

Fourth Baby Boom Recommendation

Every portfolio should have a few energy stocks. Most analysts and investors understand that one of the greatest problems the global economy faces is having enough affordable energy. They also understand that we are stuck using oil and natural gas for the foreseeable future and until an alternative can be found that is affordable, clean and available on a global basis. This could take years if not decades and trillions of dollars. In the meantime, oil and natural gas will become more valuable overtime.

Chevron, Symbol CVX

CVX is the third largest U.S. and fifth largest public energy company in the world. CVX is considered a super major oil company in the leagues with Exxon Mobil, British Petroleum, and Royal Dutch Shell. They are also considered an integrated energy company meaning they are involved in every aspect of the energy business; discovery and exploration to the selling and retailing of energy, and everything in between.

Below is a break down of CVX's revenue and profits for 2007:

Business	Revenue	Profits
Exploration and Production	26%	79%
Refining, Marketing, and Transportation	72%	19%
Chemicals	1%	2%

Other businesses include mining, power generation, insurance, real estate and technical companies.

They own 10 refineries and have interests in 12 international refineries. They have 25,082 retail sites internationally.

CVX has operation all over the world and its production businesses are in the Caspian, U.S., Gulf of Mexico, Angola, Kazakhstan, Nigeria, Australia, and Brazil.

Valuations

Below are the 1-year price targets for CVX:

The average one-year target for CVX is approximately \$118. The current price is around \$85.

Yahoo - consensus price target (10 analysts), \$112.60.

S & P - independent and conservative, \$128.

Argus - independent moderate, \$106

Lehman Brothers - Wall Street, \$117

Most of the above valuations are based on discounted cash flow models or a moderate multiple times estimated future earnings.

There are other ways to determine the value of a company including valuing its assets. Because CVX has valuable assets it's important to review its valuation on an asset basis.

CVX has substantial valuable assets in its reserves. They have approximately 7.86 billion barrels of oil equivalent, boe, (boe, a unit of energy that includes oil and natural gas that energy companies use to express their reserves as a single measure). The company has a mix of energy assets of 59% oil, 41% natural gas.

Recent acquisition by energy companies have been between \$30 to \$50 boe, which we believe is still cheap when you consider the prospects for oil prices in a healthier global economy three to five years down the road. Let's assume the 7.86 billion boe is worth \$50. That would make the reserves worth about \$393 billion dollars, and this does not include all the other business and operations it has around the world. Again, we believe these reserves will become more valuable over time. The market cap of the company is about \$173 billion less than half the value of its reserves alone. From an asset valuation perspective, CVX is very cheap.

There are other important reserve metrics that investor should consider when investing in energy companies.

3-year average reserve replacement of current production is about 103%, below its peer's average.

3-year average of finding and development costs are \$29.49 per boe.

3-year average acquisition costs are \$8.02. In 2005 CVX made an excellent acquisition of Unocal and paid approximately \$10 per barrel of equivalent.

More Fundamentals for CVX:

Notice below that the market capitalization is lower than revenue. Investors are paying about \$.81 for a dollar of revenue. This is another valuation metric that let's us know the stock is cheap.

Dividend – 3.1%

Market Capitalization - \$174.57 Billion

Revenue - \$214.09 Billion

Operating Margin – 12.32%

Because dividends are important for the Boomer Portfolio and retirees, here is an historical look at CVX's dividends:

CVX	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998	AVG.
Dividend	\$2.26	\$2.01	\$1.75	\$1.53	\$1.43	\$1.40	\$1.33	\$1.30	\$1.24	\$1.22	
Payout Ratio	26%	26%	27%	25%	40%	NM	72%	33%	79%	120%	
Dividend Growth		12%	15%	14%	7%	2%	5%	2%	5%	2%	7%

As oil prices move up, notice that CVX has made healthy increases to its dividend.

Catalysts

The main catalyst for a higher stock price is the long-term prospects for oil and natural gas prices. We believe oil prices will continue to move higher over time due to: supply/demand issues; geopolitical concerns; oil and natural gas's supplies' vulnerabilities to terrorist attacks, weather, labor shortages and strikes, weather (especially hurricanes), maintenance problems.

Another important energy trend is oil-producing countries are not providing access to their oil reserves to the big oil companies of the world such as CVX. Many of these oil-producing countries have seen their oil production decrease because their governments don't have the skills and experience, knowledge to produce oil and they're not investing enough in their energy industries.

Oil, not so much natural gas, comes from rare geological formations and the low hanging fruit has been found and produced and what is left will be more difficult and costly to find and produce. When you follow the money in the energy patch you see the companies that are doing extremely well are Canadian oil sand companies and deep, deep offshore oil drillers. We are literally scraping the bottom of the barrel.

Also, as the major industrial countries (especially the U.S. and Europe, Japan) of the world draw down their reserves they will become more dependent on OPEC, an oligopoly. OPEC will have more pricing power and control over production keeping oil prices high.

RISKS

As mentioned above there are many risks to producing oil: weather, terrorists' attacks, and maintenance issues as well as cost over runs and drilling dry holes. Investors forget this is a tough, risky business.

Even though oil prices will continue to move higher they will probably continue to be volatile and this makes analysts and investors nervous and the values (especially P/Es) tend to be less than they should be.

The super major oil companies like CVX have had difficulty increasing their reserves and this has been a drag on the groups' stocks.

There are also concerns that the oil companies may face wind fall profit taxes.

As we mentioned in the beginning of this report, CVX has operations in areas of the world that are dangerous and politically unstable such as Angola, Kazakhstan, and especially Nigeria.

There are always risks that foreign leases and agreements could be broken or adjusted that could have a material financial impact on the company.

Oil and natural gas prices are currently under intense selling pressure, so energy stocks may continue to fall. We will add to our position if that happens. According to the chart above, CVX is in an established trading range and is probably safer from more intense selling than other energy stocks.

We believe some of the worries that investors have about the company are more than in the price; the stock is cheap.

Technicals

Below is a long-term chart for CVX:



CVX has nearly tripled (from trough to peak) since the beginning of the energy bull market.

Prices have essentially been going sideways for more than a year.

Below is a medium-term chart for CVX:



As mentioned above prices have been traded from the low \$80s to the \$95 area for more than a year.

Prices are close to the bottom of the range so we should consider owning CVX at these levels.

Recommendation

The potential total return for CVX in appreciation, options, and dividends could be over 20% for the next few years (appreciation 15 to 20%, dividend 3.1% and option writing).

We recommend doing a buy write, buy the stock at the market and simultaneously sell the September \$90 call, CVXIR.

The stock is around \$84.35 and CVXIR is around \$1.05. This will give us a cost basis of around \$83.30.

We will also sell short a put for CVX, the September \$80, symbol CVXUP at the market.

CVXUP is selling for about \$1.55. If we are exercised, our cost basis would be about \$78.45.