

Rating: Buy
 S&P 500: 1182

Occidental Petroleum Buy Despite Momentum Signal

<i>Symbol</i>	OXY	<i>Ebitda Next Twelve Months ending 9/30/06 (US\$m)</i>	9,500
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	18
<i>Price (US\$/sh)</i>	72.93	<i>Natural Gas and Oil Production/Ebitda (%)</i>	89
<i>Pricing Date</i>	10/14/05	<i>Adjusted Reserves/Production NTM</i>	11.3
<i>Shares (mm)</i>	406	<i>EV/Ebitda</i>	3.8
<i>Market Capitalization (US\$m)</i>	29,600	<i>PV/Ebitda</i>	5.8
<i>Debt (US\$m)</i>	6,200	<i>Undeveloped Reserves (%)</i>	22
<i>Enterprise Value (EV) (US\$m)</i>	35,800	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	42.70
<i>Present Value (PV) (US\$m)</i>	54,900	<i>Present Value Proven Reserves(US\$/boe)</i>	19.40
<i>Net Present Value (US\$/share)</i>	120	<i>Present Value Proven Reserves(US\$/mcf)</i>	3.23
<i>Debt/Present Value</i>	0.11	<i>Earnings Next Twelve Months (US\$/sh)</i>	11.87
<i>McDep Ratio - EV/PV</i>	0.65	<i>Price/Earnings Next Twelve Months</i>	6
<i>Dividend Yield (%/year)</i>	2.0	<i>Indicated Annual Dividend (US\$/sh)</i>	1.44

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 our Buy recommendation for the common shares of **Occidental Petroleum (OXY)** despite a stock price that has dropped slightly below its 200-day average. The fundamental outlook for the stock remains positive and the just-announced acquisition of Vintage Petroleum (VPI) appears to be a sensible deal. Though experience tells us that stocks can act entirely different than the business outlook might suggest we are impressed with Oxy's low McDep Ratio and continuing positive stock price trends for peer companies. We believe 65% appreciation potential to our estimate of present value of \$120 a share remains justifiable. The risk is mainly that of an unpredictable stock market in a particularly unpredictable month of the year.

Fundamental Valuation Appealing

Oxy has a low McDep Ratio by itself and relative to peers (see table at right). The numerator depends on current stock price. The denominator depends on an oil price assumption that is less than futures quotes. Multiplying McDep Ratio times assumed oil price suggests that Oxy's stock price corresponds to oil at less than \$33 a barrel.

Oil and Gas Commodity and Stock Price

		<i>Futures Price</i>		<i>McDep Ratio</i>
	<i>Units</i>	<i>Six-Year</i>	<i>One-Year</i>	<i>Denominator</i>
Crude Oil	\$/barrel	60	62	50
Natural Gas	\$/million btu	9	12	10
				<i>Median</i>
	<i>Stocks</i>			<i>McDep Ratio</i>
	Independent - Large			0.78
	Occidental Petroleum			0.65

Source: McDep Associates, Bloomberg, New York Mercantile Exchange, Yahoo and company disclosures

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Value Concentrated 73% on Oil Resources

Oxy's value depends more on oil price than on natural gas price or downstream (see table Functional Cash Flow and Present Value). Oil price has been steady in recent weeks while natural gas price has responded to hurricane interruptions. Oxy's downstream is mainly chemical whose profit depends on the margin between rising energy and feedstock costs and intermediate product prices.

We add a line to the table that indicates that our estimate of Oxy's present value may be low compared to current correlations with estimated Next Twelve Months Cash Flow (NTM Ebitda) and reserve life (Adjusted R/P). Some cushion might be justified as the correlation may reflect the value of oil production overseas less accurately than for production in the U.S. Production sharing contracts common overseas have no price upside on that portion of production set aside to repay investment.

