

Rating: Sell
 S&P 500: 1235

Kinder Morgan Management LLC **The Game Goes On**

<i>Symbol</i>	KMI	KMP	KMR	KMx
<i>Rating</i>	Sell	Sell	Sell	
<i>Price (US\$/sh)</i>	89.48	53.79	48.63	
<i>Pricing Date</i>	7/20/05	07/20/05	07/20/05	
<i>Publicly Held Shares (mm)</i>	123	136	41	
<i>Market Capitalization (US\$mm)</i>	11,000	7,340	2,010	20,400
<i>Debt (US\$mm)</i>	7,700	2,530	770	11,000
<i>Enterprise Value (EV) (US\$mm)</i>	18,700	9,870	2,780	31,400
<i>Present Value (PV) (US\$mm)</i>	10,100	4,590	1,390	16,100
<i>Net Present Value (US\$/share)</i>	20	15	15	
<i>Debt/Present Value</i>	0.76	0.55	0.55	0.68
<i>McDep Ratio - EV/PV</i>	1.84	2.15	2.00	1.95
<i>Ebitda Next Twelve Months ending 6/30/06 (US\$mm)</i>	1,240	550	171	1,960
<i>North American Natural Gas/Ebitda (%)</i>	0	0	0	
<i>Natural Gas and Oil Production/Ebitda (%)</i>	11	19	19	
<i>Adjusted Reserves/Production NTM</i>	6.2	6.2	6.2	
<i>EV/Ebitda</i>	15.1	17.9	16.6	16.0
<i>PV/Ebitda</i>	8.2	8.3	8.3	8.2
<i>Undeveloped Reserves (%)</i>	42	42	42	
<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	20.73	20.73	20.73	
<i>Present Value Proven Reserves(US\$/boe)</i>	19.20	19.20	19.21	
<i>Present Value Proven Reserves(US\$/mcf)</i>	3.20	3.20	3.20	
<i>Earnings Next Twelve Months (US\$/sh)</i>	4.19	1.80	1.80	
<i>Price/Earnings Next Twelve Months</i>	21	30	27	24
<i>Indicated Annual Distribution (US\$/sh)</i>	3.00	3.12	3.12	
<i>Distribution Yield (%/yr)</i>	3.4	5.8	6.4	4.5

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)** have risks not shared by most energy stocks that also enjoy favorable stock price momentum. Recently reported quarterly results continue a pattern of overstated earnings and understated debt. Kinder Morgan securities are priced at an extraordinary level compared to well-established companies in the same industry with better records.

Please see disclosures on the final page.

Overstated Earnings

As general partner, KMI takes 42% of the cash distributions of KMP plus an additional 10% for the units it owns in KMP. Current GP compensation is treated as an expense that reduces limited partner earnings. Yet the GP is entitled to its 42% share of all future distributions at the current rate. That dilution is not reported as the effective reduction of limited partner equity. Instead limited partner unitholders regularly see a misrepresentation of the value of their ownership.

The general partner further overstates earnings when it transfers assets to the partnership. Before the transfer, the general partner would report depreciation as a reduction of earnings. After the transfer, the limited partnership distributes most of the depreciation in cash. The general partner reports cash received as earnings. There are more assets owned by the general partner that could be transferred to keep the game going.

Notwithstanding the positive slant of management's discussion there are some recent trends that ought to be disturbing to limited partners. Debt jumped a billion dollars in three months including a half billion comprehensive loss that may be related to crude oil hedging. Earnings to limited partners are declining while distributions are rising and the general partner share of earnings is rising faster (see table Next Twelve Months Financial Results).

