McDep Associates
Independent Stock Idea
June 11, 2002

Buy/Sell Rating: 5 – Strong Sell
S&P 500: 1031

Kinder Morgan (KMI, KMP, KMR)
Continue Strong Sell – Capital Markets Rejection

Symbol	*Price ($/sh) 10-Jun 2002*	*Shares (mm)*	*Market Cap ($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*
KMI	41.00	125	5,100	16.00	0.78	1.35	3.8	11.4	14.4	0.5	8.4
KMP	31.45	136	4,300	12.40	0.48	1.81	4.2	16.2	21.8	7.5	9.0
KMR	31.23	30	900	12.40	0.48	1.80	4.2	16.1	21.6	7.6	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:
Ebitda = Earnings before interest, tax, depreciation and amortization:
NTM = Next Twelve Months Ended June 30, 2003; P/E = Stock Price to Earnings
PV = Present Value of energy businesses:

Summary and Recommendation

We reemphasize our Strong Sell recommendation of Kinder Morgan, Inc. (KMI), Kinder Morgan Energy Partners, L.P. (KMP) and Kinder Morgan Management, LLC (KMR) calling attention to the apparent inability to date in 2002 to raise new equity to finance a voracious appetite for acquisitions. At the same time we question the proposed removal of the exchange right of KMR for KMP that helps prop up what otherwise looks to us like a Ponzi income scheme and an Insull debt pyramid. Financially engineered just a year ago, KMR allows institutions to bet whether individuals will continue to pay a high price for KMP units. Shareholders of KMR own only a shell that owns units of KMP. Without the exchange right, KMR on its own merits may trade at a steep discount to KMP. Meanwhile the rapidly deflating bubble of energy infrastructure valuation invites comparisons with the 1920s and 1930s when excess greed and leverage resulted in a valuation collapse and political backlash. Imposing the highest general partner tax, one might say Kinder Morgan is the greediest of energy companies. Excessive debt is hidden in a complicated capital structure blessed by the rating agencies that are paid by the borrowers they rate.

Why Would Shareholders Give Up a Valuable Right for a Pittance?

In return for giving up the exchange right, KMI would transfer $1million of KMI stock, or $0.03 per KMR share, to the holders of KMR. The holders are being asked to give up

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their exchange right because KMI, the guarantor of the right, cannot afford to continue to honor the commitment. Management apparently wants to float a billion dollars of new KMR units and KMI does not own sufficient units of KMP to continue coverage of possible requests to exchange. About 10% of units were exchanged in the first year.

Alternatively, management apparently considered issuing a fourth class of stock without exchange rights while leaving existing KMR shares unchanged. High greed partnerships already use enough obfuscation to inflate their valuation such that imposing another layer might be the tipping point to complete investor rejection.

A preliminary proxy statement has been filed with the Securities and Exchange Commission for a special meeting to revoke the exchange right. After approval there would be another 20-30 days before a special shareholder meeting could be held, as we understand. Thus the equity financing once promised for about February, then May, could not be done before July. Goldman Sachs would be the underwriter. It is also listed among the major holders of the securities.

Considering that individuals primarily own KMP and institutions primarily own KMR, the trading dynamics could change sharply without the presumed exchangeability. The presumption is that individuals are steady holders of KMP for income. It seems doubtful to us that sophisticated institutions would own KMR for its merits. Instead the main valuation question is whether individuals will continue to pay too much, in our opinion, for KMP. Rescinding exchangeability destroys the rationale for institutional investors to play the game, as we see it.

Kinder Morgan May Be Worried About "A Run On The Bank"

The proxy statement describes some of the issuer's concerns to which we add some interpretation. Parties other than Kinder Morgan hold about 25 million shares of KMR. KMI holds about 20 million KMP units and about 5 million subordinated KMP units convertible into common units subject to conditions. Thus KMI, more or less, has enough KMP units and near units to meet a complete exchange. Obviously, KMI does not have the financial strength to exercise its option to meet the exchange in cash.

Now management may be contemplating a new billion-dollar issue or perhaps 40 million KMR shares at perhaps $25 a share. If the new units were exchangeable, KMI would not be able to assure that it had the financial wherewithal to meet potential demand. By our work, the shares are only worth a fraction of their price. If more investors came to that realization and demanded an exchange, Kinder Morgan would soon fail financially. As a result, management appears to have decided that it cannot take the risk of assuring exchangeability.

