Rating: Buy
S&P 500: 1099

ChevronTexaco Corporation
Undervalued Mega Cap

Symbol	CVX	*Ebitda Next Twelve Months ending 3/31/05 ($mm)*	23,300
Rating	Buy	*North American Natural Gas/Ebitda (%)*	12
Price ($/sh)	91.65	*Natural Gas and Oil Production/Ebitda (%)*	74
Pricing Date	5/7/04	*Adjusted Reserves/Production NTM*	10.9
Shares (mm)	1066	*EV/Ebitda*	5.2
Market Capitalization ($mm)	97,700	*PV/Ebitda*	6.7
Debt ($mm)	22,300	*Undeveloped Reserves (%)*	30
Enterprise Value (EV) ($mm)	119,900	*Natural Gas and Oil Ebitda ($/boe)*	18.40
Present Value (PV) ($mm)	155,500	*Present Value Proven Reserves($/boe)*	9.60
Net Present Value ($/share)	125	*Present Value Proven Reserves($/mcfe)*	1.60
Debt/Present Value	0.14	*Price/Earnings Next Twelve Months*	8
McDep Ratio - EV/PV	0.77	*Dividend Yield (%)*	3.2

Summary and Recommendation

We continue to recommend current purchase of the common shares of **ChevronTexaco (CVX)** for undervalued mega cap participation in a positive outlook for crude oil and refined products. There may be more undervalued smaller energy stocks, but there are none larger than CVX that are more undervalued in our framework. By our present value measure the stock has more than 35% appreciation potential to $125 a share, the point at which it would then offer a normal return of perhaps 5% a year above inflation. While the main risk may be oil price, the company has hardly any debt implying that it would be a likely survivor in any conceivable financial storm.

Six-Year Futures Point to Higher Commodity Price

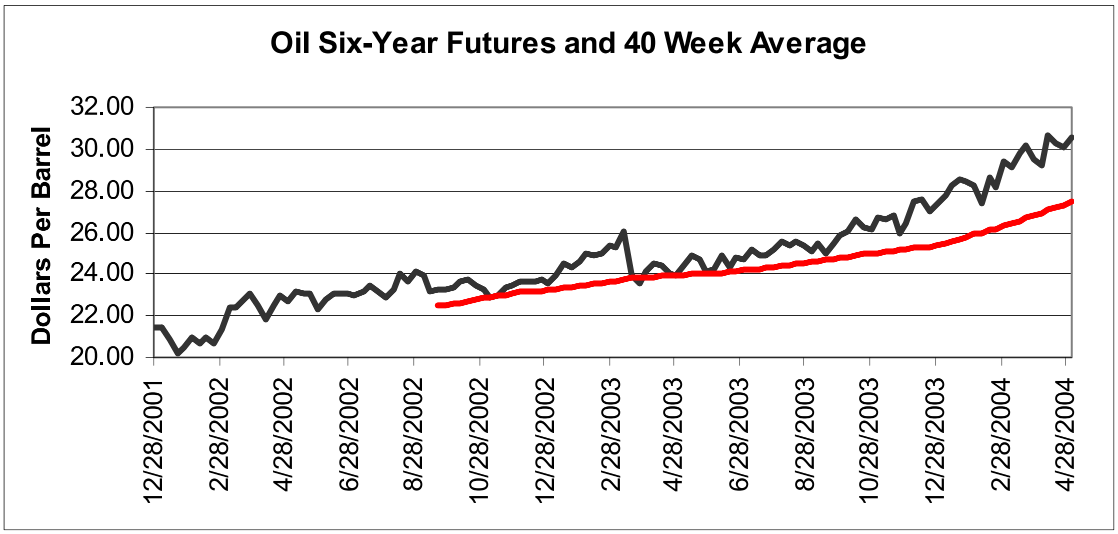
About 74% of the value of CVX is sensitive to crude oil price and the remainder is sensitive mostly to refined product margin. We look to the futures market for expectations of the trend in price of the global crude oil benchmark. Thirty years ago when we last had a decade-long major move in oil there was no meaningful futures market. Today futures prices for natural gas are quoted every trading day for each of 72 months for the next six years. Similarly futures prices for oil are quoted for the same period, but not for every month in the fifth and sixth years because there is less seasonality in crude oil price. We average the quotes for 72 months, interpolating where necessary for oil.

