

Rating: Sell
 S&P 500: 1260

Kinder Morgan (KMI, KMP, KMR)

Focus Sharpens on Limited Partners

<i>Symbol</i>	KMI	KMP	KMR	KMx
<i>Rating</i>	Sell	Sell	Sell	
<i>Price (US\$/sh)</i>	100.00	46.45	43.15	
<i>Pricing Date</i>	7/19/06	07/19/06	07/19/06	
<i>Publicly Held Shares (mm)</i>	135	145	50	
<i>Market Capitalization (US\$mm)</i>	13,500	6,740	2,150	22,400
<i>Debt (US\$mm)</i>	13,600	2,750	950	17,300
<i>Enterprise Value (EV) (US\$mm)</i>	27,100	9,490	3,100	39,700
<i>Present Value (PV) (US\$mm)</i>	18,000	4,920	1,690	24,600
<i>Net Present Value (US\$/share)</i>	33	15	15	
<i>Debt/Present Value</i>	0.75	0.56	0.56	0.70
<i>McDep Ratio - EV/PV</i>	1.50	1.93	1.83	1.61
<i>Ebitda Next Twelve Months ending 6/30/07 (US\$mm)</i>	2,050	630	218	2,900
<i>North American Natural Gas/Ebitda (%)</i>	0	0	0	
<i>Natural Gas and Oil Production/Ebitda (%)</i>	7	17	17	
<i>Adjusted Reserves/Production NTM</i>	7.2	7.2	7.2	
<i>EV/Ebitda</i>	13.2	15.2	14.4	13.7
<i>PV/Ebitda</i>	8.8	7.9	7.9	8.5
<i>Undeveloped Reserves (%)</i>	42	42	42	
<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	24.49	24.49	24.49	
<i>Present Value Proven Reserves(US\$/boe)</i>	18.19	18.19	18.21	
<i>Present Value Proven Reserves(US\$/mcf)</i>	3.03	3.03	3.03	
<i>Earnings Next Twelve Months (US\$/sh)</i>	4.77	1.86	1.86	
<i>Price/Earnings Next Twelve Months</i>	21	25	23	22
<i>Indicated Annual Distribution (US\$/sh)</i>	3.50	3.24	3.24	
<i>Distribution Yield (%/yr)</i>	3.5	7.0	7.5	4.9
<i>Ebitda by Function</i>				
<i>Natural Gas Pipelines</i>	1434	168	58	1660
<i>Oil Products Pipelines</i>	232	174	60	466
<i>CO2 Pipelines</i>	208	156	54	417
<i>Terminals</i>	176	132	46	354

Reported results may vary widely from estimates.

Estimated present value per share revised only infrequently.

Summary and Recommendation

Three new commissioners of the five-member Federal Energy Regulatory Commission (FERC) may take a new view of how well the public convenience and necessity is served by sell-recommended **Kinder Morgan Energy Partners (KMP)** and **Kinder Morgan Management LLC (KMR)**. A reassessment by investors of sell-recommended **Kinder Morgan Inc. (KMI)**

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apparently contributed to a slide in share price that was stemmed with a hastily arranged buyout. With general partner KMI soon to lose its public trading status we can concentrate on the prospects for limited partners KMP and KMR. The McDep Ratio near 1.9 implies that the market unlevered cash flow multiple (EV/Ebitda) near 15 times is almost twice the present value cash flow multiple (PV/Ebitda) around 8 times. Present value is an approximation of what the separate pieces would be worth if sold as businesses. The ratio of debt to present value of 0.56 is high, but in reality is a higher 0.70 in the consolidated entity before the buyout and higher still after the buyout that is being achieved primarily with more debt. Finally, our view that the accounting is false got some partial support from the regulatory authorities that lead to the restatement and subsequent demise of publicly-held KMI. Quarterly cash flow disclosed on July 19 seemed about in line, but larger issues of conflict of interest trouble us.

The Forest and the Trees

Focusing on unlevered cash flow we see that KMP had results that appear somewhat better than our projection while the non-KMP portion of KMI was somewhat worse than our rough projection. As a result, consolidated KMI was about in line. The Texas to Chicago natural gas pipeline appears to be exceeding expectations as producers want more capacity to move new volumes to market. The oil pipeline appears to be falling short as FERC mandates a rate reduction.

The quarterly details provide fertile material for discussing the trees while taking attention away from the forest. We have to remind ourselves that the minutiae interesting to analysts like us pertain to businesses that have a normal value of about 8 times cash flow while KMP stock trades at 15 times unlevered cash flow.