Occidental Petroleum Corporation
Functional Cash Flow and Present Value

	<i>NTM Ebitda</i> <i>(US\$mm)</i>	<i>Adjusted</i> <i>R/P</i>	<i>PV/</i> <i>Ebitda</i>	<i>Present</i> <i>Value</i> <i>(US\$mm)</i>	
North American Natural Gas	1,726	9.4	4.7	8,100	15%
Rest of World Natural Gas	63	11.0	8.0	500	1%
Oil	6,683	11.8	6.0	40,100	73%
Downstream	1,000		6.2	6,200	11%
	9,471	11.3	5.8	54,900	100%
Debt (US\$mm)				6,200	
Net Present Value (US\$mm)				48,700	
Shares (mm)				406	
Net Present Value (US\$/sh)				120	
Over (-)/ Under (+) Correlation (US\$/sh)				11	

Cash Flow Strong and Rising

It is not necessary for cash flow to be higher because current stock price does not seem to give credibility to recently reported cash flow. Yet, indications are that cash flow for the quarter just ended was higher than the previous quarter and there may be further gains ahead (see line with a box around the number in the far right column on table Next Twelve Months Operating and Financial Estimates).

Acquisition of Vintage Petroleum Makes Sense

The proposed acquisition for about \$3.8 billion in cash and stock is about 11% of Oxy's Enterprise Value. Though Vintage Petroleum has a long-term successful record as an investment, the stock usually seemed to have been priced at a steep discount to the apparent value of its resources. That conclusion seemed valid even after recognizing that all barrels are not the same and some have less value than others. Much of Vintage's oil production is heavy and much is in Argentina where price controls have interfered with economic development.

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For one reason or another Vintage had difficulty gaining credibility with investors. The company founder, claiming to have been duped, was part of a share scheme labeled as fraudulent by the Securities and Exchange Commission as reported in Platts Oilgram. The chief executive officer was replaced after reserve writedowns in 2004.

Presumably Oxy is satisfied that none of the credibility issues would carry over to a new owner. As a result Oxy could offer a premium to Vintage's stock price and still buy resources attractively. The Vintage deal has not yet been included in our valuation tables.

Stock Price Tests Moving Average

On trading after the deal was announced and in a temporarily declining trend for energy stocks, Oxy's stock price dropped below its 200 day moving average of \$73.50. That could be a sign that upward price momentum is stalling. Prices for peer stocks, mostly concentrated more on natural gas, remain well above the 200 day average. Though the asset mix is different, Oxy's McDep Ratio is lower than the median of its peers (see table Rank by McDep Ratio). A competitive McDep Ratio among peers with strong stock price trends encourages us to continue a buy recommendation for Oxy despite the momentum flag.

Oil and Gas Producers Rank by McDep Ratio: Market Cap and Debt to Present Value

	<i>Symbol/</i>	<i>Rating</i>	<i>Price</i> <i>(\$/sh)</i>	<i>Shares</i>	<i>Market</i>	<i>Net</i>	<i>Debt/</i>	<i>McDep</i>
			<i>14-Oct</i>	<i>(mm)</i>	<i>Cap</i>	<i>Present</i>	<i>Present</i>	<i>Ratio</i>
			<i>2005</i>		<i>(\$mm)</i>	<i>Value</i>	<i>Value</i>	
Independent Natural Gas and Oil - Large Cap and Mid Cap								
Encana Corporation	ECA	B	47.35	892	42,200	51.00	0.16	0.94
XTO Energy Inc.	XTO	B	40.22	367	14,760	48.00	0.17	0.87
Burlington Resources	BR	B	68.88	385	26,500	86.00	0.09	0.82
CNOOC Limited (29%)	CEO	B	62.81	119	7,490	84.00	0.01	0.75
Devon Energy Corporation	DVN	B	60.85	471	28,700	86.00	0.15	0.75
Anadarko Petroleum Corp.	APC	B	88.39	238	21,000	140.00	0.11	0.67
Occidental Petroleum Corp.	OXY	B	72.93	406	29,600	120.00	0.11	0.65
	<i>Total or Median</i>					<i>485,000</i>	<i>0.11</i>	<i>0.78</i>

Kurt H. Wulff, CFA

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Occidental Petroleum
 Next Twelve Months Operating and Financial Estimates

