

Rating: Buy  
S&P 500: 1267

## **Cimarex Energy Company** **Born to Drill**

<i>Symbol</i>	XEC	<i>Ebitda Next Twelve Months ending 12/31/06 (US\$m)</i>	1,148
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	71
<i>Price (\$/sh)</i>	44.69	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	2/3/06	<i>Adjusted Reserves/Production NTM</i>	7.5
<i>Shares (mm)</i>	85	<i>EV/Ebitda</i>	3.8
<i>Market Capitalization (\$mm)</i>	3,800	<i>PV/Ebitda</i>	5.2
<i>Debt (\$mm)</i>	580	<i>Undeveloped Reserves (%)</i>	19
<i>Enterprise Value (EV) (\$mm)</i>	4,370	<i>Natural Gas and Oil Ebitda (\$/boe)</i>	39.50
<i>Present Value (PV) (\$mm)</i>	6,020	<i>Present Value Proven Reserves(\$/boe)</i>	24.80
<i>Net Present Value (\$/share)</i>	64	<i>Present Value Proven Reserves(\$/mcf)</i>	4.10
<i>Debt/Present Value</i>	0.10	<i>Earnings Next Twelve Months (US\$/sh)</i>	5.33
<i>McDep Ratio - EV/PV</i>	0.73	<i>Price/Earnings Next Twelve Months</i>	8
<i>Dividend Yield (%/year)</i>	0.2	<i>Indicated Annual Dividend (US\$/sh)</i>	0.36

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.

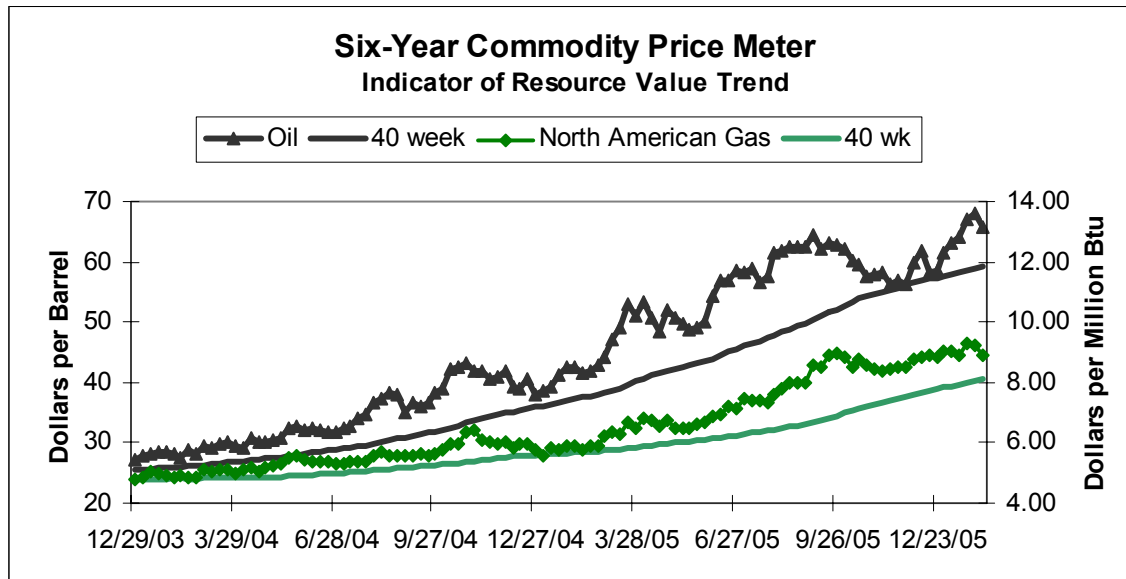
### **Summary and Recommendation**

Days before fourth quarter results are to be reported on February 15, buy-recommended **Cimarex Energy (XEC)** currently offers 44% appreciation potential to estimated net present value of \$64 a share that presumes a long-term oil price of \$50 a barrel. Futures investors price Light, Sweet Crude Oil at \$66 a barrel for the next six years. Among independent producer peers, XEC's near lowest McDep Ratio suggests that investors may be waiting to see how well the company performs having just doubled its size last year. Though adjusted reserve life at 7.5 years is shorter than the median, it should support higher unlevered cash flow multiple than the unusually low 3.8 times the company registers currently. Most of the cash flow is reinvested in drilling subject to rate of return discipline. The company will pay its first dividend this quarter and has initiated a stock repurchase program.

