Pipeline Stocks Sector Analysis

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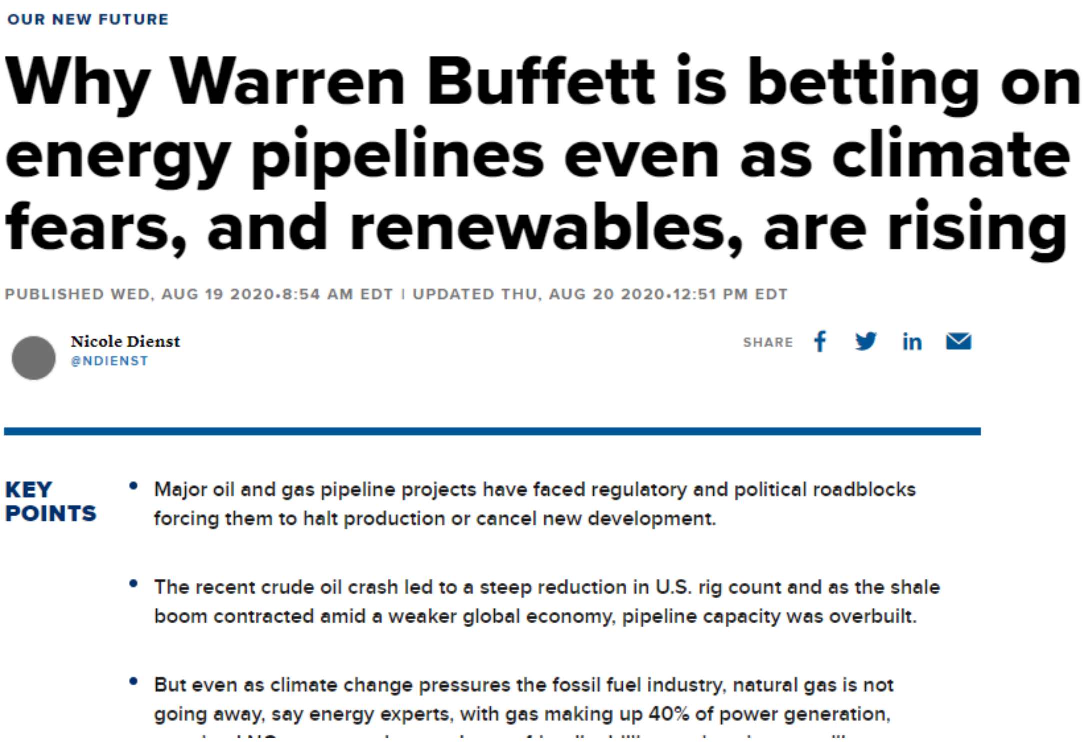
US Pipeline Sector Analysis

Studies suggest the global pipeline market could grow from USD$170.6 billion in 2020 to USD$262.1 billion in 2025 (a CAGR of 10%). Trouble is, globally, pipelines are often owned by governments or large conglomerates making it hard as investors to specifically invest in the market.



OUR NEW FUTURE

Why Warren Buffett is betting on energy pipelines even as climate fears, and renewables, are rising

PUBLISHED WED, AUG 19 2020•8:54 AM EDT | UPDATED THU, AUG 20 2020•12:51 PM EDT

Nicole Dienst
@NDIENST

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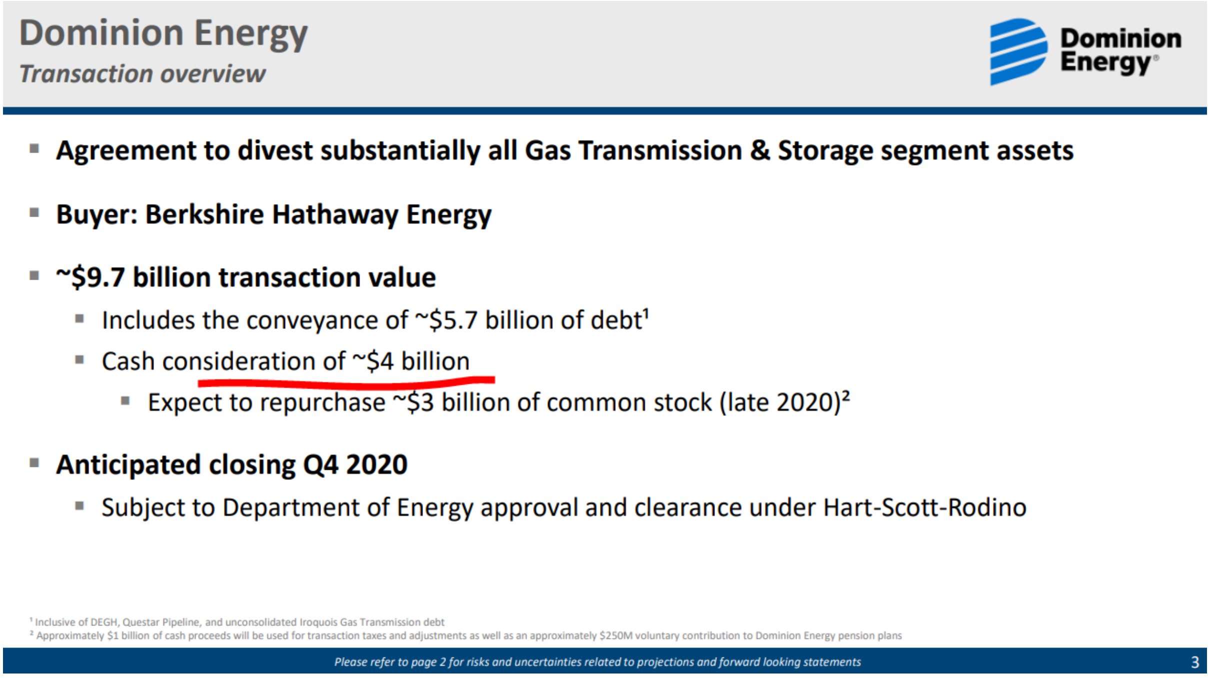
KEY POINTS

