

Rating: Buy
S&P 500: 1199

Devon Energy Clean Fuel Supplier

<i>Symbol</i>	DVN	<i>Ebitda Next Twelve Months ending 6/30/06 (US\$m)</i>	7,000
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	59
<i>Price (\$/sh)</i>	46.55	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	5/27/05	<i>Adjusted Reserves/Production NTM</i>	7.8
<i>Shares (mm)</i>	496	<i>EV/Ebitda</i>	4.1
<i>Market Capitalization (\$mm)</i>	23,100	<i>PV/Ebitda</i>	5.3
<i>Debt (\$mm)</i>	5,900	<i>Undeveloped Reserves (%)</i>	17
<i>Enterprise Value (EV) (\$mm)</i>	29,000	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	32.20
<i>Present Value (PV) (\$mm)</i>	37,100	<i>Present Value Proven Reserves(\$/boe)</i>	19.80
<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>	5.03
<i>McDep Ratio - EV/PV</i>	0.78	<i>Price/Earnings Next Twelve Months</i>	9
<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

Among buy-recommended large independent natural gas producers, **Devon Energy (DVN)** has the same person as chief executive officer who built the company's favorable long-term record. After a pullback from recent stock price highs, natural gas producers appear timely as the clean commodity has lagged oil price for two years. A hot summer or recent action in European natural gas markets could spark a change to more realistic commodity price. We see potential appreciation of 35% to our estimate of net present value subject to normal risk.

Present Value Low Relative to Cash Flow

Estimated originally on a discounted cash flow basis assuming \$40 oil, present value looks low relative to next twelve months cash flow (see table Functional Cash Flow and Present Value). The company's cash flow multiple for North American Natural Gas is lower than that indicated by our current correlation with adjusted reserve life index for thirty producers by about 0.3. The company's cash flow multiple for the Oil segment is lower than that indicated by our current correlation with adjusted reserve life index for thirty producers by about 0.1.

Cash Flow Rising with Commodity Price

A dynamic measure, projected cash flow is updated frequently with latest futures quotes (see table Next Twelve Months Operating and Financial Estimates). Recent quarterly results also influence projections. Volume changes may have only a muted impact on valuation depending on changes in reserves.

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Devon Energy
Functional Cash Flow and Present Value

	<i>NTM Ebitda</i> <i>(US\$mm)</i>	<i>Adjusted</i> <i>R/P</i>	<i>PV/</i> <i>Ebitda</i>	<i>Present</i> <i>Value</i> <i>(US\$mm)</i>	
North American Natural Gas	4,180	7.7	5.6	23,500	63%
Oil	2,860	8.1	4.8	13,600	37%
	7,040	7.8	5.3	37,100	100%
Debt (US\$mm)					5,900
Net Present Value (US\$mm)					31,200
Shares (mm)					496
Net Present Value (US\$/sh)					63

Commodity Price Discount Spells Opportunity

Oil price has increased to more than 7 times natural gas price. We expect the ratio for the next decade to average 5 times as was signaled briefly two years ago (see chart Oil/Natural Gas Futures).

Rising futures prices for natural gas in Europe dramatize unrecognized value in the natural gas resources of buy-recommended producers. Futures prices at the U.K. National Balancing Point are setting new records exceeding \$12 a million btu for first quarter 2006, 58% more than for the U.S. We believe that level would be more realistic for the U.S. as well, and we note that Atlantic gas markets are newly linked through liquefied natural gas trading.

Despite not keeping up with oil, U.S. natural gas has been rising on a well-defined trend underway for at least the past 4½ years (see chart Natural Gas Six-Year Futures Strip and 40-Week Average). Whether the trend continues at the same rate or it quickens, buy-recommended natural gas producers are likely to continue their favorable stock price trend as well.