### **McDep Ratio Relates Oil Price to Opportunity**

A McDep Ratio below 1.0 tells us that XEC'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 XEC appears low 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) 3-Feb 2006	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>							
CNOOC Limited (29%)	CEO B	82.68	119	9,860	84.00	0.00	0.98
XTO Energy Inc.	XTO B	46.63	370	17,250	48.00	0.20	0.98
Encana Corporation	ECA B	46.75	876	41,000	51.00	0.20	0.93
Occidental Petroleum Corp.	OXY B	91.34	432	39,500	120.00	0.12	0.79
Burlington Resources	BR B	90.58	378	34,300	115.00	-	0.79
Anadarko Petroleum Corp.	APC B	104.02	238	24,800	140.00	0.12	0.77
Devon Energy Corporation	DVN B	64.40	451	29,000	94.00	0.12	0.72
	<i>Total or Median</i>			196,000		0.12	0.79
<b>Independent Natural Gas and Oil - Small Cap</b>							
Berry Petroleum Company	BRY B	75.25	23	1,690	65.00	0.11	1.14
Energy Partners Ltd.	EPL B	26.79	41	1,100	38.00	0.19	0.76
Encore Acquisition Company	EAC B	34.60	50	1,720	50.00	0.21	0.76
Cimarex Energy Company	XEC B	44.69	85	3,800	64.00	0.10	0.73
	<i>Total or Median</i>			8,300		0.15	0.76

**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. XEC's adjusted reserve life index of 7.5 years is low among peers. Yet considering reserve life, XEC's unlevered multiple, EV/Ebitda, at just 3.8 times ought to be higher.

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

	Symbol/ Rating		Price (\$/sh) 3-Feb 2006	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>								
XTO Energy Inc.	XTO	B	46.63	10.8	6.9	6.7	12	0.4
Encana Corporation	ECA	B	46.75	7.1	5.9	5.6	11	0.6
Anadarko Petroleum Corp.	APC	B	104.02	12.5	6.6	5.1	10	0.7
CNOOC Limited (29%)	CEO	B	82.68	9.2	5.1	5.0	9	2.8
Occidental Petroleum Corp.	OXY	B	91.34	11.3	5.9	4.7	8	1.6
Devon Energy Corporation	DVN	B	64.40	8.6	5.5	4.0	7	0.5
Burlington Resources	BR	B	90.58	-	-	-	-	-
	<i>Median</i>			9.2	5.9	5.0	9	0.6
<b>Independent Natural Gas and Oil - Small Cap</b>								
Berry Petroleum Company	BRY	B	75.25	10.1	5.4	6.1	12	0.8
Encore Acquisition Company	EAC	B	34.60	14.3	6.7	5.1	11	-
Cimarex Energy Company	XEC	B	44.69	7.5	5.2	3.8	8	0.4
Energy Partners Ltd.	EPL	B	26.79	5.7	4.6	3.5	11	-
	<i>Median</i>			8.8	5.3	4.5	11	0.2

**Concentrated on Natural Gas**

Each oil and gas stock has its own unique mix of energy resources (see table Business Segments). XEC's concentration on natural gas is the highest among small cap peers. Natural gas may be a contrary investment currently as near term price has dropped sharply with warm weather in the U.S.

**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)
<b>Independent Natural Gas and Oil - Large Cap and Mid Cap</b>								
Occidental Petroleum Corp.	OXY	B		14	1	75	11	59,000
Encana Corporation	ECA	B	Canada	83	-	17	-	55,600
Devon Energy Corporation	DVN	B		64	-	36	-	48,100
Anadarko Petroleum Corp.	APC	B		60	-	40	-	37,700
CNOOC Limited	CEO	B	China	-	12	88	-	34,600
XTO Energy Inc.	XTO	B		83	-	17	-	22,100
Burlington Resources	BR	B						
	<i>Median</i>			62	-	38	-	257,000
<b>Independent Natural Gas and Oil - Small Cap</b>								
Cimarex Energy Company	XEC	B		72	-	28	-	5,980
Encore Acquisition Company	EAC	B		25	-	75	-	3,150
Berry Petroleum Company	BRY	B		15	-	85	-	1,950
Energy Partners Ltd.	EPL	B		54	-	46	-	1,930
	<i>Median</i>			40	-	60	-	13,010

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**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 \$5 a share higher than our ongoing standard estimate for the company (see table Functional Cash Flow and Present Value).