- Major oil and gas pipeline projects have faced regulatory and political roadblocks forcing them to halt production or cancel new development.
- The recent crude oil crash led to a steep reduction in U.S. rig count and as the shale boom contracted amid a weaker global economy, pipeline capacity was overbuilt.
- But even as climate change pressures the fossil fuel industry, natural gas is not going away, say energy experts, with gas making up 40% of power generation,

Buffett investing into pipelines - Source: CNBC

Recently, Berkshire Hathaway announced the purchase of Dominion Energies pipeline assets for $4 billion (plus $5.7 billion of debt) which means US pipeline stocks might be worth considering.



BRK pipeline transaction – Source: Dominion presentation

Analysts project that the Dominion pipeline assets will generate $1 billion in EBITDA, for Berkshire Hathaway Energy's pipelines unit, which will see mid-single-digit EBITDA growth. The $4 billion what Buffett paid, is thus at an estimated price of 4 times EBITDA, alongside the conveyance of the debt, which is equal to what you do when you buy a stock as you also get the debt a company has. From an EV/EBITDA perspective the price Buffett paid is 9.

Commentators theorized Buffett bought because Berkshire, as always, wants quality assets and a steady stream of revenue. Words like 'Toll booth cash flows' being used (meaning getting paid no matter what just for transportation of commodities).

So, quality assets, steady revenue streams, CAGR of 10%, license to print cash, what's not to like!?

Well, let's first analyze the risks and rewards of investing in pipeline stocks.

Company Structures and MLPs

Many of US Midstream oil companies (pipelines) are natural monopolies. For example, few people campaign for a new pipeline through their towns. As a result, they are regulated and have expensive barriers for entry. Midstream businesses are cyclical, with profitability and growth driven by the supply and demand for various energy products. Typically, they are capital intensive with high cash flow margins. So, in the past the US Government has tried to encourage investment in the sector as a way of fostering competition.

Often discussed in the same terms as REITs, many of these pipeline companies are Master Limited Partnerships (MLPs). Under US tax laws, only companies in certain industries – principally oil and gas infrastructure – are allowed to configure themselves as MLPs. The need for new pipelines and storage facilities created during the shale boom fueled demand. MLPs helped meet this demand.

Current US law, relating to MLPs, allows firms to pay no income tax, providing they are active in property or natural resources. They ‘distribute’ most of their cashflows direct to investors (like dividends). Instead of owning shares in energy companies, investors in MLPs receive ‘units’ that entitle them to the cash-flow from partnership-owned assets.

Each individual MLP is different, but on average an MLPs distribution is usually around 80% to 90% return of capital, and around 10% to 20% ordinary income.

MLPs tend to have plenty of depreciation and other non-cash charges. They’re tax efficient because depreciation on the assets becomes tax deductible at a partner level. This means they often have income that is significantly lower than the amount of cash they can distribute. The cash distributed is a return of capital.

If you are an accountant or taxman, a return of capital is not classed as income, instead, it is considered as the MLP returning a portion of its assets to unit holders.

Returns of capital reduce your costs as a result. Returns of capital are tax-deferred, meaning taxes for returns of capital are only due when an investor sells their MLP units.

However, taxes aside, most MLP investors have been encouraged to value their investments based solely on the distributions they receive, regardless of how they are financed and here lies the problem. An MLP might be tempted to pay out more distributions than can be supported by either profits or cashflow after capital expenditure. Instead, the MLP finances distributions through cheap debt and acquisitions. Leverage and risks may have increased as a result.

What does this mean in practice, why might it be an issue and are there any other problems other than potentially lots of debt and deferred tax?

General Partners and MLPs

If there is a limited partner in an MLP, then legally there must be a ‘general partner’ (GP) running the business. This is a lucrative job to have for a company. Typically, a GP owns a 2% interest in the MLP (along with some “units”).

