

Rating: Buy
S&P 500: 1222

Devon Energy Target Diversification

<i>Symbol</i>	DVN	<i>Ebitda Next Twelve Months ending 3/31/06 (US\$m)</i>	7,100
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	60
<i>Price (\$/sh)</i>	48.46	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	3/4/05	<i>Adjusted Reserves/Production NTM</i>	7.9
<i>Shares (mm)</i>	500	<i>EV/Ebitda</i>	4.2
<i>Market Capitalization (\$mm)</i>	24,200	<i>PV/Ebitda</i>	5.3
<i>Debt (\$mm)</i>	5,800	<i>Undeveloped Reserves (%)</i>	17
<i>Enterprise Value (EV) (\$mm)</i>	30,000	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	32.70
<i>Present Value (PV) (\$mm)</i>	37,300	<i>Present Value Proven Reserves(\$/boe)</i>	20.00
<i>Net Present Value (\$/share)</i>	63	<i>Present Value Proven Reserves(\$/mcf)</i>	3.30
<i>Debt/Present Value</i>	0.16	<i>Earnings Next Twelve Months (US\$/sh)</i>	4.82
<i>McDep Ratio - EV/PV</i>	0.81	<i>Price/Earnings Next Twelve Months</i>	10
<i>Dividend Yield (%/year)</i>	0.6	<i>Indicated Annual Dividend (US\$/sh)</i>	0.30

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. Along with closely ranked, buy-recommended peers, **Anadarko (APC)** and **Burlington Resources (BR)**, the company not only has fundamental attraction, but also may become a target of consolidation. An investor might own all three stocks for sure representation if one becomes a target. Otherwise those investors who put more weight on a stronger management record might choose DVN, while those investors who prefer a longer reserve life might choose BR and/or APC. We see 30% stock price appreciation potential to net present value where the stock would then offer a continuing unlevered real return of some 7% per year at normal risk assuming a long-term oil price of \$40 a barrel.

Largest U.S. Independent Producer

Devon ranks fourth largest in North American Natural Gas by our estimate of present value (see table Present Value by Line of Business). The first and third largest producers, buy-rated **ExxonMobil (XOM)** and **BP plc (BP)**, are mega cap integrated oil companies concentrated more on international oil production and refining/marketing of oil products. The second largest producer, buy-rated **Encana (ECA)**, is a Canadian company. That leaves Devon as the largest U.S. independent producer of the premium fuel. While size does not necessarily equate to performance it is important to institutional investors seeking performance for large sums under management.

After Devon, Burlington Resources and Anadarko rank next in North American natural gas among companies in our coverage. On a relative basis, Devon has slightly more concentration on the premium fuel resource than Anadarko and slightly less than Burlington (see second table Present Value by Line of Business).

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Present Value by Line of Business
 (US\$millions)

	<i>North American Natural Gas</i>	<i>Over- seas Natural Gas</i>	<i>Oil Production</i>	<i>Down- stream</i>	<i>Total</i>
Exxon Mobil Corporation	40,000	76,000	154,000	142,000	412,000
Encana Corporation	35,000	-	8,100	-	43,100
BP plc	28,000	29,000	118,000	88,000	263,000
Devon Energy Corporation	23,500	-	13,800	-	37,300
Burlington Resources	20,000	1,300	8,300	-	29,600
Anadarko Petroleum Corp.	18,000	-	14,200	-	32,200
ConocoPhillips	16,000	8,000	50,900	42,000	116,900
XTO Energy Inc.	12,000	-	2,900	-	14,900
ChevronTexaco Corporation	11,000	14,000	93,000	60,000	178,000
Royal Dutch/Shell	9,000	44,000	93,000	118,000	264,000
Unocal Corporation	6,000	6,000	10,300	-	22,300
Occidental Petroleum Corp.	5,700	600	30,400	4,800	41,500
Petro-Canada	5,000	1,000	12,500	3,900	22,400
Marathon Oil Corporation	3,700	1,500	8,300	7,400	20,900
Cimarex Energy Company	3,400	-	1,300	-	4,700
Imperial Oil Limited	3,200	-	15,500	6,500	25,200
San Juan Basin Royalty Trust	1,400	-	-	-	1,400
Suncor Energy	1,200	-	24,200	2,100	27,500
Energy Partners Ltd.	780	-	700	-	1,480
Encore Acquisition Company	650	-	1,640	-	2,290

