

Rating: Buy
S&P 500: 1282

Devon Energy Corporation

Raise Net Present Value to \$94 a Share

<i>Symbol</i>	DVN	<i>Ebitda Next Twelve Months ending 12/31/06 (US\$mm)</i>	9,500
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	61
<i>Price (\$/sh)</i>	65.99	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	2/1/06	<i>Adjusted Reserves/Production NTM</i>	8.6
<i>Shares (mm)</i>	451	<i>EV/Ebitda</i>	3.7
<i>Market Capitalization (\$mm)</i>	29,800	<i>PV/Ebitda</i>	5.1
<i>Debt (\$mm)</i>	5,700	<i>Undeveloped Reserves (%)</i>	24
<i>Enterprise Value (EV) (\$mm)</i>	35,400	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	43.80
<i>Present Value (PV) (\$mm)</i>	48,100	<i>Present Value Proven Reserves(\$/boe)</i>	22.80
<i>Net Present Value (\$/share)</i>	94	<i>Present Value Proven Reserves(\$/mcfe)</i>	3.80
<i>Debt/Present Value</i>	0.12	<i>Earnings Next Twelve Months (US\$/sh)</i>	9.71
<i>McDep Ratio - EV/PV</i>	0.74	<i>Price/Earnings Next Twelve Months</i>	7
<i>Dividend Yield (%/year)</i>	0.5	<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

Favorable fourth quarter results and an exceptional increase in proven reserves sparks an increase in our estimate of net present value for buy-recommended **Devon Energy (DVN)** to \$94 a share from \$86. Stock price has 42% appreciation potential to NPV that presumes a long-term oil price of \$50 a barrel. Futures investors price Light, Sweet Crude Oil at \$67 a barrel for the next six years. DVN's McDep Ratio incorporating our new estimate of present value is lowest among large cap independent producer peers. Unlevered cash flow multiple is remarkably low at 3.7 times while adjusted reserve life of 8.6 has moved closer to the median of 9.2 years. Mainly a North American natural gas producer with special emphasis on the Barnett Shale in Texas, Devon also has oil potential in oil sands, deep Gulf of Mexico, Azerbaijan and Brazil. Though the stock has commodity risk, Chairman Larry Nichols has compiled an admirable record through strong and weak cycles since founding the company with his father in 1971.

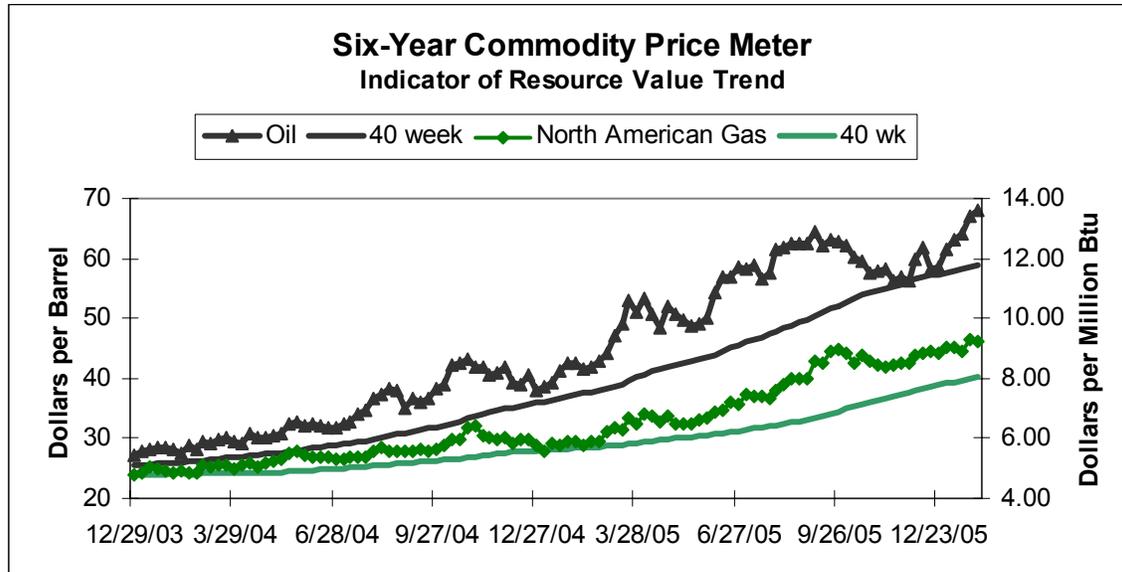
McDep Ratio Relates Oil Price to Opportunity

A McDep Ratio below 1.0 tells us that DVN's market cap and debt, or enterprise value, is less than the estimated present value of its energy resources. The estimate has been increasing with six-year oil futures. Futures price momentum has been positive for more than three years as the current quote stays above the 40-week average (see chart [Six-Year Commodity Price Meter](#)). Six-year oil has tripled in the four years we have been calculating it on a weekly basis. We do not need further gains in oil price to make money in buy recommendations. Yet our vision of \$150 oil in 2010 implies additional scope to exceed common expectations.