Why might this be a problem?

To provide the investors with growth and sustain the distribution the MLP needs to buy new assets leading to growth in the distribution. As the distribution grows, the GP gets a bigger slice of the distribution cake, called Incentive Distribution Rights (IDR).

IDRs allow the general partner to get an outsized distribution should distributions grow. The aim, then, for the MLP is to keep issuing debt and equity to buy assets to expand the distribution, so the GP makes outsized gains.

The problem is when the MLP gets so big that growing further from a large base naturally becomes more challenging (basic mathematics). And with a disproportionate cash flow being siphoned by the GP, there is less cash for MLP units and for funding growth.

But with MLPs, the depletion and depreciation remains a real cost which must be capital accounted. While it is true that the charge is tax deductible, taxes are never avoided just deferred until the units are sold.

So MLPs eventually struggle to grow, the pot gets smaller and there is a looming tax issue, unless you never, ever sell.

As a result, several MLPs have, in recent years, reverse financially engineered themselves back to the more normal US corporate structure. For example, Kinder Morgan and Williams.

Comments on MLPs

I have seen analysts using words like "Ponzi scheme" when referring to MLPs. Moody's, the rating agency, recently commented that "MLPs provide less protection for investors than do typical public companies……checks and balances tend to be weaker".

Others, think they are the best thing since sliced bread! Largely sold on their tax benefits, which increase returns. Only you can decide how you invest.

A couple of things I would draw your attention to, however. Depending on where you live in the world, it may complicate your tax returns

For example, if you are a US Citizen, holding MLPs in a retirement account is often mentioned as a good way of removing the tax issues. But, if a US investor, uses a retirement plan to conduct or invest in a business activity, they must file separate tax forms to report Unrelated Business Income (UBI) and may owe Unrelated Business Taxable Income (top rate 37%). In addition, if a US investor holds more than USD$1000 in UBI they must get their broker to file a separate tax form. In other words, its not straightforward.

As a non US citizen, living in Europe, this tax issues might not affect me, I don't know, I haven't looked, but, as a rule "complicated" in investing often mean less liquidity and higher transaction costs.

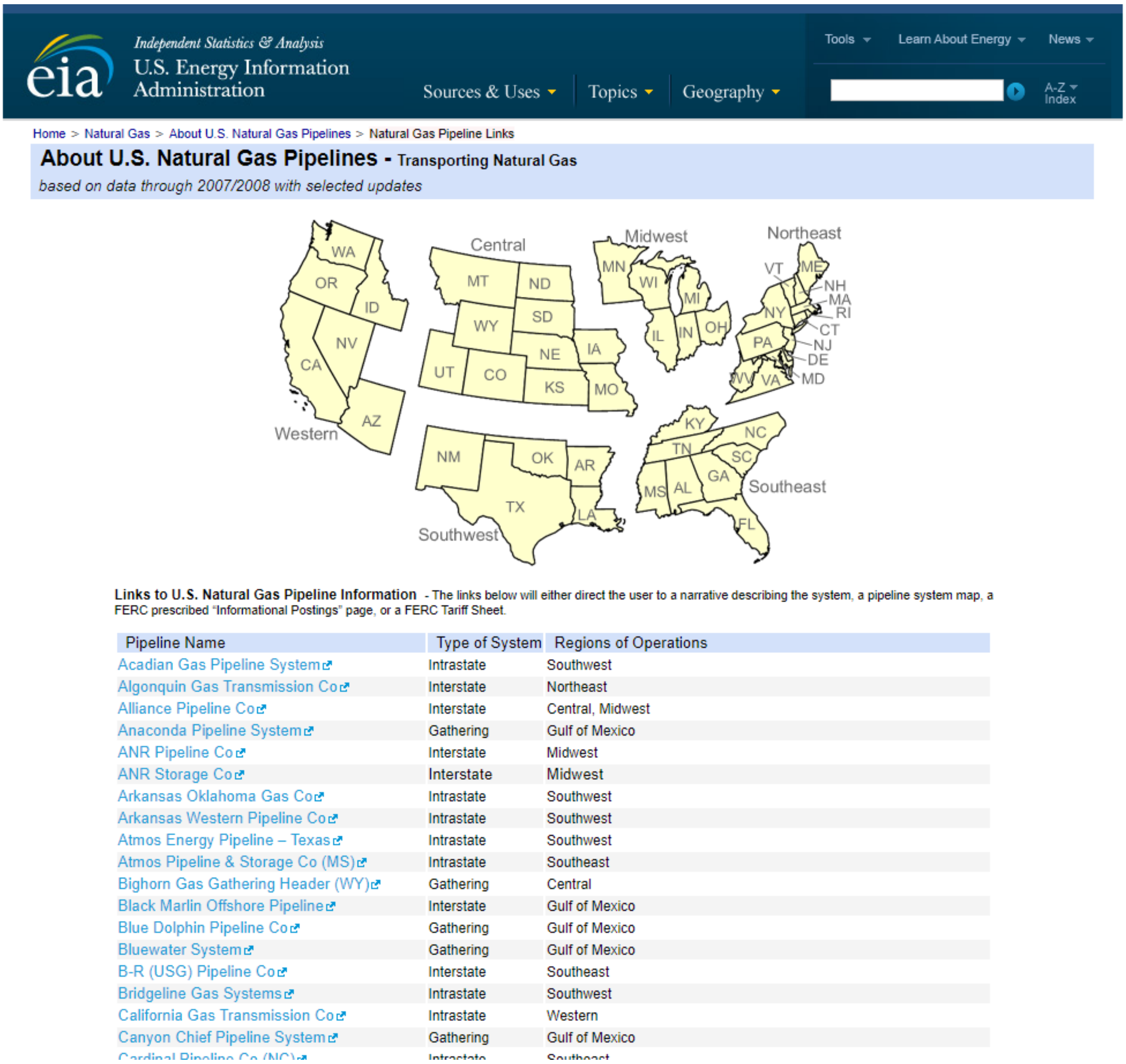
Some (foreign investors) may find the process of buying 'units' rather than shares through their brokers slightly more difficult ('phone rather than online, volume levels etc). Brokers, especially based in other countries, are not always set up to deal with unusual share structures. They make money selling what everyone wants, not doing the unusual.

