McDep LLC
Independent Stock Idea
January 17, 2008

Rating: Sell
S&P 500: 1373

Kinder Morgan (KMP, KMR)
Energy Infrastructure Fee Machine

Symbol	KMP	*Ebitda Next Twelve Months ending 12/31/08 (US$mm)*	880
Rating	Sell	*North American Natural Gas/Ebitda (%)*	0
Price (US$/sh)	55.81	*Natural Gas and Oil Production/Ebitda (%)*	16
Pricing Date	1/16/08	*Adjusted Reserves/Production NTM*	7.9
Shares (mm)	179	*EV/Ebitda*	15.8
Market Capitalization (US$mm)	10,010	*PV/Ebitda*	7.8
Debt (US$mm)	3,860	*Undeveloped Reserves (%)*	44
Enterprise Value (EV) (US$mm)	13,870	*Natural Gas and Oil Ebitda (US$/boe)*	30.86
Present Value (PV) (US$mm)	6,910	*Present Value Proven Reserves(US$/boe)*	21.13
Net Present Value (US$/share)	17	*Present Value Proven Reserves(US$/mcfe)*	3.52
Debt/Present Value	0.56	*Earnings Next Twelve Months (US$/sh)*	1.93
McDep Ratio - EV/PV	2.01	*Price/Earnings Next Twelve Months*	29
Distribution Yield (%/year)	6.6	*Indicated Annual Distribution (US$/sh)*	3.68
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			

Symbol	KMR	*Ebitda Next Twelve Months ending 12/31/08 (US$mm)*	310
Rating	Sell	*North American Natural Gas/Ebitda (%)*	0
Price (US$/sh)	53.25	*Natural Gas and Oil Production/Ebitda (%)*	16
Pricing Date	1/16/08	*Adjusted Reserves/Production NTM*	7.9
Shares (mm)	64	*EV/Ebitda*	15.2
Market Capitalization (US$mm)	3,410	*PV/Ebitda*	7.8
Debt (US$mm)	1,380	*Undeveloped Reserves (%)*	44
Enterprise Value (EV) (US$mm)	4,780	*Natural Gas and Oil Ebitda (US$/boe)*	30.86
Present Value (PV) (US$mm)	2,460	*Present Value Proven Reserves(US$/boe)*	21.08
Net Present Value (US$/share)	17	*Present Value Proven Reserves(US$/mcfe)*	3.51
Debt/Present Value	0.56	*Earnings Next Twelve Months (US$/sh)*	1.93
McDep Ratio - EV/PV	1.94	*Price/Earnings Next Twelve Months*	28
Dividend Yield (%/year)	6.9	*Indicated Annual Dividend (US$/sh)*	3.68
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 KMR since 2001 see www.mcdep.com/2kmr.htm			

Summary and Recommendation

Sell-recommended **Kinder Morgan Energy Partners (KMP)** and **Kinder Morgan Management LLC (KMR)** reported another quarter of rich fee payments to the general partner after the market close on January 16. Quarterly distributions approximated $163 million in fees to owners of the general partner, $158 million in cash to KMP unit holders and $55 million in new units to KMR holders. Exceeding cash distributions, the fees are neither reported as expenses, nor as long-term dilution of KMP equity. The general partners responsible for the misleading accounting include Goldman Sachs, the firm that has provided two Secretaries of the Treasury; Carlyle Group, the Washington buyout operator populated with ex-government officials; and AIG, the insurance company. Mr. Arthur Levitt, former chairman of the Securities and Exchange Commission (SEC) and an outspoken advocate for small investors is a paid advisor to Carlyle Group and AIG as well as a board member of Bloomberg, a data provider that passes along the misleading accounting information. The investors in KMP are predominantly small investors seeking income. In addition to underperforming other energy investments on a debt-adjusted basis, there remains a high risk that the stock market values in KMP and KMR would melt away should the deceptive accounting be exposed.

Controversial Incentive Distribution Rights (IDR's)

Cleverly created by Enron before its collapse, the general partner structure of KMP is codified with IDR's, a mechanism that now pays the general partner 50% of the present value of all new investment by the partnership. The IDR deal is that the general partner gets a dollar of cash for every dollar distributed to limited partners. The distribution to limited partners consists of about 74% in cash to KMP holders and about 26% in units to KMR holders.

The incentive distribution rights that give the general partner 50% of incremental cash flow distort the valuation of publicly-traded units of KMP and KMR. Starting innocuously years ago at a lower level, the misnamed IDR's give the general partner 44% 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 used unlevered cash flow multiple (EV/Ebitda) for valuing energy investments. 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. When we calculate a more representative EV/Ebitda ratio, the securities appear to be overpriced by a factor of two.

Though we refer to Bloomberg, the same observation applies to other financial services and to the sales literature provided by the investment bankers regularly promoting KMP and KMR securities. The bond rating agencies paid by Kinder Morgan also err on the side of the general partner in going along with misrepresentation, we think.

