



# Independent Stock Idea

August 5, 2010

rating: contrarian buy  
s&p 500: 1127

## Devon Energy (DVN) Onshore North American Value

<i>Symbol</i>	DVN	<i>Ebitda Next Twelve Months ending 6/30/11 (US\$m)</i>	5,600
<i>Rating</i>	Contrarian Buy	<i>North American Natural Gas/Ebitda (%)</i>	52
<i>Price (\$/sh)</i>	65.68	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	8/4/10	<i>Adjusted Reserves/Production NTM</i>	10.0
<i>Shares (mm)</i>	446	<i>EV/Ebitda</i>	5.9
<i>Market Capitalization (\$mm)</i>	29,300	<i>PV/Ebitda</i>	8.5
<i>Debt (\$mm)</i>	4,000	<i>Undeveloped Reserves (%)</i>	29
<i>Enterprise Value (EV) (\$mm)</i>	33,300	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	24.80
<i>Present Value (PV) (\$mm)</i>	47,700	<i>Present Value Proven Reserves(\$/boe)</i>	18.10
<i>Net Present Value (\$/share)</i>	98	<i>Present Value Proven Reserves(\$/mcf)</i>	3.00
<i>Debt/Present Value</i>	0.08	<i>Earnings Next Twelve Months (US\$/sh)</i>	5.70
<i>McDep Ratio - EV/PV</i>	0.70	<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 <a href="http://www.mcdep.com/3dvn.htm">http://www.mcdep.com/3dvn.htm</a>			

### Summary and Recommendation

Contrarian 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. Second quarter results released on August 4 displayed a positive uptick in oil production (see table [Next Twelve Months Operating and Financial Estimates](#)). New volumes come from the Permian Basin, a traditional area of operation where the company has quietly been expanding its lease holdings. Today's oil price and new technology are fueling yet another West Texas oil boom. Management talks of the "Avalon Shale" as a new area of interest joining traditional formations like Bone Springs. Oil is also growing along with natural gas from the Cana Shale in Oklahoma. Reserves in that rapidly expanding resource may multiply further if early results from a denser drilling pattern are confirmed. Meanwhile, a high level of cash flow matched with adjusted reserve life supports estimated NPV in an industry context (see table [Functional Cash Flow and Present Value](#)). Low stock price compare to NPV combined with a low ratio of debt to present value leads to the McDep Ratio that is lowest in the Large Cap U.S. Independent Producer group. Proceeds from the sale of offshore properties are being applied in part to stock repurchase that seeks to take advantage of that valuation gap.