As I say, I cannot give advice on what potential risks to take, advice on personal tax issues or on individual brokers. People must make their own mind up, consider speaking to an accountant AND DO THEIR OWN RESEARCH.

Fortunately, not all pipeline companies are MLPs.

US Pipeline Stocks

If you look at the EIA website, you will see there are literally hundreds of pipelines and pipeline companies based in the USA.



Pipeline Name	Type of System	Regions of Operations
Acadian Gas Pipeline System	Intrastate	Southwest
Algonquin Gas Transmission Co	Interstate	Northeast
Alliance Pipeline Co	Interstate	Central, Midwest
Anaconda Pipeline System	Gathering	Gulf of Mexico
ANR Pipeline Co	Interstate	Midwest
ANR Storage Co	Interstate	Midwest
Arkansas Oklahoma Gas Co	Intrastate	Southwest
Arkansas Western Pipeline Co	Intrastate	Southwest
Atmos Energy Pipeline – Texas	Intrastate	Southwest
Atmos Pipeline & Storage Co (MS)	Intrastate	Southeast
Bighorn Gas Gathering Header (WY)	Gathering	Central
Black Marlin Offshore Pipeline	Interstate	Gulf of Mexico
Blue Dolphin Pipeline Co	Gathering	Gulf of Mexico
Bluewater System	Gathering	Gulf of Mexico
B-R (USG) Pipeline Co	Interstate	Southeast
Bridgeline Gas Systems	Intrastate	Southwest
California Gas Transmission Co	Intrastate	Western
Canyon Chief Pipeline System	Gathering	Gulf of Mexico
Cardinal Pipeline Co (NC)	Intrastate	Southeast

US pipeline companies - Source: [EIA]

But 82% of the larger diameter pipelines are owned by 10 companies and are popular with investors for various reasons.

To start with I will compare the metrics of some of these firms, to see if we can find value. If I do, I will dig deeper into an individual company.

US Pipeline stocks - Valuation

Note: All these companies are shown as listed NYSE and all prices quoted are in USD millions (unless otherwise stated). For various reasons, I have included Dominion Energy. Berkshire now owns some of their assets. TC Energy was until recently called TransCanada. Some of these companies are utility companies, but my interest is largely natural gas.

Stocks: Enbridge Inc ENB, Energy Transfer LP ET, Enterprise Products Partners LP EPD, TC Energy Corp TRP, Kinder Morgan Inc KMI, Williams Companies Inc WMB, MPLX LP MPLX, ONEOK Inc OKE, Dominion Energy Inc, D, PG&E Corp PCG, Enable Midstream Partners LP ENBL.

Let's start with a bit of fun (well fun if you like analysing stocks and don't get out much).

As mentioned earlier Berkshire Hathaway recently bought the pipeline assets of Dominion Energy for USD$4 billion in cash (9.7 billion assets, 5.7 debt). This price is 4 times EBITDA or 9 EV/EBITDA.

Let's apply this metric to the current EBITDA of the above companies and MLPs to see if their current share price is above or below their valuation of 4x EBITDA. This will give us a basic indication, using Buffett's measurement, if they are cheap/expensive and of any margin of safety.

