

Rating: Buy
S&P 500: 1184

Occidental Petroleum Still Cheap

<i>Symbol</i>	OXY	<i>Ebitda Next Twelve Months ending 9/30/05 (US\$mm)</i>	6,400
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	14
<i>Price (US\$/sh)</i>	57.91	<i>Natural Gas and Oil Production/Ebitda (%)</i>	87
<i>Pricing Date</i>	11/12/04	<i>Adjusted Reserves/Production NTM</i>	11.2
<i>Shares (mm)</i>	403	<i>EV/Ebitda</i>	4.6
<i>Market Capitalization (US\$mm)</i>	23,400	<i>PV/Ebitda</i>	5.7
<i>Debt (US\$mm)</i>	6,200	<i>Undeveloped Reserves (%)</i>	21
<i>Enterprise Value (EV) (US\$mm)</i>	29,500	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	28.60
<i>Present Value (PV) (US\$mm)</i>	36,400	<i>Present Value Proven Reserves(US\$/boe)</i>	12.90
<i>Net Present Value (US\$/share)</i>	75	<i>Present Value Proven Reserves(US\$/mcf)</i>	2.15
<i>Debt/Present Value</i>	0.17	<i>Earnings Next Twelve Months (US\$/sh)</i>	7.67
<i>McDep Ratio - EV/PV</i>	0.81	<i>Price/Earnings Next Twelve Months</i>	8
<i>Dividend Yield (%/year)</i>	1.9	<i>Indicated Annual Dividend (US\$/sh)</i>	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 continue a Buy rating on the common shares of **Occidental Petroleum (OXY)** for natural resource value concentrated primarily on long-life, politically safe, U.S. oil and gas reserves. Though the stock price is up in the past six months, so is estimated cash flow. As a result, cash flow multiple, EV/Ebitda, is still at the same low level of six months ago. That means to us that the stock continues to have appreciation potential to our estimated net present value of \$75 a share. In our opinion, the estimate can be justified by a constant real crude oil price of \$35 a barrel. Moreover, our estimate could be low as recent average futures price for the next six years is \$41 a barrel.

Politically Safe Oil and Gas

Most of the company's value, to no surprise, is in oil production (see table [Functional Cash Flow and Present Value](#)). Of the latest quarter's oil production, 58% is from the U.S. Natural gas is concentrated in North America, but growing overseas.

Overseas the company operates in Ecuador, Colombia, Yemen and a handful of other countries. There is currently a dispute with the Ecuadorean government that should be resolvable. If not, the negative impact ought to be limited as the company does not depend unduly on profits from a single overseas country.

Downstream is a holdover from the company's diversification into chemicals. We are puzzled as to why Oxy has not divested those businesses by now. One reason could be that even the "politically safe" U.S. has its risks. Old chemicals businesses may have environmental exposure.

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Occidental Petroleum Corporation
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	924	9.7	5.3	4,900
Overseas Natural Gas	94	8.2	5.0	500
Oil	4,609	11.7	5.9	27,000
Downstream	806		5.0	4,000
	6,433	11.2	5.7	36,400
Debt (US\$mm)				6,200
Net Present Value (US\$mm)				30,200
Shares (mm)				403
Net Present Value (US\$/sh)				75

More Gains Appear to Lie Ahead

Commodity price drives further gains in cash flow in our model (see table Next Twelve Months Operating and Financial Estimates). The high rate of cash flow implies a low multiple of Enterprise Value to Ebitda of 4.6 times. Reserve life of 11.2 years on our adjusted basis is longer than for peer companies.

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. Recent softening of oil price 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).

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.

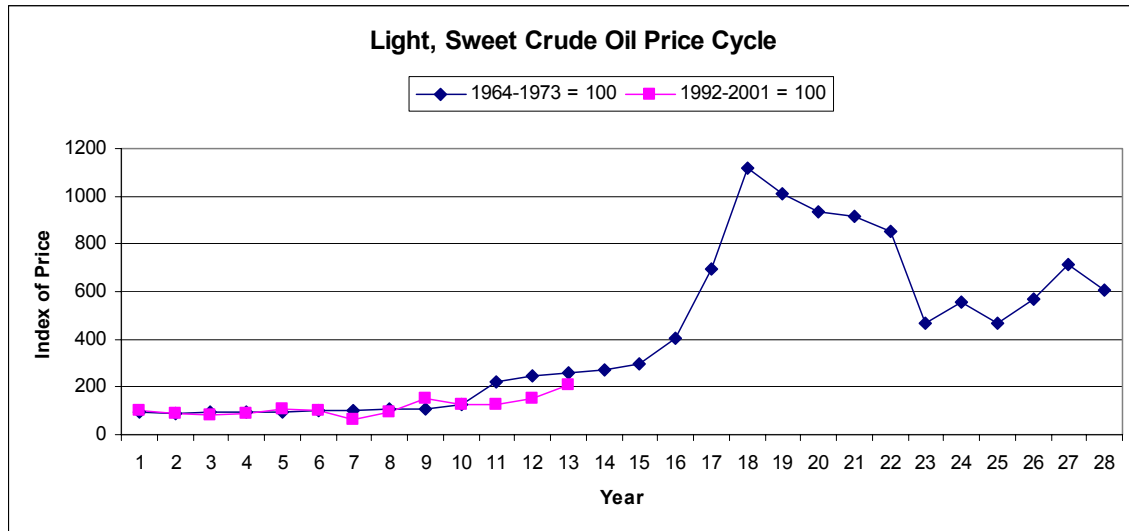
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Occidental Petroleum
Next Twelve Months Operating and Financial Estimates