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In the end, management essentially says the continuation of the exchange right potentially would be too negative for KMI. "Because of our interrelationships, a negative effect on Kinder Morgan, Inc. could also indirectly have adverse consequences for us [KMR], Kinder Morgan Energy Partners, L.P., and its operating partnerships."

Recall that Jeff Skilling blamed the fall of Enron on a "run on the bank". That is a reasonable assessment of the final dynamics. Counter parties and investors could only act on their suspicions and some did. In the end those suspicions proved to be more than justified. Woe to those holders who hesitated to act.

Take Your PIK

Whatever the rationale, KMR also is a payment-in-kind (PIK) financing. Instead of being paid cash in the amount of the distribution on KMP, KMR holders get new units of KMR equivalent to the cash. Innocuous as that may seem, it can be a sign of deteriorating financial quality. PIK financing was common among failed partnerships a decade ago. Once the stock price starts to decline for a company with PIK financing it may be a death spiral. Lower price means more shares issued to satisfy PIK requirements and more shares means lower price because of dilution.

Capacity to Acquire Diminishing

It is not a good sign that Kinder Morgan has not been able to do the equity financing it promised when it made its last major acquisition at the turn of the year. Without new financing the company cannot make new acquisitions. Without new acquisitions the company cannot continue to make distributions and pay the general partner an incremental 50% of all income and cash flow distributed. Without acquisitions, the valuation of the Kinder Morgan entities falls apart like the Ponzi schemes and Insull debt pyramids of 70 years ago. In the aftermath there is likely to be recrimination and, hopefully, reform.

Energy Infrastructure Bubble Deflating

The independent generators, **AES** and **Calpine**, along with the traders Enron, **El Paso**, **Williams**, **Dynegy**, **CMS Energy**, and **Mirant** among stocks in our coverage or formerly in our coverage have suffered mightily in stock price. Kinder Morgan in comparison has held up surprisingly well. Yet Kinder Morgan's operations overlap and the entities have high valuation, high debt and deceptive practices.

Conflicts of Interest Compromise Advice

The sad fact of a bear market is that investors learn of the reasons they should sell a stock only after it is too late. Considering the conflicts of interests it is only too obvious why that is the case. KMP, for example, is among the most highly recommended stocks on the First Call list. The brokers who have just been telling retirement investors how great Kinder Morgan is, are reluctant to reverse themselves to say that the stock is really a "POS", to use an expression popularized in analyst emails.

Financial services firms do see the problem. The head of KMR's underwriter bemoans the lack of credibility. Like the pot calling the kettle black, his words seem the height of hypocrisy.

Debt rating agencies, in part, a creation of the aftermath of financial collapse seventy years ago, seem to be contributing to the lack of credibility. Kinder Morgan has the same characteristics of the debt pyramids of Samuel Insull that the rating agencies are supposed to expose. If the experience with Enron, Williams, Worldcom and Quest are any indication, we will see realistic credit ratings on Kinder Morgan only after the stocks fall to single digit prices. Loathe to offend clients, the agencies seem to look to the stock market for cover. When the price is down, they can then downgrade debt after equity investors have already exposed the obvious.

Nor is the business press much help in advance. If nothing else, the Kinder Morgan people are great at public relations. After a few critical printed words about the company earlier this year, management's PR succeeded in placing "puff" pieces, in *Business Week Online* among examples, that quoted friendly sources including the company's PR person. The business press relies primarily on advertising for its revenue. Few editors can turn down suggestions from those who butter their bread.

Kinder Morgan's manipulation appears to extend to how it deals with insider selling. Mr. Morgan has apparently decided to cash in. His sales are characterized as part of "estate planning". At the same time the chief financial officer suddenly makes a large purchase touted as evidence of conviction about the company's prospects. Turns out that the purchase was apparently financed by a forgivable loan. Seems like more high reward, no risk, executive compensation. Meanwhile KMI announces an expansion of its stock repurchase program. For a company loaded to the gills with debt already, stock repurchase can only be a desperate act. Yet it seems to have been enough to help Mr. Morgan reap peak prices on his sales so far in 2002.

Can You Trust the Greediest?

With no clues from Wall Street, the debt raters or the business press, how can investors even suspect the truth? We have made our arguments on valuation, leverage and the company's business model. Perhaps, the most telling, easy-to-understand indicator of impending decline is plain, old-fashioned, simple g-r-e-e-d. Don't mistake us; we agree that greed is good, to a degree. Excess greed can only be a sign of trouble ahead.

