

Rating: Buy
S&P 500: 1179

ChevronTexaco

Mega Cap at a Discount

<i>Symbol</i>	CVX	<i>Ebitda Next Twelve Months ending 12/31/05 (US\$m)</i>	25,400
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	9
<i>Price (\$/sh)</i>	51.96	<i>Natural Gas and Oil Production/Ebitda (%)</i>	69
<i>Pricing Date</i>	12/8/04	<i>Adjusted Reserves/Production NTM</i>	11.4
<i>Shares (mm)</i>	2126	<i>EV/Ebitda</i>	5.1
<i>Market Capitalization (\$mm)</i>	110,500	<i>PV/Ebitda</i>	6.0
<i>Debt (\$mm)</i>	19,200	<i>Undeveloped Reserves (%)</i>	30
<i>Enterprise Value (EV) (\$mm)</i>	129,600	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	19.70
<i>Present Value (PV) (\$mm)</i>	152,000	<i>Present Value Proven Reserves(\$/boe)</i>	8.70
<i>Net Present Value (\$/share)</i>	63	<i>Present Value Proven Reserves(\$/mcf)</i>	1.50
<i>Debt/Present Value</i>	0.13	<i>Earnings Next Twelve Months (US\$/sh)</i>	5.95
<i>McDep Ratio - EV/PV</i>	0.85	<i>Price/Earnings Next Twelve Months</i>	9
<i>Dividend Yield (%/year)</i>	3.1	<i>Indicated Annual Dividend (US\$/sh)</i>	1.60

Note: Estimated cash flow and earnings tied to one-year futures prices for oil, natural gas and refining crack.

Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

Summary and Recommendation

We continue to recommend the common shares of **ChevronTexaco (CVX)** for mega cap participation in the rising profit opportunities in oil and gas production and refined products at a discounted valuation compared to peers. Adjusted reserve life is the longest of the five largest energy companies while unlevered cash flow multiple is the lowest. Longer reserve life is normally associated with higher cash flow multiple. Financial risk is low with a ratio of debt to present value of 0.13. We see potential appreciation in CVX stock to estimated net present value of \$63 a share that relates to a constant real oil price of \$35 a barrel. The average futures price for continuous delivery over the next six years is about \$38 a barrel.

Rich in Oil Resources

To no surprise for a mega cap energy company, oil resources account for the dominant portion of value (see table Functional Cash Flow and Present Value). The company has a solid base in the U.S. and Asia-Pacific with growth potential in Africa and Kazakhstan. Management is scheduled to present its latest plans to analysts on December 14.

Though overseas natural gas is the smallest of the four functional areas there is favorable growth potential in liquefied natural gas (LNG). Projects in Australia, Angola and Nigeria appear promising. With product expected from those areas, CVX is enmeshed in developing and procuring receiving terminal access in North America.

Refining/marketing exposure is close to that of mega cap peers with proportionately more concentration in the U.S. and Asia. One of the benefits of the merger of Chevron and Texaco was to bring the Asian joint venture, Caltex, under common ownership.

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ChevronTexaco
Functional Cash Flow and Present Value

	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>(US\$mm)</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
				<i>(US\$mm)</i>	
North American Natural Gas	2,320	7.7	4.8	11,100	7%
Overseas Natural Gas	1,130	16.4	7.6	8,600	6%
Oil	14,080	11.0	6.0	85,100	56%
Downstream	7,920		6.0	47,300	31%
	25,450	11.4	6.0	152,100	100%
Debt (US\$mm)					19,200
Net Present Value (US\$mm)					132,900
Shares (mm)					2,126
Net Present Value (US\$/sh)					63

Adjusted reserve life of 11.4 years for oil and natural gas is longer than for peer companies. Comparing present value against the latest NTM cash flow projection results in a multiple, PV/Ebitda, of 6.0 times. In the current correlation of present value with reserve life for 30 stocks, the company's multiple could be considered low by 0.8 times below the level implied by the correlation. Should that difference persist in our continuous analysis there could be a case for an upward revision for present value compared to peer companies.

Cash Flow Continues at a High Level

Commodity price drives cash flow in our model (see table Next Twelve Months Operating and Financial Estimates). We project modest volume decline for production operations reflecting recent experience. Projected refining/marketing margins reflect futures prices for gasoline and heating oil compared to crude oil.

