



Independent Stock Idea

November 4, 2009

rating: buy
s&p 500: 1047

Devon Energy (DVN) Progress in Shale Gas

<i>Symbol</i>	DVN	<i>Ebitda Next Twelve Months ending 9/30/10 (US\$mm)</i>	6,600
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	45
<i>Price (\$/sh)</i>	67.07	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	11/4/09	<i>Adjusted Reserves/Production NTM</i>	8.9
<i>Shares (mm)</i>	450	<i>EV/Ebitda</i>	6.0
<i>Market Capitalization (\$mm)</i>	30,200	<i>PV/Ebitda</i>	8.1
<i>Debt (\$mm)</i>	9,200	<i>Undeveloped Reserves (%)</i>	20
<i>Enterprise Value (EV) (\$mm)</i>	39,400	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	26.70
<i>Present Value (PV) (\$mm)</i>	53,400	<i>Present Value Proven Reserves(\$/boe)</i>	22.00
<i>Net Present Value (\$/share)</i>	98	<i>Present Value Proven Reserves(\$/mcf)</i>	3.70
<i>Debt/Present Value</i>	0.17	<i>Earnings Next Twelve Months (US\$/sh)</i>	5.65
<i>McDep Ratio - EV/PV</i>	0.74	<i>Price/Earnings Next Twelve Months</i>	12
<i>Dividend Yield (%/year)</i>	1.0	<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

Analyzing third quarter results released today, we reaffirm estimated Net Present Value (NPV) of \$98 a share for buy-recommended **Devon Energy (DVN)**. On that basis unlevered appreciation potential is 35% to a McDep Ratio of 1.0 where stock price would equal NPV. Unlevered cash flow (Ebitda) met expectations in the latest quarter. Volume was lower as a result of conscious choice at a time of low natural gas price. Nonetheless, the quarter just completed looks like the start of a rising trend (see table Next Twelve Months Operating and Financial Estimates). Natural gas emphasis dominates the current property mix, driving 61% of NPV in our valuation, which capitalizes cash flow at unlevered multiples (PV/Ebitda) related to reserve life (Adjusted R/P) for natural gas and oil (see table Functional Cash Flow and Present Value). On the quarterly call, management said it expects volume in the Barnett Shale field, where Devon is the largest producer, to advance again in the winter months. Devon also recently disclosed a big well testing at 30 million cubic feet daily (mmcf/d) that “blows the lid off” of secrecy in a new area of the Haynesville shale, according to competitor XTO Energy (XTO). Management was further willing to talk of high expectations in the Cana shale play now that all the land has been tied up by Devon and Cimarex Energy (XEC). Finally, the industry backdrop is helped by the positive trend indicated by six-year oil trading above the 40-week average (see chart Six-Year Commodity Price Meter).

