



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

October 2, 2009

Cimarex Energy (XEC) Drilling Picking Up

Summary and Recommendation

Buy-recommended **Cimarex Energy (XEC)** has built up its best backlog of drilling projects while maintaining low debt, minimal hedging and generating cash at the highest rate of any stock in our income and small cap coverage. Shale gas in western Oklahoma, a 3-D seismic natural gas play in southeast Texas and horizontal oil in west Texas all appear to be working well. The prospects are reassuring because reinvestment effectiveness is especially important for companies generating high levels of cash. At the same time, Cimarex's low-debt policy helped the company to gain ground on high-debt competitors during the turmoil of the past year. Nonetheless, management felt it necessary to take out some price insurance in the form of hedging to assure minimal operations to keep the organization on top of its game, among other considerations. XEC stock has appreciation potential of 9% to a McDep Ratio of 1.0 where stock price would equal Net Present Value (NPV) of \$46 a share (see Table 1 and Table 2). NPV could be higher considering a somewhat low unlevered multiple of Present Value to Ebitda compared to the ratio of Adjusted Reserves to production (see Table 3). We may also be entering the phase of the cycle where natural gas price moves up while drilling costs lag, the most favorable conditions for Cimarex's active drilling strategy.

Volume and Price in Cycles

During the immediate four quarters ahead, producing volume may decline while natural gas and oil price may be rising (see table [Next Twelve Months Operating and Financial Performance](#), page 6). Volume is responding on a delayed basis to last year's reduction in drilling that in turn was triggered by last year's decline in price. Such are the industry dynamics reflecting the lead and lag of the classic price and production cycles in business and economics. Now Cimarex is expanding drilling again and volume should turn up in future quarters.

Cimarex creates shareholder value through a combination of volume, price and costs. Real growth requires increasing volume per share over the cycles. Cimarex's business model calls for reinvesting all its cash flow as opposed to distributing it in dividends or stock repurchase. The Cimarex organization has the experience and capability to reinvest effectively, we believe. Some expectation of energy price increase is already built in to stock price. Should energy price increase more, a likely prospect in our view, Cimarex stock should also increase and vice versa. Costs are mainly determined by how much oil and gas can be produced relative to the effort expended on drilling and production. Recent experience gives management the confidence to expand drilling as we discuss below. We need management to deliver on volume and costs, as we believe is the case, because in the end our interest in the stock is in the upside potential of oil and gas price.



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Cana Shale Economic at Low Price

A representative well drilled into the Cana Shale in Oklahoma can earn an annual rate of return of 15% at a natural gas price of \$3 a million btu and 60% at \$7 (see slide on page 7 repeated in recent Cimarex presentations). Those attractive numbers are what one would expect for an active drilling play. At the low end, a driller can justify incremental activity. At the high end a driller can make enough profit to carry the rest of the company in its activities leading up to finding a drilling play and then getting the commodity to market. Operating 3 rigs in 2009, Cimarex now looks to run 4-6 rigs in the Cana Shale in 2010.

Big Well Boosts Gulf Coast Program

Emphasized in the second quarter analyst call, the Two Sisters well may have reserves of 20 to 40 billion cubic feet, or some seven times the average for the Yequa/Cook Mountain program. In its September 29 presentation, management talked of drilling 6-8 wells in the area in 2009, up from 5-6 two months ago. The company is in its seventh year of drilling in the Gulf Coast play (see slide on page 7).

Horizontal Oil Rig Count Increasing

Finally, Cimarex is also expanding its activity in its third major area of concentration, oil in the Permian Basin of Texas and New Mexico. The current three rigs running is to expand to 4-5 by year end (see slide on page 8). An unattractive return at \$40 oil early this year becomes quite attractive at \$70 oil today.

