McDep Associates
Stock Idea
April 3, 2002

Buy/Sell Rating: 2 – Buy
S&P 500: 1129

ChevronTexaco Corporation
Initiate Buy Recommendation

Symbol	*Price ($/sh) 3-Apr 2002*	*Shares (mm)*	*Market Cap ($mm)*	*Net Present Value ($/sh)*	*Debt/ Present Value*	*McDep Ratio*	*EV/ Sales NTM*	*EV/ Ebitda NTM*	*P/E NTM*	*Div'd NTM (%)*	*PV/ Ebitda NTM*
CVX	89.60	1,062	95,200	110	0.16	0.84	1.3	7.3	17.2	3.1	8.7

McDep Ratio = **M**arket **c**ap and **De**bt to **p**resent value of oil and gas and other businesses
EV = Enterprise Value = Market Cap and Debt: US$mm 117,100
Ebitda = Earnings before interest, tax, depreciation and amortization: US$mm 16,000
NTM = Next Twelve Months Ended March 31, 2003; P/E = Stock Price to Earnings
PV = Present Value of energy businesses: US$mm 138,700

Summary and Recommendation

We recommend current purchase of the common stock of ChevronTexaco for inflation protection in diversified portfolios offering the liquidity of mega capitalization for mega investors and a conservative anchor for investors who can concentrate more on our large, mid and small cap recommendations. At the same time events in the Middle East appear to be raising the risk of an earlier shift upward in the long-term price of crude oil, an important determinant of the bulk of future cash flow for CVX. Like other Mega Caps, CVX offers volume growth in production primarily from new projects in deep water offshore and in less developed countries. The stock has a low McDep Ratio among Mega Cap Energy peers and has a low ratio of debt. While energy stocks have already advanced some recently, there remains further potential and momentum is upward. Energy stocks are subject to political, economic, financial and business risk.

Take Out Some Inflation Insurance

The most fundamental market development in recent weeks in our mind is the increase in inflation expectations telegraphed by the difference in yield between U.S. Treasury Notes and U.S. Treasury Inflation Indexed Securities. For the optimists we can say that inflation expectations are still low at 2.1% per year for the next ten years. For the pragmatic, we can say that the level is up from under 1.5% only a few weeks ago. That is a sharp change in a short period of time. Even 2% per year can be insidious and maybe it is headed for 3% per year. Meanwhile we suspect that most investors are complacent about inflation and have very little protection from any surprise. Buying a little CVX stock is a sound step that could be suitable for a wide range of investors to reduce their portfolio risk and enhance long-term risk-adjusted return.

Take Out a Little War Insurance

Another surprise in recent weeks is the intensity of conflict in Israel. Such conflagrations have been associated in the past with dramatic oil price developments. We wonder if this time the world loses patience with the rationalizations of the past and there is a new determination to take police action to a more complete resolution. Sure there are protests as most of us do not want war. Yet sometimes war is necessary and appeasement has to end. The cost can be great, but the ultimate outcome may justify the cost. One need only view the changed skyline of lower Manhattan to be reminded of the need to deal decisively with those who incite suicide missions. This is not intended to be a political statement, only an acknowledgment that the balance of opinion may have shifted.