After a gain in the last quarter of 2004, cash flow would be sustained at a high level in 2005. Of course that could change depending on how well futures prices anticipate actual prices among other factors.

Investors' greatest concern may be the sustainability of the current level of oil price. Energy consumers and energy investors should, in our opinion, take recent oil price action as a sign of a long term change to higher price. Softening of oil price from the temporary highs is welcome relief for the economy while we adjust to the price increases that have occurred and prepare for those that may occur in the future.

Oil Price Move Possibly Just Starting

To offset any inclination to underestimate further potential for oil and gas price, we compare the relatively stable price period from 1992 to 2001 to the period from 1964 to 1973. Each was a ten year period that immediately preceded a sharply lower stock market in 2002 and in 1974. After quiescence, oil price started moving up in each case. We may be in the early stages of a new historic move (see chart Light, Sweet Crude Oil Price Cycle).

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ChevronTexaco
Next Twelve Months Operating and Financial Estimates

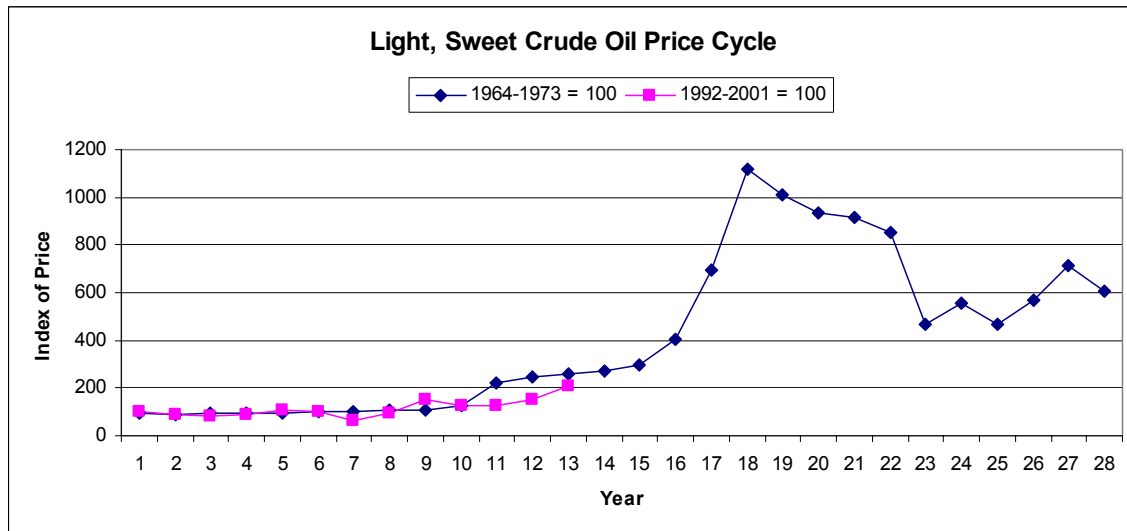
	<i>Q1</i>	<i>Q2</i>	<i>Q3</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Next Twelve Months</i>
	<i>3/31/04</i>	<i>6/30/04</i>	<i>9/30/04</i>	<i>12/31/04</i>	<i>2004E</i>	<i>3/31/05</i>	<i>6/30/05</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>12/31/05</i>
Volume										
Natural Gas (mmcf)										
U.S. (or North America)	2,061	2,001	1,813	1,795	1,916	1,795	1,777	1,759	1,742	1,768
Overseas (or Int'l)	2,170	2,098	1,914	2,105	2,071	2,170	2,098	1,975	2,105	2,086
Total	4,231	4,099	3,727	3,900	3,988	3,965	3,875	3,734	3,846	3,854
Oil (mmb)	171	172	168	167	677	163	164	165	164	657
Oil (mmbd)	1,896	1,891	1,822	1,813	1,855	1,813	1,804	1,795	1,786	1,799
Total gas & oil (mmb)	234	234	225	227	920	223	223	222	223	891
Price										
Natural gas (\$/mcf)										
Henry Hub (\$/mmbtu)	5.64	6.10	5.75	7.10	6.15	6.96	6.33	6.38	6.68	6.59
U.S. (or North America)	5.23	5.59	5.28	6.60	5.66	6.46	5.83	5.88	6.18	6.09
Overseas (or Int'l)	2.67	2.55	2.59	2.84	2.66	2.55	2.54	2.51	2.47	2.52
Total	3.92	4.03	3.90	4.57	4.10	4.32	4.05	4.10	4.15	4.15
Oil (\$/bbl)										
WTI Cushing	35.23	38.34	43.89	48.12	41.39	43.14	43.02	42.50	41.92	42.65
Worldwide	29.52	32.54	37.34	40.94	35.04	36.70	36.60	36.15	35.67	36.28
Total gas & oil (\$/bbl)	27.89	30.33	33.80	37.37	32.29	33.82	33.35	33.18	32.82	33.29
NY Harbor 3-2-1 (\$/bbl)	6.98	12.67	7.83	5.02	8.12	6.50	8.02	7.25	5.95	6.93
Revenue (\$mm)										
Natural Gas										
