Company Overview:

DVN is a diversified large cap US Exploration and Production company with 2.0Bboe of reserves and 611 mboe/d of production from core assets during 2016. Production is weighted towards crude oil while growth opportunities are liquids focused - anchored by the Delaware Basin, SCOOP/STACK, Eagle Ford Shale, and Canadian Oil Sands, and the Barnett.

Name	Ticker	Yield	Growth	D + G
Devon Energy Corporation	DVN	6.63%	5.00%	11.63%

Highlights:

Operational headwinds continue to persist but could start to take a step change in a couple of quarters. DVN has taken action to enhance capital efficiency including shifting more capital to the Permian and reducing its maintenance production levels.

Starting in 2024, DVN enhanced its shareholder returns to now target 75% of FCF. Near-term there is a strong emphasis on buybacks given stock price weakness, which could amount to a majority of excess FCF. We expect ~$400 million buybacks pace over the coming couple of quarters. There is also a desire for future fixed dividend increases, and to be competitive with peers, it would need to move to a minimum 2.0% yield from the current 1.7% rate.

Bull Case:

- ***A Strategy of Growth Has Been Replaced by a Strategy of Return on Invested Capital → Yet to be Rewarded by the Market from a Multiples Standpoint –*** We believe that when asset intensive industries change strategy focus from "growth" to "ROIC", relative performance has not only been better in many of these older, capital-intensive industries than the market overall, they've all actually beaten the fastest growing sector as well (technology). Energy relative returns have averaged -1% annually for 20 years now, while its revenue growth has been very similar to these other industries. Value creation is all about ROIC for asset intensive industries specifically – energy is just 10-20 years late to this game. Many other industries have gone through this transformation of a mindset, all of which, have outperformed: Airlines, Restaurants, Semiconductors, and Railroads.
- ***E&Ps → Cheap Valuations and Growth FCF is a One-Two Punch -*** Absolute EV/EBITDA for the E&P sector is a below 6x, ~1x higher than the 20-year median, but relative to the market, its near 20-year lows. However, the real story of E&P is increasingly on FCF, as the sector has never had a FCF outlook like it does today given the change in management philosophy. Simply put, the E&P sector has the highest FCF yield in the S&P 500…with the cheapest valuation in the S&P 500. A pretty good combination in our opinion.
- ***Multi-Basin Portfolio*** - DVN's multi-basin production portfolio provides good diversity of both production and pricing. JVs within different basins provide further diversity and strengthen cash flows through lower capital requirements while realizing strong production.

Bear Case:

- ***Commodity Price Risk -*** Prices for natural gas and oil fluctuate widely, and we believe that DVN's cash flow and dividends depend substantially on prevailing oil and gas prices. As a result, current and expected oil and gas prices can significantly influence the price of DVN's shares.
- ***Exploration Risk –*** Devon's business depends not only on commodity prices, but also on its ability to find, develop, and acquire oil and gas reserves that are economically recoverable. Producing oil and gas reservoirs are typically associated with high production depletion rates. Because of this, significant capital expenditures are often required to find, develop, and produce oil and gas reserves to replace those depleted by production.
- ***Expectation Of Faster Acceptance of Green Energy*** – The biggest threat to "dirty" energy has been the argument that Green Energy will overtake fossil fuels – this has been the bear thesis on the space for almost a decade now – compressing multiples across the sector. It has been the sentiment driving the devaluation of these companies. We don't disagree with this – we are big believers in growth regarding the Clean Energy space. But, in the past, the transition to a new energy source has provided a big boost to the old one. Solving this conundrum — how to supply enough dirty old material to build a new green economy — will require balance. Blocking new mines/rigs will not always be the environmentally responsible move. We believe that governments, and greens in particular, need to recognize that trying to shut down the old economy too fast threatens to push the price of building a cleaner one out of reach.

Overview:

We believe that DVN shares should perform well within the peer group over a full business cycle. Over recent years, DVN repositioned its asset portfolio to focus on high-returning, oil- growth properties with an emphasis on running the business for shareholder returns. DVN was one of the first E&Ps to introduce a variable dividend framework that provides an attractive mechanism for investors to see a more "real-time" benefit to current oil price strength.

Disclosures:

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