

Equities

3 November 2010 | 7 pages

EOG Resources Inc (EOG)

Quick Read: Q3 Beats, Production Outlook Slashed, Rating to Hold

- **Bottom Line Results** – Reported adjusted, recurring Q3 EPS/CFPS of \$0.18/\$3.30 versus our \$(0.01)/\$2.76 estimates; Street consensus of \$0.18/\$2.81. The beat was largely driven by U.S. oil production being at mid-point of guidance while we were modeling the low-end, while domestic natural gas was well below the guidance range. Otherwise, a \$353 million non-cash impairment charge was incurred for Canadian assets the company plans to sell by year end.
- **Production Guidance Slashed** – Growth for the full year was lowered to 9% from 13% with nearly three-quarters of the drop attributed to a reduction in natural gas drilling with the remainder due to availability of completion crews/equipment. For 2011, growth was slashed to 10% from 19%, and for 2012 to 12% from 21%. Both gas and liquids growth was lowered with North American gas activity limited to holding acreage and liquids slowed by costs and crew/equipment availability.
- **Budget Again Raised** – Despite the reduction in drilling/completions, 2010 spending was again increased (~3%). We project capex will be up 10% in 2011 which will put it \$2.4 billion above our cash flow projection. Thus, EOG boosted its net debt to capitalization threshold to 30-35% from 25%.
- **More Assets For Sale** – In addition to the \$600 million to \$1.0 billion of producing and non-producing asset sales expected to close by year end, EOG now plans to sell up to an additional \$1.0 billion (we suspect Barnett will hit auction block).
- **Drilling Results Encouraging** – Otherwise, EOG did report encouraging results from its Eagle Ford shale, Barnett Combo, North Dakota Bakken, and New Mexico Leonard shale plays. But these didn't negate the reduced liquids growth outlook.
- **Reducing Estimates, Price Target, Rating** – Based on this revised outlook, we are lowering 2011 EPS/CFPS estimates to \$3.08/\$15.18 from \$3.62/\$16.58, and for 2012 to \$6.18/\$20.45 from \$8.25/\$25.14. In turn, we are lowering our 12-month price target to \$95 from \$110 per share, and rating to Hold from Buy.
- **Conference Call** – Tomorrow 9 AM EDT; dial 888-504-7963, conf code: 2527314.

EPS	Q1	Q2	Q3	Q4	FY	FC Cons
2009A	0.53A	0.73A	0.81A	0.92A	3.00A	3.00A
2010E	0.46A	0.18A	0.18A	0.43E	1.25E	1.38E
Previous	0.46A	0.18A	-0.01E	0.55E	1.18E	na
2011E	na	na	na	na	3.08E	4.04E
Previous	na	na	na	na	3.62E	na
2012E	na	na	na	na	6.18E	7.10E
Previous	na	na	na	na	8.25E	na

Source: Company Reports and dataCentral, CIR. FC Cons: First Call Consensus.

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

Hold/Medium Risk	2M
<i>from Buy/Medium Risk</i>	
Price (02 Nov 10)	US\$97.74
Target price	US\$95.00
<i>from US\$110.00</i>	
Expected share price return	-2.8%
Expected dividend yield	0.6%
Expected total return	-2.2%
Market Cap	US\$24,774M

Price Performance (RIC: EOG.N, BB: EOG US)



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Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	13.0	32.6	77.9	31.7	15.8
EV/EBITDA adjusted (x)	4.9	9.4	9.0	7.6	5.5
P/BV (x)	2.7	2.5	2.4	2.3	2.0
Dividend yield (%)	0.5	0.6	0.6	0.6	0.6
Per Share Data (US\$)					
EPS adjusted	7.50	3.00	1.25	3.08	6.18
EPS reported	9.72	2.17	0.85	3.08	6.18
BVPS	36.11	39.58	40.33	43.32	49.42
DPS	0.51	0.58	0.62	0.62	0.62
Profit & Loss (US\$K)					
Net sales	6,962,610	4,379,843	5,123,287	6,200,648	8,221,970
Operating expenses	-3,002,551	-3,103,170	-3,972,967	-4,354,202	-4,932,012
EBIT	3,960,059	1,276,673	1,150,320	1,846,446	3,289,958
Net interest expense	-51,658	-100,901	-124,215	-140,490	-151,608
Non-operating/exceptionals	-161,846	-303,761	-582,455	-280,000	-280,000
Pre-tax profit	3,746,555	872,011	443,650	1,425,956	2,858,350
Tax	-1,309,621	-325,384	-227,140	-641,680	-1,286,258
Extraord./Min.Int./Pref.div.	-443	0	0	0	0
Reported net income	2,436,491	546,627	216,511	784,276	1,572,093
Adjusted earnings	1,879,069	754,506	318,780	784,276	1,572,093
Adjusted EBITDA	5,286,934	2,825,861	3,104,674	3,929,656	5,561,849
Growth Rates (%)					
Sales	67.1	-37.1	17.0	21.0	32.6
EBIT adjusted	128.5	-74.2	-42.3	179.7	92.2
EBITDA adjusted	84.8	-46.6	9.9	26.6	41.5
EPS adjusted	72.2	-60.0	-58.2	145.7	100.5
Cash Flow (US\$K)					
Operating cash flow	4,633,249	2,922,439	2,794,190	3,220,410	4,551,425
Depreciation/amortization	1,326,875	1,549,188	1,954,354	2,083,210	2,271,890
Net working capital	525,666	150,446	39,922	0	0
Investing cash flow	-4,966,518	-3,414,551	-5,274,672	-5,051,900	-5,557,090
Capital expenditure	-5,461,000	-3,527,000	-5,613,383	-6,301,900	-6,932,090
Acquisitions/disposals	-109,000	-707,000	-21,000	1,250,000	1,375,000
Financing cash flow	645,105	834,162	1,200,410	1,831,490	1,005,665
Borrowings	712,000	900,000	1,763,720	1,303,905	476,126
Dividends paid	-125,838	-144,400	-155,496	-155,629	-155,629
Change in cash	277,080	354,440	-1,280,201	0	0
Balance Sheet (US\$K)					
Total assets	15,951,226	18,118,667	20,870,570	23,285,530	26,015,045
Cash & cash equivalent	331,311	685,751	27,832	27,832	27,832
Accounts receivable	722,695	771,417	897,732	897,732	897,732
Net fixed assets	13,657,302	16,139,225	19,175,521	21,590,481	24,319,996
Total liabilities	6,936,729	8,120,625	10,645,077	12,301,906	13,485,474
Accounts payable	1,122,209	979,139	1,541,268	1,541,268	1,541,268
Total Debt	1,860,000	2,760,000	4,544,263	5,848,168	6,324,295
Shareholders' funds	9,014,497	9,998,042	10,225,493	10,983,624	12,529,571
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	75.9	64.5	60.6	63.4	67.6
ROE adjusted	23.5	7.9	3.2	7.4	13.4
ROIC adjusted	20.1	4.3	1.9	4.6	7.6
Net debt to equity	17.0	20.7	44.2	53.0	50.3
Total debt to capital	17.1	21.6	30.8	34.7	33.5