U.S. (or North America)	970	1,018	881	1,089	3,958	1,043	943	952	990	3,928
Overseas (or Int'l)	521	487	456	550	2,014	497	485	456	479	1,916
Total	1,492	1,505	1,337	1,639	5,972	1,540	1,427	1,408	1,469	5,844
Oil	5,038	5,599	6,259	6,827	23,724	5,989	6,007	5,970	5,860	23,825
Other	27,037	31,197	33,119	33,119	124,472	33,119	33,119	33,119	33,119	132,475
Total	33,566	38,301	40,715	41,585	154,167	40,647	40,553	40,496	40,448	162,144
Expense (\$mm)										
Production	2,629	2,904	3,196	3,270	11,999	3,083	3,064	3,052	2,943	12,141
Other	25,632	28,825	31,090	31,454	117,001	31,210	30,986	31,088	31,271	124,554
Ebitda (\$mm)										
Exploration and Production	3,900	4,200	4,400	5,196	17,696	4,446	4,371	4,325	4,386	17,527
Other	1,405	2,372	2,029	1,665	7,471	1,909	2,133	2,031	1,848	7,922
Total Ebitda	5,305	6,572	6,429	6,861	25,167	6,355	6,504	6,356	6,234	25,449
Exploration	84	165	173	173	595	173	173	173	173	692
Deprec., Deplet., & Amort.	1,192	1,251	1,219	1,219	4,881	1,219	1,219	1,219	1,219	4,876
Other non cash										
Ebit	4,029	5,156	5,037	5,469	19,691	4,963	5,112	4,964	4,842	19,881
Interest	93	93	107	107	400	107	107	107	107	428
Ebt	3,936	5,063	4,930	5,362	19,291	4,856	5,005	4,857	4,735	19,453
Income Tax	1,378	1,772	1,725	1,877	6,752	1,700	1,752	1,700	1,657	6,809
Net Income (\$mm)										
Exploration and Production	1,985	2,180	2,324							
Other	714	1,142	612							
Unallocated	(141)	(31)	268							
Total	2,558	3,291	3,204	3,486	12,539	3,156	3,253	3,157	3,078	12,645
Shares (millions)	2,132	2,130	2,122	2,122	2,126	2,126	2,126	2,126	2,126	2,126
Per share (\$)	1.20	1.55	1.51	1.64	5.90	1.48	1.53	1.48	1.45	5.95
Ebitda Margin (E&P)	60%	59%	58%	61%	60%	59%	59%	59%	60%	59%
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%

Frankly, few investors would give much weight to the likelihood of continued oil price strength. Contrast that with the growing chorus for a weaker dollar. It may just be that oil price is not high, but the real value of the dollar is low. That, too, is a parallel to historical experience.

Let us imagine how the cycle might unfold. By the way we chose to draw the chart Year 13 corresponds to 1976 and 2004. Once the move got going in the previous cycle, the annual average oil price did not decline until Year 19 (1982). The annual peak of 1100, or 11 times the

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first ten year average, was too high to be sustained. It might be less disruptive economically if the peak ahead of us were lower and the decline shallower. The end point in Year 28 at 600 implies a tripling over the next 15 years. If higher oil price unfolded gradually it would give everyone time to adjust.



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