Rating: Buy
S&P 500: 1136

Cimarex Energy Company
No Debt, No Hedges, No PUDs

Symbol	XEC	*Ebitda Next Twelve Months ending 3/31/05 ($mm)*	338
Rating	Buy	*North American Natural Gas/Ebitda (%)*	79
Price ($/sh)	28.02	*Natural Gas and Oil Production/Ebitda (%)*	100
Pricing Date	6/10/04	*Adjusted Reserves/Production NTM*	5.9
Shares (mm)	43	*EV/Ebitda*	3.5
Market Capitalization ($mm)	1,190	*PV/Ebitda*	4.8
Debt ($mm)	0	*Undeveloped Reserves (%)*	1
Enterprise Value (EV) ($mm)	1,190	*Natural Gas and Oil Ebitda ($/boe)*	28.30
Present Value (PV) ($mm)	1,620	*Present Value Proven Reserves($/boe)*	23.10
Net Present Value ($/share)	38	*Present Value Proven Reserves($/mcfe)*	3.80
Debt/Present Value	0.00	*Earnings Next Twelve Months (US$/sh)*	3.51
McDep Ratio - EV/PV	0.74	*Price/Earnings Next Twelve Months*	8
Dividend Yield (%/year)	0.0	*Indicated Annual Dividend (US$/sh)*	0.00

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 to recommend current purchase of the shares of small cap Cimarex Energy Company for high concentration on natural gas unencumbered by debt or commodity hedges while reserves appear understated. The company's active drilling program is yielding accelerating volume growth at a time when the natural gas price outlook is strong. One of the benefits of a lack of debt is that no lender or debt-rater is requiring the company to hedge natural gas price as so many competitors have done at such great cost. Nor is there any likelihood that reserves are potentially overstated with a high percentage proven undeveloped (PUDs) because the company reports none. Chairman Mick Merelli has delivered a total return to stockholders of seven times in the past ten years. Now we see about 37% appreciation potential to net present value of US$38 a share. The main risk is a short reserve life.

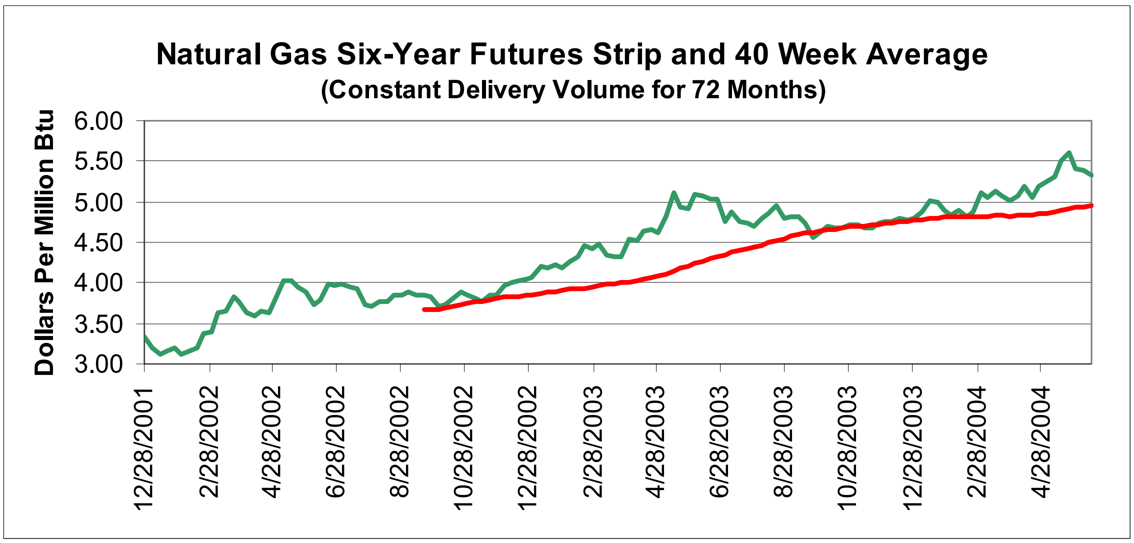
Natural Gas Outlook Stronger than Oil

Natural gas prices are advancing faster than oil. The ratio of natural gas to oil on a heating content basis advanced from 0.2 times oil in 1970 to 1.0 times oil today. That trend points to a ratio of perhaps 1.3 in 2010. We find that easy to believe in part because the ratio exceeded that for one-year futures for most of the spring of 2003. As the cleanest fuel, natural gas should continue to advance in price relative to oil as the world increasingly desires a cleaner environment.

