Rating: Sell
S&P 500: 1196

Kinder Morgan Management LLC
Energy Houdini

Symbol	KMR	*Ebitda Next Twelve Months ending 12/31/05 (US$mm)*	230
Rating	Sell	*North American Natural Gas/Ebitda (%)*	0
Price (US$/sh)	41.43	*Natural Gas and Oil Production/Ebitda (%)*	19
Pricing Date	1/18/05	*Adjusted Reserves/Production NTM*	12.0
Shares (mm)	56	*EV/Ebitda*	14.3
Market Capitalization (US$mm)	2,340	*PV/Ebitda*	7.7
Debt (US$mm)	900	*Undeveloped Reserves (%)*	50
Enterprise Value (EV) (US$mm)	3,240	*Natural Gas and Oil Ebitda (US$/boe)*	19.54
Present Value (PV) (US$mm)	1,750	*Present Value Proven Reserves(US$/boe)*	8.29
Net Present Value (US$/share)	15	*Present Value Proven Reserves(US$/mcfe)*	1.38
Debt/Present Value	0.52	*Earnings Next Twelve Months (US$/sh)*	2.25
McDep Ratio - EV/PV	1.85	*Price/Earnings Next Twelve Months*	18
Dividend Yield (%/year)	7.0	*Indicated Annual Dividend (US$/sh)*	2.92

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.

Summary and Recommendation

Shares of sell-recommended **Kinder Morgan Inc. (KMI)**, **Kinder Morgan Energy Partners (KMP)**, and **Kinder Morgan Management LLC (KMR)** offer illusory appeal that masks high valuation risk and high financial risk. During 2004 existing limited partners appeared to capture premium value from offerings of new units to investors. Yet the proceeds of the offerings were essentially transferred to the general partner. The limited partnership also borrowed to increase distributions that had the effect of increasing earnings for the general partner without any of the debt showing on the general partner's balance sheet. For a more realistic look, we recombine the separate pieces into a consolidated whole that compares unfavorably with any other energy stock in our coverage. By our analysis, KMR stock has the potential to lose some 60% of value to reach estimated net present value of equity of $15 a share in the next few years.

Access to Capital Helps Perpetuate Illusion

Combining the pieces of Kinder Morgan we construct a consolidated entity that we might call KMx (see table Kinder Morgan Matrix). KMx would presumably be valued in the stock market near present value of about $15 billion, near 8 times unlevered cash flow. Indeed the largest, safest and most successful energy stock in the world on a long-term basis, **ExxonMobil (XOM)** is valued at about 7 times unlevered cash flow. Yet KMx commands a premium value with Enterprise Value to cash flow near 14 times.

Perhaps part of the reason KMx enjoys such a premium, twice the unlevered value of XOM, is that aggressive investors may seek leverage. Investors who would not normally buy stocks on margin are getting the effect of the leverage of margin and more in KMx where the total ratio of debt to present value is 0.66 compared to just 0.07 in XOM, for example. For investors who don't have to stretch for high risk stocks, it makes more sense, in our opinion, to own two to three times as much XOM for the same amount of financial risk as in KMx.

Kinder Morgan Matrix

	Kinder Morgan Inc. General Partner	*KM Energy Partners Ltd Partner Units*	*KM Mgt LLC i-Shares*	*Kinder Morgan Consolidated*
Symbol	KMI	KMP	KMR	KMx
Stock Price ($/share or unit)	72.49	45.55	41.43	
Publicly Held Shares/Units (mm)	125	132	41	
Market Cap ($mm)	9100	6010	1710	16820
Debt ($mm)	7000	2120	660	9780
Enterprise Value (EV) ($mm)	16100	8130	2370	26600
Present Value (PV) ($mm)	9500	4100	1280	14880
Net Present Value ($/sh or un)	20	15	15	
Debt/Present Value	0.74	0.52	0.52	0.66
McDep Ratio - EV/PV	1.69	1.98	1.85	1.79
Indicated Annual Distribution ($/sh)	2.80	2.92	2.92	
Distribution Yield (%/yr)	3.9	6.4	7.0	5.1
Ebitda NTM 12/31/05 ($mm)	1260	530	169	1959
EV/Ebitda	12.7	15.3	14.3	13.6
PV/Ebitda	7.5	7.7	7.7	7.6
Earnings NTM ($/sh)	4.47	2.25	2.25	
Price/Earnings NTM	16	20	18	18
Ebitda by Function				
GP Natural Gas Pipelines	529			529
LP Natural Gas Pipelines	182	132	42	357
Products Pipelines	216	157	50	423
CO2 Pipelines	199	145	46	391
Terminals	118	86	27	232

Other investors may not realize how much leverage there really is in KMx. KMP reports leverage near the 0.52 in our table that is still lower than 0.66 for the combined entities. KMI reports leverage near the same level as KMP, but much lower than the 0.74 we attribute to KMI. The explanation is that KMI reports none of the debt on KMP's books. KMI apparently justifies the omission of partnership debt by ignoring the ownership implication of the general partner's 42% share of limited partner cash flow for essentially no capital outlay.

Regardless of the explanation, it is clear that the greatest strength of KMx is its stock price. The partnership sold new units in 2004 priced at a premium that was worth about $300 million after fees. That is $300 million of value created for the partnership simply because investors were willing to pay more for the stock than buyers would pay for the partnership's assets.

Also during 2004, the partnership made some $600 million of acquisitions including about half from the general partner. When the general partner transfers assets to the limited partner it receives the full purchase price in the non-arms length transaction. Yet it retains 42% of the cash flow from the asset in the form of general partner compensation that requires essentially no capital outlay. As a result the value creation of the public offering of limited partner units at a high price becomes value creation almost entirely for the general partner.