How excessive is Kinder Morgan's greed? It ranks at the top of our greed gauge (see chart). Popularized by Enron, Arthur Andersen and Vinson & Elkins, high greed partnerships have exploding general partner compensation. Like a Ponzi scheme, the partnerships start out innocently enough at modest compensation levels. Then as investors grow accustomed to their regular payments (partly out of their own principal) the general partner compensation, or tax, really starts to bite. Picture Kinder Morgan being successful in raising another billion dollars in a KMR offering. Immediately almost half the investment, nearly $500 million of value, starts to accrue to the general partner who has put up no money, to speak of, for its windfall.

Ironically, the general partner grab is billed as "incentive". The early investors in a Ponzi scheme are happy to see the general partner make out because they have done well, too, so far. But what has the general partner done for new investors to justify taking maximum incentive immediately? Nothing, of course. It is hard for us to believe that responsible institutional investors would support such a scam. It is hard to believe that the New York Stock Exchange and the Securities and Exchange Commission do not act on behalf of investors. Sadly, that is the way it works. Investors must lose their money before our conflicted system responds to fraud.

Reliant Partner

Kinder Morgan would also have investors believe that it has "organic growth" opportunities beyond acquisitions. In part we have not yet seen the front end loaded impact on quarterly earnings comparisons of acquisitions made in the last year. It could be a year before a shut off of financing for new acquisitions is fully reflected in statements.

Meanwhile, it is nice to have hometown friends. After acquiring early this year the natural gas pipeline that serves Houston, Kinder Morgan has apparently completed some transactions with Reliant, the local utility, that give an immediate boost to cash flow and thereby make Kinder Morgan's financial statements look better. Reliant, one of the exposed practitioners of bogus energy trades, accounts for some 20% of Kinder Morgan's revenue. What kind of "wash" transactions might Reliant and Kinder Morgan be engaged in to hype reported financial results?

Kinder Morgan Equity Securities May Soon Be Nearly Worthless

By our analysis the Kinder Morgan securities are worth only about $12 or $16 a share. That is optimistic. It presumes that energy infrastructure cash flow is worth a multiple of eight to nine times. Yet current stock prices for Mid Cap peers imply only about seven times. Put that multiple on Kinder Morgan's properties and the equity securities have value only in single digits. Add any aura of deception and the equity would quickly be worthless.

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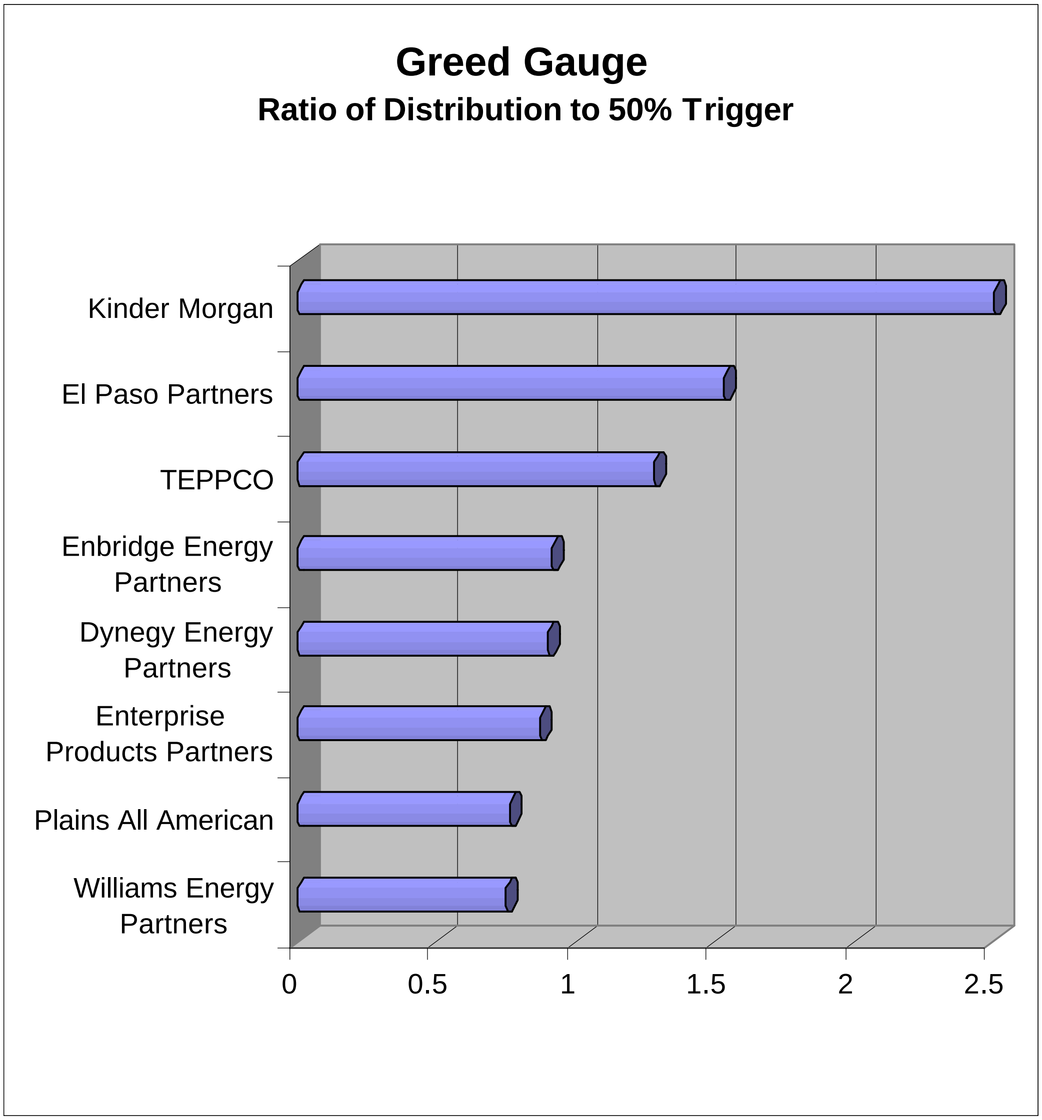
Alternatively, confidence could be magically restored and Kinder Morgan securities may take off again as touted by others. That seems a long shot. More likely Kinder Morgan securities seem headed the route taken by so many other over-promoted bubbles. Better for investors to put their money in issues where greed is restrained and the management is honest.

