

Rating: Buy  
S&P 500: 1183

## **Cimarex Energy Company**

### **Timely Talent**

<i>Symbol</i>	XEC	<i>Ebitda Next Twelve Months ending 12/31/05 (US\$m)</i>	424
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	78
<i>Price (\$/sh)</i>	40.91	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	11/26/04	<i>Adjusted Reserves/Production NTM</i>	5.2
<i>Shares (mm)</i>	43	<i>EV/Ebitda</i>	4.1
<i>Market Capitalization (\$mm)</i>	1,750	<i>PV/Ebitda</i>	3.8
<i>Debt (\$mm)</i>	0	<i>Undeveloped Reserves (%)</i>	1
<i>Enterprise Value (EV) (\$mm)</i>	1,750	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	31.60
<i>Present Value (PV) (\$mm)</i>	1,630	<i>Present Value Proven Reserves(\$/boe)</i>	23.20
<i>Net Present Value (\$/share)</i>	38	<i>Present Value Proven Reserves(\$/mcf)</i>	3.90
<i>Debt/Present Value</i>	0.00	<i>Earnings Next Twelve Months (US\$/sh)</i>	3.68
<i>McDep Ratio - EV/PV</i>	1.08	<i>Price/Earnings Next Twelve Months</i>	11
<i>Dividend Yield (%/year)</i>	0.0	<i>Indicated Annual Dividend (US\$/sh)</i>	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 common shares of **Cimarex Energy Company (XEC)** for small cap participation in natural gas production with capable leadership. A talent for continually developing new natural gas supply is a timely strength in a new commodity price environment. A rare absence of hedges assures that the company and its investors get the full benefit of timely talent. Though the stock price exceeds net present value of \$38 a share, that estimate assumes a constant real oil price of \$35 a barrel when the average futures price for the next six years is \$41 a barrel. A continued favorable industry outlook for a well-managed company with a strong record supports our current buy recommendation up to a McDep Ratio of 1.2 that would relate to a stock price of \$46 for Cimarex on current estimates.

### **Timely for Talent to Find New Supply**

Cimarex predecessor Key Production began life as a spinoff of properties rejected by Apache Corporation. As a result the company has survived and prospered living by its wits, continually finding new supply just in time to offset rapid decline of existing production. That talent has become more valuable with the strong demand and limited supply of the company's primary product, natural gas.

During the latest quarter, new volumes from Louisiana and Texas made up for declining volumes from Oklahoma. The prolific Mauboules #2 well started producing in September in the West Gueydan project in Vermilion Parish, South Louisiana. Two high-volume Henderson wells started producing in July on the Yegua/Cook Mountain project in Liberty County north of Houston, Texas.

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Management points out results in western Oklahoma, where the company is a long-term player, have fallen short of expectations. Drilling deeper and on the edges of prospective areas has turned up some 65-70% of targeted reserves with 87% success while oil field costs escalate. Fortunately at higher commodity price the results are economic. Nonetheless, overall costs of finding and developing new production will appear higher when the company reports year end reserves.

Cimarex has a diversified list of projects for originating promising drilling. The Edge Line Play in the San Joaquin Valley of California has started to contribute production from the first two wells, 80 miles apart. One rig now drilling may be supplemented by another as the company attempts to fill in with a line of producers.

### **Concentrated on Longer-Life North American Natural Gas**

The company's natural gas representation dominates resource value (see table Functional Cash Flow and Present Value). The overall adjusted reserve life of 5.2 years is at the low end of the range for peer companies. The company reports essentially no undeveloped reserves. If we attributed the peer median of 30% undeveloped to Cimarex, the adjusted life index would increase to 7.4 years.

<b>Cimarex Energy Company</b>					
<b>Functional Cash Flow and Present Value</b>					
	<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	330	5.2	3.8	1,240	78%
Oil	94	5.2	3.8	360	23%
	424	5.2	3.8	1,600	100%
Debt (US\$mm)					-
Net Present Value (US\$mm)					1,600
Shares (mm)					43
Net Present Value (US\$/sh)					38

### **Commodity Price Points to Further Gains**

Natural gas and oil futures prices drive further gains in cash flow in our model (see table Next Twelve Months Operating and Financial Estimates). We hold volume constant in our projection. The current quarter volume may be slightly higher. Considering the company's rate of spending there should be volume gains ahead.