Higher electricity quotes compared to a year ago point to possibly surprising strength in natural gas price in the hotter months ahead. A strong economy and air conditioning can stimulate a voracious appetite for electricity generated by natural gas.

Six-year futures describe the commodity price trends most relevant to estimating resource value. The longer time horizon better matches the period during which more of current resources will actually be produced. The longer term measure also smoothes the frantic near-month fluctuations and has the potential to keep climbing even if near-month quotes drop back temporarily.

The plots of weekly results since the beginning of 2002 trace a trend of six-year natural gas price rising 21% a year (see chart). Momentum is positive as long as the current six-year quote remains above the trailing 40-week average. If momentum were not favorable temporarily, the contrarian case would probably continue to justify our long-term interest.



Volume, Price and Costs Translate to Attractive Cash Flow

Our process of estimating company-specific present value begins with an estimate of next twelve months cash flow. Current projections lead to a healthy level of unlevered cash flow, also known as Ebitda, short for earnings before interest, tax, depreciation and amortization (see table). We choose the next twelve months ending March 31, 2005 as the relevant time period.

For the next twelve months we project natural gas and oil volume near the first quarter 2004 level. The company has raised its guidance for the second quarter to as much as 9% above the first quarter.

We take the futures market at face value in projecting price for the next twelve months. Henry Hub quotes guide our projection of natural gas revenue. Light Sweet Crude quotes guide our projections of oil revenue. Because futures are constantly changing, our projection is adjusted accordingly. As a result, the specific amounts we project today may not be the amounts realized when the company next reports.

Assess Present Value Multiple Depending on Reserve Life

The important variables in the valuation of future production are captured in base year cash flow and a multiple of that cash flow that depends on reserve life. Indeed investors do differentiate on that basis as reflected in a high correlation of unlevered cash flow multiple with adjusted reserve life. We convert the market relationship to a formula that produces an anticipatory value with somewhat more sensitivity to reserve life.

Cimarex Energy Company
Next Twelve Months Operating and Financial Performance

	Q1 3/31/04	*Q2E 6/30/04*	*Q3E 9/30/04*	*Q4E 12/31/04*	***Year 2004E***	*Q1E 3/31/05*	***Next Twelve Months 3/31/05***
Volume							
Natural Gas (mmcfd)	155	155	155	155	**155**	155	**155**
Oil (mbd)	6.9	6.9	6.9	6.9	**6.9**	6.9	**6.9**
Total (bcfe)	17.7	17.9	18.1	18.1	**72**	17.7	**72**
Total (mmcfd)	197	197	197	197	**197**	197	**197**
Price							
Henry Hub ($/mmbtu)	5.64	6.13	6.27	6.52	**6.14**	6.75	**6.42**
Differential ($/mmbtu)	0.38	0.41	0.42	0.44	**0.41**	0.46	**0.43**
Company ($/mcf)	5.26	5.72	5.85	6.08	**5.73**	6.29	**5.98**
WTI Cushing ($/bbl)	35.23	38.61	38.86	37.96	**37.67**	36.62	**38.01**
Differential	1.43	1.56	1.57	1.54	**1.52**	1.48	**1.53**
Company ($/bbl)	33.80	37.05	37.29	36.42	**36.15**	35.13	**36.48**
Total ($/bbl)							
Revenue ($mm)							
Natural Gas	74	81	84	87	**325**	88	**339**
Oil	21	23	24	23	**91**	22	**92**
Other	1		-		**0.5**		**-**
Total	95	104	107	110	**416**	110	**431**
Expense							
Operating	9	9	9	9	**36**	9	**36**
Production taxes	8	9	9	9	**35**	9	**37**
General and administrative	5	5	5	5	**20**	5	**20**
Total	22	23	23	23	**91**	23	**92**
Ebitda	73	81	84	87	**325**	87	**338**
Deprec., Deplet., & Amort.	26	26	26	26	**104**	26	**104**
Other Non Cash	1	1	1	1	**4**	1	**4**
Ebit	46	54	57	59	**216**	59	**230**
Interest	-	-	-	-	**-**	-	**-**
Ebt	46	54	57	59	**216**	59	**230**
Income Tax	16	19	20	21	**76**	21	**80**
Net Income ($mm)	30	35	37	39	**141**	39	**149**
Per Share ($)	0.70	0.83	0.87	0.91	**3.30**	0.91	**3.51**
Shares (millions)	43	43	43	43	**43**	43	**43**