Kurt H. Wulff, CFA



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

October 2, 2009

Table 1										
McDep Income and Small Cap Energy Portfolio										
Debt, Business Segments and Income Yield										
						Present Value by Segment (%)				
	Symbol/Rating	Price (US\$/sh)	EV/ Market	Enterprise Value (\$mm)	NAmer. Natural Gas	Oil Prod'n	Dist. NTM (\$/un)	Dist. Yield (%)	McDep Ratio	
	B = Buy H = Hold	1-Oct 2009	Cap							
Canadian Income Trusts (US\$)										
Penn West Energy Trust	PWE	H	15.06	1.67	10,300	27	73	1.67	11.1	0.86
Pengrowth Energy Trust	PGH		10.16	1.70	4,500	34	66	1.11	11.0	0.82
Peyto Energy Trust	PEYUF		9.62	1.42	1,450	67	33	1.34	13.9	0.80
Canadian Oil Sands Trust	COSWF	B	27.13	1.11	14,600		100	2.12	7.8	0.67
Enerplus Resources Fund	ERF		21.90	1.24	4,500	43	57	2.00	9.1	0.66
<i>Total or Median</i>					35,400					0.80
Small Cap Independent Producers										
Cimarex Energy Company	XEC	B	41.27	1.25	4,220	62	38	0.24	0.6	0.91
Encore Acquisition Company	EAC	B	36.68	1.88	3,640	23	77	-	-	0.90
Berry Petroleum Company	BRY	H	25.68	1.99	2,290	31	69	0.30	1.2	0.85
Birchcliff Energy Ltd. (US\$)	BIREF		7.02	1.22	1,060	62	38	-	-	0.81
<i>Total or Median</i>					11,210					0.87
Top Line Cash Payers										
Cross Timbers Royalty Trust	CRT		29.25	1.00	180	64	36	1.87	6.4	1.05
Freehold Royalty Trust (US\$)	FRHLF		14.17	1.21	850	25	75	1.32	9.3	0.86
Dorchester Minerals, L.P.	DMLP	B	22.20	1.00	660	63	38	1.39	6.3	0.82
Sabine Royalty Trust	SBR		39.83	1.00	580	38	63	2.90	7.3	0.72
Permian Basin RT	PBT		12.29	1.00	570	27	73	0.89	7.2	0.68
<i>Total or Median</i>					2,840					0.82
Bottom Line Cash Payers										
Linn Energy, LLC	LINE		22.45	1.55	3,980	38	62	2.52	11.2	1.27
Encore Energy Partners, L.P. (52%)	ENP		15.85	1.35	500	24	76	2.15	13.6	0.95
San Juan Basin Royalty Trust	SJT	B	17.16	1.00	800	100	-	1.23	7.2	0.82
Hugoton Royalty Trust	HGT	B	16.69	1.00	670	89	11	1.03	6.2	0.73
Mesa Royalty Trust	MTR		33.75	1.00	63	75	25	2.47	7.3	0.70
<i>Total or Median</i>					6,010					0.82
Composite (excl COSWF)										
<i>Enterprise Value Weighting</i>					40,800	40	60			0.85
<i>Equal Weighting</i>						50	50			0.85
<i>Equal Weighted Buys</i>						53	47			0.84
* Percentages in Symbol column refer to current market Enterprise Value weightings; Rating column, equal weightings.										
* Percentages in Price column refer to equal weighted buys.										