US Pipeline Stocks Valuation

Company	Market Cap ($	Shares Outstanding (Basic Average)	EBITDA	4x EBITDA Valuation	Valuation per share	Current Share Price	Margin of Safety	Market Cap/EBITDA
Enbridge Inc	87497.92254	2026.353	11466.89	45867.548	22.64	43.18	-48%	7.63
Energy Transfer LP	27553.76	2704	11318	45272	16.74	10.19	64%	2.43
Enterprise Products Partners LP	53955.057	2185.3	7341.7	29366.8	13.44	24.69	-46%	7.35
TC Energy Corp	51273.29632	980.744	5638.921	22555.684	23.00	52.28	-56%	9.09
Kinder Morgan Inc	42242.25	2265	6610	26440	11.67	18.65	-37%	6.39
Williams Companies Inc	35436.69	1215.25	4573	18292	15.05	29.16	-48%	7.75
MPLX LP	32392.92	1029	5026	20104	19.54	31.48	-38%	6.45
ONEOK Inc	29069.92881	446.337	3126.339	12505.356	28.02	65.13	-57%	9.30
Dominion Energy Inc	61777.494	806.6	6978	27912	34.60	76.59	-55%	8.85
PG&E Corp	22847.35	1985	5634	22536	11.35	11.51	-1%	4.06
Enable Midstream Partners LP	3801.84	438	776	3104	7.09	8.68	-18%	4.90

Source: Authors data – Oct 2021

From a margin of safety, compared to what Buffett paid and assuming equal debt to equity ratios, most companies are overvalued. The exception is Energy Transfer LP (ET) but it has had plenty of leverage issues in the past, it is not cash flow positive yet and therefore it is likely the market sees it as riskier. P&G is trading at a level what Buffett paid for his pipeline, but you never know what will be the consequences of the $59 billion restructuring plan for investors.

Of the non MLP structured companies, Kinder Morgan appears to fare best. Kinder is trading at 6.39x its Market Cap to EBITDA, slightly below the average of 6.75. At a Buffett valuation of 4x EBITDA it has a valuation price of USD$11.67 while its current share price is USD$18.65.

The above shows how Buffett sticks to the value investing mantra; be greedy when others are fearful, and how he executes very well on that over time.

Buying a pipeline in 2020, when most of the market's sentiment was strongly oriented towards sustainability and against fossil fuels but when the economy was and still is, mostly using fossil fuels, shows exactly what value investing is and how it should be applied. Buffett liked the cash produced by the pipeline and the likely future cash flows streams, even in the worst case, 'sustainable' scenario for fossil fuels. Pure value investing, i.e. when you like the returns a business will deliver in the future even in the worst possible scenario.

Of course, 2020 was an exceptional year and we all had great returns since, but we are now in 2021 and some pipeline stocks haven't gone up as much as the market or, especially other commodity stocks like copper miners, iron ore or aluminium producers.

I'll analyse Kinder Morgan to see whether it pays to dig deeper into the sector or not. But before analysing KMI, I have to discuss the elephant in the room when it comes to pipelines: debt. We must also consider that debt for Buffett is no issue because he can refinance whatever he wants with the $150 billion of cash on the balance sheet and Berkshire's credit rating, but that doesn't hold for most of pipeline businesses and Dominion being forced to sell its pipeline to Buffett to deleverage is a perfect example of that. Btw. they sold at the worst possible time in a market downturn when Buffett was happy to buy.

Debt

One of the accusations against MLPs and several other companies I could mention is that they have too much debt and cannot afford to operate at higher interest rates or with weaker cashflows. Debt and poor cashflow can be a killer.

DEBTS									
Company	**Price**	**Net Issuance of Debt**	**Debt-to-Equity**	**Debt-to-Asset**	**Net Debt/EB**	**Interest Coverage**	**Short-Term Debt**	**Long-Term Debt**	**Total Debt**
Enbridge Inc	39.93	3477.954	1.10	0.43	**605%**	**3.19**	4072.774	49903.144	53975.918
Energy Transfer LP	9.355	-5079	1.73	0.49	**466%**	**3.83**	674	45612	46286
Enterprise Products Partners LP	22.255	-1064.7	1.15	0.44	**390%**	**3.85**	1398.9	27148.6	28547.5
TC Energy Corp	48.18	4893.814	1.63	0.52	**852%**	**2.65**	6094.527	35269.951	41364.478
Kinder Morgan Inc	15.975	-886	1.08	0.47	**526%**	**2.95**	2072	30967	33039
Williams Companies Inc	24.185	275	2.02	0.51	**626%**	**2.28**	2143	21091	23234
MPLX LP	28.34	-875	1.46	0.55	**411%**	**4.34**	1	19234	19235
ONEOK Inc	52.63	-119.89	2.41	0.61	**489%**	**3.27**	536.107	13637.581	14173.688
Dominion Energy Inc	77.3	4654	1.50	0.41	**919%**	**3.37**	5124	34585	39709
PG&E Corp	9.31	1002	2.05	0.44	**1214%**	**1.54**	6633	35955	42588
Enable Midstream Partners LP	7.83	-259	0.58	0.35	**527%**	**3.37**	171	3153	3324
Average		547.20	1.52	0.47	6.39	3.15	2629.12	28777.84	31406.96

Debt overview for pipelines – Author's calculations

However, many companies have been paying off debt in the last 12 months. Traditionally, midstream companies with their capex etc have had higher debt requirements. This is reflected in the high debt ratios.

