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DVN Ramps Up Production Guidance

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For Rothbort's preview heading into the Devon Energy conference call, please [click here](#).

Devon Energy (DVN) had an excellent quarter due to higher realizations and production. The company is ramping up its production guidance, which will help to offset the potential for realization softness due to the pullback in crude oil and nat gas. Looking to 2009, Devon is expecting top-line production growth of at least 10%.

One item that bypassed most observers but caught my attention was the deleveraging of the balance sheet. Debt reduction and stock repurchases are going to equate to less interest costs, a cleaner balance sheet and earnings growth. So far, the company has repurchased less than 2% of the 12% board authorization. This should create a natural floor for the stock and help to build EPS growth in excess of production growth less realization declines.

The market liked the production guidance bump higher, and the stock got a nice bid once that item was discussed on the call. I would also point out that the drilling success rate was outstanding.

It goes without saying that Devon is a well-managed company -- albeit, in a very volatile energy commodity business. The need for more supply is still more than ever, however, so the company will benefit from the world's insatiable need for crude oil and natural gas.

Clearly, the stock got ahead of itself when it rose to \$127.43 a few months back, but the recent selloff below \$100 was overdone as well. At about 4.5 times cash flow and with debt on the decline, Devon is still a reasonable long-term investment.

The company reported second-quarter 2008 EPS of \$2.91 on a GAAP basis and \$3.39 on a pro forma basis, excluding certain items. The \$3.39 compares to analysts EPS estimates of \$3.28. Revenue of \$3.55 billion excluded sales from operations that were divested in Africa. Those were recorded as discontinued operations. Excluding discontinued operations, Devon earned \$3.28, which compares to a similar analyst estimate of \$3.23, per management. No matter how you look at it, it appears that the company had an excellent quarter and surpassed Wall Street expectations.

Cash flow was a record \$2.7 billion and \$3.0 billion after excluding the tax effect of repatriated natural gas. Devon redeemed all of its outstanding preferred stock and repaid all commercial paper during the quarter. The debt-to-capital ratio is the lowest in more than a decade at 11%. Later this month, management will eliminate the convertible debentures inherited from a 199 acquisition. These debentures are convertible into shares of **Chevron** (CVX).

In the first half, Devon repurchased 2.8 million shares of stock and an additional 3 million in the third quarter. So far, 5.9 million of the 54 million shares authorized by the board have been repurchased. The full repurchase represents 12% of outstanding shares.

Drilling activity:

- 494 wells drilled;

- 16 wells were exploratory, of which 81% were successful;
- 478 wells classified as development, of which 98% were successful;
- expect first Haynesville drilling in third quarter 2008; and
- the Jackfish operation in Alberta ready to double production.

Production:

- North American onshore produced half a million barrels better than expected;
- first-half onshore growth significantly less than expectations for the full year;
- increased production outlook by 2 million barrels for the year and narrowed the range to 240 million to 244 million barrels; and
- production will grow by 61 million barrels in third quarter and 64 million barrels in fourth quarter.

Price realizations:

- oil of \$110.55 per barrel vs. WTI average crude of \$124.38 per barrel, an 89% ratio (WTI up 91% year over year for the quarter);
- natural gas of \$8.29 per million cubic feet, or 88% of benchmark, up 47% year over year (cash settlement on hedges reduced realized price by \$1.32 per million cubic feet);
- very little oil hedged, about only 20,000 barrels per day; and
- four months left to the natural gas hedges, and so far the decision is not unwind the 2008 and 2009 hedges in natural gas.

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At the time of publication, Rothbort was long Devon Energy, although positions can change at any time.

Scott Rothbort has over 20 years of experience in the financial services industry. In 2002, Rothbort founded LakeView Asset Management, LLC, a registered investment advisor based in Millburn, N.J., which offers customized individually managed separate accounts, including proprietary long/short strategies to its high net worth clientele. He also is the founder and manager of the social networking educational Web site TheFinanceProfessor.com.

Immediately prior to that, Rothbort worked at Merrill Lynch for 10 years, where he was instrumental in building the global equity derivative business and managed the global equity swap business from its inception. Rothbort previously held international assignments in Tokyo, Hong Kong and London while working for Morgan Stanley and County NatWest Securities.

Rothbort holds an MBA in finance and international business from the Stern School of Business of New York University and a BS in economics and accounting from the Wharton School of Business of the University of Pennsylvania. He is a Term Professor of Finance and the Chief Market Strategist for the Stillman School of Business of Seton Hall University.

For more information about Scott Rothbort and LakeView Asset Management, LLC, visit the company's Web site at www.lakeviewasset.com. Scott appreciates your feedback; [click here](#) to send him an email.

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