Projected cash flow becomes the base against which we apply a multiple to test the continuing validity of our estimate of present value. That multiple is low at 3.8 times. In the current correlation of present value with reserve life for 28 stocks, the company's multiple could be considered low by 0.3 times under the level implied by the correlation.

Investors' greatest concern may be the sustainability of the current level of oil price. Energy consumers and energy investors should, in our opinion, take the oil price trend as a sign of a long term change to higher price. Recent softening of oil price is welcome relief for the economy

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while we adjust to the price increases that have occurred and prepare for those that may occur in the future.

**Cimarex Energy Company**  
**Next Twelve Months Operating and Financial Performance**

	<i>Q1</i>	<i>Q2</i>	<i>Q3</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Next Twelve Months</i>
	<i>3/31/04</i>	<i>6/30/04</i>	<i>9/30/04</i>	<i>12/31/04</i>	<i>2004E</i>	<i>3/31/05</i>	<i>6/30/05</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>12/31/05</i>
<b>Volume</b>										
Natural Gas (mmcf)	155	177	176	176	<b>171</b>	176	176	176	176	<b>176</b>
Oil (mbd)	6.9	7.2	7.4	7.4	<b>7.2</b>	7.4	7.4	7.4	7.4	<b>7.4</b>
Total (bcfe)	17.7	20.0	20.3	20.3	<b>78</b>	19.8	20.1	20.3	20.3	<b>80</b>
Total (mmcf)	197	220	220	220	<b>214</b>	220	220	220	220	<b>220</b>
<b>Price</b>										
Henry Hub (\$/mmbtu)	5.64	6.10	5.75	6.75	<b>6.06</b>	7.56	6.62	6.64	6.94	<b>6.94</b>
Differential (\$/mmbtu)	0.38	0.45	0.12	0.34	<b>0.31</b>	0.38	0.33	0.33	0.35	<b>0.35</b>
Company (\$/mcf)	5.26	5.65	5.63	6.41	<b>5.75</b>	7.18	6.29	6.31	6.59	<b>6.59</b>
WTI Cushing (\$/bbl)	35.23	38.34	43.89	49.90	<b>41.84</b>	48.68	47.68	46.26	45.01	<b>46.91</b>
Differential	1.43	0.94	2.08	2.37	<b>1.54</b>	2.31	2.26	2.20	2.14	<b>2.24</b>
Company (\$/bbl)	33.80	37.40	41.81	47.53	<b>40.30</b>	46.37	45.42	44.06	42.87	<b>44.67</b>
<b>Revenue (\$mm)</b>										
Natural Gas	74	91	91	104	<b>360</b>	114	101	102	107	<b>424</b>
Oil	21	24	28	32	<b>106</b>	31	30	30	29	<b>120</b>
Other	1	(0)	0	0	<b>1</b>	0	0	0	0	<b>0</b>
Total	95	115	120	136	<b>466</b>	145	131	132	136	<b>544</b>
<b>Expense</b>										
Operating	9	9	9	12	<b>39</b>	12	12	12	12	<b>48</b>
Production taxes	8	9	10	11	<b>38</b>	12	11	11	11	<b>44</b>
General and administrative	5	5	6	7	<b>23</b>	7	7	7	7	<b>28</b>
Total	22	23	24	30	<b>100</b>	31	30	30	30	<b>121</b>
<b>Ebitda</b>	73	92	95	106	<b>367</b>	114	102	102	106	<b>424</b>
Deprec., Deplet., & Amort.	26	31	32	34	<b>123</b>	36	38	41	43	<b>157</b>
Other Non Cash	1	5	3	6	<b>16</b>	6	6	6	6	<b>24</b>
<b>Ebit</b>	46	56	60	65	<b>227</b>	72	58	56	57	<b>243</b>
<b>Ebt</b>	46	56	60	65	<b>227</b>	72	58	56	57	<b>243</b>
Income Tax	16	20	21	23	<b>80</b>	25	20	20	20	<b>85</b>
<b>Net Income (\$mm)</b>	30	36	39	43	<b>148</b>	47	37	36	37	<b>158</b>
Per Share (\$)	0.70	0.85	0.91	0.99	<b>3.45</b>	1.10	0.87	0.85	0.87	<b>3.68</b>
<b>Shares (millions)</b>	43	43	43	43	<b>43</b>	43	43	43	43	<b>43</b>
Operating (\$/mcf)	0.51	0.45	0.43	0.60	<b>0.50</b>	0.60	0.60	0.60	0.60	<b>0.60</b>
Production taxes (%rev)	8.4	7.8	8.1	8.1	<b>8.1</b>	8.1	8.1	8.1	8.1	<b>8.1</b>
General and admin (\$/mcf)	0.28	0.25	0.29	0.35	<b>0.29</b>	0.35	0.35	0.35	0.35	<b>0.35</b>
Deprec., D, & A (\$/mcf)	1.47	1.55	1.58	1.70	<b>1.58</b>	1.80	1.90	2.00	2.10	<b>1.95</b>
Ebitda Margin	77%	80%	80%	78%	<b>79%</b>	79%	77%	77%	78%	<b>78%</b>
Tax rate	35%	35%	35%	35%	<b>35%</b>	35%	35%	35%	35%	<b>35%</b>