	<i>Q4</i>	<i>Year</i>	<i>Q1</i>	<i>Q2</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Next</i>
	<i>12/31/04</i>	<i>2004</i>	<i>3/31/05</i>	<i>6/30/05</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>2005E</i>	<i>3/31/06</i>	<i>6/30/06</i>	<i>9/30/06</i>	<i>Twelve</i>
											<i>Months</i>
											<i>9/30/06</i>
Volume											
Natural Gas (mmcf)											
U.S. (or North America)	499	508	528	548	548	548	543	548	548	548	548
Overseas (or Int'l)	145	131	134	133	133	133	133	133	133	133	133
Total	644	639	662	681	681	681	676	681	681	681	681
Oil (mbd)	427	436	427	416	430	430	426	430	430	430	430
Total gas & oil (mmb)	49	198	48	48	50	50	197	49	49	50	198
Total gas & oil (mbd)	534	541	537	530	544	544	538	544	544	544	544
Price											
Natural gas (\$/mcf)											
Henry Hub (\$/mmbtu)	7.10	6.15	6.27	6.76	8.56	13.69	8.82	14.18	10.50	10.39	12.19
U.S. (or North America)	5.65	5.35	5.94	6.18	7.83	12.52	8.16	12.97	9.60	9.50	11.14
Overseas (or Int'l)	1.53	1.70	1.69	1.67	1.67	1.67	1.68	1.67	1.67	1.67	1.67
Total	4.72	4.60	5.08	5.30	6.63	10.40	6.88	10.76	8.05	7.97	9.29
Oil (\$/bbl)											
WTI Cushing	48.31	41.44	49.65	53.05	62.52	62.43	56.91	63.16	63.67	63.68	63.24
Worldwide	39.11	35.87	41.71	46.32	54.58	54.51	49.37	55.14	55.59	55.59	55.21
Total gas & oil (\$/bbl)	36.95	34.25	39.40	43.21	51.49	56.16	47.67	57.11	54.07	53.98	55.32
Revenue (\$mm)											
Natural Gas											
U.S. (or North America)	259	991	282	308	395	631	1,617	640	479	479	2,229
Overseas (or Int'l)	20	81	20	20	20	20	82	20	20	20	81
Total	280	1,073	303	328	415	652	1,698	660	499	500	2,310
Oil	1,536	5,707	1,603	1,753	2,159	2,156	7,672	2,134	2,175	2,199	8,665
Other	1,266	4,707	1,434	1,436	1,436	1,436	5,743	1,436	1,436	1,436	5,744
Total	3,082	11,487	3,340	3,518	4,011	4,244	15,113	4,230	4,110	4,135	16,719
Expense (\$mm)											
Fixed	174	901	211	270	270	270	1,021	270	270	270	1,080
Variable	174	901	211	270	334	364	1,179	362	347	350	1,424
Other	1,069	4,044	1,152	1,140	1,186	1,186	4,664	1,186	1,186	1,186	4,744
Ebitda (\$mm)											
Exploration and Production	1,469	4,977	1,483	1,542	1,971	2,174	7,170	2,161	2,057	2,079	8,471
Other	197	663	283	296	250	250	1,079	250	250	250	1,000
Total Ebitda	1,665	5,640	1,766	1,838	2,221	2,424	8,249	2,411	2,307	2,329	9,471
Exploration	88	219	47	111	111	111	380	111	111	111	444
Deprec., Deplet., & Amort.	333	1,305	344	356	356	356	1,412	356	356	356	1,424
Other non cash											
Ebit	1,244	4,116	1,375	1,371	1,754	1,957	6,457	1,944	1,840	1,862	7,603
Interest	63	255	75	47	47	47	216	47	47	47	188
Ebt	1,181	3,861	1,300	1,324	1,707	1,910	6,241	1,897	1,793	1,815	7,415
Income Tax	413	1,264	455	463	597	668	2,184	664	628	635	2,595
Net Income (\$mm)											
Exploration and Production	977	3,544	1,349	1,351							
Other	130	402	214	225							
Unallocated	(339)	(1,349)	(718)	(715)							
Total	768	2,597	845	861	1,109	1,241	4,057	1,233	1,166	1,180	4,820
Shares (millions)	406	402	406	406	406	406	406	406	406	406	406
Per share (\$)	1.89	6.46	2.08	2.12	2.73	3.06	9.99	3.04	2.87	2.91	11.87
Ebitda Margin (E&P)	81%	73%	78%	74%	77%	77%	77%	77%	77%	77%	77%
Tax Rate	35%	33%	35%	35%	35%	35%	35%	35%	35%	35%	35%

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