Buy Oil and Gas Producers at Mid Decade

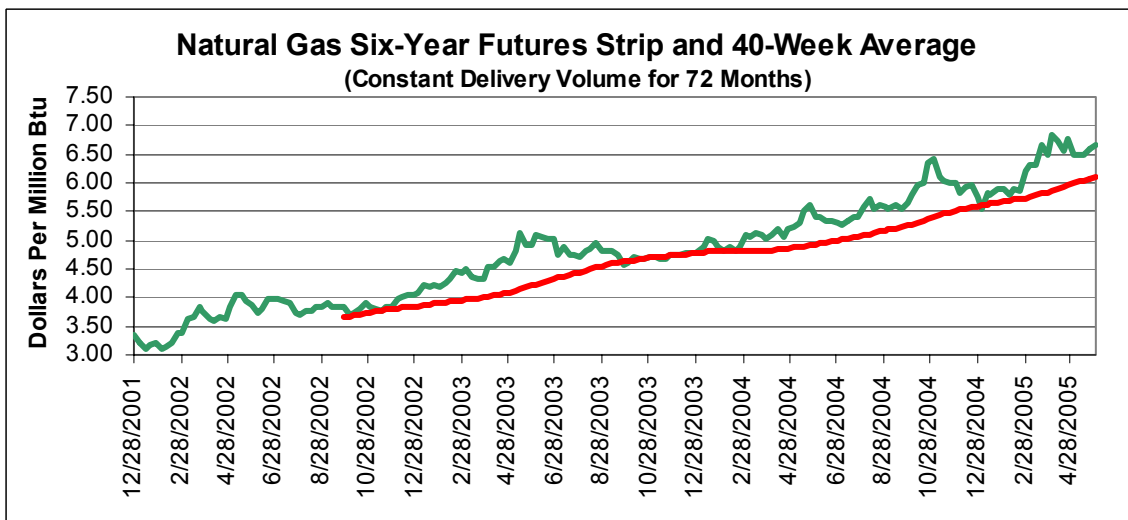
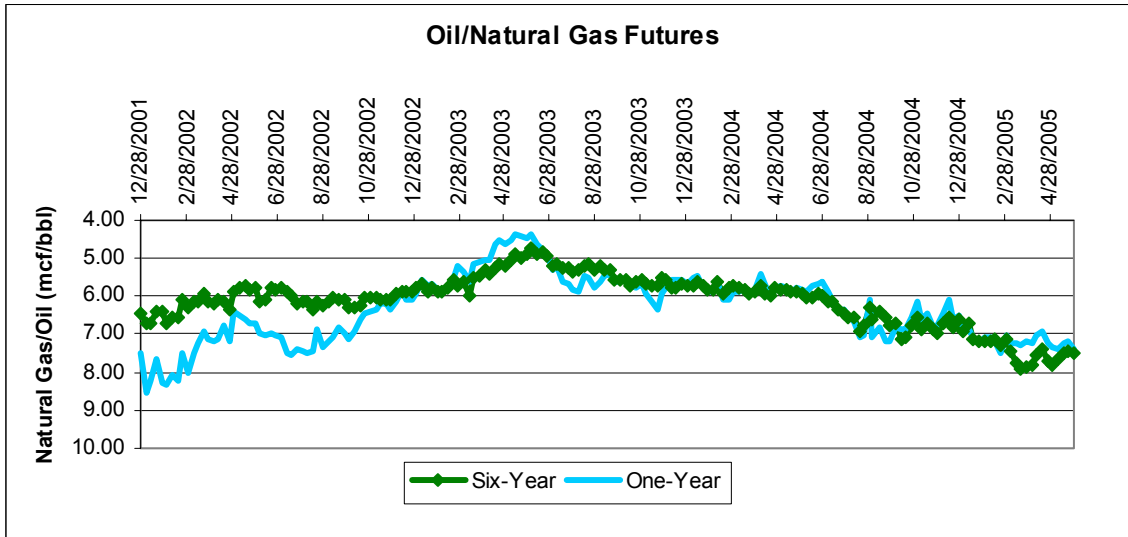
Multi-fold gain potential for oil and gas price over the years ahead justifies investment in recommended oil and gas producers, in our opinion. A McDep Ratio of 1.0 implies that a stock would be priced at present value assuming a constant real oil price of US\$40 (see table Rank by McDep Ratio).