Devon's McDep Ratio ranks low among peer companies (see table [Rank by McDep Ratio](#)). Aside from the fundamental appreciation potential we outlined above, a McDep Ratio of 1.0 is an indication of takeover value. The McDep Ratio of buy-recommended **Burlington Resources**

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(BR), increased to 1.0 immediately after buy-recommended **ConocoPhillips (COP)** announced its takeover offer.



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

	Symbol/ Rating	Price (\$/sh) 1-Feb 2006	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
Independent Natural Gas and Oil - Large Cap and Mid Cap							
CNOOC Limited (29%)	CEO B	86.85	119	10,360	84.00	0.00	1.03
XTO Energy Inc.	XTO B	47.87	370	17,710	48.00	0.20	1.00
Encana Corporation	ECA B	48.16	876	42,200	51.00	0.20	0.96
Occidental Petroleum Corp.	OXY B	93.96	432	40,600	120.00	0.12	0.81
Burlington Resources	BR B	91.10	378	34,500	115.00	-	0.79
Anadarko Petroleum Corp.	APC B	104.56	238	24,900	140.00	0.12	0.78
Devon Energy Corporation	DVN B	65.99	451	29,800	94.00	0.12	0.74
<i>Total or Median</i>				<i>200,000</i>		<i>0.12</i>	<i>0.81</i>

Low Cash Flow Multiple

Unlevered cash flow multiples in single digits attest to low valuation (see table Rank by EV/Ebitda). Cash flow estimated for the next twelve months, Ebitda NTM, reflects latest futures prices. Reserve life is measured as adjusted reserves divided by next twelve months production. DVN's adjusted reserve life index of 8.6 years approaches the median of large cap peers. While longer-life ought to be worth a higher cash flow multiple, DVN's unlevered multiple, EV/Ebitda, is the lowest.

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Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.

	Symbol/ Rating		Price (\$/sh) 1-Feb 2006	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
Independent Natural Gas and Oil - Large Cap and Mid Cap								
XTO Energy Inc.	XTO	B	47.87	10.8	6.4	6.3	11	0.4
Encana Corporation	ECA	B	48.16	7.1	5.5	5.3	10	0.6
CNOOC Limited (29%)	CEO	B	86.85	9.2	5.0	5.2	9	2.7
Anadarko Petroleum Corp.	APC	B	104.56	12.5	6.2	4.8	9	0.7
Occidental Petroleum Corp.	OXY	B	93.96	11.3	5.6	4.6	8	1.5
Devon Energy Corporation	DVN	B	65.99	8.6	5.1	3.7	7	0.5
Burlington Resources	BR	B	91.10	-	-	-	-	-
	<i>Median</i>			9.2	5.5	4.8	9	0.6

Natural Gas Concentration at 64% Blended with Oil at 36%

Each oil and gas stock has its own unique mix of energy resources (see table [Business Segments](#)). DVN's concentration on natural gas is not as great as that of Burlington Resources, but its oil exposure could also be appealing to a potential major company acquirer.

Home Country and Business Segments

	Symbol/ Rating		Non- U.S. Domicile	North Amer. Natural Gas (%)	Rest of World Natural Gas (%)	Oil Prod'n (%)	Down- stream (%)	Total Present Value (US\$mm)
Independent Natural Gas and Oil - Large Cap and Mid Cap								
Occidental Petroleum Corp.	OXY	B		14	1	75	11	59,000
Encana Corporation	ECA	B	Canada	83	-	17	-	55,600
Devon Energy Corporation	DVN	B		64	-	36	-	48,100
Anadarko Petroleum Corp.	APC	B		60	-	40	-	37,700
CNOOC Limited	CEO	B	China	-	12	88	-	34,600
XTO Energy Inc.	XTO	B		83	-	17	-	22,100
Burlington Resources	BR	B						
	<i>Median</i>			62	-	38	-	257,000

Correlation Verifies Present Value in Real Time

Our underlying quantitative method for estimating present value projects cash flows years into the future and brings them to the present by applying a real discount rate, currently 7% a year. Around that traditional discounted cash flow analysis (DCF) we deal with uncertainty on a qualitative basis. "Option value" to us, for example, is "upside potential". After awhile DCF analyses fall into a pattern where differences among companies depend mostly on first year cash flow and reserve life. Meanwhile input information is continually changing as companies make new disclosures, each on a different day or at a different hour and commodity prices fluctuate. We aggregate latest information into a correlation analysis that determines a real-time present value approximation. When that approximation deviates too much from our steady, official estimate of present value and we cannot justify the difference with company-specific explanation,

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we change the official estimate. Net present value indicated by the current correlation is about \$9 a share higher than our ongoing standard estimate for the company (see table Functional Cash Flow and Present Value).