Present Value by Line of Business

	<i>North Amer. Natural Gas (%)</i>	<i>Over- seas Natural Gas (%)</i>	<i>Oil Prod'n (%)</i>	<i>Down- stream (%)</i>	<i>Total (US\$m)</i>
Devon Energy Corporation	63	-	37	-	37,300
Burlington Resources	68	4	28	-	29,600
Anadarko Petroleum Corp.	56	-	44	-	32,200

Devon's present value of North American Natural Gas amounts to 6.2 times cash flow estimates assuming latest commodity price (see table Functional Cash Flow and Present Value). Projections assume completion of a sale of \$1.5 billion of non-core properties within the month.

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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	3,810	7.7	6.2	23,500	63%
Oil	2,500	8.1	5.5	13,800	37%
	6,310	7.9	5.9	37,300	100%
Debt (US\$mm)				5,800	
Net Present Value (US\$mm)				31,500	
Shares (mm)				500	
Net Present Value (US\$/sh)				63	

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, Devon's long-time leader, 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. Other great fields for Devon in the U.S. are Carthage in East Texas and Washakie in Wyoming. In Canada, Devon has a large position in the Deep Basin that has similar characteristics as the San Juan Basin. 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.

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. Those prospects were dampened temporarily in the last quarter with an unusually steep price discount for the heavy oil product.

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

Expected Property Sales Influence Projections

Production volumes are adjusted for expected property sales (see table Next Twelve Months Operating and Financial Estimates). Similarly we have adjusted reserves, debt and other financial measures.

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Devon Energy
Next Twelve Months Operating and Financial Results

	<i>Q3</i>	<i>Q4</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Next Twelve Months</i>
	<i>9/30/04</i>	<i>12/31/04</i>	<i>2004</i>	<i>3/31/05</i>	<i>6/30/05</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>2005E</i>	<i>3/31/06</i>	<i>3/31/06</i>
Volume										
Natural Gas (mmcf)										
U.S.	1,630	1,620	1,647	1,620	1,485	1,485	1,485	1,518	1,485	1,485
Canada	762	768	764	768	699	699	699	716	699	699
Overseas	22	33	28	33	20	20	20	23	20	20
Total	2,414	2,420	2,439	2,420	2,204	2,204	2,204	2,257	2,204	2,204
Oil (mbd)	276	269	279	269	229	229	229	239	229	229
Total gas & oil (bcf)	375	371	1,503	363	325	329	329	1,346	322	1,305
Price										
Natural gas (\$/mcf)										
Henry Hub (\$/mmbtu)	5.75	7.10	6.15	6.27	6.76	6.97	7.37	6.84	7.90	7.25
U.S.	5.25	6.07	5.47	5.38	5.97	5.93	6.51	5.94	6.98	6.35
Canada	5.18	5.65	5.30	5.01	5.85	5.57	6.38	5.69	6.83	6.15
Overseas	4.72	3.23	3.33	2.86	3.67	3.18	4.01	3.36	4.29	3.79
Total	5.23	5.90	5.39	5.23	5.91	5.79	6.45	5.83	6.91	6.26
Oil (\$/bbl)										
WTI Cushing	43.89	48.30	41.44	49.17	53.90	53.51	52.36	52.23	51.09	52.72
Worldwide	35.44	37.08	32.94	37.29	41.37	39.82	40.64	39.68	40.05	40.47
Total gas & oil (\$/mcf)	5.50	6.01	5.43	5.62	6.29	6.12	6.57	6.14	6.82	6.45
Revenue (\$mm)										
Natural Gas										
U.S.	788	904	3,287	784	807	810	890	3,291	933	3,440
Canada	363	399	1,479	346	372	358	410	1,486	430	1,569
Overseas	9	10	34	8	7	6	7	28	8	28
Total	1,161	1,313	4,800	1,138	1,185	1,174	1,307	4,805	1,371	5,037
Oil	901	919	3,365	904	860	837	854	3,456	824	3,376
Total	2,062	2,232	8,167	2,042	2,046	2,011	2,162	8,261	2,194	8,413
Expense										
Fixed	183	105	664	166	149	149	199	662	199	695
Variable	183	105	664	166	149	146	157	619	160	613
Ebitda (\$mm)	1,695	2,023	6,628	1,710	1,748	1,716	1,805	6,980	1,836	7,105
Deprec., Deplet., & Amort.	572	604	2,300	604	541	541	541	2,226	541	2,163
Hedging	203	266	469	160	196	196	192	744	192	775
Ebit	921	1,152	3,859	946	1,011	979	1,073	4,010	1,103	4,167
Interest	109	114	475	114	114	114	114	456	114	456
Ebt	812	1,038	3,384	832	897	865	959	3,554	989	3,711
Income Tax	284	363	1,184	291	314	303	336	1,244	346	1,299
Net Income (\$mm)	528	675	2,199	541	583	562	623	2,310	643	2,412
Shares (millions)	500	500	1,992	500	500	500	500	2,000	500	500
Per Share (\$)	1.06	1.35	4.42	1.08	1.17	1.12	1.25	4.62	1.29	4.82
Ebitda Margin	82%	91%	81%	84%	85%	85%	84%	84%	84%	84%
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%

