Rating: Buy
S&P 500: 1165

Devon Energy
Large Cap Natural Gas

Symbol	DVN	*Ebitda Next Twelve Months ending 9/30/05 ($mm)*	8,100
Rating	Buy	*North American Natural Gas/Ebitda (%)*	60
Price ($/sh)	75.52	*Natural Gas and Oil Production/Ebitda (%)*	100
Pricing Date	11/8/04	*Adjusted Reserves/Production NTM*	6.6
Shares (mm)	250	*EV/Ebitda*	3.3
Market Capitalization ($mm)	18,900	*PV/Ebitda*	4.4
Debt ($mm)	7,900	*Undeveloped Reserves (%)*	25
Enterprise Value (EV) ($mm)	26,800	*Natural Gas and Oil Ebitda ($/boe)*	32.70
Present Value (PV) ($mm)	35,400	*Present Value Proven Reserves($/boe)*	18.80
Net Present Value ($/share)	110	*Present Value Proven Reserves($/mcfe)*	3.10
Debt/Present Value	0.22	*Earnings Next Twelve Months (US$/sh)*	11.48
McDep Ratio - EV/PV	0.76	*Price/Earnings Next Twelve Months*	7
Dividend Yield (%/year)	0.5	*Indicated Annual Dividend (US$/sh)*	0.40

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.

Summary and Recommendation

We continue a Buy rating on the common shares of **Devon Energy Corporation (DVN)** for large cap North American natural gas representation and capable leadership. Because the largest capitalization energy stocks tend to be integrated oil companies, Devon offers large investors a valuable complement with its greater concentration on a premium energy business. Natural gas accounts for about two-thirds of the company's resource value and the natural gas reserve life is longer than for oil. The same person most responsible for the growth of the company in the past two decades, Mr. Larry Nichols, continues as chairman and chief executive officer today. Our estimate of net present value of $110 a share appears justified by a constant real oil price of $35 a barrel while the recent average futures price for the next six years is $42.

North American Natural Gas Dominates

North American Natural Gas is the larger of just two functional distinctions (see table Functional Cash Flow and Present Value). After allocating cash flow on the basis of wellhead revenue we apply a cash flow multiple that depends mostly on reserve life. The concentration on natural gas increases further as a result of a longer reserve life than for oil.

By virtue of its acquisition of Mitchell Energy, Devon is the dominant producer in the Barnett Shale, now possibly the largest gas field in Texas. The field accounts for about a quarter of Devon's natural gas reserves and production. Devon has converted most of the undeveloped reserves reported for the Mitchell acquisition into developed reserves. The company has further expanded reserves in the Mitchell area and is developing new reserves and production by the application of horizontal drilling outside the core area.

The Barnett Shale is proving to be an impressive legacy asset. Larry Nichols learned about the potential of great gas fields from his father, John Nichols, a pioneer in the development of the San

Juan Basin in New Mexico. In Canada, Devon has a large position in the Deep Basin that has similar characteristics as the San Juan Basin.

Devon Energy
Functional Cash Flow and Present Value

	NTM Ebitda (US$mm)	*Adjusted R/P*	*PV/ Ebitda*	*Present Value (US$mm)*	
North American Natural Gas	4,832	7.5	4.9	23,700	
Oil	3,263	5.3	3.6	11,700	
	8,095	6.6	4.4	35,400	
Debt (US$mm)					7,900
Net Present Value (US$mm)					27,500
Shares (mm)					250
Net Present Value (US$/sh)					110

More Gains Appear to Lie Ahead

Commodity price drives further gains in cash flow in our model (see table Next Twelve Months Operating and Financial Estimates). The high rate of cash flow implies a low multiple of Enterprise Value to Ebitda of about 3 times. The low multiple reflects in part a reserve life of 6.6 years on our adjusted basis that is shorter than for peer companies.

Though the reserve life is short, Devon has visible replacement and possible growth prospects. In Canada, for example, the company has a project to recover oil from sands too deep to be mined, but susceptible to in-situ production by the SAGD, Steam-Assisted Gravity Drainage technique.