The plot of weekly results for oil shows a strong uptrend with the 40-week moving average rising at the rate of 12% a year (see Chart). At that rate the price in 2010 would be three times the price in 2000. The comparable rate of gain from 1970 to 1980 was about ten times.

Fundamental factors support the price trends. Oil demand is strong with world economic growth paced by developing countries, especially China. Supply is tight as the Middle East is showing maturity with the workhorse giant fields on the verge of peaking.

Interest rates below inflation encourage investment in assets like oil that can increase in price more than inflation. Nor is the increase in oil price close to the rate that would induce a recession in economic activity and energy demand. We believe an oil price gain of three times from 2000 to 2010 can be accommodated in continued economic progress while we know a gain of ten times was accompanied by economic pain.

There may be security concerns affecting the near-term oil price. We are optimistic that there will be no catastrophic interruption. At the same time it should be clear that the ability of even the U.S. military to enforce an artificially low oil price is limited.

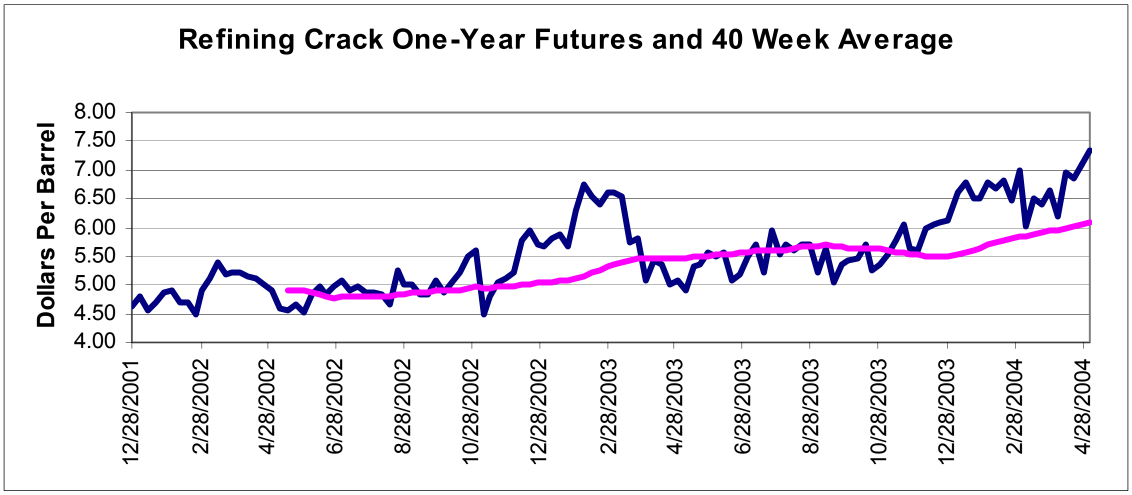


Upstream Trends Also Strong

Industry people like to refer to the oil producing business as upstream and the oil refining/marketing business as downstream. Strong upstream business prospects captured in the rising trend of six-year futures are complemented by improving downstream prospects captured in the trend of one-year refining crack futures (see chart).

Compared to the two previous years, there has been no sign yet of a seasonal peak in the trend. Perhaps there will be some falloff this year as in the past, but it would occur from a higher level.

The crack spread we measure is the price of two/thirds barrel of gasoline plus one/third barrel of heating oil minus a barrel of crude oil. While there are innumerable varieties of crude oil and products quoted around the world there is only one source of transparent, public quotes of futures prices for the next year, the New York Mercantile Exchange. Even at Nymex there are times for gasoline when the last month may not be quoted. In those cases we add an estimate. There is also the complication of multiple environmental blends required in the market place. Despite the possible seasonal cycle noted above, the crack spread should be seasonally neutral because it always includes twelve months.