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

October 2, 2009

Table 2								
Oil and Gas Income and Small Cap Stocks								
Net Present Value and McDep Ratio								
			Price (\$/sh)		Market	Net		
	Symbol/ Rating		1-Oct 2009	Shares (mm)	Cap (\$mm)	Value (\$/un)	Debt/ Present Value	McDep Ratio
Canadian Income Trusts (US\$)								
	PWE	H	15.06	410.0	6,170	19.00	0.35	0.86
	PGH		10.16	260.0	2,640	14.00	0.34	0.82
	PEYUF		9.62	105.9	1,020	13.00	0.24	0.80
	COSWF	B	27.13	484.0	13,130	42.00	0.07	0.67
	ERF		21.90	166.3	3,640	36.00	0.13	0.66
	<i>Total or Median</i>				26,600		0.24	0.80
Small Cap Independent Producers								
	XEC	B	41.27	82.0	3,380	46.00	0.18	0.91
	EAC	B	36.68	53.0	1,940	44.00	0.42	0.90
	BRY	H	25.68	44.8	1,150	35.00	0.42	0.85
	BIREF		7.02	124.0	870	9.00	0.15	0.81
	<i>Total or Median</i>				7,340		0.30	0.87
Top Line Cash Payers								
	CRT		29.25	6.0	180	28.00	-	1.05
	FRHLF		14.17	49.5	700	17.00	0.15	0.86
	DMLP	B	22.20	29.8	660	27.00	-	0.82
	SBR		39.83	14.6	580	55.00	-	0.72
	PBT		12.29	46.6	570	18.00	-	0.68
	<i>Total or Median</i>				2,690			0.82
Bottom Line Cash Payers								
	LINE		22.45	114.0	2,560	15.00	0.45	1.27
	ENP		15.85	23.4	370	17.00	0.25	0.95
	SJT	B	17.16	46.6	800	21.00	-	0.82
	HGT	B	16.69	40.0	670	23.00	-	0.73
	MTR		33.75	1.9	63	48.00	-	0.70
	<i>Total or Median</i>				4,460			0.82
B = Buy, H = Hold								
McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses								
Present Value presumes long-term prices of \$75 a barrel for oil and \$8 a million btu for natural gas.								



Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

October 2, 2009

Table 3								
Oil and Gas Income and Small Cap Stocks								
Value Multiples - Rank by EV/Ebitda								
			Price (\$/sh)	Revenue	Dist/ Equity	Adjstd Resrvs/ Prod	PV/ Ebitda	EV/ Ebitda
	Symbol/ Rating		1-Oct 2009	Royalty (%)	Ebitda	NTM	NTM	NTM
Canadian Income Trusts (US\$)								
	COSWF	B	27.13		0.76	21.8	15.0	10.0
	PEYUF		9.62		1.15	17.2	11.2	9.0
	PWE	H	15.06		0.85	8.2	9.7	8.4
	PGH		10.16		0.75	7.9	9.4	7.7
	ERF		21.90		0.64	9.4	11.4	7.5
	<i>Median</i>					9.4	11.2	8.4
Small Cap Independent Producers								
	BIREF		7.02		-	10.1	14.2	11.6
	EAC	B	36.68		-	11.5	9.4	8.5
	BRY	H	25.68		-	12.1	9.1	7.7
	XEC	B	41.27		-	7.8	6.0	5.5
	<i>Median</i>					10.8	9.2	8.1
Top Line Cash Payers								
	CRT		29.25	84	0.93	13.3	14.0	14.7
	DMLP	B	22.20	64	0.87	8.2	16.9	13.9
	SBR		39.83	100	1.00	10.2	19.0	13.7
	PBT		12.29	32	0.89	11.7	17.9	12.2
	FRHLF		14.17	71	0.78	6.4	10.1	8.6
	<i>Median</i>					10.2	16.9	13.7
Bottom Line Cash Payers								
	LINE		22.45		2.60	18.2	15.4	19.6
	HGT	B	16.69		0.71	13.4	15.9	11.5
	SJT	B	17.16		0.78	9.1	13.2	10.8
	MTR		33.75		0.77	7.9	14.9	10.5
	ENP		15.85		1.37	13.9	10.8	10.3
	<i>Median</i>					13.4	14.9	10.8
EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended June 30, 2010; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses								
Top Line Cash Payers defined as those having Revenue Royalty (see fifth column from right).								



