

Rating: Buy
S&P 500: 1284

Chevron Corporation **High Earnings, Low Stock Price**

<i>Symbol</i>	CVX	<i>Ebitda Next Twelve Months ending 12/31/06 (US\$m)</i>	39,582
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	7
<i>Price (\$/sh)</i>	60.38	<i>Natural Gas and Oil Production/Ebitda (%)</i>	76
<i>Pricing Date</i>	1/27/06	<i>Adjusted Reserves/Production NTM</i>	9.7
<i>Shares (mm)</i>	2236	<i>EV/Ebitda</i>	4.0
<i>Market Capitalization (\$mm)</i>	135,000	<i>PV/Ebitda</i>	5.4
<i>Debt (\$mm)</i>	24,000	<i>Undeveloped Reserves (%)</i>	29
<i>Enterprise Value (EV) (\$mm)</i>	159,000	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	29.90
<i>Present Value (PV) (\$mm)</i>	214,000	<i>Present Value Proven Reserves(\$/boe)</i>	14.20
<i>Net Present Value (\$/share)</i>	85	<i>Present Value Proven Reserves(\$/mcf)</i>	2.40
<i>Debt/Present Value</i>	0.11	<i>Earnings Next Twelve Months (US\$/sh)</i>	9.01
<i>McDep Ratio - EV/PV</i>	0.74	<i>Price/Earnings Next Twelve Months</i>	7
<i>Dividend Yield (%/year)</i>	3.0	<i>Indicated Annual Dividend (US\$/sh)</i>	1.80

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.

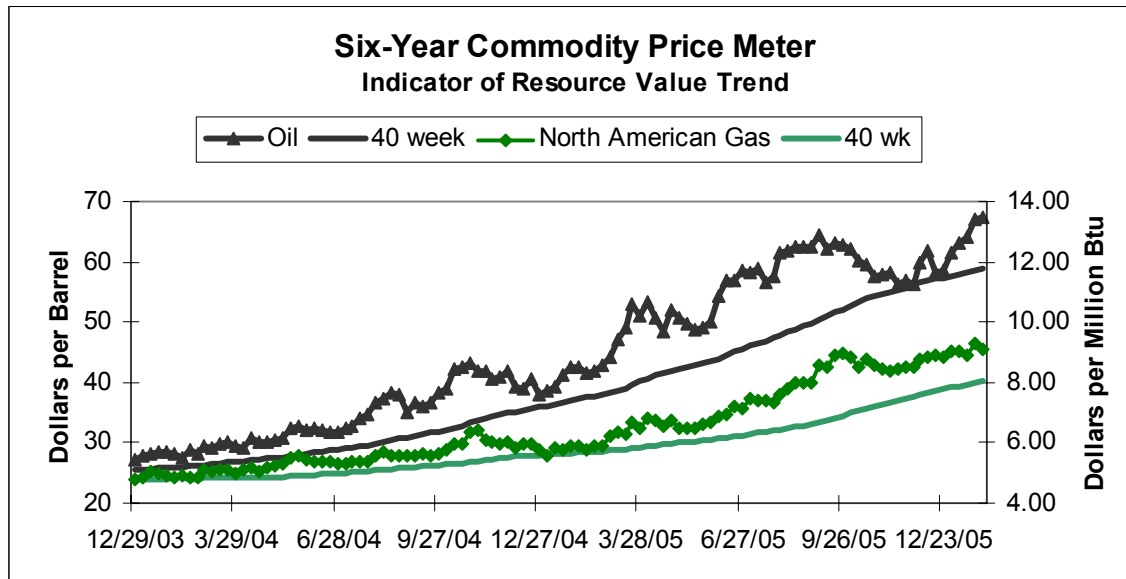
Summary and Recommendation

Fourth quarter earnings reported on January 27 reflected improving global industry conditions while stock price for buy-recommended **Chevron Corporation (CVX)** may correspond to a long-term oil price of perhaps just \$37 a barrel. The stock offers 41% appreciation potential to estimated net present value of \$85 a share that presumes a long-term oil price of \$50 a barrel. Futures investors price Light, Sweet Crude Oil at \$67 a barrel for the next six years. Among mega cap peers CVX matches the lowest unlevered multiple of cash flow at 4.0 times. Adjusted reserve life at 9.7 years exceeds the median suggesting that cash flow multiple, hence stock price, should be higher. The mega cap retains the highest concentration on oil among peers moderated by the acquisition of Unocal last year. Often dismissed as “always a cheap stock” Chevron has delivered surprisingly good long term performance and ought to continue to do so.

McDep Ratio Relates Oil Price to Opportunity

A McDep Ratio below 1.0 tells us that CVX’s market cap and debt, or enterprise value, is less than the estimated present value of its energy resources. The estimate has been increasing with six-year oil futures. Futures price momentum has been positive for more than three years as the current quote stays above the 40-week average (see chart [Six-Year Commodity Price Meter](#)). Six-year oil has tripled in the four years we have been calculating it on a weekly basis. We do not need further gains in oil price to make money in buy recommendations. Yet our vision of \$150 oil in 2010 implies additional scope to exceed common expectations. Meanwhile the McDep Ratio for CVX appears lowest among peers (see table [Rank by McDep Ratio](#)).

