McDep Associates
Stock Idea
February 11, 2002

Buy/Sell Rating: 5 – Strong Sell

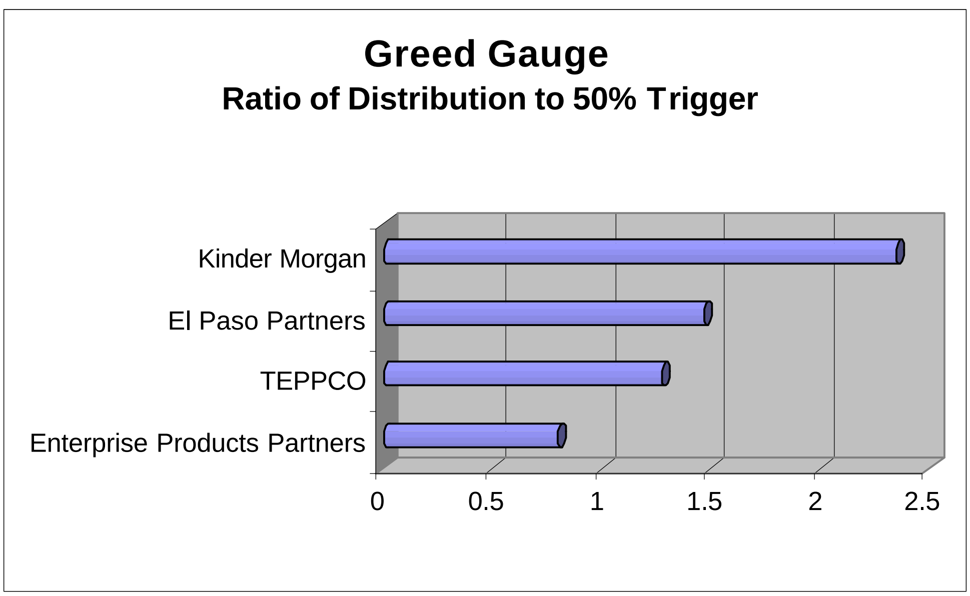
Kinder Morgan Entities
Greed Gauge

	Symbol	Price ($/sh) 8-Feb 2002	Shares (mm)	Market Cap ($mm)	Net Present Value ($/sh)	Debt/ Present Value	McDep Ratio	EV/ Sales NTM	EV/ Ebitda NTM	P/E NTM	Div'd NTM (%)	PV/ Ebitda NTM
Kinder Morgan, Inc.	KMI	49.50	120	5,900	16.10	0.77	1.48	4.2	13.3	20.6	0.4	9.0
KM Energy Partners, L.P.	KMP	31.92	136	4,300	12.30	0.42	1.92	4.5	17.3	21.9	6.9	9.0
KM Management, LLC	KMR	32.85	30	1,000	12.30	0.42	1.97	4.6	17.8	22.5	6.7	9.0

McDep Ratio = **M**arket **c**ap and **De**bt to **p**resent value of oil and gas and other businesses		
EV = Enterprise Value = Market Cap and Debt:	$mm	19,100
Ebitda = Earnings before interest, tax, depreciation and amortization:	$mm	1,320
NTM = Next Twelve Months Ended March 31, 2003; P/E = Stock Price to Earnings		
PV = Present Value of energy businesses:	$mm	11,800
Present Value of Equity	$mm	3,900

Summary and Recommendation

Kinder Morgan leads by a wide margin in our first presentation of the ratio of current distribution rate to the distribution rate that triggers a 50% share for the general partner (see Chart). We have heard nothing yet to change our opinion that the general partner, the auditor, Wall Street financiers and the business media overstate value and understate risk in Kinder Morgan securities.



Greed Prospers in Energy Infrastructure After Enron

Rich Kinder's personal fortune of $1.5 billion, amassed in just a few years since he left Enron, has inspired fellow travelers. Even the paragon of prudent growth in the power industry, **Duke Energy (DUK)**, is general partner of TEPPCO. More highly leveraged leaders like **El Paso (EP)** and **Williams (WMB)** are also active in promoting limited partnerships of which they are the general partner.

We have seen three waves of limited partnership formation in the energy industry. Shortly after 1980 we saw privately placed drilling partnerships proliferate. Around 1990 we saw master limited partnerships for natural gas and oil production flower. Now one of the hottest things in energy finance seems to be master limited partnerships for energy infrastructure.

General partner greed contributed to multiple failures in each of the first two waves. Today, general partner greed is approaching its highest level ever in terms of limited partner value diverted to general partners.

Here is how the game might be played. First, set up a small entity to codify an "incentive" schedule. The schedule typically provides three target distribution levels after which the general partner gets an increasing share of incremental cash starting at 1 or 2% and progressing rapidly through 15% and 25% to 50%. Second, start doing deals and pay out more cash to earn "incentive" cash. Magically, the stock price of the new entity may move up as distributions increase. Promoters may hype the distribution yield while overstating value and understating risk. Third, use the high stock price to do more deals or raise more money to do deals.

Here is how the technique could work out wonderfully for Williams, for example. In a few more quarters Williams Energy Partners may be deep into the "incentive" schedule. Meanwhile Williams Companies, under some financial pressure, announces it will sell an oil pipeline to raise capital to pay down debt. Perhaps Williams might simply transfer the oil pipeline to its limited partnership at a price that may not be arms length. In anticipation of this great acquisition, the partnership may issue new units at a high price and take on debt in order to pay its parent a full purchase price. The parent not only gets cash for full economic value, but can retain perhaps half of the economic value through the general partner share of the cash distributed by the partnership.

Will general partner greed bring the third wave of energy partnerships to a bitter end? Who are we to say? Hey, it might work.

Prudent investors, particularly advisors who are already collecting a fee from primary investors, would presumably be wary of paying the high fee implied by a high reading on the Greed Gauge. Hedge fund managers who are long KMP, and apparently there are some, should be especially wary of adding a fee on top of a fee. If Kinder Morgan is charging an incremental 50% and the hedge fund manager an incremental 20%, the underlying investment has to be extraordinarily profitable just to give the primary investor an ordinary return.

Perhaps one ought to regard Kinder Morgan as a hedge fund. Who would pay a hedge fund manager a 50% fee? Should Kinder Morgan become an unsuccessful investment, it may be especially embarrassing to professional advisors because of the compounding of fees.

Cynical investors might want to pay attention to the Greed Gauge as well. If "incentive" limited partnerships are going to continue to proliferate, a speculative strategy may be to buy when the Greed Gauge is low and harness the "incentive" to promote the stock. Then sell when the Greed Gauge is high and it becomes enormously difficult for the stock to continue appreciating.

The first eight power stocks in our coverage lost a median 50% in stock price in nine months. Is that a sign of what is to come for Greed Gauge stocks? The McDep Ratio suggests vulnerability. Debt may accelerate change. Greed may precipitate the downfall.

Kurt H. Wulff, CFA