<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	820	6.7	5.2	4,300	72%
Oil	328	10.3	5.1	1,680	28%
	1,148	7.5	5.2	5,980	100%
Debt (US\$mm)					580
Net Present Value (US\$mm)					5,400
Shares (mm)					85
Net Present Value - Standard Estimate (US\$/sh)					64
Net Present Value - Approximation by Correlation (US\$/sh)					69

**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.

Kurt H. Wulff, CFA

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

	<i>Q4</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>12/31/04</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>2005E</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>
<b>Volume</b>									
Natural Gas (mmcf)	187	338	331	<b>275</b>	350	370	370	370	<b>365</b>
Oil (mbd)	7.4	18.0	16.7	<b>13.2</b>	18.0	19.0	19.0	19.0	<b>18.8</b>
Total (bcfe)	21.3	41.0	39.7	<b>129</b>	41.2	44.0	44.5	44.5	<b>174</b>
Total (mmcf)	220	446	431	<b>354</b>	458	484	484	484	<b>478</b>
<b>Price</b>									
Henry Hub (\$/mmbtu)	7.10	8.56	13.00	<b>8.65</b>	9.35	8.60	8.88	9.85	<b>9.17</b>
Differential (\$/mmbtu)	0.71	0.68	2.60	<b>0.63</b>	1.20	1.10	1.00	1.11	<b>1.10</b>
Company (\$/mcf)	6.39	7.88	10.40	<b>8.02</b>	8.15	7.49	7.88	8.74	<b>8.06</b>
WTI Cushing (\$/bbl)	48.31	62.52	60.02	<b>56.31</b>	64.95	66.12	67.39	67.94	<b>66.60</b>
Differential	1.19	3.07	2.95	<b>1.06</b>	3.19	3.25	3.43	3.46	<b>3.30</b>
Company (\$/bbl)	47.12	59.45	57.07	<b>55.25</b>	61.76	62.87	63.96	64.48	<b>63.30</b>
<b>Revenue (\$mm)</b>									
Natural Gas	110	245	317	<b>805</b>	257	252	268	297	<b>1,075</b>
Oil	32	98	88	<b>265</b>	100	109	112	113	<b>433</b>
Other	(0)	(0)	(0)	<b>(1)</b>	(0)	(0)	(0)	(0)	<b>(1)</b>
Total	142	343	404	<b>1,069</b>	356	361	380	410	<b>1,506</b>
<b>Expense</b>									
Operating	10	47	46	<b>124</b>	47	51	51	51	<b>200</b>
Production taxes	10	21	28	<b>74</b>	25	25	27	29	<b>105</b>
General and administrative	8	8	12	<b>38</b>	12	13	13	13	<b>52</b>
Total	28	76	86	<b>236</b>	85	89	91	93	<b>358</b>
<b>Ebitda</b>	114	267	318	<b>833</b>	272	272	288	317	<b>1,148</b>
Deprec., Deplet., & Amort.	35	84	87	<b>261</b>	91	97	98	98	<b>384</b>
Other Non Cash	5	(11)	49	<b>46</b>	9	8	9	10	<b>36</b>
<b>Ebit</b>	74	194	182	<b>526</b>	172	167	182	208	<b>729</b>
Interest	-	8	8	<b>20</b>	8	8	8	8	<b>32</b>
<b>Ebt</b>	74	186	174	<b>506</b>	164	159	174	200	<b>697</b>
Income Tax	26	65	61	<b>177</b>	57	56	61	70	<b>244</b>
<b>Net Income (\$mm)</b>	48	121	113	<b>329</b>	106	103	113	130	<b>453</b>
Per Share (\$)	1.12	1.42	1.33	<b>4.83</b>	1.25	1.21	1.33	1.53	<b>5.33</b>
<b>Shares (millions)</b>	43	85	85	<b>85</b>	85	85	85	85	<b>85</b>
Operating (\$/mcf)	0.47	1.15	1.15	<b>0.96</b>	1.15	1.15	1.15	1.15	<b>1.15</b>
Production taxes (%rev)	7.0	6.1	7.0	<b>6.9</b>	7.0	7.0	7.0	7.0	<b>7.0</b>
General and admin (\$/mcf)	0.38	0.20	0.30	<b>0.29</b>	0.30	0.30	0.30	0.30	<b>0.30</b>
Deprec., D, & A (\$/mcf)	1.64	2.05	2.20	<b>2.02</b>	2.20	2.20	2.20	2.20	<b>2.20</b>
Ebitda Margin	80%	78%	79%	<b>78%</b>	76%	75%	76%	77%	<b>76%</b>
Tax rate	35%	35%	35%	<b>35%</b>	35%	35%	35%	35%	<b>35%</b>

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