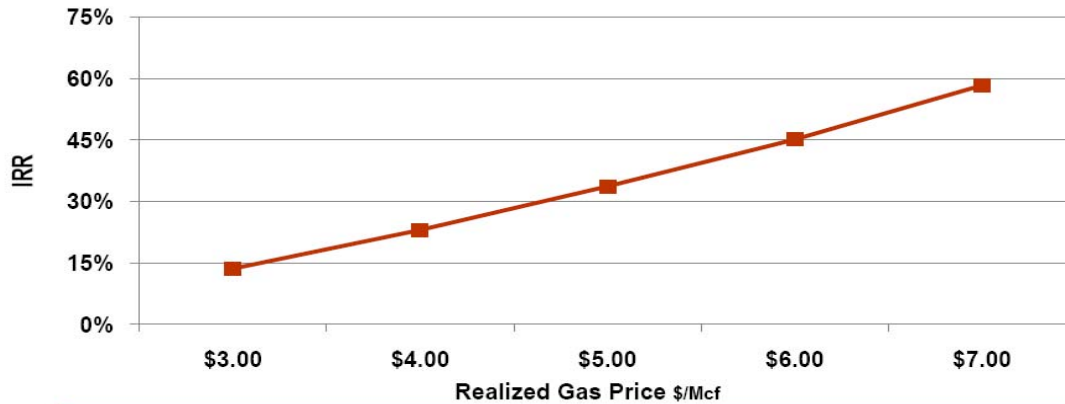
Income and Small Cap Weekly

Analysis of Oil & Gas Stocks

October 2, 2009

Cimarex Energy Company									
Next Twelve Months Operating and Financial Performance									
	Q3	Q2	Q3E	Q4E	Year	Q1E	Q2E	Q3E	Next Twelve Months
	9/30/08	6/30/09	9/30/09	12/31/09	2009E	3/31/10	6/30/10	9/30/10	9/30/10
Volume									
Natural Gas (bcf)	32.1	28.9	28.8	28.4	117	27.3	27.2	27.1	110
Natural Gas (mmcf)	349	318	313	308	319	304	299	295	301
Days	92	91	92	92	365	90	91	92	365
Oil (mmb)	2.1	2.1	2.1	2.0	8.4	2.0	1.9	1.9	7.9
Oil (mbd)	22.6	22.7	22.4	22.0	23.0	21.7	21.4	21.1	21.5
Total (bcfe)	44.6	41.3	41.1	40.5	167	39.0	38.9	38.7	157
Total (mmcf)	485	454	447	440	457	434	427	421	431
Price									
Henry Hub (\$/mmbtu)	10.25	3.50	3.39	4.72	4.12	5.87	5.88	6.10	5.64
Differential (\$/mmbtu)	0.46	0.02	0.02	0.02	0.28	0.03	0.03	0.03	0.04
Company (\$/mcf)	9.79	3.48	3.37	4.69	3.84	5.84	5.85	6.07	5.60
WTI Cushing (\$/bbl)	117.99	59.52	68.16	66.95	59.40	68.16	69.92	71.37	69.10
Differential	3.12	4.91	5.74	5.64	6.34	5.74	5.89	6.13	5.87
Company (\$/bbl)	114.87	54.61	62.42	61.31	53.06	62.41	64.03	65.23	63.22
Total (\$/bbl)	74.44	31.00	32.90	38.11	32.11	43.25	43.78	45.08	42.51
Revenue (\$mm)									
Natural Gas	315	101	97	133	448	160	159	165	616
Oil	239	113	128	124	446	122	125	126	497
Other									
Total	554	213	226	257	894	281	284	291	1,114
Expense									
Operating	78	54	58	57	227	55	54	54	220
Production taxes	39	15	16	18	64	20	20	20	78
General and administrative	15	12	12	12	46	12	12	12	47
Total	132	81	86	87	338	86	86	86	345
Ebitda	422	132	140	170	555	195	198	205	768
Deprec., Deplet., & Amort	149	59	59	59	269	59	59	59	235
Other Non Cash	(14)	(4)			4				-
Ebit	287	77	81	111	283	137	139	146	534
Interest	2	6	6	6	20	6	6	6	24
Ebt	285	71	75	105	263	131	133	140	510
Income Tax	100	25	26	37	92	46	47	49	178
Net Income (\$mm)	185	46	49	69	171	85	87	91	331
Per Share (\$)	2.19	0.56	0.59	0.84	2.08	1.04	1.06	1.11	4.04
Shares (millions)									
Operating (\$/mcf)	1.75	1.31	1.40	1.40	1.36	1.40	1.40	1.40	1.40
Production taxes (%rev)	7.0	7.0	7.0	7.0	7.2	7.0	7.0	7.0	7.0
General and admin (\$/mcf)	0.34	0.29	0.30	0.30	0.28	0.30	0.30	0.30	0.30
Deprec., D,& A (\$/mcf)	3.34	1.43	1.43	1.46	1.61	1.50	1.51	1.51	1.49
Ebitda Margin	76%	62%	62%	66%	62%	69%	70%	70%	69%
Tax rate	35%	35%	35%	35%	35%	35%	35%	35%	35%

