Rating: Buy
S&P 500: 1094

Occidental Petroleum
Timely Transformation

Symbol	OXY	*Ebitda Next Twelve Months ending 3/31/05 (US$mm)*	5,400
Rating	Buy	*North American Natural Gas/Ebitda (%)*	15
Price (US$/sh)	44.75	*Natural Gas and Oil Production/Ebitda (%)*	92
Pricing Date	5/21/04	*Adjusted Reserves/Production NTM*	11.2
Shares (mm)	397	*EV/Ebitda*	4.5
Market Capitalization (US$mm)	17,800	*PV/Ebitda*	6.7
Debt (US$mm)	6,900	*Undeveloped Reserves (%)*	21
Enterprise Value (EV) (US$mm)	24,600	*Natural Gas and Oil Ebitda (US$/boe)*	25.20
Present Value (PV) (US$mm)	36,600	*Present Value Proven Reserves(US$/boe)*	13.56
Net Present Value (US$/share)	75	*Present Value Proven Reserves(US$/mcfe)*	2.26
Debt/Present Value	0.19	*Earnings Next Twelve Months (US$/sh)*	5.97
McDep Ratio - EV/PV	0.67	*Price/Earnings Next Twelve Months*	7
Dividend Yield (%/year)	2.5	*Indicated Annual Dividend (US$/sh)*	1.10

Note: Estimated cash flow and earnings tied to one-year futures prices for oil and natural gas.
Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

Summary and Recommendation

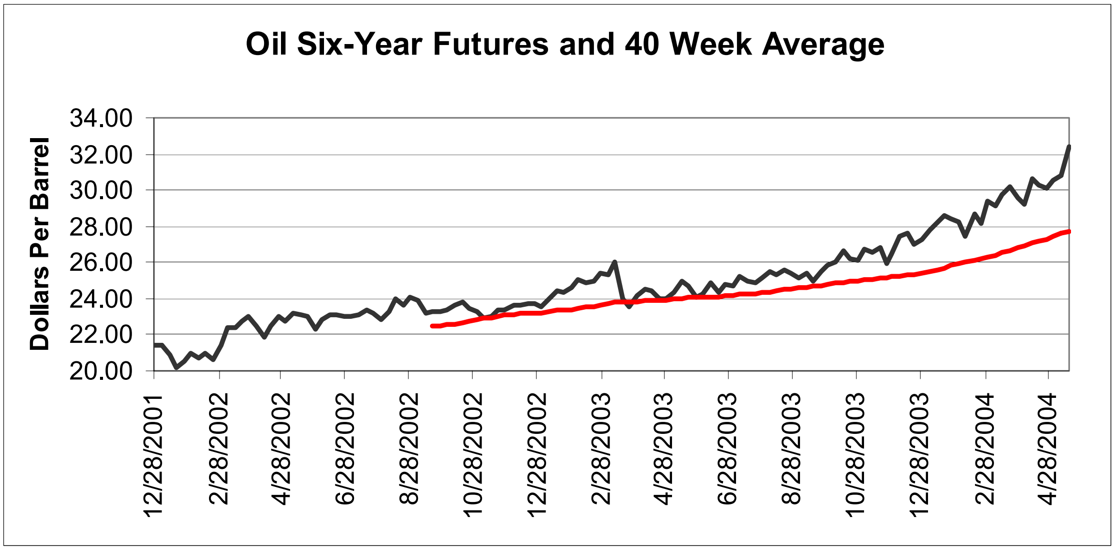
We initiate a "Buy" rating on the common shares of **Occidental Petroleum (OXY)** for concentration on long-life, politically safe, U.S. oil and gas reserves. The independent producer that made its fortune in Libyan oil now produces 63% of its oil and gas in the U.S. Two large acquisitions in the 21st century, Elk Hills in California and in the Permian Basin of West Texas, completed the transformation just in time to catch the long-term reversal in oil price trend. The change in strategy has also finally reversed a long period of lagging stockholder returns. Better results and a paling in comparison to examples in other industries have also helped diminish a reputation for overcompensation of management. We see possible appreciation in stock price of some 68% to reach our estimate of net present value. There are industry and company risks that remind us that making money is always a challenge.