Volume, Price and Costs Translate to Attractive Cash Flow

Our process of estimating company-specific present value begins with an estimate of next twelve months cash flow. Current projections lead to some $23 billion of unlevered cash flow, also known as Ebitda, short for earnings before interest, tax, depreciation and amortization (see table). We choose the next twelve months ending March 31, 2005 as the relevant time period. The rationale is that if one is buying a stock today, previously reported cash flow is relevant only for the information it may give about future cash flow.

We project modest decline in oil volume and in U.S. natural gas. We recognize seasonality in overseas natural gas. Though we would like to be surprised by a positive volume trend, our main assumption is that the cash generated be redeployed effectively in one fashion or another.

We take the futures market at face value in projecting price for the next twelve months. Light Sweet Crude quotes guide our projections of oil revenue while Henry Hub natural gas quotes guide our projections for North American natural gas revenue. The New York Harbor 3-2-1 quote, the refining crack, guides our projection for downstream margin. Because futures are constantly changing, our projection is adjusted accordingly. As a result, the specific amounts we project today may not be the amounts realized when the company next reports.

Long Reserve Life Implies Higher Cash Flow Multiple

The important variables in the valuation of future production are captured in base year cash flow and a multiple of that cash flow that depends on reserve life. Indeed investors do differentiate on that basis as reflected in a high correlation of unlevered cash flow multiple with adjusted reserve life. We convert the market relationship to a formula that produces an anticipatory value with somewhat more sensitivity to reserve life.

ChevronTexaco
Next Twelve Months Operating and Financial Estimates

	Q1 3/31/04	*Q2E 6/30/04*	*Q3E 9/30/04*	*Q4E 12/31/04*	***Year 2004E***	*Q1E 3/31/05*	***Next Twelve** Months 3/31/05*
Volume							
Natural Gas (mmcfd)							
U.S. (or North America)	2,061	2,040	2,020	2,000	**2,030**	2,000	**2,015**
Overseas (or Int'l)	2,170	2,127	1,975	2,105	**2,094**	2,170	**2,094**
Total	4,231	4,167	3,995	4,105	**4,124**	4,170	**4,109**
Oil (mmb)	171	172	173	172	**687**	168	**684**
Oil (mbd)	1,896	1,887	1,877	1,868	**1,882**	1,868	**1,875**
Total gas & oil (mmb)	234	235	234	235	**938**	231	**934**
Price							
Natural gas ($/mcf)							
Henry Hub ($/mmbtu)	5.64	5.90	6.34	6.50	**6.09**	6.66	**6.09**
U.S. (or North America)	5.23	5.47	5.87	6.10	**5.67**	6.25	**5.92**
Overseas (or Int'l)	2.67	3.40	3.41	3.29	**3.19**	3.17	**3.32**
Total	3.92	4.42	4.66	4.66	**4.41**	4.65	**4.59**
Oil ($/bbl)							
WTI Cushing	35.23	37.43	37.55	36.21	**36.60**	34.89	**36.52**
Worldwide	29.52	31.37	31.47	30.34	**30.68**	29.24	**30.61**
Total gas & oil ($/bbl)	27.89	30.06	30.54	29.70	**29.55**	28.87	**29.80**
NY Harbor 3-2-1 ($/bbl)	6.98	10.19	9.00	6.24	**8.10**	6.10	**7.88**
Revenue ($mm)							
Natural Gas							
U.S. (or North America)	970	1,016	1,092	1,122	**4,200**	1,125	**4,354**
Overseas (or Int'l)	521	658	620	637	**2,437**	620	**2,535**
Total	1,492	1,675	1,712	1,760	**6,637**	1,744	**6,890**
Oil	5,038	5,385	5,434	5,214	**21,071**	4,916	**20,949**
Other	27,037	27,037	27,037	27,037	**108,146**	27,037	**108,146**
Total	33,566	34,096	34,182	34,010	**135,854**	33,696	**135,985**
Expense							
Production	2,629	2,735	2,753	2,618	**10,736**	2,555	**10,662**
Other	25,632	25,308	25,409	25,659	**102,008**	25,674	**102,050**
Ebitda ($mm)							
Exploration and Production	3,900	4,324	4,393	4,355	**16,972**	4,104	**17,177**
Other	1,405	1,729	1,627	1,377	**6,138**	1,363	**6,096**
Total Ebitda	5,305	6,052	6,020	5,733	**23,111**	5,467	**23,273**
Exploration	84	84	84	84	**336**	84	**336**
Deprec., Deplet., & Amort.	1,192	1,192	1,192	1,192	**4,768**	1,192	**4,768**
Other non cash							
Ebit	4,029	4,776	4,744	4,457	**18,007**	4,191	**18,169**
Interest	93	93	93	93	**372**	93	**372**
Ebt	3,936	4,683	4,651	4,364	**17,635**	4,098	**17,797**
Income Tax	1,378	1,639	1,628	1,527	**6,172**	1,434	**6,229**
Net Income ($mm)							
Exploration and Production	1,985						
Other	714						
Unallocated	(141)						
Total	2,558	3,044	3,023	2,837	**11,463**	2,664	**11,568**
Shares (millions)	1,066	1,066	1,066	1,066	**1,066**	1,066	**1,066**
Per share ($)	2.40	2.86	2.84	2.66	**10.75**	2.50	**10.85**
Ebitda Margin (E&P)	60%	61%	61%	62%	**61%**	62%	**62%**
Tax Rate	35%	35%	35%	35%	**35%**	35%	**35%**