Devon has a 5.6% carried interest in the Azeri-Guneshli-Chiraq field in the Caspian Sea. As production builds up in the next several years Devon's share will approach 50,000 barrels daily with no further investment required.

The company thinks it has more than a billion barrels of potential in 68 prospects in the Gulf of Mexico in deep waters or deep formations. Complementary oil prone land positions offshore West Africa and eastern Brazil overlay what might have once been a common geographic area.

The favorable timing of Mr. Nichol's deals that built the company to its current position is borne out by high cash flow generation at today's oil price. Investors' greatest concern may be the sustainability of the current level of oil price. Energy consumers and energy investors should, in our opinion, take recent oil price action as a sign of a long term change to higher price. Recent softening of oil price is welcome relief for the economy while we adjust to the oil and gas price increases that have occurred and prepare for those that may occur in the future.

Devon Energy
Next Twelve Months Operating and Financial Results

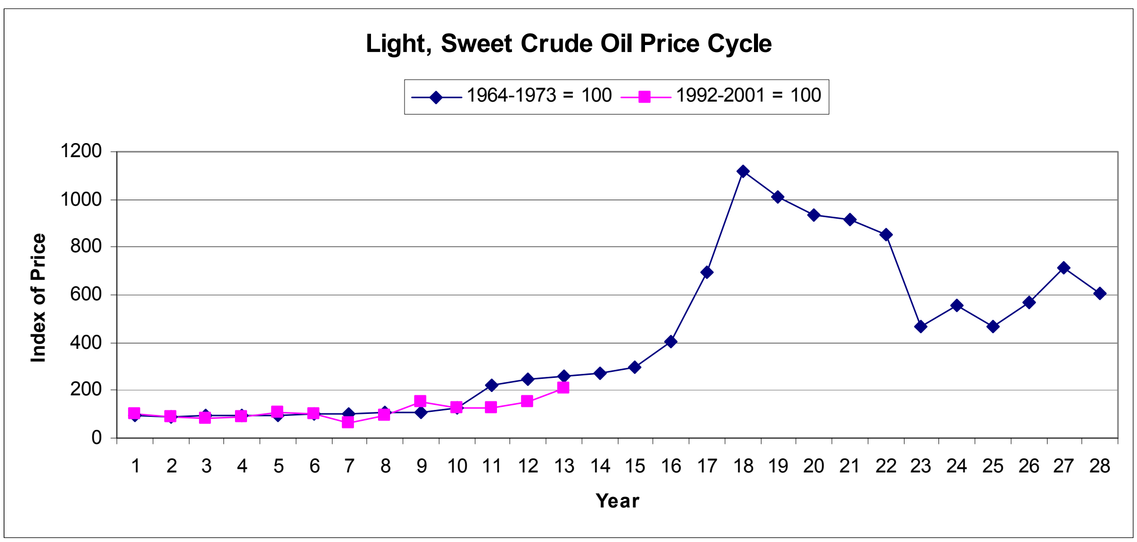
	Q1 3/31/04	*Q2 6/30/04*	*Q3 9/30/04*	*Q4E 12/31/04*	***Year 2004E***	*Q1E 3/31/05*	*Q2E 6/30/05*	*Q3E 9/30/05*	***Next Twelve Months 9/30/05***
Volume									
Natural Gas (mmcfd)									
U.S.	1,669	1,651	1,630	1,630	**1,649**	1,630	1,630	1,630	**1,630**
Canada	739	780	762	762	**763**	762	762	762	**762**
Overseas	33	24	22	22	**25**	22	22	22	**22**
Total	2,441	2,455	2,414	2,414	**2,438**	2,414	2,414	2,414	**2,414**
Oil (mbd)	296	275	276	276	**281**	276	276	276	**276**
Total gas & oil (bcf)	384	374	374	374	**1,506**	366	370	374	**1,486**
Price									
Natural gas ($/mcf)									
Henry Hub ($/mmbtu)	5.64	6.10	5.49	6.84	**6.02**	8.04	6.80	6.80	**7.12**
U.S.	5.14	5.41	5.25	6.54	**5.58**	7.69	6.50	6.50	**6.80**
Canada	5.07	5.31	5.18	6.45	**5.51**	7.59	6.41	6.41	**6.71**
Overseas	3.14	2.43	4.72	5.44	**3.82**	5.27	5.15	5.01	**5.22**
Total	5.09	5.35	5.22	6.50	**5.54**	7.63	6.46	6.46	**6.76**
Oil ($/bbl)									
WTI Cushing	35.23	38.34	43.89	50.62	**42.02**	48.99	47.89	46.61	**48.53**
Worldwide	28.66	30.90	35.49	40.93	**33.93**	39.61	38.72	37.68	**39.23**
Total gas & oil ($/mcf)	4.96	5.27	5.50	6.63	**5.59**	7.21	6.46	6.39	**6.67**
Revenue ($mm)									
Natural Gas									
U.S.	781	813	787	981	**3,361**	1,128	964	975	**4,048**
Canada	341	377	363	452	**1,533**	520	445	450	**1,867**
Overseas	9	5	10	11	**35**	10	10	10	**42**
