



Independent Stock Idea

February 19, 2016

Devon Energy (DVN) Flexibility to Adapt

<i>Symbol</i>	DVN	<i>Ebitda Next Twelve Months ending 12/31/16 (US\$m)</i>	1,000
<i>Rating</i>		<i>North American Natural Gas/Ebitda (%)</i>	16
<i>Price (\$/sh)</i>	19.70	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	2/18/16	<i>Adjusted Reserves/Production NTM</i>	8.9
<i>Shares (mm)</i>	413	<i>EV/Ebitda</i>	18.1
<i>Market Capitalization (\$mm)</i>	8,100	<i>PV/Ebitda</i>	24.1
<i>Debt (\$mm)</i>	10,800	<i>Undeveloped Reserves (%)</i>	17
<i>Enterprise Value (EV) (\$mm)</i>	18,900	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	5.50
<i>Present Value (PV) (\$mm)</i>	25,200	<i>Present Value Proven Reserves(\$/boe)</i>	11.50
<i>Net Present Value (\$/share)</i>	35	<i>Present Value Proven Reserves(\$/mcfe)</i>	1.90
<i>Debt/Present Value</i>	0.43	<i>Earnings Next Twelve Months (US\$/sh)</i>	0.43
<i>McDep Ratio - EV/PV</i>	0.75	<i>Price/Earnings Next Twelve Months</i>	45
<i>Dividend Yield (%/year)</i>	1.2	<i>Indicated Annual Dividend (US\$/sh)</i>	0.24
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 capped by unlevered cash flow multiple.			
For historical research on Devon since 2004 see http://www.mcdep.com/3dvn.htm			

Summary and Recommendation

Subject to volatility that has contributed to low price, the common stock of Large Cap Independent Producer **Devon Energy (DVN)** looks attractive for appreciation on the basis of leverage to oil price, high quality shale oil prospects, continually improving operating efficiency and long-life conventional projects. The company has shown better flexibility to adapt to negative conditions than the stock price might suggest. A low current price of \$30 a barrel for crude oil squeezes cash margin. Lower price for natural gas liquids and natural gas reduces the average to \$14 an equivalent barrel, which is a slim \$2 a barrel above cash operating costs of \$12. To keep an investment grade debt rating, management announced on February 17 a proposed sale of a billion dollars of shares and a reduced dividend. It is proceeding with the sale of up to \$3 billion dollars of assets that would help finance a steeply reduced capital program. That would only be enough drilling to limit production decline to 10% in 2016. Such a decline at DVN and other producers would contribute to a balancing of the market that restores oil price to a sustaining level. Yet, to acknowledge low current cash flow, we reduce our estimate of Net Present Value (NPV) to \$35 a share from \$65 a share. McDep Ratio remains at a low 0.75 and financial leverage moves up to a ratio of Debt to Present Value at a high 0.43 before a stock sale. Looking to the upside, oil price can take the stock price up just as fast as it took stock price down. DVN has a low cost operating position in the Texas Eagle Ford, Permian Delaware and Oklahoma Woodford shale oil trends. The productivity of new wells keeps improving even in the oil price downturn. Balancing out shale, DVN has a long-life oil sands project in Canada. Financial risk can be managed by sizing stock owned on an unlevered basis.

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Devon Energy										
Next Twelve Months Operating and Financial Results										
	Q4	Year	Q3	Q4	Year	Q1E	Q2E	Q3E	Q4E	Next Twelve Months
	12/31/14	2014	9/30/15	12/31/15	2015	3/31/16	6/30/16	9/30/16	12/31/16	12/31/16
Volume										
Natural Gas (bcf)	157	701	146	146	588	141	134	126	118	519
Natural Gas (mmcf)	1,710	1,920	1,586	1,583	1,610	1,570	1,468	1,373	1,283	1,423
Oil (mb)	35	129	38	38	150	37	35	34	32	138
Oil (mbd)	380	353	416	417	412	414	389	366	344	378
Total gas & oil (mmboe)	61	246	63	63	248	61	58	55	51	225
Total gas & oil (mboed)	665	673	680	681	680	676	634	595	558	615
Price										
Natural gas (\$/mcf)										
Henry Hub (\$/mmbtu)	4.02	4.43	2.76	2.28	2.67	2.18	2.10	2.26	2.44	2.24
Company	3.49	3.90	2.24	1.75	2.14	1.67	1.61	1.74	1.87	1.72
Oil (\$/bbl)										
WTI Cushing	73.18	93.04	46.39	42.21	48.79	30.22	33.67	36.98	38.92	34.95
Company	43.98	55.64	26.41	22.48	27.43	16.99	18.92	20.79	21.88	19.53
Total gas & oil (\$/mcf)	5.68	6.72	3.56	2.97	3.61	2.38	2.56	2.80	2.97	2.66
Revenue (\$mm)										
Natural Gas	549	2,736	327	255	1,260	237	215	219	221	892
Oil	1,538	7,172	1,011	862	4,125	633	670	700	692	2,695
Total	2,087	9,908	1,338	1,117	5,384	870	885	919	913	3,587
Expense										
928	3,088	799	746	3,347	754	715	678	636	2,784	
Ebitda (\$mm)										
Production	1,057	6,092	539	371	2,037	116	170	241	277	804
Midstream (DVN share)	102	728	95	95	378	97	115	115	115	442
Total Ebitda	1,159	6,820	634	466	2,415	212	285	356	392	1,245
Deprec., Deplet., & Amort.	910	3,319	744	641	3,129	600	600	600	600	2,400
Hedging and other	(441)	(121)	(726)	(804)	(2,832)	(594)	(522)	(454)	(417)	(1,987)
Ebit										
689	3,622	617	628	2,119	206	207	210	209	832	
Interest										
167	526	136	139	517	139	139	139	139	556	
Ebt										
522	3,096	481	489	1,602	67	68	71	70	276	
Income Tax										
183	1,084	168	171	561	23	24	25	25	97	
Net Income (\$mm)										
339	2,012	312	318	1,041	43	44	46	46	179	
Shares (millions)										
409	410	411	413	412	413	413	413	413	413	
Per Share (\$)										
0.83	4.91	0.76	0.77	2.53	0.11	0.11	0.11	0.11	0.43	
Ebitda Margin (Production)										
51%	61%	40%	33%	38%	13%	19%	26%	30%	22%	



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Devon Energy					
Functional Cash Flow and Present Value					
				<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	200	11.1	25.0	5,000	20%
Oil	604	7.5	26.2	15,800	62%
Midstream (DVN share)	442		10.2	4,500	18%
	1,045	8.9	24.2	25,300	100%
Debt (US\$mm) (DVN share)					10,800
Net Present Value (US\$mm)					14,500
Shares (mm)					413
Net Present Value - Standard Estimate (US\$/sh)					35
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					22

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