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

	Symbol/ Rating	Price (\$/sh) 27-Jan 2006	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
Mega Cap							
BP plc	BP B	71.01	3,501	249,000	77.00	0.11	0.93
Total S.A.	TOT B	137.10	1,176	161,000	160.00	0.12	0.87
Exxon Mobil Corporation	XOM B	61.29	6,303	386,000	74.00	0.04	0.84
Royal Dutch Shell plc	RDS-A B	66.52	3,352	223,000	84.00	0.10	0.81
ConocoPhillips	COP B	65.08	1,693	110,000	95.00	0.22	0.76
Chevron Corporation	CVX B	60.38	2,236	135,000	85.00	0.11	0.74
	<i>Total or Median</i>			<i>1,264,000</i>		<i>0.11</i>	<i>0.82</i>

Low Cash Flow Multiple

Unlevered cash flow multiples in single digits attest to low valuation (see table [Rank by EV/Ebitda](#)). Cash flow estimated for the next twelve months, Ebitda NTM, reflects latest futures prices. Reserve life is measured as adjusted reserves divided by next twelve months production. CVX's adjusted reserve life index of 9.7 years exceeds slightly the median of peers. While long-life ought to be worth a higher cash flow multiple, CVX's unlevered multiple, EV/Ebitda, matches the lowest of peers.

Traditionally Concentrated on Oil

Each oil and gas stock has its own unique mix of energy resources (see table [Business Segments](#)). CVX's concentration on oil remains the highest among peers despite the addition of natural gas concentration with the acquisition of Unocal. With the world moving from the oil economy to the natural gas economy, CVX may want more exposure to the clean fuel.

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Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.

	Symbol/ Rating		Price (\$/sh) 27-Jan 2006	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
Mega Cap								
BP plc	BP	B	71.01	9.5	6.0	5.6	9	3.0
Exxon Mobil Corporation	XOM	B	61.29	11.7	6.6	5.5	10	2.1
Total S.A.	TOT	B	137.10	9.2	5.9	5.1	9	2.7
Royal Dutch Shell plc	RDS-A	B	66.52	7.5	5.4	4.4	8	3.4
ConocoPhillips	COP	B	65.08	10.9	5.4	4.0	6	1.9
Chevron Corporation	CVX	B	60.38	9.7	5.4	4.0	7	3.0
	<i>Median</i>			9.6	5.6	4.8	8	2.8

Home Country and Business Segments

	Symbol/ Rating		Non- U.S. Domicile	North Amer. Natural Gas (%)	Rest of World Natural Gas (%)	Oil Prod'n (%)	Down- stream (%)	Total Present Value (US\$mm)
Mega Cap								
Exxon Mobil Corporation	XOM	B		10	19	38	33	487,000
Royal Dutch Shell plc	RDS-A	B	UK	4	19	33	45	313,000
BP plc	BP	B	UK	10	12	42	36	302,000
Total S.A.	TOT	B	France	-	27	38	35	215,000
Chevron Corporation	CVX	B		9	9	51	30	214,000
ConocoPhillips	COP	B		23	7	43	28	207,000
	<i>Total or Median</i>			9	15	40	34	1,738,000

Correlation Verifies Present Value in Real Time

Our underlying quantitative method for estimating present value projects cash flows years into the future and brings them to the present by applying a real discount rate, currently 7% a year. Around that traditional discounted cash flow analysis (DCF) we deal with uncertainty on a qualitative basis. "Option value" to us, for example, is "upside potential". After awhile DCF analyses fall into a pattern where differences among companies depend mostly on first year cash flow and reserve life. Meanwhile input information is continually changing as companies make new disclosures, each on a different day or at a different hour and commodity prices fluctuate. We aggregate latest information into a correlation analysis that determines a real-time present value approximation. When that approximation deviates too much from our steady, official estimate of present value and we cannot justify the difference with company-specific explanation, we change the official estimate. Net present value indicated by the current correlation is about \$7 a share higher than our ongoing standard estimate for the company (see table Functional Cash Flow and Present Value).

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Chevron 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	2,800	7.7	7.1	20,000	9%
Rest of World Natural Gas	2,820	12.4	7.1	20,000	9%
Oil	24,360	9.3	4.5	109,000	51%
Downstream	9,600		6.8	65,000	30%
	39,580	9.7	5.4	214,000	100%
Debt (US\$mm)				24,000	
Net Present Value (US\$mm)				190,000	
Shares (mm)				2,236	
Net Present Value - Standard Estimate (US\$/sh)				85	
Net Present Value - Approximation by Correlation (US\$/sh)				92	

Futures Prices and Company Disclosures Propel Estimated Cash Flow by Quarter

Cash flow for the next year is projected from a base through the latest reported quarter (see table [Next Twelve Months Operating and Financial Estimates](#)). Company disclosures provide the clues for future volumes and costs as well as geographic and quality differences in price. Futures prices from the New York Mercantile Exchange determine industry benchmarks for the next year in our model.