Oil Looks Up by the Charts, Fundamentals, Inflation and Security

Six-year futures describe the commodity price trends most relevant to estimating resource value. The longer time horizon better matches the period during which more of current resources will actually be produced. The longer term measure also smoothes the frantic near-month fluctuations and has the potential to keep climbing even if near-month quotes drop back temporarily.

The plots of weekly results since the beginning of 2002 trace a trend of six-year oil price rising 16% a year (see chart). We measure momentum with the 40-week moving average.
The charts look good as long as the current six-year quote remains above the trailing average.

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.



Monetary factors also favor oil investment as interest rates below inflation drive investors to real assets for protection against currency debasement. Compared to Treasury Inflation Protected Securities that we also favor, oil price is likely to rise more than the official government determined inflation measure.

There appears to be little of the cost of maintaining global security reflected in the price of oil. As a result oil from safe areas like the U.S. has greater value than might appear in today's price.

At some point oil price could be too strong and economic activity would be adversely affected. Six times in the past thirty years the annual gain in monthly price exceeded 70% briefly. July futures near $40 a barrel for Light, Sweet Crude Oil would have to exceed $52 a barrel to trigger a 70% warning.

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 a healthy level 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.

For the next twelve months we project constant natural gas and oil volume at the first quarter 2004 level. That is sufficient for our valuation calculation. Management provides rich detail in conference calls, presentations and copious regulatory disclosures to put more color on a projection of growth for the rest of the decade.

We take the futures market at face value in projecting price for the next twelve months. Henry Hub quotes guide our projection of natural gas revenue. Light Sweet Crude quotes guide our projections of oil revenue. 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.

Occidental Petroleum
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)	527	527	527	527	**528**	527	**527**
Overseas (or Int'l)	86	86	86	86	**86**	86	**86**
Total	613	613	613	613	**615**	613	**613**
Oil (mbd)	441	441	441	441	**442**	441	**441**
Total gas & oil (bcf)	297	297	300	300	**1,193**	293	**1,190**
Price							
Natural gas ($/mcf)							
Henry Hub ($/mmbtu)	5.64	6.14	6.52	6.69	**6.25**	6.88	**6.55**
U.S. (or North America)	5.00	5.44	5.78	5.93	**5.54**	6.10	**5.81**
Overseas (or Int'l)	2.07	2.30	2.30	2.30	**2.24**	2.30	**2.30**
Total	4.59	5.00	5.29	5.42	**5.08**	5.56	**5.32**
Oil ($/bbl)							
WTI Cushing	35.23	39.60	40.90	39.00	**38.68**	37.26	**39.19**
Worldwide	31.36	35.25	36.41	34.71	**34.44**	33.17	**34.89**
Total gas & oil ($/mcf)	5.11	5.71	5.92	5.72	**9.27**	5.53	**9.38**
Revenue ($mm)							
Natural Gas							
U.S. (or North America)	240	261	280	287	**1,068**	289	**1,117**
Overseas (or Int'l)	16	18	18	18	**71**	18	**72**
Total	256	279	298	305	**1,139**	307	**1,190**
Oil	1,258	1,415	1,477	1,408	**5,558**	1,316	**5,617**
Other	1,089	1,089	1,089	1,089	**4,355**	1,089	**4,355**
Total	2,603	2,782	2,864	2,802	**11,052**	2,712	**11,161**
Expense							
Fixed	214	214	214	214	**856**	214	**856**
Variable	214	239	251	242	**947**	229	**962**
Other	974	974	974	974	**3,895**	974	**3,895**
Ebitda ($mm)							
Exploration and Production	1,086	1,240	1,310	1,258	**4,894**	1,180	**4,988**
Other	115	115	115	115	**460**	115	**460**
Total Ebitda	1,201	1,355	1,425	1,373	**5,354**	1,295	**5,448**
Exploration	54	54	54	54	**216**	54	**216**
Deprec., Deplet., & Amort.	325	325	325	325	**1,300**	325	**1,300**
Ebit	822	976	1,046	994	**3,838**	916	**3,932**
Interest	71	71	71	71	**284**	71	**284**
Ebt	751	905	975	923	**3,554**	845	**3,648**
Income Tax	263	317	341	323	**1,244**	296	**1,277**
Net Income ($mm)							
Exploration and Production	750						
Other	50						
Unallocated	(312)						
Total	488	588	634	600	**2,310**	549	**2,371**
Shares (millions)	397	397	397	397	**397**	397	**397**
Per share ($)	1.23	1.48	1.60	1.51	**5.82**	1.38	**5.97**
Ebitda Margin (E&P)	72%	73%	74%	73%	**73%**	73%	**73%**
Tax Rate	35%	35%	35%	35%	**35%**	35%	**35%**