Total	1,131	1,195	1,160	1,444	**4,930**	1,659	1,419	1,434	**5,957**
Oil	772	773	901	1,039	**3,485**	984	973	957	**3,952**
Other	(82)	(126)	(202)		**(410)**				**-**
Total	1,821	1,842	1,859	2,483	**8,005**	2,643	2,392	2,391	**9,909**
Expense									
Fixed	186	191	183	233	**793**	233	233	233	**933**
Variable	186	191	183	221	**781**	235	213	213	**881**
Other									
Ebitda ($mm)	1,450	1,460	1,493	2,029	**6,432**	2,174	1,946	1,945	**8,095**
Deprec., Deplet., & Amort.	572	552	572	572	**2,268**	572	572	572	**2,288**
Other Non Cash				388	**388**	229	174	164	**955**
Ebit	878	908	921	1,069	**3,775**	1,374	1,200	1,209	**4,852**
Interest	118	134	109	109	**470**	109	109	109	**436**
Ebt	760	774	812	960	**3,305**	1,265	1,091	1,100	**4,416**
Income Tax	266	271	284	336	**1,157**	443	382	385	**1,546**
Net Income ($mm)	494	503	528	624	**2,148**	822	709	715	**2,870**
Shares (millions)	247	249	250	250	**996**	250	250	250	**250**
Per Share ($)	2.00	2.02	2.11	2.50	**8.63**	3.29	2.84	2.86	**11.48**
Ebitda Margin	80%	79%	80%	82%	**80%**	82%	81%	81%	**82%**
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	**35%**

Oil Price Move Possibly Just Starting

To offset any inclination to underestimate further potential for oil and gas price, we compare the relatively stable price period from 1992 to 2001 to the period from 1964 to 1973. Each was a ten year period that immediately preceded a sharply lower stock market in 2002 and in 1974. After quiescence, oil price started moving up in each case. We may be in the early stages of a new historic move (see chart Light, Sweet Crude Oil Price Cycle).

Frankly, few investors would give much weight to the likelihood of continued oil price strength. Contrast that with the growing chorus for a weaker dollar. It may just be that oil price is not high, but the real value of the dollar is low. That, too, is a parallel to historical experience.

Let us imagine how the cycle might unfold. By the way we chose to draw the chart Year 13 corresponds to 1976 and 2004. Once the move got going in the previous cycle, the annual average oil price did not decline until Year 19 (1982). The annual peak of 1100, or 11 times the first ten year average, was too high to be sustained. It might be less disruptive economically if the peak ahead of us were lower and the decline shallower. The end point in Year 28 at 600 implies a tripling over the next 15 years. If higher oil price unfolded gradually it would give everyone time to adjust.



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