Cana-Woodford Well Economics



Completed well cost (CWC)	\$8.0 MM
Land (avg. cost of \$2,300/acre)	\$0.36 MM
NRI	80%
EUR	6.4 BCF
IP – 1 st 30 day average	4.7 MMcf/d

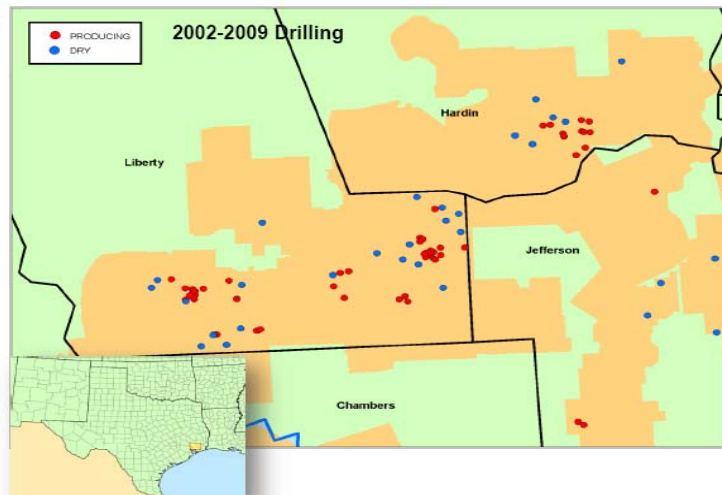
10



Gulf Coast – Yegua/Cook Mountain



- 3D seismic driven program; 2,000 sq. miles
- 2002-'09: 93 wells; 65% successful
- 2008: 19 wells
- 2009: 6-8 wells - good start with Two Sisters #1 discovery
 - 20 - 40 Bcfe
- Typical risked well stats:
 - Depths: 10,500'-16,000'
 - EUR: 3-5 Bcfe



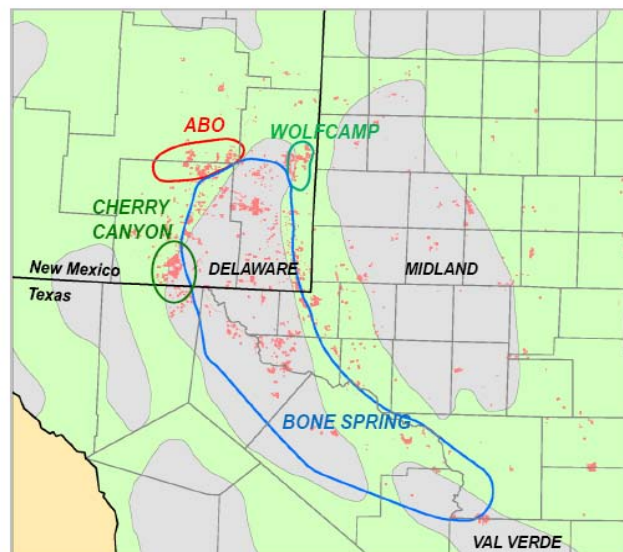
13



Permian Basin – Horizontal Oil Plays



- Significant drilling potential in horizontal oil plays
- Drilled > 60 horizontal oil wells in 2008
- Costs down ~25-30%
- Oil prices have improved
- 3 operated rigs running
- 4-5 rigs by year end



12

CIMAREX

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