Kurt H. Wulff, CFA



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Devon Energy									
Next Twelve Months Operating and Financial Results									
									<i>Next Twelve Months</i>
	<i>Q2</i>	<i>Q1</i>	<i>Q2</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	
	<i>6/30/09</i>	<i>3/31/10</i>	<i>6/30/10</i>	<i>9/30/10</i>	<i>12/31/10</i>	<i>2010E</i>	<i>3/31/11</i>	<i>6/30/11</i>	<i>6/30/11</i>
<b>Volume</b>									
Natural Gas (mmcf)									
U.S.	2,129	1,952	1,906	1,906	1,906	<b>1,917</b>	1,906	1,906	<b>1,906</b>
Canada	660	564	630	630	630	<b>614</b>	630	630	<b>630</b>
Overseas	3					-			
Total	2,792	2,516	2,536	2,536	2,536	<b>2,531</b>	2,536	2,536	<b>2,536</b>
Days	91	90	91	92	92	<b>365</b>	90	91	<b>365</b>
Oil (mbd)	253	201	197	197	197	<b>198</b>	197	197	<b>197</b>
Total gas & oil (bcf)	392	335	338	342	342	<b>1,358</b>	335	338	<b>1,358</b>
Total gas & oil (mmb)	65	56	56	57	57	<b>226</b>	56	56	<b>226</b>
<b>Price</b>									
Natural gas (\$/mcf)									
Henry Hub (\$/mmbtu)	3.50	5.32	4.09	4.75	4.94	<b>4.77</b>	5.20	4.99	<b>4.97</b>
U.S.	2.81	4.71	3.65	4.23	4.41	<b>4.25</b>	4.64	4.44	<b>4.43</b>
Canada	3.25	5.08	3.99	4.63	4.82	<b>4.62</b>	5.08	4.87	<b>4.85</b>
Overseas	4.24								
Total	2.92	4.80	3.73	4.33	4.51	<b>4.34</b>	4.75	4.55	<b>4.53</b>
Oil (\$/bbl)									
WTI Cushing	59.52	78.67	77.85	78.07	79.81	<b>78.60</b>	81.10	82.34	<b>80.33</b>
Worldwide	42.41	54.38	51.37	51.51	52.66	<b>52.48</b>	53.51	54.32	<b>52.99</b>
Total gas & oil (\$/mcf)	4.38	6.18	5.27	5.68	5.87	<b>5.75</b>	6.07	5.98	<b>5.90</b>
<b>Revenue (\$mm)</b>									
Natural Gas									
U.S.	544	828	632	742	772	<b>2,975</b>	795	771	<b>3,080</b>
Canada	195	258	229	268	279	<b>1,034</b>	288	279	<b>1,115</b>
Overseas	1					-			
Total	741	1,086	861	1,010	1,052	<b>4,009</b>	1,083	1,050	<b>4,195</b>
Oil	976	983	922	934	955	<b>3,795</b>	950	975	<b>3,814</b>
Total	1,717	2,069	1,783	1,944	2,007	<b>7,804</b>	2,033	2,025	<b>8,009</b>
<b>Expense</b>	446	520	614	583	602	<b>2,320</b>	610	607	<b>2,403</b>
<b>Ebitda (\$mm)</b>	1,271	1,549	1,169	1,361	1,405	<b>5,484</b>	1,423	1,417	<b>5,607</b>
Deprec., Deplet., & Amort.	592	515	513	513	513	<b>2,054</b>	513	513	<b>2,052</b>
Hedging and other		(327)	(505)	(200)	(200)	<b>(1,232)</b>	(200)	(200)	<b>(800)</b>
<b>Ebit</b>	679	1,361	1,161	1,048	1,092	<b>4,662</b>	1,110	1,104	<b>4,355</b>
Interest	90	86	111	111	111	<b>419</b>	111	111	<b>444</b>
<b>Ebt</b>	589	1,275	1,050	937	981	<b>4,243</b>	999	993	<b>3,911</b>
Income Tax	206	446	367	328	343	<b>1,485</b>	350	348	<b>1,369</b>
<b>Net Income (\$mm)</b>	383	829	682	609	638	<b>2,758</b>	649	646	<b>2,542</b>
<b>Shares (millions)</b>	450	448	446	446	446	<b>447</b>	446	446	<b>446</b>
Per Share (\$)	0.85	1.85	1.53	1.37	1.43	<b>6.18</b>	1.46	1.45	<b>5.70</b>
Ebitda Margin	74%	75%	66%	70%	70%	<b>70%</b>	70%	70%	<b>70%</b>
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	<b>35%</b>



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<b>Devon Energy</b>					
<b>Functional Cash Flow and Present Value</b>					
				<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	2,940	9.2	9.9	29,000	61%
Oil	2,670	11.6	7.0	18,700	39%
	5,610	10.0	8.5	47,700	100%
Debt (US\$mm)					4,000
Net Present Value (US\$mm)					43,700
Shares (mm)					446
Net Present Value - Standard Estimate (US\$/sh)					98
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					104

**Disclaimer:** This analysis was prepared by Kurt Wulff, Manager of McDep LLC. The firm used sources and data believed to be reliable, but makes no representation as to their accuracy or completeness. This analysis is intended for informational purposes and is not a solicitation to buy or sell a security. Past performance is no guarantee of future results.

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