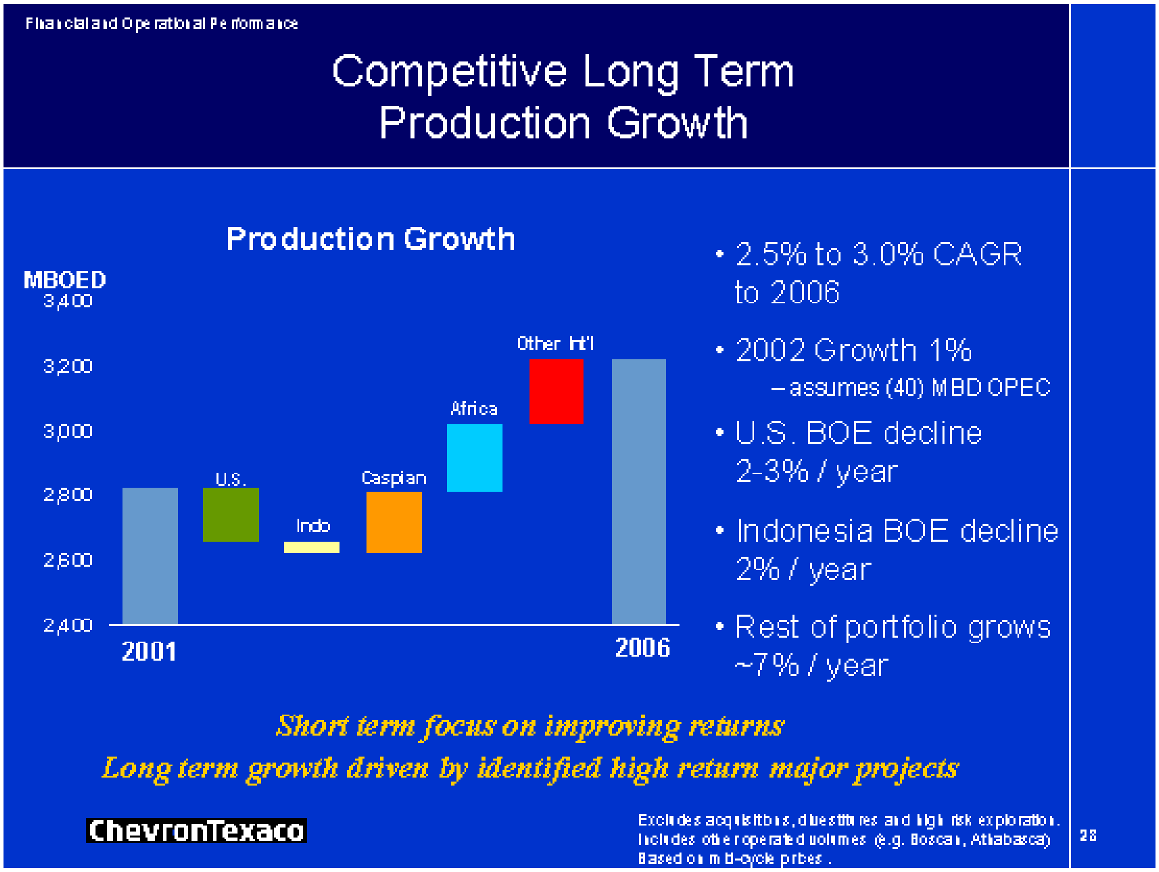
We don't feel comfortable about using the threat of war as a reason to buy a stock. Yet analyzing oil stocks is our job. As a result we point out that buying CVX is also the equivalent of taking out some war insurance for a diversified investment portfolio.

Might oil actually go the other way? The downward slope of the futures curve for oil in the first few months is somewhat steeper than normal. That implies some risk of a decline in near term price. In our opinion, the oil price would have to be quite a bit higher and peace closer at hand in the Middle East before we would be especially concerned about the risk of oil price decline.

CVX is More Than Inflation and War Insurance

Unlike an insurance premium that we hope will be worthless in reality, ChevronTexaco stock has promising potential under normal economic growth. If price gains are only moderate, volume becomes more important in determining the trend of profits. At its analyst meeting last fall management projected that growth in oil and gas volumes in the Caspian, Africa and other international areas would more than offset moderate declines in the U.S. and Indonesia (see Chart on next page).

Over the next twelve months we see CVX generating perhaps 60% of its cash flow from oil production, about 20% from natural gas and some 20% from refining/marketing and chemicals (see Table on last page). Formed only last October, CVX's first complete quarter of operation as the combination of Chevron and Texaco ended only a few days ago. Historical financial results are complicated to interpret because of the merger. At the same time financial projections are a moving target because pricing relationships are changing rapidly. Expectations for the next twelve months operating and financial potential are now quite strong compared to recent projections.



Trying to keep things simple for what could be a complex analysis, we hold many parameters constant for the next twelve months. The differences quarter to quarter are mostly related to commodity price for natural gas, oil and refined products that we take from market quotes. As a result natural gas profits depend on natural gas price and oil profits on recent oil price quotes. The New York Mercantile Exchange also provides a platform for trading refined product futures. We use those prices to calculate the margin from the hypothetical refining of three barrels of Light Sweet Crude into two barrels of Unleaded Gasoline and one barrel of Heating Oil. We relate our projection of profits in downstream businesses to the resulting NY Harbor 3-2-1 spread.

Value Energy Stocks on Cash Flow

Cash flow estimates for the next twelve months form the base to which we apply a multiple to estimate present value of all future cash flow (see right hand column in mast head on first page). At the same time we can measure the multiple that the market applies (see fourth column from right headed EV/Ebitda).

Typically for oil and gas producers, reserve life, an index of how long cash flow from existing resources may last, is a differentiating factor. CVX has an adjusted reserve life index of 9.9 years that falls within a tight range for Mega Cap Energy stocks.

Growth in cash flow beyond the base is theoretically the most important differentiating factor, but it is difficult to know. Six-year futures for North American natural gas are higher than one-year futures. That would justify a higher multiple than for oil where the reverse is true. CVX and BP have the most concentration on the clean fuel in North America, but it still may be only ten percent of total value in each case.

Finding cost is a useful technique for differentiating past performance. Indeed there may be a correlation of stock price with finding cost for oil and gas producers. The problem is that finding costs can only be known in hindsight. A further problem with finding costs is that not all barrels are the same.

Another popular technique is return on capital employed. That measure has the same problems as finding cost, i.e. it may have no predictive value. Moreover, accounting results depend heavily on costs that may be understated because they were incurred long ago and because investments are depleted far more rapidly than value is used up.

