

Rating: Sell  
 S&P 500: 1546

## **Kinder Morgan Energy (KMP, KMR)**

### **Suggestions for New General Partner Owners**

<i>Symbol</i>	KMP	<i>Ebitda Next Twelve Months ending 6/30/08 (US\$mm)</i>	800
<i>Rating</i>	Sell	<i>North American Natural Gas/Ebitda (%)</i>	0
<i>Price (US\$/sh)</i>	55.65	<i>Natural Gas and Oil Production/Ebitda (%)</i>	16
<i>Pricing Date</i>	7/18/07	<i>Adjusted Reserves/Production NTM</i>	7.6
<i>Shares (mm)</i>	179	<i>EV/Ebitda</i>	16.6
<i>Market Capitalization (US\$mm)</i>	9,940	<i>PV/Ebitda</i>	8.0
<i>Debt (US\$mm)</i>	3,380	<i>Undeveloped Reserves (%)</i>	42
<i>Enterprise Value (EV) (US\$mm)</i>	13,320	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	27.51
<i>Present Value (PV) (US\$mm)</i>	6,410	<i>Present Value Proven Reserves(US\$/boe)</i>	19.78
<i>Net Present Value (US\$/share)</i>	17	<i>Present Value Proven Reserves(US\$/mcfe)</i>	3.30
<i>Debt/Present Value</i>	0.53	<i>Earnings Next Twelve Months (US\$/sh)</i>	1.45
<i>McDep Ratio - EV/PV</i>	2.08	<i>Price/Earnings Next Twelve Months</i>	38
<i>Distribution Yield (%/year)</i>	6.1	<i>Indicated Annual Distribution (US\$/sh)</i>	3.40

Note: Estimated cash flow and earnings at recent quarter rate annualized.

Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

For historical analysis of KMP since 2001 see [www.mcdep.com/2kmp.htm](http://www.mcdep.com/2kmp.htm)

<i>Symbol</i>	KMR	<i>Ebitda Next Twelve Months ending 6/30/08 (US\$mm)</i>	280
<i>Rating</i>	Sell	<i>North American Natural Gas/Ebitda (%)</i>	0
<i>Price (US\$/sh)</i>	51.92	<i>Natural Gas and Oil Production/Ebitda (%)</i>	16
<i>Pricing Date</i>	7/18/07	<i>Adjusted Reserves/Production NTM</i>	7.6
<i>Shares (mm)</i>	62	<i>EV/Ebitda</i>	15.7
<i>Market Capitalization (US\$mm)</i>	3,200	<i>PV/Ebitda</i>	8.0
<i>Debt (US\$mm)</i>	1,170	<i>Undeveloped Reserves (%)</i>	42
<i>Enterprise Value (EV) (US\$mm)</i>	4,370	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	27.51
<i>Present Value (PV) (US\$mm)</i>	2,220	<i>Present Value Proven Reserves(US\$/boe)</i>	19.83
<i>Net Present Value (US\$/share)</i>	17	<i>Present Value Proven Reserves(US\$/mcfe)</i>	3.31
<i>Debt/Present Value</i>	0.53	<i>Earnings Next Twelve Months (US\$/sh)</i>	1.45
<i>McDep Ratio - EV/PV</i>	1.97	<i>Price/Earnings Next Twelve Months</i>	36
<i>Dividend Yield (%/year)</i>	6.5	<i>Indicated Annual Dividend (US\$/sh)</i>	3.40

Note: Estimated cash flow and earnings at recent quarter rate annualized.

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For historical analysis of KMR since 2001 see [www.mcdep.com/2kmr.htm](http://www.mcdep.com/2kmr.htm)

### **Summary and Recommendation**

After the market close on July 18, sell-recommendations **Kinder Morgan Energy Partners (KMP)** and **Kinder Morgan Management LLC (KMR)** reported financial results for the first time under new owners of the general partner including Wall Street house Goldman Sachs, leveraged buyout operator Carlyle Group and insurance company American International Group. The most important step we would like to see the reputedly honorable new owners take is to abolish the 50% incentive distribution rights (idr's) that distort the valuation of publicly-traded units of KMP and KMR. Failing that, we would like to see transparent accounting of the dilutive effect of the idr's on the value of partnership equity. The timing to make those changes now is good while market conditions are permissive for highly leveraged entities. Should financial conditions

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worsen unexpectedly, the partnership could rapidly become insolvent and make the general partners targets to be penalized for losses by limited partners who relied on misleading accounting of the idr's.

### **How the IDR's Mislead**

Misnamed idr's give the general partner 50% of incremental cash flow and 43% of average cash flow generated from the partnership's energy properties. Should idr's be counted as compensation or ownership? Too often, services for research and information such as *Bloomberg* just forget about it in calculating the widely respected unlevered cash flow multiple (EV/Ebitda) for valuing energy investments (see table). If idr's are compensation, the amount should be excluded from earnings before interest, tax, depreciation and amortization (Ebitda). If idr's are equity, their value should be included in Enterprise Value (EV). It looks like *Bloomberg* fails to make either adjustment and thereby computes an unlevered cash flow multiple that is too low by practically a half.