**Oil Price Move Possibly Just Starting**

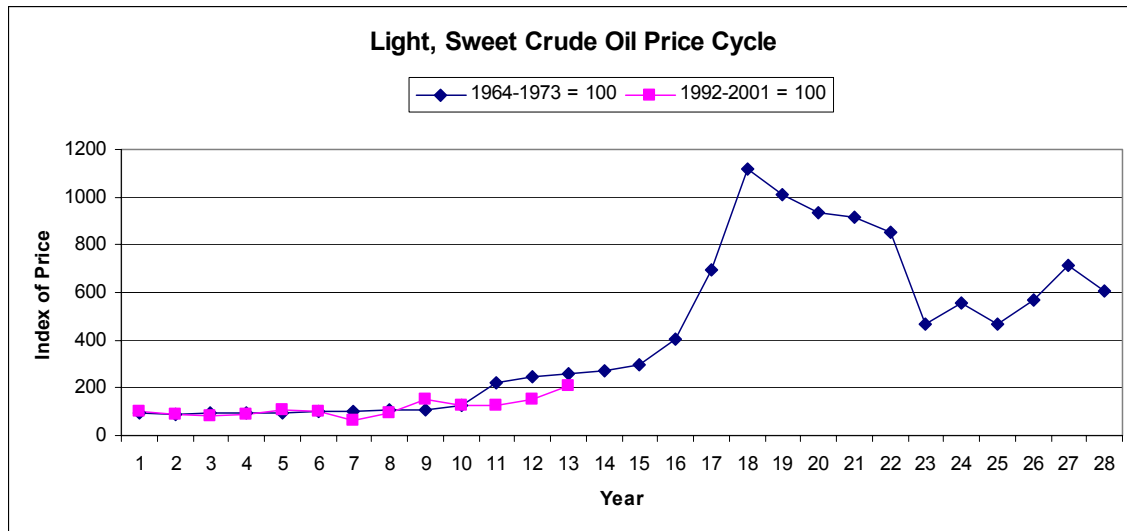
To offset any inclination to underestimate further potential for oil and gas price, we compare the relatively stable price period from 1992 to 2001 to the period from 1964 to 1973. Each was a ten year period that immediately preceded a sharply lower stock market in 2002 and in 1974. After quiescence, oil price started moving up in each case. We may be in the early stages of a new historic move (see chart [Light, Sweet Crude Oil Price Cycle](#)).

Frankly, few investors would give much weight to the likelihood of continued oil price strength. Contrast that with the growing chorus for a weaker dollar. It may just be that oil price is not high, but the real value of the dollar is low. That, too, is a parallel to historical experience.

Let us imagine how the cycle might unfold. By the way we draw the chart, Year 13 corresponds to 1976 and 2004. Once the move got going in the previous cycle, the annual average oil price

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did not decline until Year 19 (1982). The annual peak of 1100, or 11 times the first ten year average, was too high to be sustained. It might be less disruptive economically if the peak ahead of us were lower and the decline shallower. The end point in Year 28 at 600 implies a tripling over the next 15 years. If higher oil price unfolded gradually it would give everyone time to adjust.



Kurt H. Wulff, CFA

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