Lastly there is the question of other businesses like refining/marketing, chemicals and power. One thing we can say, cash is cash. Cash generation has value in and of itself. Cash generation helps us estimate present value that becomes the denominator of the McDep Ratio.

Merger Savings Estimated at $1.8 Billion Annually

Contemplated gains from combining two large companies amounts to some 11% of Ebitda at the cash-generating rate projected for the next twelve months. How much of those savings are already incorporated in stock price is hard to say. What we do know is that we have not introduced any cost savings for CVX relative to peers in our projections.

CVX Stock Lags Peers in 2002

Around late January when earnings were reported CVX stock dropped relative to peers and has not made up that difference. CVX reported a large loss for the fourth quarter as it wrote down the value of some acquired properties. Apparently the Midway Sunset oil properties that were written up when Texaco acquired Monterrey, the spin-off from Santa Fe, were written down after Chevron acquired Texaco. Write-offs are common at year-end and with new acquisitions, but have no implications for value in our framework.

Kurt H. Wulff, CFA

ChevronTexaco
Next Twelve Months Operating and Financial Estimates

	Q1E 3/31/02	*Q2E 6/30/02*	*Q3E 9/30/02*	*Q4E 12/31/02*	***Year 2002E***	*Q1E 3/31/03*	***Next Twelve** Months 3/31/03*
Volume							
Natural Gas (mmcfd)							
U.S. (or North America)	2,530	2,530	2,530	2,530	**2,530**	2,530	**2,530**
Overseas (or Int'l)	1,841	1,841	1,841	1,841	**1,841**	1,841	**1,841**
Total	4,371	4,371	4,371	4,371	**4,371**	4,371	**4,371**
Oil (mmb)	181	183	185	185	**735**	181	**735**
Oil (mbd)	2,014	2,014	2,014	2,014	**2,014**	2,014	**2,014**
Total gas & oil (mmb)	247	250	252	252	**1,001**	247	**1,001**
Price							
Natural gas ($/mcf)							
Henry Hub ($/mmbtu)	2.54	3.26	3.32	3.63	**3.19**	3.87	**3.52**
U.S. (or North America)	2.54	3.26	3.32	3.63	**3.19**	3.87	**3.52**
Overseas (or Int'l)	2.16	2.59	2.57	2.52	**2.46**	2.46	**2.53**
Total	2.38	2.97	3.00	3.16	**2.88**	3.28	**3.10**
Oil ($/bbl)							
WTI Cushing	21.62	25.88	25.72	25.20	**24.60**	24.59	**25.35**
Worldwide	18.26	21.86	21.73	21.28	**20.79**	20.77	**21.41**
Total gas & oil ($/bbl)	17.20	20.79	20.74	20.67	**19.86**	20.47	**20.67**
NY Harbor 3-2-1 ($/bbl)	3.63	5.80	5.70	4.40	**4.88**	4.73	**5.16**
Revenue ($mm)							
Natural Gas							
U.S. (or North America)	578	750	773	845	**2,945**	881	**3,249**
Overseas (or Int'l)	358	434	436	427	**1,654**	407	**1,703**
Total	936	1,183	1,208	1,272	**4,599**	1,289	**4,952**
Oil	3,310	4,006	4,026	3,943	**15,284**	3,764	**15,738**
Other	17,364	17,364	17,364	17,364	**69,457**	17,364	**69,457**
Total	21,610	22,553	22,598	22,579	**89,340**	22,417	**90,147**
Expense							
Production	1,709	1,898	1,907	1,903	**7,417**	1,871	**7,579**
Other	16,764	16,586	16,592	16,680	**66,622**	16,726	**66,584**
Ebitda ($mm)							
Exploration and Production	2,537	3,291	3,327	3,312	**12,466**	3,182	**13,112**
Other	600	779	772	684	**2,834**	639	**2,873**
Total Ebitda	3,137	4,070	4,099	3,996	**15,301**	3,821	**15,985**
Exploration	300	300	300	300	**1,200**	300	**1,200**
Deprec., Deplet., & Amort.	1,400	1,400	1,400	1,400	**5,600**	1,400	**5,600**
Other non cash							
Ebit	1,437	2,370	2,399	2,296	**8,501**	2,121	**9,185**
Interest	171	171	171	171	**684**	171	**684**
Ebt	1,266	2,199	2,228	2,125	**7,817**	1,950	**8,501**
Income Tax	443	770	780	744	**2,736**	682	**2,975**
Net Income ($mm)							
Total	823	1,429	1,448	1,381	**5,081**	1,267	**5,526**
Shares (millions)	1,062	1,062	1,062	1,062	**1,062**	1,062	**1,062**
Per share ($)	0.77	1.35	1.36	1.30	**4.78**	1.19	**5.20**