Like most producers, Devon is losing money on oil price hedges. We project cash flow before the deduction for hedging while our projected net income is after hedging. Devon could argue that when its debt was high, it needed the insurance of hedging.

Buy Oil and Gas Producers at Mid Decade

Measured by McDep Ratio, Devon stock appears undervalued along with peers (see table of stocks ranked by McDep Ratio). Three to five-fold gain potential for oil and gas price over the next 5 to 13 years justifies investment in recommended oil and gas producers, in our opinion. Supporting improving prospects, the average futures price of oil for continuous delivery over the next six years is in a multi-year uptrend as defined by the current quotes above the 40-week average. The current benchmark oil average futures price for the next six years is about \$46 a barrel.

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Oil and Gas Producers
Rank by McDep Ratio: Market Cap and Debt to Present Value

	<i>Symbol/</i>	<i>Rating</i>	<i>Price</i> <i>(\$/sh)</i> <i>4-Mar</i> <i>2005</i>	<i>Shares</i> <i>(mm)</i>	<i>Market</i> <i>Cap</i> <i>(\$mm)</i>	<i>Net</i> <i>Present</i> <i>Value</i> <i>(\$/sh)</i>	<i>Debt/</i> <i>Present</i> <i>Value</i>	<i>McDep</i> <i>Ratio</i>
Independent Natural Gas and Oil - Large Cap and Mid Cap								
XTO Energy Inc.	XTO	B	45.35	280	12,700	45.00	0.16	1.01
Unocal Corporation	UCL	B	60.75	271	16,500	65.00	0.21	0.95
Encana Corporation	ECA	B	71.14	471	33,500	77.00	0.16	0.94
Occidental Petroleum Corp.	OXY	B	73.65	406	29,900	87.00	0.15	0.87
CNOOC Limited (19%)	CEO	B	56.92	78	4,450	67.00	-	0.85
Burlington Resources	BR	B	53.10	391	20,800	67.00	0.12	0.82
Devon Energy Corporation	DVN	B	48.46	500	24,200	63.00	0.16	0.80
Anadarko Petroleum Corp.	APC	B	81.37	246	20,000	113.00	0.14	0.76
	<i>Total or Median</i>				<i>162,000</i>		<i>0.15</i>	<i>0.86</i>

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