Potential for Self-Dealing

The ground rules of the quarterly call allowed no discussion of the management/investment banker/private equity buyout of the general partner. We learned that the general partner has just concluded a one and a half billion dollar transaction to sell oil production mostly in 2010-2011 or so with minimal margin requirements. There is a great deal of discretion in pricing such a transaction and determining the fees. The counter party is the investment banker to whom management is beholden for arranging the proposed buyout.

We have not paid much attention yet to the FERC members recently confirmed except to note that one apparently is from Arizona, the state that suffered a Kinder Morgan pipeline failure in the past few years. We do have an opinion on what we think the FERC should do. On one hand we like to see the commission set rates that are on the generous side to well-run regulated companies. Rates that are too low encourage overuse of debt and contribute to an industry that is poorly capitalized and prone to periodic bouts of financial failures. On the other hand, FERC has to be alert to questionable practices. Having watched the FERC and its predecessor the Federal Power Commission (FPC) struggle to do an imperfect job over the years, we are puzzled that the commission allows extraordinary general partner compensation disguised by misleading accounting as we see it.

Kurt H. Wulff, CFA

Kinder Morgan Energy Partners, L.P.
Next Twelve Months Financial Results

	Q2	Q3	Year	Q1	Q2	Q3E	Q4E	Year	Next Twelve Months
	6/30/05	9/30/05	2005	3/31/06	6/30/06	9/30/06	12/31/06	2006E	6/30/07
Oil Volume									
Oil (mmb)	3.4	3.3	14	3.3	3.4	3.4	3.4	14	14
Oil (mbd)	38	36	37	37	37	37	37	37	37
Oil Price (\$/bbl)									
WTI Cushing	53.05	62.52	56.31	63.33	70.40	75.84	78.13	71.92	77.96
Partnership	28.98	29.35	29.70	32.66	34.08	34.74	35.00	34.13	34.98
Oil Revenue (\$mm)	99	98	405	109	115	119	119	462	474
Ebitda									
Products Pipelines	123	127	503	126	130	130	130	516	520
Natural Gas Pipelines	115	122	501	144	131	122	140	537	537
CO2 Pipelines	115	120	472	122	125	120	114	481	481
Terminals	78	82	319	90	102	102	102	396	408
Overhead	(54)	(53)	(238)	(66)	(66)	(66)	(66)	(264)	(264)
Total Ebitda	377	398	1,557	416	422	408	420	1,666	1,682
Deprec., Deplet., & Amort.	88	85	349	93	97	97	97	384	388
Ebit	289	313	1,208	323	325	311	323	1,282	1,294
Interest	67	68	262	76	84	84	84	328	336
Ebt	222	245	946	247	241	227	239	954	958
General Partner	117	123	478	130	130	134	135	529	541
Net Income (\$mm)	105	122	468	117	111	93	104	425	417
Units (mm)	210	214	213	221	222	223	224	222	224
Net Income Per Unit (\$/un)	0.50	0.57	2.20	0.53	0.50	0.42	0.47	1.91	1.86
Distribution Per L.P. Unit	0.76	0.78	3.07	0.80	0.81	0.81	0.81	3.23	3.24
Distribution (\$mm)	275	289	1,129	308	314	315	316	1,252	1,267
General Partner	116	122	476	131	134	134	135	534	541
Limited Partner	159	167	653	177	180	181	181	718	727
General Partner Share									
Earnings	53%	50%	51%	53%	54%	59%	56%	55%	56%
Distribution	42%	42%	42%	43%	43%	43%	43%	43%	43%

Kinder Morgan, Inc.
Next Twelve Months Financial Results

	Q2	Q3	Year	Q1	Q2	Q3E	Q4E	Year	Next Twelve Months
	6/30/05	9/30/05	2005	3/31/06	6/30/06	9/30/06	12/31/06	2006E	6/30/07
Ebitda									
Natural Gas Pipelines	97	97	571	349	272	272	332	1,224	1,209
Kinder Morgan Energy Partner:	189	200	782	209	212	205	211	836	844
Total Ebitda	286	297	1,353	558	484	477	543	2,060	2,054
Deprec., Deplet., & Amort.	30	30	131	156	156	156	156	624	624
Kinder Morgan Energy Partner:	32	31	177	(85)	(91)	(91)	(91)	(356)	(362)
Ebit	224	236	1,045	486	418	411	477	1,792	1,792
Interest	44	45	199	189	200	200	200	789	800
Ebt	180	191	846	297	218	211	277	1,003	992
Income Tax	63	67	296	104	76	74	97	351	347
Net Income (\$mm)	117	124	550	193	142	137	180	652	645
Shares (millions)	123	123	124	135	135	135	135	135	135
Per Share (\$)	0.95	1.01	4.42	1.43	1.05	1.02	1.33	4.83	4.77
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%

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