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EOG Resources Inc

Investment strategy

We rate EOG Resources Hold/Medium Risk (2M) based on the upside to our current price target in the context of the risk rating. Overall, while EOG should post strong production growth next year while continuing to achieve top-tier economic returns, we believe that the stock currently fully reflects the company's growth prospects. Meanwhile, EOG's lack of hedges in 2011 with still significant leverage to natural gas prices in what we expect will be a weak natural gas price environment near-term further tempers our risk appetite for the name.

Valuation

Our \$95 price target is based on the company achieving a enterprise value to discretionary cash flow (EV/DACF) multiple of and 6.9x our 2011 estimates based on "normalized" WTI spot crude oil and composite spot natural gas prices of \$80.00/Bbl and \$5.25/MMBtu, respectively, and ~143% of proven NAV.

Risks

We rate EOG Resources Medium Risk.

Our risk rating on EOG is Medium based on a combination of quantitative and qualitative risk assessments compared to other stocks covered by Citi Investment Research.

Drilling Results - Disappointing drilling results, particularly in EOG's key operating areas in the Eagle Ford, Barnett Combo play, the Bakken, the Haynesville shale, the Marcellus shale and the Horn River Basin, could impact EOG's share performance.

Volatile Commodity Prices - Hydrocarbon prices have shown increasing volatility in recent years, as well as cash flow and earnings. This volatility tends to significantly impact sector stock performance.

If the impact on the company from any of these factors proves to be less than we anticipate, the stock could materially outperform our target. Conversely, if the impact on the company from any of these factors proves to be greater than we anticipate, the stock could underperform our target price.

Appendix A-1

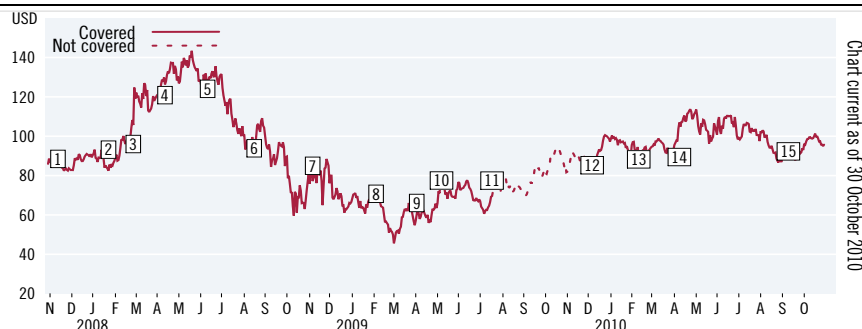
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Analyst: Robert S Morris
Covered since December 7 2009



	Date	Rating	Target Price	Closing Price
1	13-Nov-07	*2H	*90.00	85.66
2	23-Jan-08	*1H	*100.00	82.47
3	27-Feb-08	*2H	*112.00	105.68
4	11-Apr-08	2H	*138.00	126.32
5	11-Jun-08	2H	*139.00	128.39

	Date	Rating	Target Price	Closing Price
6	15-Aug-08	2H	*106.00	95.60
7	6-Nov-08	*1H	*95.00	77.17
8	4-Feb-09	1H	*88.00	68.58
9	2-Apr-09	1H	*70.00	60.33
10	7-May-09	*2H	*82.00	73.52

	Date	Rating	Target Price	Closing Price
11	17-Jul-09	Coverage terminated		
12	7-Dec-09	*1M	*110.00	87.27
13	10-Feb-10	1M	*102.00	88.24
14	8-Apr-10	1M	*120.00	106.96
15	9-Sep-10	1M	*110.00	89.37

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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