Kurt H. Wulff, CFA



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

	Q1 *3/31/01*	*Q2* *6/30/01*	*Q3* *9/30/01*	*Q4* *12/31/01*	***Year*** ***2001***	*Q1* *3/31/02*	***Year*** ***2001***	***Next Twelve*** *Months* *6/30/03*
Revenue ($mm)	1,029	736	638	564	**2,967**	803	**3,392**	**3,452**
Expense	847	551	444	368	**2,210**	580	**2,500**	**2,560**
Ebitda	182	185	194	196	**757**	223	**892**	**892**
Deprec., Deplet., & Amort.	30	36	37	39	**142**	41	**164**	**164**
Other Non Cash								
Ebit	152	149	157	157	**615**	182	**728**	**728**
Interest	50	45	41	36	**172**	40	**220**	**240**
Ebt	102	104	116	121	**443**	142	**508**	**488**
Income Tax								
Net Income ($mm)	102	104	116	121	**442**	142	**508**	**488**
General Partner	42	50	55	55	**202**	62	**248**	**248**
Limited Partner	60	54	61	66	**240**	80	**260**	**240**
G.P. Share	41%	48%	47%	45%	**46%**	44%	**49%**	**51%**
Units (mm)	229	289	314	303	**283**	296	**325**	**338**
General Partner Equivalent	94	140	149	137	**129**	130	**159**	**172**
Limited Partner	135	149	165	166	**154**	166	**166**	**166**
Net Income Per Unit ($/un)	0.45	0.36	0.37	0.40	**1.56**	0.48	**1.56**	**1.45**
Distribution ($mm)	114	126	147	148	**535**	161	**646**	**646**
General Partner	43	47	57	57	**204**	64	**254**	**254**
Limited Partner	71	78	91	91	**331**	98	**392**	**392**
G.P. Share	38%	38%	38%	38%	**38%**	39%	**39%**	**39%**
Distribution Per L.P. Unit	0.53	0.53	0.55	0.55	**2.15**	0.59	**2.36**	**2.36**
D.,D.&A. Per Unit	0.13	0.12	0.12	0.13	**0.50**	0.14	**0.51**	**0.49**
Cash Flow Per L.P. Unit	0.58	0.48	0.49	0.53	**2.06**	0.62	**2.07**	**1.93**
L.P. Dist/Cash Flow (%)	91%	108%	113%	104%	**104%**	95%	**114%**	**122%**
Dist/Net+DDA	0.86	0.90	0.96	0.93	**0.92**	0.88	**0.96**	**0.99**
Ebitda Margin	18%	25%	30%	35%	**26%**	28%	**26%**	**26%**
Tax Rate	0%	0%	0%	0%	**0%**	0%	**0%**	**0%**

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