Kurt H. Wulff, CFA

Devon Energy
Next Twelve Months Operating and Financial Results

	<i>Q4</i>	<i>Year</i>	<i>Q1</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Next Twelve Months</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>6/30/06</i>	<i>6/30/06</i>
Volume										
Natural Gas (mmcf)										
U.S.	1,620	1,647	1,610	1,485	1,485	1,485	1,516	1,485	1,485	1,485
Canada	768	764	735	699	699	699	708	699	699	699
Overseas	33	28	30	20	20	20	23	20	20	20
Total	2,420	2,439	2,375	2,204	2,204	2,204	2,246	2,204	2,204	2,204
Oil (mbd)	269	279	265	231	231	231	239	231	231	231
Total gas & oil (bcf)	371	1,503	357	327	330	330	1,343	323	327	1,310
Price										
Natural gas (\$/mcf)										
Henry Hub (\$/mmbtu)	7.10	6.15	6.27	6.83	6.43	7.11	6.66	7.94	6.84	7.08
U.S.	6.07	5.47	5.45	6.04	5.53	6.28	5.82	7.02	5.96	6.19
Canada	5.65	5.30	5.84	5.91	5.99	6.14	5.97	6.87	6.13	6.28
Overseas	3.23	3.33	4.81	5.34	4.92	5.57	5.12	6.40	5.31	5.54
Total	5.90	5.39	5.56	5.99	5.67	6.23	5.86	6.96	6.01	6.21
Oil (\$/bbl)										
WTI Cushing	48.31	41.44	49.65	51.05	51.57	52.68	51.24	52.78	52.47	52.38
Worldwide	37.08	32.94	37.86	38.82	38.47	40.10	38.79	40.62	39.57	39.68
Total gas & oil (\$/mcf)	6.01	5.43	5.86	6.17	5.96	6.40	6.09	6.89	6.23	6.37
Revenue (\$mm)										
Natural Gas										
U.S.	904	3,287	789	816	755	858	3,218	938	805	3,356
Canada	399	1,479	387	376	385	395	1,542	432	390	1,602
Overseas	10	34	13	10	9	10	42	12	10	40
Total	1,313	4,800	1,189	1,201	1,149	1,263	4,802	1,381	1,205	4,998
Oil	919	3,365	901	815	817	851	3,384	843	831	3,342
Total	2,232	8,167	2,091	2,016	1,966	2,114	8,188	2,224	2,036	8,340
Expense										
Fixed	105	664	166	149	149	199	662	199	178	724
Variable	105	664	166	143	140	150	600	158	130	578
Ebitda (\$mm)	2,023	6,628	1,759	1,724	1,677	1,765	6,925	1,867	1,728	7,038
Deprec., Deplet., & Amort.	604	2,300	579	518	518	518	2,134	518	464	2,019
Hedging	266	469	156	166	169	180	671	183	176	707
Ebit	1,152	3,859	988	1,039	990	1,067	4,084	1,166	1,088	4,312
Interest	114	475	118	118	118	118	472	118	118	472
Ebt	1,038	3,384	870	921	872	949	3,612	1,048	970	3,840
Income Tax	363	1,184	304	322	305	332	1,264	367	340	1,344
Net Income (\$mm)	675	2,199	565	599	567	617	2,348	681	631	2,496
Shares (millions)	500	1,992	496	496	496	496	1,984	496	496	496
Per Share (\$)	1.35	4.42	1.14	1.21	1.14	1.24	4.73	1.37	1.27	5.03
Ebitda Margin	91%	81%	84%	86%	85%	83%	85%	84%	85%	84%
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%

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

	<i>Symbol/</i>	<i>Rating</i>	<i>Price</i> <i>(\$/sh)</i> <i>27-May</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								
Encana Corporation	ECA	B	35.43	909	32,200	38.50	0.19	0.94
Unocal Corporation	UCL	B	57.56	273	15,700	65.00	0.19	0.91
XTO Energy Inc.	XTO	B	30.94	366	11,330	36.00	0.19	0.89
Occidental Petroleum Corp.	OXY	B	73.52	406	29,900	87.00	0.14	0.87
CNOOC Limited (19%)	CEO	B	54.29	78	4,240	67.00	-	0.81
Burlington Resources	BR	B	51.43	389	20,000	67.00	0.12	0.79
Devon Energy Corporation	DVN	B	46.55	496	23,100	63.00	0.16	0.78
Anadarko Petroleum Corp.	APC	B	76.09	239	18,200	113.00	0.14	0.72
<i>Total or Median</i>					<i>155,000</i>		<i>0.15</i>	<i>0.84</i>

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