



Independent Stock Idea

March 12, 2010

rating: buy
s&p 500: 1150, intraday

Devon Energy (DVN) Virtually Eliminates Debt

<i>Symbol</i>	DVN	<i>Ebitda Next Twelve Months ending 12/31/10 (US\$mm)</i>	5,500
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	52
<i>Price (\$/sh)</i>	70.55	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	3/12/10	<i>Adjusted Reserves/Production NTM</i>	10.4
<i>Shares (mm)</i>	450	<i>EV/Ebitda</i>	6.0
<i>Market Capitalization (\$mm)</i>	31,800	<i>PV/Ebitda</i>	8.3
<i>Debt (\$mm)</i>	1,400	<i>Undeveloped Reserves (%)</i>	29
<i>Enterprise Value (EV) (\$mm)</i>	33,100	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	25.30
<i>Present Value (PV) (\$mm)</i>	45,500	<i>Present Value Proven Reserves(\$/boe)</i>	17.20
<i>Net Present Value (\$/share)</i>	98	<i>Present Value Proven Reserves(\$/mcf)</i>	2.90
<i>Debt/Present Value</i>	0.03	<i>Earnings Next Twelve Months (US\$/sh)</i>	5.01
<i>McDep Ratio - EV/PV</i>	0.73	<i>Price/Earnings Next Twelve Months</i>	14
<i>Dividend Yield (%/year)</i>	0.9	<i>Indicated Annual Dividend (US\$/sh)</i>	0.64
Note: Estimated cash flow and earnings tied to one-year futures prices for natural gas and oil.			
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 Devon since 2004 see http://www.mcdep.com/3dvn.htm			

Summary and Recommendation

Selling \$10 billion of properties, buy-recommended **Devon Energy (DVN)** is divesting its offshore and international resources to concentrate its oil and gas operations onshore North America with special emphasis on shale gas and oil sands. The sale of \$8 billion to buy-recommended **BP plc (BP)** announced on March 11 triggers our revised analysis with no change to estimated Net Present Value (NPV) of \$98 a share. Applying the expected proceeds to virtually eliminate debt lowers McDep Ratio and increases unlevered appreciation potential to 39%. Removing the production of divested properties from our projection reduces unlevered cash flow (Ebitda) modestly (see table [Next Twelve Months Operating and Financial Estimates](#)). While the proceeds of the sales reduce Enterprise Value by 19%, weighted reserves decline just 6% (see table, [Production and Reserves, 2009](#)). Revised cash flow and adjusted reserve life readily support estimated NPV in an industry context (see table [Functional Cash Flow and Present Value](#)). Shale gas increases by 14% in the U.S. and 12% in Canada in share of future potential as measured by probability-adjusted resources, while Gulf of Mexico and International no longer represent 23% and 9% (see table [Risky Resources](#)). With newly minimal financial risk, Devon is an appealing investment as the lowest McDep Ratio large cap independent oil and gas producer.