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	5,840	8.2	5.3	31,000	64%
Oil	3,660	9.2	4.7	17,100	36%
	9,500	8.6	5.1	48,100	100%
Debt (US\$mm)					5,700
Net Present Value (US\$mm)					42,400
Shares (mm)					451
Net Present Value - Standard Estimate (US\$/sh)					94
Net Present Value - Approximation by Correlation (US\$/sh)					103

Futures Prices and Company Disclosures Propel Estimated Cash Flow by Quarter

Cash flow for the next year is projected from a base through the latest reported quarter (see table Next Twelve Months Operating and Financial Estimates). Company disclosures provide the clues for future volumes and costs as well as geographic and quality differences in price. Futures prices from the New York Mercantile Exchange determine industry benchmarks for the next year in our model.

Kurt H. Wulff, CFA

Devon Energy
Next Twelve Months Operating and Financial Results

	<i>Q4</i>	<i>Q3</i>	<i>Q4</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Next Twelve Months</i>
	<i>12/31/04</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>9/30/06</i>	<i>12/31/06</i>	<i>12/31/06</i>
Volume									
Natural Gas (mmcf)									
U.S.	1,620	1,485	1,458	1,521	1,553	1,553	1,553	1,553	1,553
Canada	768	725	666	715	666	666	666	666	666
Overseas	33	27	34	30	28	28	28	28	28
Total	2,420	2,237	2,158	2,266	2,247	2,247	2,247	2,247	2,247
Oil (mbd)	269	225	220	242	220	220	220	220	220
Total gas & oil (bcf)	371	330	320	1,357	321	324	328	328	1,301
Price									
Natural gas (\$/mcf)									
Henry Hub (\$/mmbtu)	7.10	8.56	13.00	8.65	10.04	9.54	9.77	10.72	10.02
U.S.	6.07	7.30	9.80	7.14	8.25	7.84	8.02	8.80	8.23
Canada	5.65	7.19	9.74	7.18	8.34	7.93	8.11	8.90	8.32
Overseas	3.23	6.52	3.08	4.85	5.63	5.35	5.48	6.02	5.62
Total	5.90	7.26	9.68	7.13	8.24	7.83	8.02	8.80	8.22
Oil (\$/bbl)									
WTI Cushing	48.31	62.52	60.02	56.31	67.44	69.57	70.44	70.76	69.56
Worldwide	37.08	49.60	45.81	43.24	50.17	51.25	52.09	52.58	51.53
Total gas & oil (\$/mcf)	6.01	7.64	8.90	7.16	8.29	8.09	8.26	8.79	8.36
Revenue (\$mm)									
Natural Gas									
U.S.	904	998	1,315	3,966	1,153	1,107	1,146	1,258	4,664
Canada	399	480	597	1,875	500	480	497	545	2,022
Overseas	10	16	10	52	14	14	14	15	57
Total	1,313	1,494	1,921	5,893	1,667	1,601	1,657	1,819	6,743
Oil	919	1,027	929	3,816	991	1,024	1,052	1,062	4,129
Total	2,232	2,520	2,850	9,710	2,658	2,625	2,709	2,880	10,872
Expense									
Fixed	105	174	146	702	146	146	146	300	737
Variable	105	174	146	702	136	120	111	266	633
Ebitda (\$mm)	2,023	2,173	2,558	8,306	2,376	2,359	2,452	2,315	9,502
Deprec., Deplet., & Amort.	604	533	553	2,200	553	553	553	553	2,212
Hedging	266	221	284	831	33	32	33	37	134
Ebit	1,152	1,419	1,722	5,275	1,790	1,774	1,866	1,725	7,156
Interest	114	113	105	482	105	105	105	105	420
Ebt	1,038	1,306	1,617	4,793	1,685	1,669	1,761	1,620	6,736
Income Tax	363	457	566	1,677	590	584	616	567	2,357
Net Income (\$mm)	675	849	1,051	3,115	1,095	1,085	1,145	1,053	4,378
Shares (millions)	500	454	451	1,872	451	451	451	451	451
Per Share (\$)	1.35	1.87	2.33	6.72	2.43	2.41	2.54	2.33	9.71
Ebitda Margin	91%	86%	90%	86%	89%	90%	91%	80%	87%
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%

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