



Independent Stock Idea

May 5, 2010

rating: buy
s&p 500: 1166

Devon Energy (DVN) Stock Repurchase Compelling

<i>Symbol</i>	DVN	<i>Ebitda Next Twelve Months ending 3/31/11 (US\$m)</i>	5,800
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	45
<i>Price (\$/sh)</i>	67.51	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	5/5/10	<i>Adjusted Reserves/Production NTM</i>	10.0
<i>Shares (mm)</i>	448	<i>EV/Ebitda</i>	5.5
<i>Market Capitalization (\$mm)</i>	30,200	<i>PV/Ebitda</i>	7.8
<i>Debt (\$mm)</i>	1,400	<i>Undeveloped Reserves (%)</i>	29
<i>Enterprise Value (EV) (\$mm)</i>	31,600	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	25.60
<i>Present Value (PV) (\$mm)</i>	45,300	<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>	5.50
<i>McDep Ratio - EV/PV</i>	0.70	<i>Price/Earnings Next Twelve Months</i>	12
<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

Buy-recommended **Devon Energy (DVN)** offers unlevered appreciation potential of 43% to a McDep Ratio of 1.0 where stock price would equal estimated Net Present Value (NPV) of \$98 a share. First quarter results released today exceeded expectations from two months ago. Projected unlevered cash flow (Ebitda) continues at a high level despite Devon's sale of offshore oil properties (see table [Next Twelve Months Operating and Financial Estimates](#)). "We are out of the deep water entirely" comments Chairman Larry Nichols on the earnings call. Onshore cash flow and adjusted reserve life readily support estimated NPV in an industry context (see table [Functional Cash Flow and Present Value](#)). Seeing "compelling" value, management confirms that it is repurchasing Devon stock in a \$3.5 billion program that could reduce shares outstanding by 12% at the current price. At the same time, the company is investing in growth. Oil in Canada may add 150,000 barrels daily to production by 2020. Results in the Cana Shale in Western Oklahoma are the most profitable of any of the company's natural gas drilling in part because the gas is rich in liquids that are processed in Devon's own plants. Currently on the 200-day average the stock is in an uptrend by that definition. In any case, with the lowest McDep Ratio and low financial risk, Devon offers a favorable combination of reward and risk among large cap independent oil and gas producers.

Kurt H. Wulff, CFA



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Devon Energy									
Next Twelve Months Operating and Financial Results									
	Q1	Q4	Year	Q1	Q2E	Q3E	Q4E	Year	Next Twelve Months
	3/31/09	12/31/09	2009	3/31/10	6/30/10	9/30/10	12/31/10	2010E	3/31/11
Volume									
Natural Gas (mmcf)									
U.S.	2,131	2,037	2,074	1,952	1,952	1,952	1,952	1,952	1,952
Canada	585	611	623	564	564	564	564	564	564
Overseas	3	5	4					-	
Total	2,719	2,653	2,700	2,516	2,516	2,516	2,516	2,516	2,516
Days	90	92	365	90	91	92	92	365	365
Oil (mbd)	232	242	240	201	201	201	201	201	201
Total gas & oil (bcf)	370	378	1,511	335	339	342	342	1,358	1,358
Total gas & oil (mmb)	62	63	252	56	56	57	57	226	226
Price									
Natural gas (\$/mcf)									
Henry Hub (\$/mmbtu)	4.90	4.16	3.99	5.32	4.04	4.22	4.83	4.60	4.58
U.S.	3.53	3.70	3.21	4.71	3.26	3.40	3.89	3.81	3.69
Canada	4.48	4.13	3.66	5.08	3.86	4.03	4.61	4.39	4.37
Overseas	3.47	5.90	5.11						
Total	3.73	3.80	3.32	4.80	3.39	3.54	4.05	3.94	3.85
Oil (\$/bbl)									
WTI Cushing	42.96	76.09	61.70	78.67	85.65	90.56	92.66	86.88	90.46
Worldwide	28.35	50.52	42.64	52.24	56.87	60.13	61.52	57.72	60.06
Total gas & oil (\$/mcf)	4.07	5.44	4.64	6.06	5.36	5.64	6.06	5.78	5.84
Revenue (\$mm)									
Natural Gas									
U.S.	677	693	2,433	828	578	611	699	2,717	2,631
Canada	236	232	833	258	198	209	239	904	900
Overseas	1	3	7					-	
Total	914	928	3,274	1,086	776	821	938	3,621	3,531
Oil	591	1,125	3,733	945	1,040	1,111	1,137	4,233	4,404
Total	1,505	2,053	7,006	2,031	1,816	1,932	2,075	7,854	7,936
Expense	401	604	1,760	520	490	522	560	2,092	2,143
Ebitda (\$mm)	1,104	1,449	5,246	1,511	1,326	1,410	1,515	5,762	5,793
Deprec., Deplet., & Amort.	693	509	2,364	515	515	515	515	2,060	2,060
Hedging and other		(170)	(170)	(365)	(100)	(100)	(100)	(665)	(400)
Ebit	411	1,110	3,052	1,361	911	995	1,100	4,367	4,133
Interest	83	86	349	86	86	86	86	344	344
Ebt	328	1,024	2,703	1,275	825	909	1,014	4,023	3,789
Income Tax	115	309	897	446	289	318	355	1,408	1,326
Net Income (\$mm)	213	715	1,806	829	536	591	659	2,615	2,463
Shares (millions)	444	447	448	448	448	448	448	448	448
Per Share (\$)	0.48	1.60	4.03	1.85	1.20	1.32	1.47	5.84	5.50
Ebitda Margin	73%	71%	75%	74%	73%	73%	73%	73%	73%
Tax Rate	35%	30%	33%	35%	35%	35%	35%	35%	35%



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Devon Energy					
Functional Cash Flow and Present Value					
				<i>Present</i>	
	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Value</i>	
	<i>(US\$mm)</i>	<i>R/P</i>	<i>Ebitda</i>	<i>(US\$mm)</i>	
North American Natural Gas	2,580	9.3	10.1	26,000	57%
Oil	3,210	11.4	6.0	19,300	43%
	5,790	10.0	7.8	45,300	100%
Debt (US\$mm)					1,400
Net Present Value (US\$mm)					43,900
Shares (mm)					448
Net Present Value - Standard Estimate (US\$/sh)					98
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					109

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