The adjusted reserve life index is the sum of developed and half undeveloped reserves divided by next twelve months production. When we last did an industry-wide upward revaluation on March 23, we estimated cash flow multiple equal to 2.5 plus 0.5 times reserve life. That approximates present value assuming constant commodity price near the one-year quotes at that time, about $35 a barrel for crude oil. Higher commodity prices since then imply higher cash flow and lower multiple.

On the basis of reported quantities, Cimarex has an adjusted reserve life of just 5.9 years. That is less than the median for short-life peers and half the median for long-life peers. With no reported undeveloped reserves and with developed reserves estimated by the conservative firm of Ryder, Scott, Cimarex manages investor expectations conservatively. The risk of disappointment from management overpromising is low.

Cimarex Formed by Key Production and Helmerich and Payne

The company's unusual characteristics become less surprising when we consider how Cimarex was formed almost two years ago. About 60% of reserves were contributed by the producing operations from Helmerich & Payne. The rest of Cimarex was once Key Production.

Helmerich & Payne has traditionally had a high quality position in natural gas, much of it in the famed Hugoton field, with a low percentage of reserves classified as undeveloped. That company has also usually had zero debt. While that means almost no financial risk, investors can add their own leverage merely by controlling the amount owned relative to higher debt investments.

Key Production had been a stellar performer since it was formed in 1988. When Apache Corporation folded Apache Petroleum, its limited partnership, holders who did not want Apache Corporation stock were allowed to keep units that were transformed to stock in a new corporation, Key Production Company.

Key Production became independent of Apache in 1992 and was staffed with its own management headed by Mr. Merelli, a former Apache exec, as we recall. The strategy shifted to growth from a successful run of paying down debt and distributing a high dividend.

The owner of a share of Key in 1987 would have received double digit percentage dividends for about four years and would now own a share of Cimarex. Since June 1994 the stock has gained seven fold in ten years for a total return of 22% a year.

Reinvestment Success Important to Value Creation

Our investment bias is that high quality oil and gas resources are attractive to own, but creating new high quality properties is a tough business. Perhaps the former is true in part because of the latter. Cimarex has high margin properties, but they are being produced at a rapid rate and the proceeds are being reinvested to find new resources. As a result reinvestment success may be an even more critical indicator of value creation than commodity price. We are willing to bet on the company's future success in part because we have seen how management has had historical success.

Kurt H. Wulff, CFA

Research Methodology/Ratings Description: McDep Associates is an independent research originator focused on oil and gas stocks exclusively. The firm applies the thirty years of experience of its analyst to estimate a present value of the oil and gas resources and other businesses of covered companies. That value is compared with a company's stock market capitalization and debt. Stocks with low market cap and debt relative to present value tend to outperform stocks with high market cap and debt relative to present value. Buy recommendations are expected to deliver a total return better than 7% per year above inflation. Hold recommendations assume the attributes of the underlying business are more than fully reflected in the current price of the stock. Sell recommendations are expected to deliver a negative total return less than 7% per year including the effects of inflation.

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