As can be seen most have ok coverage of interest payments, the lowest being PG&E. Personally, I like to see a company with an interest coverage greater than 5, but here an average of 3 is ok, especially in this low-rate financial system. But there is always the question what happens if the financial environment changes that we'll touch a bit more on in the final conclusion on KMI stock.

Kinder Morgan Stock Analysis

Let’s look at what is going on with KMI stock price, give a key factor business & financial overview, make a stock valuation, and conclude with the investment risk and reward thesis.

Kinder Morgan Stock Price Overview

KMI stock has been notorious over the last decade and hasn’t recovered from the 2015/2016 crash. However, as we will see in the fundamental and business analysis, a lot has changed from those overleveraged and overpromising early to mid 2010s. But, to add gas to the fire, the early 2020s are all in for sustainable energy where projections go as far as complete fossil fuel eradication which would be negative for KMI.

KMI stock price overview

The negative sentiment towards fossil fuels and uncertain long-term outlook is likely why KMI hasn’t done as good as many energy stocks did over the last 12 months. KMI stock is still below its 2020 pre-covid peak.

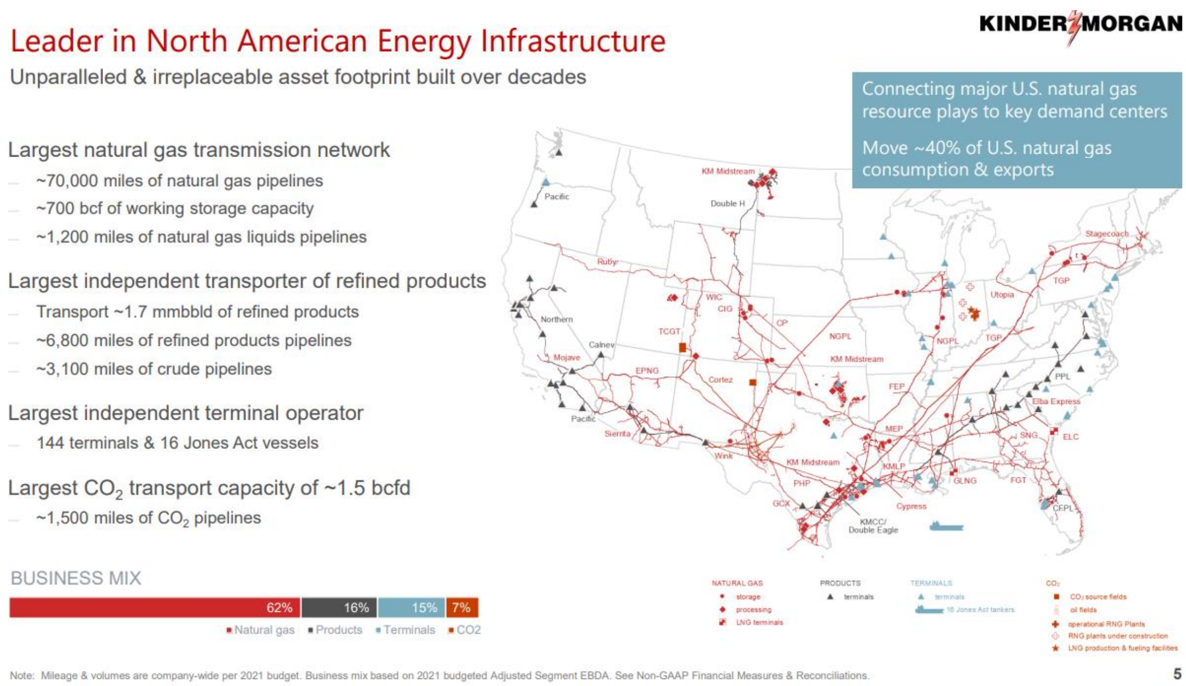
A sector that has lost money for many investors usually carries a stigma for a long time, but such a stigma often creates a great place to fish for investing opportunities.

Plus, when it comes to sustainability one has to carefully differentiate between reality and noise. For example, while the sustainability talk is stronger and stronger, 2020 was the year where SUVs passed the 50% market share according to IHS Markit analysis. As investors we must eliminate emotions and focus on facts.

Let's give a business overview of KMI, make a fundamental analysis, a KMI stock valuation and investment conclusion based on the market outlook we have made above and the specific business factors.

Kinder Morgan Stock Analysis – Business Overview

KMI owns 70,000 miles of natural gas pipelines, 700 billion cubic feet (bcf) of gas storage capacity, 1,200 miles of liquid gas pipe and roughly a combined total of 10,000 miles of oil pipeline among other things like CO2 transport capacity, 144 terminals and 16 Jones Act vessels.



Kinder Morgan Business Overview – Source: KMI Stock Presentation 2021

The company is not limited to what it already owns but is also investing for future growth. The pipeline is there, and we can expect further investments where the contracted return on investment is above the cost of capital.