Reported reserves at year end 2003 imply an adjusted life index of 10.9 years. The index is the sum of developed and half undeveloped reserves divided by next twelve months production. That could justify a multiple of 7.9 in the framework we applied on March 23 when we estimated present value assuming constant commodity price near the one-year quotes at that time, about $35 a barrel for crude oil and $6 a barrel for the refining crack. Our present value remains unchanged while higher commodity prices since then imply higher cash flow and a lower multiple of 6.7 times. That implies ChevronTexaco can generate more cash in less than 7 years than the total value of its stock market capitalization and debt.

For the time being we are not differentiating in assessed multiple for oil production, North American natural gas production or downstream. Should the balance of price relationships change sharply, we may need to be more specific.

Historical Trivia

Chevron stock started from an undervalued base as we measured it in August of 1973 when we did the first type of analysis that ultimately became our McDep Ratio technique. There were four companies at that time that are now all part of ChevronTexaco. Standard Oil of California, the main predecessor of ChevronTexaco, had a McDep Ratio of 0.67. After the company changed its name to Chevron, it acquired Gulf. At about the same time Texaco acquired Getty and ultimately Chevron acquired Texaco. The McDep Ratios for those components in 1973 were 0.72 for Texaco, 0.76 for Gulf and 0.78 for Getty.

With that historical perspective, one must expect that there will be more acquisitions by ChevronTexaco in the future. We can think of some targets though we know of nothing imminent. At the time of acquisition it is usually better to own the target rather than the acquirer. There was a lot of money to be made in Gulf and Getty in the period leading up to the acquisition by Chevron and Texaco respectively. Yet the long-time owners of the acquirer also made out well. Similarly we believe that long term owners of ChevronTexaco will do well in the future.

Kurt H. Wulff, CFA

Research Methodology: McDep Associates ("the Firm") applies the thirty plus years of experience of its analyst to estimate a present value of the oil and gas resources and other businesses of covered companies. That value becomes the denominator of the McDep Ratio while market capitalization and debt are the numerator. Stocks with low McDep Ratios tend to outperform stocks with high McDep Ratios on an unlevered basis. The firm emphasizes quantitative tools in deriving estimates while applying a final qualitative refinement.

Ratings Description: Stocks are rated by expected risk-adjusted return over one to three years compared to Treasury Inflation Protected Securities. Buy, Hold and Sell ratings imply expectations better than, equal to and inferior to those of TIPS. The McDep Ratio for a Buy may range up to 1.2; for a Hold**,** 1.0 to 1.4; and for a Sell, above 1.2.

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