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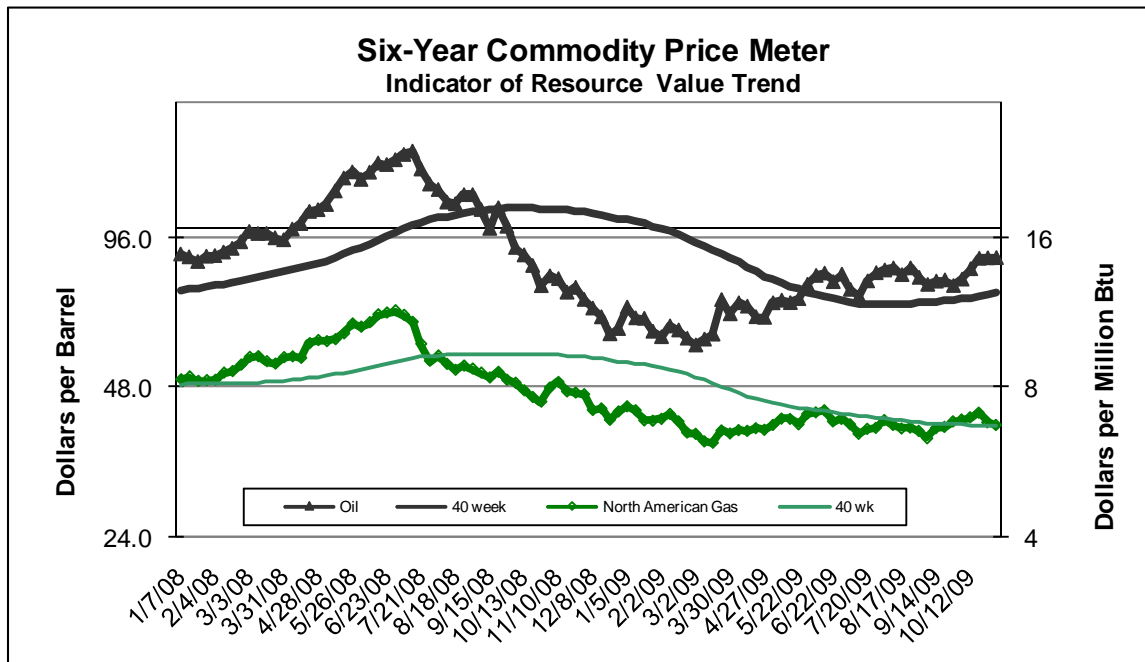
Devon Energy									
Next Twelve Months Operating and Financial Results									
	Q3	Q2	Q3	Q4E	Year	Q1E	Q2E	Q3E	Next Twelve Months
	9/30/08	6/30/09	9/30/09	12/31/09	2009E	3/31/10	6/30/10	9/30/10	9/30/10
Volume									
Natural Gas (mmcf)									
U.S.	2,007	2,129	1,999	1,999	2,064	1,999	1,999	1,999	1,999
Canada	585	660	636	636	629	636	636	636	636
Overseas	5	3	4	4	4	4	4	4	4
Total	2,597	2,792	2,639	2,639	2,697	2,639	2,639	2,639	2,639
Days	92	91	92	92	365	90	91	92	365
Oil (mbd)	204	253	233	233	237	233	233	233	233
Total gas & oil (bcf)	352	392	371	371	1,504	363	367	371	1,473
Total gas & oil (mmb)	59	65	62	62	251	61	61	62	245
Price									
Natural gas (\$/mcf)									
Henry Hub (\$/mmbtu)	10.25	3.50	3.39	4.28	4.02	5.20	5.28	5.54	5.07
U.S.	8.94	2.81	2.82	3.56	3.18	4.32	4.18	4.39	4.11
Canada	9.15	3.25	2.91	3.67	3.55	4.46	4.53	4.76	4.35
Overseas	10.31	4.24	5.90	5.90	5.03	5.90	5.90	5.90	5.90
Total	8.99	2.92	2.85	3.59	3.27	4.36	4.27	4.48	4.17
Oil (\$/bbl)									
WTI Cushing	117.99	59.52	68.22	77.22	61.98	79.30	81.15	82.28	79.99
Worldwide	84.71	42.41	48.58	54.99	43.66	56.48	57.79	58.59	56.96
Total gas & oil (\$/mcf)	10.63	4.38	4.66	5.52	4.65	6.11	6.12	6.31	6.01
Revenue (\$mm)									
Natural Gas									
U.S.	1,651	544	519	654	2,395	778	760	807	2,999
Canada	492	195	170	215	816	255	262	278	1,011
Overseas	5	1	2	2	6	2	2	2	9
Total	2,148	741	691	872	3,217	1,036	1,024	1,088	4,019
Oil	1,591	976	1,040	1,177	3,785	1,183	1,224	1,254	4,838
Total	3,739	1,717	1,731	2,049	7,002	2,218	2,248	2,342	8,857
Expense	680	446	309	533	1,689	577	584	609	2,303
Ebitda (\$mm)	3,059	1,271	1,422	1,516	5,313	1,642	1,664	1,733	6,554
Deprec., Deplet., & Amort.	870	592	570	570	2,425	570	570	570	2,280
Hedging and other					-				-
Ebit	2,189	679	852	946	2,888	1,072	1,094	1,163	4,274
Interest	69	90	90	90	353	90	90	90	360
Ebt	2,120	589	762	856	2,535	982	1,004	1,073	3,914
Income Tax	742	206	267	300	887	344	351	376	1,370
Net Income (\$mm)	1,378	383	495	556	1,648	638	652	697	2,544
Shares (millions)	446	450	450	450	1,795	450	450	450	450
Per Share (\$)	3.09	0.85	1.10	1.24	3.67	1.42	1.45	1.55	5.65
Ebitda Margin	82%	74%	82%	74%	76%	74%	74%	74%	74%
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%



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Devon Energy					
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	2,970	9.3	10.9	32,400	61%
Oil	3,580	8.1	5.8	20,900	39%
	6,550	8.9	8.1	53,300	100%
Debt (US\$mm)					9,200
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)					98





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