KINDER MORGAN

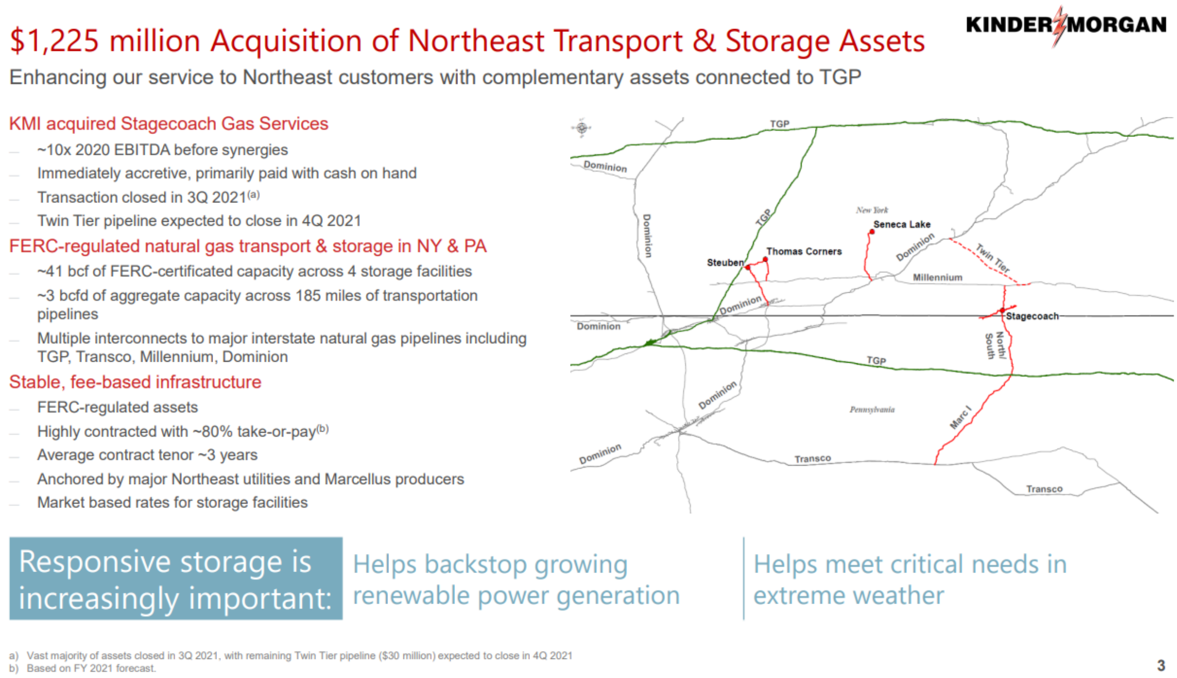
$1.3 Billion Project Backlog as of 6/30/2021

Primarily focused on contracted natural gas opportunities

	DEMAND PULL	SUPPLY PUSH	CAPITAL ($ billion)	ESTIMATED IN-SERVICE	PIPELINE CAPACITY
Supply for U.S. power & LDC demand (TGP, FGT, TX intra, SNG)	●		$ 0.4	Q3 2021 – 2023	1.0 bcfd
Supply for LNG export (KMLP & EPNG)	●		0.2	Q1 2022 – Q2 2022	1.0 bcfd
Gathering & processing (primarily Hiland, Altamont & KinderHawk)		●	0.2	Q3 2021 – 2022	various
Other natural gas	●	●	0.1	Q3 2021 – 2023	0.1 bcfd
Natural Gas			$ 0.9	~64% of total with 4.1x EBITDA build multiple on average	
Products		●	0.1		
Terminals		●	0.1		
CO_2		●	0.4		
Total backlog			$ 1.3		

