-----	-----	-----
NET PRICE REALIZATION WITH HEDGES			
Quarter ended March 31, 2002 .....	\$ 18.92	\$ 2.60	\$ 18.24
Quarter ended March 31, 2001 .....	22.98	4.64	24.00

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AVERAGE WELLHEAD PRICE

Quarter ended March 31, 2002 .....	\$ 18.59	\$ 2.21	\$ 17.49
Quarter ended March 31, 2001 .....	25.75	6.49	28.52

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information included in "Quantitative and Qualitative Disclosures About Market Risk" in Encore's 2001 Annual Report filed on Form 10-K is incorporated herein by reference. Such information includes a description of Encore's potential exposure to market risks, including commodity price risk and interest rate risk. Encore's open commodity positions as of March 31, 2001 are presented in Note 6 to the accompanying financial statements. The fair value of our open commodity and interest rate hedges is (\$8.1) million as of March 31, 2002.

Subsequent to the first quarter of 2002, we entered into several additional oil hedges. The following table summarizes the additional commodity hedging positions entered into through May 3, 2002:

PERIOD	DAILY FLOOR VOLUME (Bbl)	FLOOR PRICE (PER Bbl)	DAILY CAP VOLUME (Bbl)	CAP PRICE (PER Bbl)	SWA
-----	-----	-----	-----	-----	-----
July -- Dec 2002	2,500	\$ 23.00	1,500	\$ 29.85	
Jan -- June 2003	1,000	\$ 22.50	1,000	\$ 26.33	
July -- Dec 2003	1,000	\$ 22.50	1,000	\$ 26.33	

Additionally, we entered into an interest rate swap effective April 3, 2002 through April 3, 2007 with a \$30 million notional, whereby we pay a 5.26% fixed rate and receive the floating LIBOR rate.

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PART II. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

Exhibits

None.

Reports on Form 8-K

None.



SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ENCORE ACQUISITION COMPANY

Date: May 3, 2002

By: /s/ Morris B. Smith

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Morris B. Smith  
Chief Financial Officer, Treasurer, Executive  
Vice President and Principal Financial Officer

Date: May 3, 2002

By: /s/ Robert C. Reeves

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Robert C. Reeves  
Vice President, Controller and Principal  
Accounting Officer