Kinder Morgan Energy Partners, L.P.										
Next Twelve Months Financial Results										
	<i>Q4</i>	<i>Year</i>	<i>Q1</i>	<i>Q2</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Next</i>
	<i>12/31/04</i>	<i>2004</i>	<i>3/31/05</i>	<i>6/30/05</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>Twelve</i>
										<i>Months</i>
										<i>6/30/06</i>
Oil Volume										
Oil (mmb)	4.0		4.0	4.0	4.0	4.0	16	3.9	4.0	16
Oil (mbd)	43		45	44	44	44	44	44	44	44
Oil Price (\$/bbl)										
WTI Cushing	48.31		49.65	53.05	57.73	59.30	54.93	59.89	59.50	59.11
Partnership	28.12		29.73	28.80	29.44	29.64	29.40	29.71	29.66	29.61
Oil Revenue (\$mm)	112		120	114	118	119	471	116	117	470
Ebitda										
Products Pipelines	122	475	126	123	123	123	495	123	123	492
Natural Gas Pipelines	107	410	124	115	105	105	449	105	115	430
CO2 Pipelines	114	354	123	115	118	118	474	117	117	470
Terminals	67	263	74	78	78	78	308	78	78	312
Overhead	(51)	(184)	(79)	(54)	(54)	(54)	(241)	(54)	(54)	(217)
Total Ebitda	359	1,318	368	377	369	370	1,484	368	379	1,487
Deprec., Deplet., & Amort.	79	291	85	88	88	88	349	88	88	352
Ebit	280	1,027	283	289	281	282	1,135	280	291	1,135
Interest	54	196	59	67	67	67	260	67	67	268
Ebt	226	831	224	222	214	215	875	213	224	867
General Partner	107	395	112	117	120	121	470	122	122	485
Net Income (\$mm)	119	436	112	105	94	94	405	92	102	382
Units (mm)										
Net Income Per Unit (\$/un)	0.59	2.21	0.54	0.50	0.45	0.44	1.93	0.43	0.48	1.80
Distribution Per L.P. Unit	0.73	2.81	0.74	0.76	0.78	0.78	3.06	0.78	0.78	3.12
Distribution (\$mm)	254	944	265	275	285	286	1,110	287	288	1,146
General Partner	106	390	111	116	120	121	468	122	122	485
Limited Partner	148	554	154	159	164	165	642	166	166	661
General Partner Share										
Earnings	47%	48%	50%	53%	56%	56%	54%	57%	54%	56%
Distribution	42%	41%	42%	42%	42%	42%	42%	42%	42%	42%

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Kinder Morgan, Inc.
 Next Twelve Months Financial Results

	<i>Q4</i>	<i>Year</i>	<i>Q1</i>	<i>Q2</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Next Twelve Months</i>
	<i>12/31/04</i>	<i>2004</i>	<i>3/31/05</i>	<i>6/30/05</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>6/30/06</i>
Ebitda										
Natural Gas Pipelines	201	529	139	97	98	135	469	139	97	469
Kinder Morgan Energy Partners	185	678	190	194	191	191	766	190	196	767
Total Ebitda	386	1,207	329	291	288	326	1,235	329	293	1,236
Deprec., Deplet., & Amort.	30	119	29	30	30	30	119	30	30	120
Kinder Morgan Energy Partners	32	119	36	37	37	37	147	37	37	146
Ebit	324	969	264	224	221	259	969	263	226	969
Interest	39	154	41	44	44	44	173	44	44	176
Ebt	285	815	223	180	177	215	796	219	182	793
Income Tax	100	285	78	63	62	75	279	77	64	278
Net Income (\$mm)	185	530	145	117	115	140	517	142	118	516
Shares (millions)	125	125	124	123	123	123	123	123	123	123
Per Share (\$)	1.48	4.24	1.17	0.95	0.94	1.14	4.19	1.15	0.96	4.19
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%

Among other concerns, management points out that cash flow may not cover the distribution in the next quarter. Interest costs are rising as half the company's debt is at floating rates. Also KMP may sell more units soon. Distilled into a nutshell, the "success" of Kinder Morgan is the ability to persuade KMP investors to put up all the capital to finance acquisitions in return for only half the cash flow from the acquired properties.

Understated Debt

A debt ratio of 0.50 is a normal maximum in the energy industry. The combined KMx entities have a debt ratio of 0.68. Yet investors don't see that as both the general partner, KMI, and the limited partnership, KMP report leverage near the normal maximum. The explanation is that KMI reports none of the KMP debt on KMI's balance sheet despite the fact that KMI has effective ownership of the partnership of more than 50%. While KMI hides debt in the KMP partnership, management represents its capital structure as "conservative".