	<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>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>9/30/05</i>
Volume									
Natural Gas (mmcf)									
U.S. (or North America)	527	513	488	488	505	488	488	488	488
Overseas (or Int'l)	86	129	161	161	135	161	161	161	161
Total	613	642	649	649	640	649	649	649	649
Oil (mmb)	40	40	40	40	159	39	39	40	157
Oil (mbd)	441	440	431	431	437	431	431	431	431
Total gas & oil (mmb)	49	50	50	50	198	49	49	50	197
Total gas & oil (mbd)	543	547	539	539	542	539	539	539	539
Price									
Natural gas (\$/mcf)									
Henry Hub (\$/mmbtu)	5.64	6.10	5.49	6.61	5.96	7.90	6.72	6.73	6.99
U.S. (or North America)	5.00	4.90	5.87	7.07	5.69	8.44	7.19	7.19	7.47
Overseas (or Int'l)	2.07	1.82	1.57	2.30	1.93	2.30	2.30	2.30	2.30
Total	4.59	4.28	4.80	5.88	4.90	6.92	5.97	5.98	6.18
Oil (\$/bbl)									
WTI Cushing	35.23	38.34	43.89	49.89	41.84	47.54	46.60	45.42	47.36
Worldwide	31.36	34.25	38.85	44.16	37.13	42.08	41.25	40.21	41.93
Total gas & oil (\$/bbl)	30.64	32.58	36.84	42.38	35.61	41.97	40.17	39.33	40.96
Revenue (\$mm)									
Natural Gas									
U.S. (or North America)	240	229	264	317	1,049	371	319	323	1,330
Overseas (or Int'l)	16	21	23	34	95	33	34	34	135
Total	256	250	287	351	1,144	404	353	357	1,465
Oil	1,258	1,372	1,541	1,751	5,922	1,632	1,618	1,594	6,596
Other	1,089	1,147	1,205	1,205	4,647	1,205	1,205	1,205	4,822
Total	2,603	2,769	3,033	3,308	11,713	3,242	3,176	3,157	12,883
Expense									
Fixed	214	224	289	289	1,017	289	289	289	1,157
Variable	214	224	289	333	1,060	322	312	309	1,276
Other	974	997	1,004	1,004	3,979	1,004	1,004	1,004	4,016
Ebitda (\$mm)									
Exploration and Production	1,086	1,173	1,249	1,480	4,988	1,425	1,369	1,353	5,627
Other	115	150	201	201	668	201	201	201	806
Total Ebitda	1,201	1,323	1,450	1,682	5,656	1,626	1,571	1,554	6,433
Exploration	54	40	37	37	168	37	37	37	148
Deprec., Deplet., & Amort.	325	325	322	322	1,294	322	322	322	1,288
Ebit	822	958	1,091	1,323	4,194	1,267	1,212	1,195	4,997
Interest	71	62	59	59	251	59	59	59	236
Ebt	751	896	1,032	1,264	3,943	1,208	1,153	1,136	4,761
Income Tax	263	314	274	442	1,293	423	403	398	1,666
Net Income (\$mm)									
Exploration and Production	750	814	1,003						
Other	50	85	137						
Unallocated	(312)	(316)	(382)						
Total	488	583	758	821	2,650	785	749	739	3,094
Shares (millions)	397	399	403	403	401	403	403	403	403
Per share (\$)	1.23	1.46	1.88	2.04	6.61	1.95	1.86	1.83	7.67
Ebitda Margin (E&P)	72%	72%	68%	70%	71%	70%	69%	69%	70%
Tax Rate	35%	35%	27%	35%	33%	35%	35%	35%	35%

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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 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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