Devon Energy Corporation (DVN)

Updated November 12th, 2022, by Tiago Dias

Key Metrics

Current Price:	$71	**5 Year CAGR Estimate:**	-1.6%	**Market Cap:**	$46 B
Fair Value Price:	$77	**5 Year Growth Estimate:**	-10.0%	**Ex-Dividend Date:**	12/09/2022
% Fair Value:	92%	**5 Year Valuation Multiple Estimate:**	1.7%	**Dividend Payment Date:**	12/30/2022
Dividend Yield:	7.6%	**5 Year Price Target**	$46	**Years Of Dividend Growth:**	5
Dividend Risk Score:	F	**Retirement Suitability Score:**	D	**Rating:**	Sell

Overview & Current Events

Founded in 1971, Devon Energy Corporation (DVN) is an independent energy company engaged primarily in the exploration, development and production of oil, natural gas and NGLs. On January 7th, 2021, Devon and WPX Energy completed an all-stock merger of equals. The combined $46 billion market cap company benefits from enhanced scale, improved margins, higher free cash flow, and the financial strength to accelerate the return of cash to shareholders through a "fixed plus variable" dividend strategy.

Devon reported Q3 2022 earnings on November 1st, 2022. For the quarter, earnings per share equalled $2.88. In line with its fixed-plus-variable dividend pay-out, Devon declared a $1.35 quarterly dividend, a decrease over the previous quarter. As of the end of July the company repurchased 25.2 million shares at a total cost of $1.3 billion. The company is on track to decrease its outstanding share count by 5 percent.

The company is revising its financial and operational outlook higher for the fourth quarter as a result of the immediate value of the 2 accretive acquisitions of Wiliston Basin and Eagle Ford. This updated outlook increases production targets, raises free cash flow projections and enhances its ability to deliver differentiated cash returns to shareholders.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$3.26	$4.29	$4.91	$2.52	-$0.13	$1.59	$1.28	$1.41	-$0.09	$3.52	***$5.15***	***$3.04***
DPS	$0.80	$0.86	$0.94	$0.96	$0.42	$0.24	$0.30	$0.35	$0.68	$1.97	***$5.40***	***$3.19***
Shares[1]	406	406	409	418	523	525	449	382	382	671	***661***	***700***

The cyclicality inherent to commodity producers, and particularly oil and gas companies makes it difficult to accurately estimate a future growth rate over the next 5 years, particularly given that Devon Energy's earnings will be heavily impacted by the price of oil 5 years from now, which is something we cannot predict.

That said, the currently elevated oil and gas prices are the result of temporary supply constraints stemming from supply chain disruptions, lack of investment in new production since the 2014 oil price crash, and geopolitical issues with Russia. While none of these issues have a clear end in sight now, it's not unreasonable to assume that they will be worked out at some point over the next 5 years, and oil prices will subsequently drop.

For these reasons we expect that 2027 earnings and dividends will be significantly lower than 2022, at only around $3.04 per share in earnings and $3.19 in dividends.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	18.9	13.5	13.7	21.0	---	23.8	28.9	18.7	---	8.5	***13.8***	***15.0***
Avg. Yld.	1.3%	1.5%	1.4%	1.8%	1.2%	0.6%	0.8%	1.3%	3.2%	1.5%	***7.6%***	***7.0%***

[1] In millions.

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Devon has traded at a surprisingly elevated average P/E of around 18 times earnings over the last decade. Part of the reason for this is because much of that time was spent in an oil and gas bear market, which depressed earnings and subsequently raised P/E ratios. While this premium has since reversed given the massive earnings growth the business saw in the past 2 years, we believe the company will be re-rated to a level more in line with the market average of 15, as the top of the oil cycle could slowly unwind over the next 5 years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	25%	20%	19%	38%	---	15%	23%	25%	---	56%	***105%***	***105%***