Kurt H. Wulff, CFA



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Devon Energy									
Next Twelve Months Operating and Financial Results									
	Q4	Q3	Q4	Year	Q1E	Q2E	Q3E	Q4E	Next Twelve Months
	12/31/08	9/30/09	12/31/09	2009	3/31/10	6/30/10	9/30/10	12/31/10	12/31/10
Volume									
Natural Gas (mmcf)									
U.S.	2,106	1,999	2,037	2,074	1,930	1,930	1,930	1,930	1,930
Canada	583	636	611	623	570	570	570	570	570
Overseas	8	4	5	4					
Total	2,697	2,639	2,653	2,700	2,500	2,500	2,500	2,500	2,500
Days	92	92	92	365	90	91	92	92	365
Oil (mbd)	230	233	242	240	180	180	180	180	180
Total gas & oil (bcf)	375	371	378	1,511	322	326	329	329	1,307
Total gas & oil (mmb)	63	62	63	252	54	54	55	55	218
Price									
Natural gas (\$/mcf)									
Henry Hub (\$/mmbtu)	6.95	3.39	4.16	3.99	5.32	4.59	4.81	5.30	5.00
U.S.	5.11	2.82	3.70	3.21	4.73	3.70	3.88	4.27	4.14
Canada	6.02	2.91	4.13	3.66	5.28	4.56	4.77	5.25	4.96
Overseas	4.90	5.90	5.90	5.11					
Total	5.31	2.85	3.80	3.32	4.85	3.90	4.08	4.49	4.33
Oil (\$/bbl)									
WTI Cushing	58.45	68.22	76.09	61.70	78.88	82.32	83.61	84.55	82.34
Worldwide	34.96	48.58	50.52	42.64	52.38	54.66	55.52	56.14	54.69
Total gas & oil (\$/mcf)	5.48	4.66	5.44	4.64	6.02	5.47	5.64	5.96	5.77
Revenue (\$mm)									
Natural Gas									
U.S.	990	519	693	2,433	821	650	688	758	2,917
Canada	323	170	232	833	271	236	250	275	1,033
Overseas	4	2	3	7					
Total	1,317	691	928	3,274	1,091	887	938	1,034	3,950
Oil	740	1,040	1,125	3,733	848	895	919	930	3,593
Total	2,056	1,731	2,053	7,006	1,940	1,782	1,858	1,963	7,543
Expense	468	309	598	1,755	524	481	502	530	2,037
Ebitda (\$mm)	1,589	1,422	1,455	5,252	1,416	1,301	1,356	1,433	5,506
Deprec., Deplet., & Amort.	1,063	570	509	2,364	509	509	509	509	2,036
Hedging and other			(170)	(170)					-
Ebit	526	852	1,116	3,057	907	792	847	924	3,470
Interest	68	90	86	349		-	-	-	-
Ebt	458	762	1,030	2,708	907	792	847	924	3,470
Income Tax	160	267	309	897	318	277	296	323	1,215
Net Income (\$mm)	297	495	721	1,812	590	515	551	601	2,256
Shares (millions)	444	450	450	1,795	450	450	450	450	450
Per Share (\$)	0.67	1.10	1.60	4.03	1.31	1.14	1.22	1.33	5.01
Ebitda Margin	77%	82%	71%	75%	73%	73%	73%	73%	73%
Tax Rate	35%	35%	30%	33%	35%	35%	35%	35%	35%



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Devon Energy									
Production and Reserves, 2009									
			12/31/2009 Proven Reserves			Weighted	NTM		
	2009 Production	Developed	Undeveloped	Weighted	Life Index	Adjusted			
	(daily)	(annual)	(bcf or mmb)	(bcf or mmb)	(bcf or mmb)	(years)	R/P		
							(years)		
North American Natural Gas									
U.S. Onshore	1,912	698	6,447	1,680	7,287	10.4			
Canada	611	223	1,213	75	1,251	5.6			
Total	2,523	921	7,660	1,755	8,538	9.3	9.4		
Oil									
U.S. Onshore	101	37	412	112	468	12.6			
Canada	71	26	181	367	365	14.0			
	173	63	593	479	833	13.2	12.7		
Total Oil Equivalent	593	217	1,870	772	2,255	10.4	10.4		

Devon Energy					
Functional Cash Flow and Present Value					
	NTM Ebitda	Adjusted	PV/	Present	
	(US\$mm)	R/P	Ebitda	Value	
				(US\$mm)	
North American Natural Gas	2,890	9.4	9.0	26,000	57%
Oil	2,620	12.7	7.4	19,500	43%
	5,510	10.4	8.3	45,500	100%
Debt (US\$mm)					1,400
Net Present Value (US\$mm)					44,100
Shares (mm)					450
Net Present Value - Standard Estimate (US\$/sh)					98
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					108



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Devon Energy					
Risked (Probability Adjusted) Resources					
Million Barrels Equivalent					
			<u>March 2010</u>	<u>May 2008</u>	
U.S. Shale Gas	5,670	42%		3,050	28%
U.S. Other Onshore	2,890	21%		2,050	19%
U.S. Gulf of Mexico				2,450	23%
Canada Oil Sands	1,350	10%		1,150	11%
Canada Shale Gas	1,630	12%			
Canada Other	2,020	15%		1,120	10%
International				950	9%
	13,560	100%		10,770	100%
Source: Devon					

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