### **Kinder Morgan Energy Partners, L.P.** **Valuation Measures and Mismeasures**

	<i>Bloomberg</i>	<i>McDep</i>
<u>KMP</u>		
EV/Ebitda	8.6	17
Price/Earnings	29	38
Dividend Yield (%/yr)	6.0	6.1
<u>ExxonMobil</u>		
EV/Ebitda	6.2	6.9
Price/Earnings	14	12
Dividend Yield (%/yr)	1.5	1.5

We blame *Bloomberg's* failing on the misleading manner in which idr's are reported in the financial statements. It takes too much work to find the appropriate numbers to make an honest assessment. We would not say whether the general partner intends that the financial statements be misinterpreted to the limited partner's detriment, but the longer the misinterpretation continues the more the presumption must be that the general partner's obfuscation is deliberate.

### **Surge of New MLP's May Be Competition for KMP**

Few days pass without a new disclosure of a strategy to form a Master Limited Partnership (MLP). On July 17, upon announcement of its acquisition of Pogo Producing (PPP), Plains Exploration and Production (PXP) promised to create a new income stock. On July 18, buy-recommended Devon Energy (DVN) announced its plans to create an MLP to hold its midstream natural gas gathering, processing and marketing operations. When asked about the trend on the KMP earnings conference call, chief executive Kinder exclaimed that KMP's oil fields were among the most suitable for an MLP. We agree, but what Mr. Kinder did not say was that his compensation as a general partner at 50% of incremental cash flow makes KMP much less attractive to investors.

Kurt H. Wulff, CFA

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

	<i>Q2</i>	<i>Year</i>	<i>Q1</i>	<i>Q2</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Next</i>
	<i>6/30/06</i>	<i>2006</i>	<i>3/31/07</i>	<i>6/30/07</i>	<i>9/30/07</i>	<i>12/31/07</i>	<i>2007E</i>	<i>Twelve</i>
								<i>Months</i>
								<i>6/30/08</i>
<b>Oil Volume</b>								
Oil (mmb)	3.4	<b>14</b>	3.3	3.2	3.2	3.2	<b>13</b>	<b>13</b>
Oil (mbd)	37	<b>37</b>	37	35	35	35	<b>36</b>	<b>35</b>
<b>Oil Price (\$/bbl)</b>								
WTI Cushing	70.47	<b>66.05</b>	58.08	64.91	72.33	72.87	<b>67.05</b>	<b>72.99</b>
Partnership	34.08	<b>33.82</b>	36.54	38.12	39.21	39.28	<b>38.28</b>	<b>39.30</b>
<b>Oil Revenue (\$mm)</b>								
	115	<b>459</b>	120	122	127	128	<b>497</b>	<b>506</b>
<b>Ebitda</b>								
Products Pipelines	130	<b>502</b>	143	149	149	149	<b>590</b>	<b>596</b>
Natural Gas Pipelines	131	<b>556</b>	136	145	145	145	<b>571</b>	<b>580</b>
CO2 Pipelines	125	<b>489</b>	125	129	129	129	<b>512</b>	<b>516</b>
Terminals	102	<b>397</b>	99	110	110	110	<b>429</b>	<b>440</b>
Trans Mountain				21	13	13	<b>47</b>	<b>52</b>
Overhead	(66)	<b>(259)</b>	(69)	(71)	(71)	(71)	<b>(283)</b>	<b>(286)</b>
Total Ebitda	422	<b>1,685</b>	434	483	475	475	<b>1,866</b>	<b>1,898</b>
Deprec., Deplet., & Amort.	97	<b>414</b>	128	136	136	136	<b>536</b>	<b>544</b>
Other Non Cash		<b>(20)</b>			-	-	<b>-</b>	<b>-</b>
<b>Ebit</b>								
	325	<b>1,291</b>	306	347	339	339	<b>1,330</b>	<b>1,354</b>
Interest	84	<b>333</b>	90	97	97	97	<b>381</b>	<b>388</b>
<b>Ebt</b>								
	241	<b>958</b>	216	250	242	242	<b>949</b>	<b>966</b>
General Partner	130	<b>533</b>	140	148	154	154	<b>596</b>	<b>618</b>
<b>Net Income (\$mm)</b>								
	111	<b>425</b>	76	102	88	87	<b>353</b>	<b>349</b>
<b>Units (mm)</b>								
	222	<b>225</b>	231	235	239	240	<b>236</b>	<b>240</b>
Net Income Per Unit (\$/un)	0.50	<b>1.89</b>	0.33	0.43	0.37	0.36	<b>1.50</b>	<b>1.45</b>
Distribution Per L.P. Unit	0.81	<b>3.25</b>	0.83	0.83	0.85	0.85	<b>3.36</b>	<b>3.40</b>
<b>Distribution (\$mm)</b>								
	314	<b>1,275</b>	336	341	357	358	<b>1,392</b>	<b>1,435</b>
General Partner	134	<b>544</b>	144	146	154	154	<b>598</b>	<b>618</b>
Limited Partner	180	<b>731</b>	192	195	203	204	<b>794</b>	<b>817</b>
<b>General Partner Share</b>								
Earnings	54%	<b>56%</b>	65%	59%	64%	64%	<b>63%</b>	<b>64%</b>
Distribution	43%	<b>43%</b>	43%	43%	43%	43%	<b>43%</b>	<b>43%</b>

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