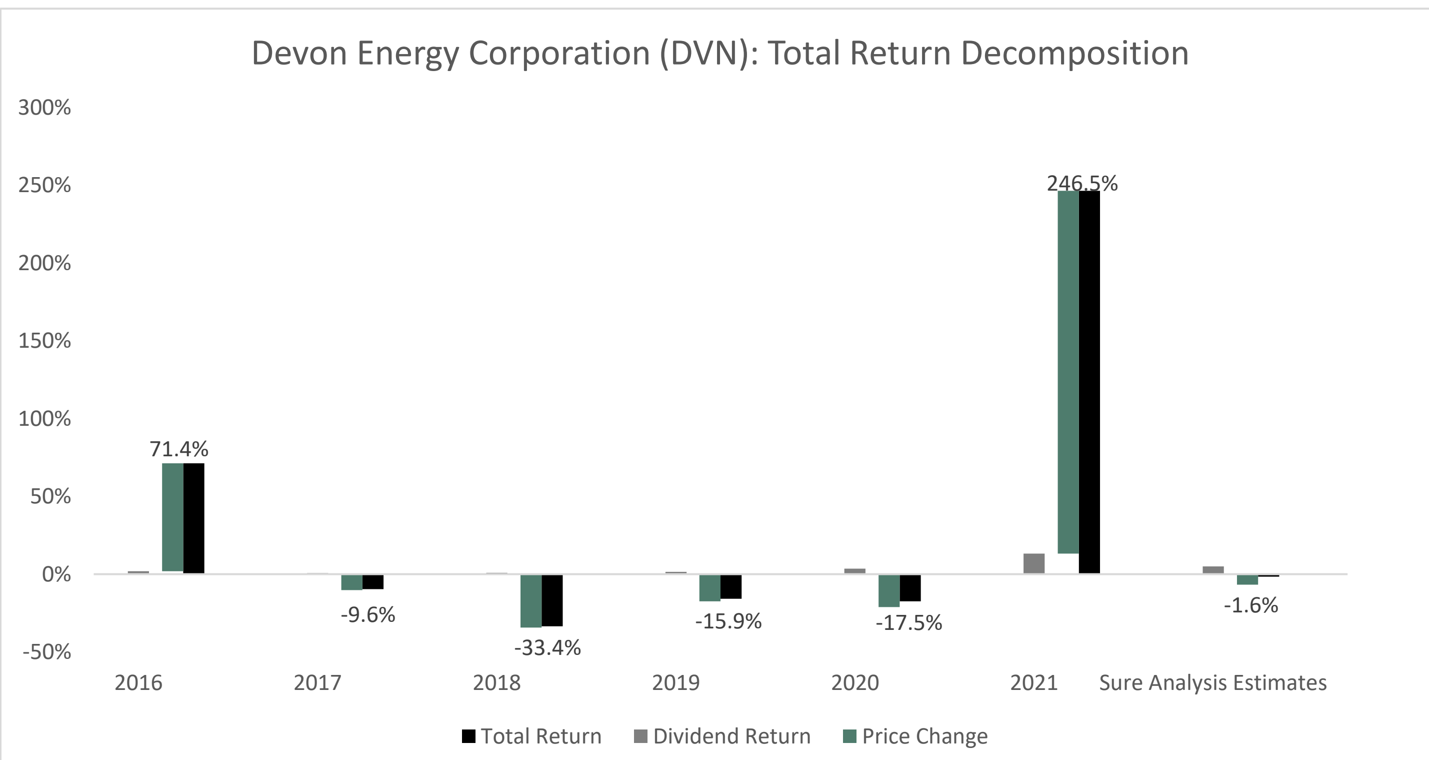
The focus that the management team has in strengthening the balance sheet and returning capital to investors, rather than re-invest into the business at what is clearly the top of an oil cycle means that Devon Energy is well prepared for any downturn in the foreseeable future and will likely survive another oil price crash.

It's important to be aware though that in the event of such a crash the fixed-plus-variable dividend structure will likely result in a dividend cut.

Final Thoughts & Recommendation

Cyclical oil companies like Devon are best purchased at the bottom of a cycle, and so despite seemingly good performance over the past few years, investors would do well to be skeptical of that outperformance continuing in the mid to long term. As such, and despite an attractive 7.6% dividend yield, we expect the next 5 years to give a total return of negative 1.6% annually. The bulk of that loss comes from our -10% earnings and dividend contraction estimate, coming from our expectation that oil prices will return to levels closer to their historical norms. The security earns a sell rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	9,501	10,397	19,566	13,145	10,304	6,501	8,896	6,220	4,828	12,206
Gross Profit	5,030	5,603	8,897	223	872	1,143	2,194	714	392	3,679
Gross Margin	52.9%	53.9%	45.5%	1.7%	8.5%	17.6%	24.7%	11.5%	8.1%	30.1%
SG&A Exp.	692	617	847	1,193	865	645	574	475	338	391
Operating Profit	2,159	2,606	5,625	(1,496)	(283)	152	1,492	160	(133)	3,246
Op. Margin	22.7%	25.1%	28.7%	-11.4%	-2.7%	2.3%	16.8%	2.6%	-2.8%	26.6%
Net Profit	(206)	(20)	1,607	(12,896)	(1,056)	898	3,064	(355)	(2,680)	2,813
Net Margin	-2.2%	-0.2%	8.2%	-98.1%	-10.2%	13.8%	34.4%	-5.7%	-55.5%	23.0%
Free Cash Flow	(3,269)	(1,322)	(7,429)	(996)	(733)	1,251	533	130	193	2,892
Income Tax	(132)	169	2,368	(6,213)	141	7	230	(30)	(547)	65

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	43,326	42,877	50,637	29,451	28,675	30,241	19,566	13,717	9,912	21,025
Cash & Equivalents	4,637	6,066	1,480	2,310	1,959	2,642	2,414	1,464	2,047	2,111
Acc. Receivable	1,245	1,520	1,959	1,105	1,356	989	812	832	601	1,543
Goodwill & Int.	6,079	5,858	6,836	5,722	4,007	841	753	753	753	753
Total Liabilities	22,048	22,378	24,296	18,462	15,953	16,137	10,380	7,797	6,893	11,626
Accounts Payable	1,451	1,229	1,400	906	642	633	530	428	242	500
Long-Term Debt	11,644	12,022	11,262	13,032	10,154	6,864	4,454	4,294	4,298	6,482
Total Equity	21,278	20,499	21,539	7,049	8,274	9,254	9,186	5,802	2,885	9,262
D/E Ratio	0.55	0.59	0.52	1.85	1.23	0.74	0.48	0.74	1.49	0.70

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	-0.5%	0.0%	3.4%	-32.2%	-3.6%	3.0%	12.3%	-2.1%	-22.7%	18.2%
Return on Equity	-1.0%	-0.1%	7.6%	-90.2%	-13.8%	10.2%	33.2%	-4.7%	-61.7%	46.3%
ROIC	-0.6%	-0.1%	4.6%	-41.9%	-4.5%	4.1%	17.7%	-3.0%	-30.6%	24.3%
Shares Out.	406	406	409	418	523	525	449	382	382	671
Revenue/Share	23.75	25.86	48.07	32.30	20.32	12.50	17.90	15.51	12.81	18.35
FCF/Share	(8.17)	(3.29)	(18.25)	(2.45)	(1.45)	2.41	1.07	0.32	0.51	4.35

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.