Limited partner distributions also seem to manufacture earnings for the general partner. Keep in mind that distributions approximate cash flow. When the general partner owns an asset the general partner reports earnings after depreciation. When the limited partners own an asset the limited partner distributes earnings and most of the depreciation. The general partner apparently reports its 42% share of distributions as "earnings".

The year would not be complete without more borrowing to support higher distributions. Borrowing is just as illusory as the sale of new units. When the limited partner borrows to buy assets, none of the debt shows up on the general partner's balance sheet. Yet the general partner gets 42% of the distribution from the asset that it reports as earnings. Presto! Earnings from thin air! Houdini would be jealous, as we say.

After stock price, the strongest part of KMx's current business seems to be oil production in West Texas. Oil production from the SACROC unit increased from 27.7 thousand barrels daily (mbd in the third quarter to 32.2 mbd in the fourth quarter 2004 following an investment of $300 million in 2004. While we like that we note that investors can buy the best performing oil and gas producer, **XTO Energy (XTO)**, for 6 times cash flow, not 14 times for KMx.

Acquisitions Contribute to Growth

Acquisitions are financed by issuing units and debt. The dilution from new units and 42% general partner compensation leaves little for limited partner growth per unit (see table Next Twelve Months Financial Results). KMR's sole asset is units of KMP.

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

	Q1 3/31/04	*Q2 6/30/04*	*Q3 9/30/04*	*Q4 12/31/04*	***Year 2004E***	*Q1E 3/31/05*	*Q2E 6/30/05*	*Q3E 9/30/05*	*Q4E 12/31/05*	***Next Twelve Months 12/31/05***
Oil Volume										
Oil (mmb)			3.6	4.0		3.9	3.9	4.0	4.0	**16**
Oil (mbd)			39	43		43	43	43	43	**14**
Oil Price ($/bbl)										
WTI Cushing			43.89	48.30		47.89	47.77	46.52	45.51	**46.92**
Partnership			26.48	28.12		28.06	28.05	27.86	27.71	**27.92**
Oil Revenue ($mm)			95	112		109	111	111	111	**442**
Ebitda										
Products Pipelines	114	119	120	122	**475**	122	122	122	122	**488**
Natural Gas Pipelines	103	95	105	107	**410**	107	95	105	105	**412**
CO2 Pipelines	78	76	86	114	**354**	112	113	113	113	**451**
Terminals	63	66	67	67	**263**	67	67	67	67	**268**
Overhead	(51)	(43)	(40)	(51)	**(184)**	(51)	(51)	(51)	(40)	**(192)**
Total Ebitda	307	313	338	359	**1,318**	358	346	357	367	**1,428**
Deprec., Deplet., & Amort.	68	70	74	79	**291**	79	79	79	79	**316**
Ebit	239	243	264	280	**1,027**	279	267	278	288	**1,112**
Interest	47	47	48	54	**196**	54	54	54	54	**216**
Ebt	192	196	216	226	**831**	225	213	224	234	**896**
General Partner	92	96	100	107	**395**	107	108	108	109	**431**
Net Income ($mm)	100	100	116	119	**436**	117	106	116	125	**464**
Units (mm)	193	196	197	203	**197**	205	206	207	208	**206**
Net Income Per Unit ($/un)	0.52	0.51	0.59	0.59	**2.21**	0.57	0.51	0.56	0.60	**2.25**
Distribution Per L.P. Unit	0.68	0.69	0.71	0.73	**2.81**	0.73	0.73	0.73	0.73	**2.92**
Distribution ($mm)	222	230	239	254	**944**	257	258	259	260	**1,034**
General Partner	91	95	99	106	**390**	107	108	108	109	**431**
Limited Partner	131	135	140	148	**554**	150	150	151	152	**603**
General Partner Share										
Earnings	48%	49%	46%	47%	**48%**	48%	50%	48%	46%	**48%**
Distribution	41%	41%	41%	42%	**41%**	42%	42%	42%	42%	**42%**

Non-Competitive Value among Oil and Gas Income Stocks

KMR stock appears to have potential for depreciation compared to other income stocks (see table of stocks ranked by McDep Ratio). The high valuation investors accord KMR helps make the case for investment in stocks with lower valuation and lower debt.

	Symbol/	*Rating*	*Price ($/sh) 18-Jan 2005*	*Shares (mm)*	*Market Cap ($mm)*	*Net Present Value ($/sh)*	*Debt/ Present Value*	*McDep Ratio*
Income								
Kinder Morgan Energy Partners, L.P.	KMP	S3	45.55	150	6,830	15.00	0.52	1.98
Kinder Morgan Management, LLC	KMR	S3	41.43	56	2,340	15.00	0.52	1.85
Pengrowth Energy Trust	PGH		20.99	136	2,850	14.00	0.26	1.37
Enerplus Resources Fund	ERF		36.62	104	3,810	28.00	0.19	1.25
San Juan Basin Royalty Trust	SJT	H	28.94	47	1,350	27.00	-	1.07
Canadian Oil Sands Trust (US$)	COSWF	B1	56.48	91	5,150	72.00	0.19	0.83
Total or Median					*22,300*		*0.23*	*1.31*

B1 = Buy full unlevered position, B2 = Buy half unlevered position, B3 = Alternative buy, H = Hold
S2 = Short half unlevered position, S3 = Short quarter unlevered position
McDep Ratio = **M**arket **c**ap and **De**bt to **p**resent value of oil and gas and other businesses

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