Assess Present Value Multiple Depending on Reserve Life

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.

The adjusted reserve life index is the sum of developed and half undeveloped reserves divided by next twelve months production. When we last did an industry-wide upward revaluation on March 23, we estimated cash flow multiple equal to 2.5 plus 0.5 times reserve life. That approximates present value assuming constant commodity price near the one-year quotes at that time, about $35 a barrel for crude oil. Higher commodity prices since then imply higher cash flow and lower multiple by about 10%. Estimated present value provides a measure of appreciation potential should the market move toward that level as we expect.

Management Projects Oil Volume Growth

At 92% of next twelve months cash flow, oil and gas production accounts for most of the value in OXY. The adjusted life index is a long 11.2 years. That implies a cash flow multiple more than seven times in today's parameters for our framework.

Reported undeveloped reserves are 21%, high enough to point to potential and low enough to appear moderately conservative.

Management estimates that its reinvestment of cash flow from production can boost volumes 14% in calendar 2006 from our projection for the next twelve months ended March 31, 2005.

Though perhaps higher risk, international projects in the Middle East and South America promise growth. The latest ironic twist is that Libya appears to be in the process of inviting OXY and other publicly traded producers back to develop more reserves in the African country.

Chemicals Exposure Remains a Moderate Complication

Among its early diversification moves, OXY acquired a major chlorine and caustic soda chemicals producer. Operations include downstream integration to vinyl chloride. Along the way OXY has ended up owning 23% of Lyondell and 12% of Premcor, publicly traded stocks worth about a billion dollars to OXY in the current market. Cautious about the valuation of chemicals, we apply a somewhat lower multiple to overall cash flow than what oil operations might imply.

Bold Action at a Critical Time in Stock Market History

Occidental's acquisition of Cities Service that advanced the company's diversification to U.S. natural gas production also "rescued" Wall Street from "The Edge of Panic" at a critical juncture in August 1982. We had been recommending Cities Service for its Hugoton natural gas and takeover potential. Gulf Oil eventually made a bid for Cities Service. Loaded up on Cities Service stock, Wall Street traders were stunned when Gulf withdrew its offer, or "reneged" as we put it. Rumors were flying that some financial houses would collapse as a result of expected losses and some worried about a crash after a long bear market.

On a Saturday that August we were on a call with the chief executive of Donaldson, Lufkin & Jenrette to the late Dr. Hammer of Occidental to persuade him to have Occidental buy Cities Service. The rest is history. OXY bought Cities Service. Wall Street traders were saved. Dr. Hammer's bold action coincided with the turn in the stock market from a 16-year bear to an 18-year bull.

Kurt H. Wulff, CFA

Research Methodology/Ratings Description: McDep Associates is an independent research originator focused on oil and gas stocks exclusively. The firm applies the thirty 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 is compared with a company's stock market capitalization and debt. Stocks with low market cap and debt relative to present value tend to outperform stocks with high market cap and debt relative to present value. Buy recommendations are expected to deliver a total return better than 7% per year above inflation. Hold recommendations assume the attributes of the underlying business are more than fully reflected in the current price of the stock. Sell recommendations are expected to deliver a negative total return less than 7% per year including the effects of inflation.

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