Ben Graham Rejects Standard of California as an Investment

Just as major oil companies are reviled politically, in the press and publicly, they are subject to unending dismissal by most investors. Listening to the audio version of an early 1970s edition of "The Intelligent Investor" we heard the words of the respected advisor, Ben Graham, refer to Standard Oil of California. The company is the predecessor of Chevron and coincidentally the employer that provided us with our first full time job. After identifying the oil stock as a standout value, Mr. Graham then went on to dismiss the idea because he observed that the price/earnings ratio had always been low. We do not fault Mr. Graham because no one gets all the good ideas, yet Socal and its successor went on to deliver a risk-adjusted return superior to most readily available alternative investments. When we hear the same sentiments expressed today, also at a time when we think the stock faces a promising future, we remember Ben Graham's words.

Kurt H. Wulff, CFA

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Chevron
Next Twelve Months Operating and Financial Estimates

	<i>Q4</i>	<i>Q3</i>	<i>Q4</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Next Twelve Months</i>
	<i>12/31/04</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>2005</i>	<i>3/31/06</i>	<i>6/30/06</i>	<i>9/30/06</i>	<i>12/31/06</i>	<i>12/31/06</i>
Volume									
Natural Gas (mmcf)									
U.S. (or North America)	1,618	1,676	1,638	1,634	1,800	1,800	1,800	1,800	1,800
Overseas (or Int'l)	2,107	2,785	3,289	2,599	3,300	3,300	3,300	3,300	3,300
Total	3,725	4,461	4,927	4,233	5,100	5,100	5,100	5,100	5,100
Oil (mbd)	1,792	1,805	1,862	7,120	1,900	1,900	1,900	1,900	1,900
Total gas & oil (mmb)	222	234	247	919	248	250	253	253	1,004
Price									
Natural gas (\$/mcf)									
Henry Hub (\$/mmbtu)	7.10	8.56	13.00	8.65	9.45	8.75	9.02	10.05	9.32
U.S. (or North America)	6.05	7.34	10.22	7.43	7.43	6.88	7.09	7.80	7.30
Overseas (or Int'l)	2.89	3.13	3.50	3.19	3.68	3.86	4.05	4.45	4.01
Total	4.26	4.71	5.73	4.83	5.00	4.92	5.12	5.64	5.17
Oil (\$/bbl)									
WTI Cushing	48.31	62.52	60.02	56.31	67.11	68.97	69.80	70.12	69.00
Worldwide	37.61	53.94	50.70	47.48	57.49	59.09	59.80	60.47	59.22
Total gas & oil (\$/bbl)	34.51	46.45	45.71	42.28	49.00	49.96	50.82	52.23	50.51
NY Harbor 3-2-1 (\$/bbl)	5.72	16.70	9.05	10.63	8.04	11.92	12.44	10.23	10.66
Revenue (\$mm)									
Natural Gas									
U.S. (or North America)	901	1,132	1,540	4,432	1,204	1,127	1,174	1,292	4,797
Overseas (or Int'l)	560	802	1,059	3,022	1,091	1,159	1,230	1,352	4,833
Total	1,461	1,934	2,599	7,454	2,295	2,286	2,405	2,644	9,630
Oil	6,201	8,958	8,685	31,387	9,831	10,216	10,453	10,570	41,070
Other	35,030	43,565	42,510	159,359	42,510	42,510	42,510	43,310	170,840
Total	42,692	54,456	53,794	198,200	54,637	55,012	55,367	56,524	221,540
Expense									
Production	3,262	4,491	4,484	15,941	4,905	5,093	5,271	5,449	20,718
Other	32,469	41,737	39,878	151,658	40,110	40,110	40,110	40,910	161,240
Ebitda (\$mm)									
Exploration and Production	4,400	6,400	6,800	22,900	7,221	7,409	7,587	7,765	29,982
Other	2,561	1,828	2,632	7,701	2,400	2,400	2,400	2,400	9,600
Total Ebitda	6,961	8,228	9,432	30,601	9,621	9,809	9,987	10,165	39,582
Exploration	275	122	274	688	274	274	200	200	948
Deprec., Deplet., & Amort.	1,283	1,534	1,725	5,913	1,725	1,725	1,725	1,800	6,975
Other non cash		900	900						
Ebit	5,403	5,672	6,533	22,200	7,622	7,810	8,062	8,165	31,659
Interest	112	136	135	482	135	135	135	270	675
Ebt	5,291	5,536	6,398	21,718	7,487	7,675	7,927	7,895	30,984
Income Tax	1,852	1,937	2,239	7,601	2,621	2,686	2,774	2,763	10,844
Net Income (\$mm)									
Exploration and Production	2,227	3,323	3,250	11,724					
Other	1,151	579	879	3,064					
Unallocated	61	(304)	30	(672)					
Total	3,439	3,598	4,159	14,116	4,867	4,989	5,152	5,132	20,139
Shares (millions)									
Per share (\$)	1.63	1.64	1.86	6.54	2.18	2.23	2.30	2.30	9.01
Ebitda Margin (E&P)	57%	59%	60%	59%	60%	59%	59%	59%	59%
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%

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