Financing Fiction

During the past quarter, KMP holders reinvested $343 million in new units for a net investment of $185 million. In the same quarter the general partner took out $163 million and underwriting commissions on the new units may have been near $20 million. The approximate $800 million increase in total assets was matched by about an $800 million increase in debt. It seems fair to conclude that practically all the new investment that facilitates payment of general partner fees and limited partner distributions is financed by debt.

Booming Energy Investments

The need for new energy infrastructure provides abundant opportunities for the partnership to put more borrowed funds to work. Because the partnership has been aggressive in pursuing such opportunities, the general partner has much to talk about that appears interesting to investors who overlook the underlying financing fiction.

Yet if there were no Kinder Morgan, the energy projects would still be built. Natural gas producers have a keen interest in new pipelines. Buy-recommended **Encana (ECA)** initiated an early leg of the Kinder Morgan Rocky Mountain pipeline and buy-recommended **ConocoPhillips (COP)** is an equity investor in the line.

Who Cares?

History teaches us that potential blowups can sometimes be postponed a long time. The highly levered energy transportation business in which Kinder Morgan operates goes through periodic cycles of financial failure. Investors lose in old companies and new companies are formed. Kinder Morgan was practically insolvent in the last cycle as we calculated at the time. Usually only the most exposed companies fail in a particular cycle. KMP may be more prominent in the next cycle as it is now more dominant and it has carried the IDR ruse further than any competitor.

We can't promise that KMP will collapse soon. As long as Wall Street has found new debt and equity investors for KMP, investors as well as the regulators at the SEC and Federal Energy Regulatory Commission have shown little concern. Yet, investors need not own an energy stock among the most exposed to risk when other stocks offer less risk and more reward.

Kurt H. Wulff, CFA

Kinder Morgan Energy Partners, L.P.									
Next Twelve Months Financial Results									
									Next
									Twelve
	Q4	*Q3*	*Q4*	***Year***	*Q1E*	*Q2E*	*Q3E*	*Q4E*	***Months***
	12/31/06	*9/30/07*	*12/31/07*	***2007***	*3/31/08*	*6/30/08*	*9/30/08*	*12/31/08*	***12/31/08***
Oil Volume									
Oil (mmb)	3.5	3.2	3.1	**13**	3.0	3.0	3.1	3.1	**12**
Oil (mbd)	38	35	33	**35**	33	33	33	33	**33**
Oil Price ($/bbl)									
WTI Cushing	59.99	75.48	90.75	**72.30**	95.03	94.14	93.03	92.02	**93.56**
Partnership	33.23	40.54	43.75	**39.68**	44.26	44.16	44.03	43.91	**44.09**
Oil Revenue ($mm)	115	130	134	**507**	135	134	135	135	**539**
Ebitda									
Products Pipelines	129	155	138	**585**	138	138	138	138	**552**
Natural Gas Pipelines	140	142	178	**601**	178	178	178	178	**712**
CO2 Pipelines	115	138	145	**537**	145	145	145	145	**580**
Terminals	107	109	124	**442**	124	124	124	124	**496**
Trans Mountain		22	14	**57**	14	14	14	14	**56**
Overhead	(64)	(67)	(69)	**(276)**	(69)	(69)	(69)	(69)	**(276)**
Total Ebitda	428	499	530	**1,946**	530	530	530	530	**2,120**
Deprec., Deplet., & Amort.	117	138	138	**540**	138	138	138	138	**552**
Other Non Cash	(20)			**-**	-	-	-	-	**-**
Ebit	331	361	392	**1,406**	392	392	392	392	**1,568**
Interest	85	102	101	**390**	101	101	101	101	**404**
Ebt	246	259	291	**1,016**	291	291	291	291	**1,164**
General Partner	139	156	170	**614**	173	174	173	174	**694**
Net Income ($mm)	107	103	121	**402**	118	117	118	117	**470**
Units (mm)	230	239	242	**237**	243	244	243	244	**243**
Net Income Per Unit ($/un)	0.46	0.43	0.50	**1.69**	0.49	0.48	0.48	0.48	**1.93**
Distribution Per L.P. Unit	0.83	0.85	0.88	**3.39**	0.92	0.92	0.92	0.92	**3.68**
Distribution ($mm)	334	357	376	**1,409**	397	398	397	398	**1,589**
General Partner	143	154	163	**606**	173	174	173	174	**694**
Limited Partner	191	203	213	**803**	223	224	224	224	**896**
General Partner Share									
Earnings	57%	60%	58%	**60%**	59%	60%	60%	60%	**60%**
Distribution	43%	43%	43%	**43%**	44%	44%	44%	44%	**44%**

Disclaimer: This analysis was prepared by Kurt Wulff, Manager of McDep LLC as of January 1, 2008. Previously Mr. Wulff was doing business as McDep Associates. The firm used sources and data believed to be reliable, but makes no representation as to their accuracy or completeness. This analysis is intended for informational purposes and is not a solicitation to buy or sell a security. Past performance is no guarantee of future results.

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