Extraordinary Valuation

Overstating earnings and understating debt might not be so significant if Kinder Morgan were an undervalued stock. Instead by an objective valuation measure, Enterprise Value to Ebitda, the separate entities or the combined entities are more highly valued by a wide margin than any of the leading energy companies in the industry (see table Rank by EV/Ebitda).

Misleading accounting causes analysts and data sources to misrepresent the stocks. Bloomberg, for example, reports an EV/Ebitda multiple of 9 times for KMP compared to our calculation of almost 18 times. Bloomberg reports a debt ratio of .44 for KMI compared to our estimate of 0.76. As a result, misleading accounting may be contributing to excess valuation.

One of the indirect consequences of our work on Kinder Morgan is to have a greater appreciation for the companies that do look more undervalued. **ExxonMobil (XOM)**, for example, has a long term rate of return that few companies, if any, can match of all the largest companies in the world. Priced at 6 times cash flow, less than a third the multiple for KMx and having almost no debt, XOM seems sure to deliver a better risk-adjusted return in the future. For those investors who want current distributions, **San Juan Basin Royalty Trust (SJT)** pays more than KMP, has no debt and has an EV/Ebitda multiple two-thirds that of KMP. For investors who can wait a

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year or so, **Canadian Oil Sands Trust (COSWF)** is likely to pay more than KMP and has an unlevered cash flow multiple little more than a third that of KMP. For investors in KMR who get no cash distribution, **XTO Energy (XTO)** has a stellar record and is valued at just 6 times cash flow.

Kurt H. Wulff, CFA

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

	<i>Symbol/</i>	<i>Rating</i>	<i>Price</i> <i>(\$/sh)</i>	<i>Adjstd</i> <i>Resrvs/</i>	<i>PV/</i>	<i>EV/</i>	<i>P/E</i>	<i>Divd or</i> <i>Distrib</i>
			<i>20-Jul</i>	<i>Prod</i>	<i>Ebitda</i>	<i>Ebitda</i>	<i>NTM</i>	<i>NTM</i>
			<i>2005</i>	<i>NTM</i>	<i>NTM</i>	<i>NTM</i>	<i>NTM</i>	<i>(%)</i>
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	89.48		8.2	15.1	21	3.4
Imperial Oil Limited (30%)	IMO	B	83.46	9.9	6.5	8.2	15	0.9
Suncor Energy	SU	B	48.57	20.1	8.7	7.9	17	0.4
Marathon Oil Corporation	MRO	B	55.91	7.5	4.0	4.9	8	2.0
PetroChina Company Ltd (10%)	PTR	B	77.89	13.7	5.7	4.8	9	4.1
Petro-Canada	PCZ	B	68.64	5.4	4.8	4.7	9	0.7
ConocoPhillips	COP	B	60.55	11.6	5.0	4.5	7	2.0
Norsk Hydro ASA	NHY	B	95.67	8.2	4.7	4.2	9	3.2
Lukoil Oil Company	LUKOY	B	38.95	19.8	4.5	3.4	6	2.5
	<i>Median</i>			<i>10.7</i>	<i>5.0</i>	<i>4.8</i>	<i>9</i>	<i>2.0</i>
Income								
Kinder Morgan Energy Partners, L.P.	KMP	S3	53.79		8.3	17.9	30	5.8
Kinder Morgan Management, LLC	KMR	S3	48.63		8.3	16.6	27	6.4
San Juan Basin Royalty Trust	SJT		44.19	12.1	8.3	11.5	13	7.9
Pengrowth Energy Trust	PGH		22.74	7.4	5.2	7.0	11	10.0
Canadian Oil Sands Trust (US\$)	COSWF	B	76.70	20.0	8.1	6.8	7	2.1
Enerplus Resources Fund	ERF		38.39	9.4	5.4	6.3	10	9.0
	<i>Median</i>			<i>10.7</i>	<i>8.2</i>	<i>9.3</i>	<i>12</i>	<i>7.2</i>

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