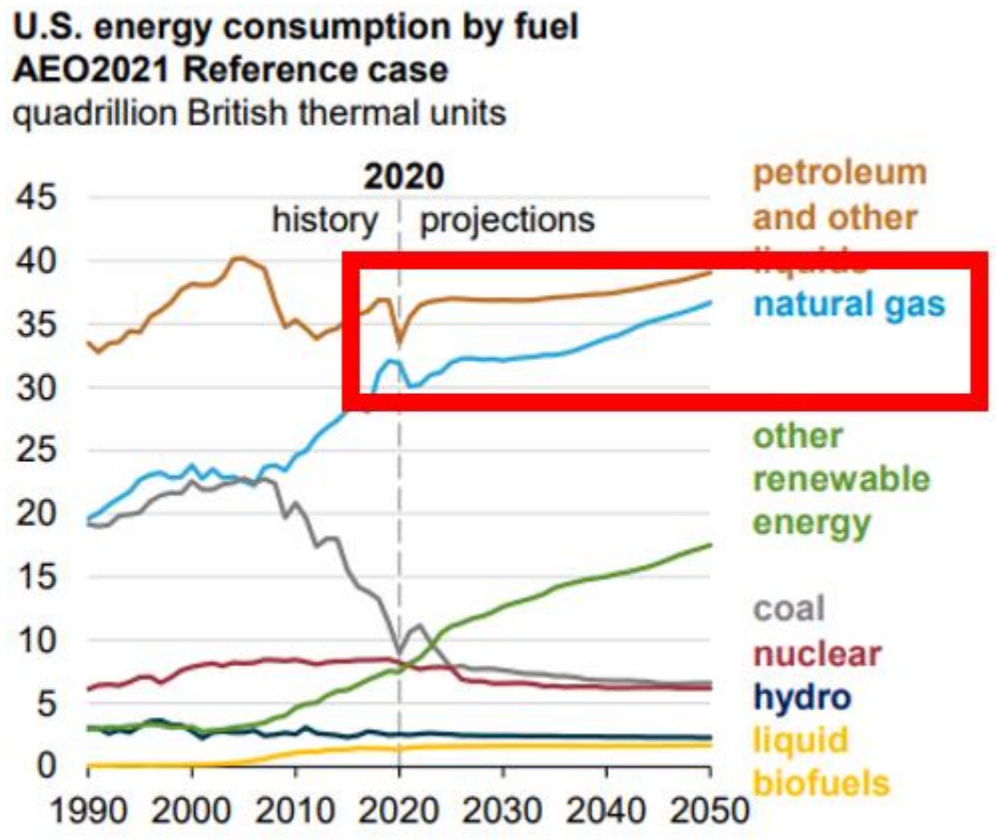
Kinder Morgan Business Overview – Source: [KMI Stock Presentation 2021]

Another growth strategy is through acquisitions like the $1.2 billion acquisition of Northeast Transport & Storage and the $310 million Acquisition of Kinetrex Energy.



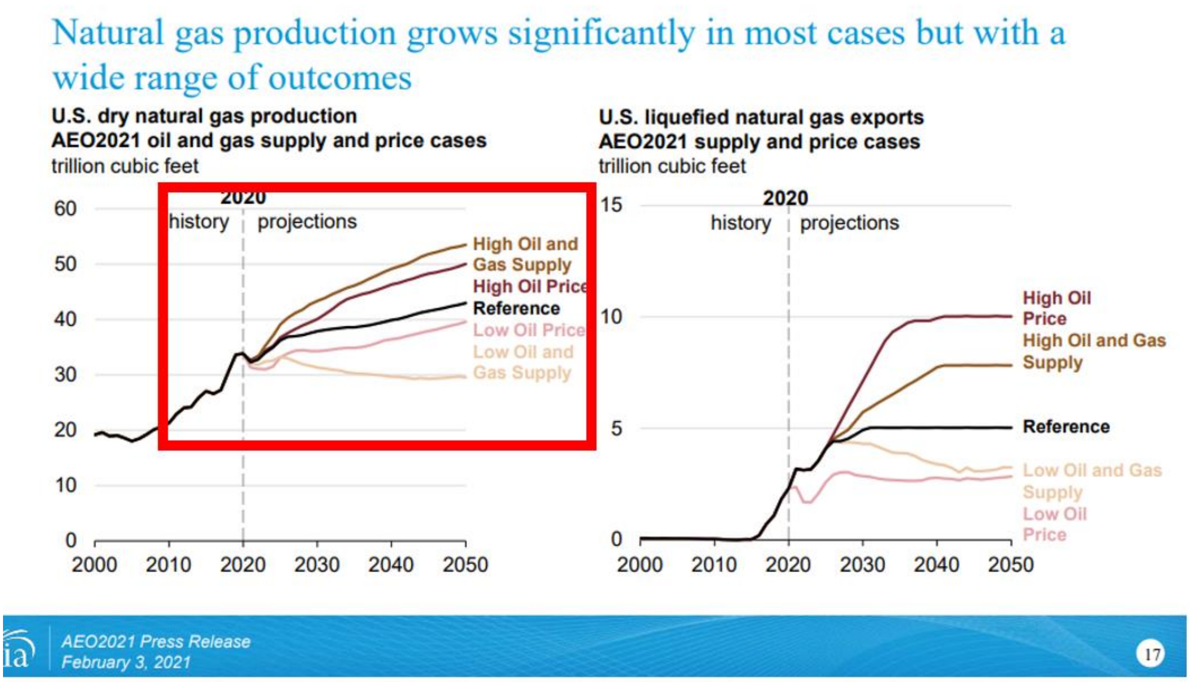
Kinder Morgan Business Overview – Source: [KMI Stock Presentation 2021]

If the environment for natural gas stays in the range of the EIA projections with slow and steady growth in natural gas demand over the next 20 years and longer, KMI will likely be a good investment.



Natural gas demand outlook – Source: [EIA Annual Energy Outlook 2021]

But, if the situation gets worse than the above projection for fossil fuels, then KMI might be in trouble alongside other pipeline investments due to debt issues.

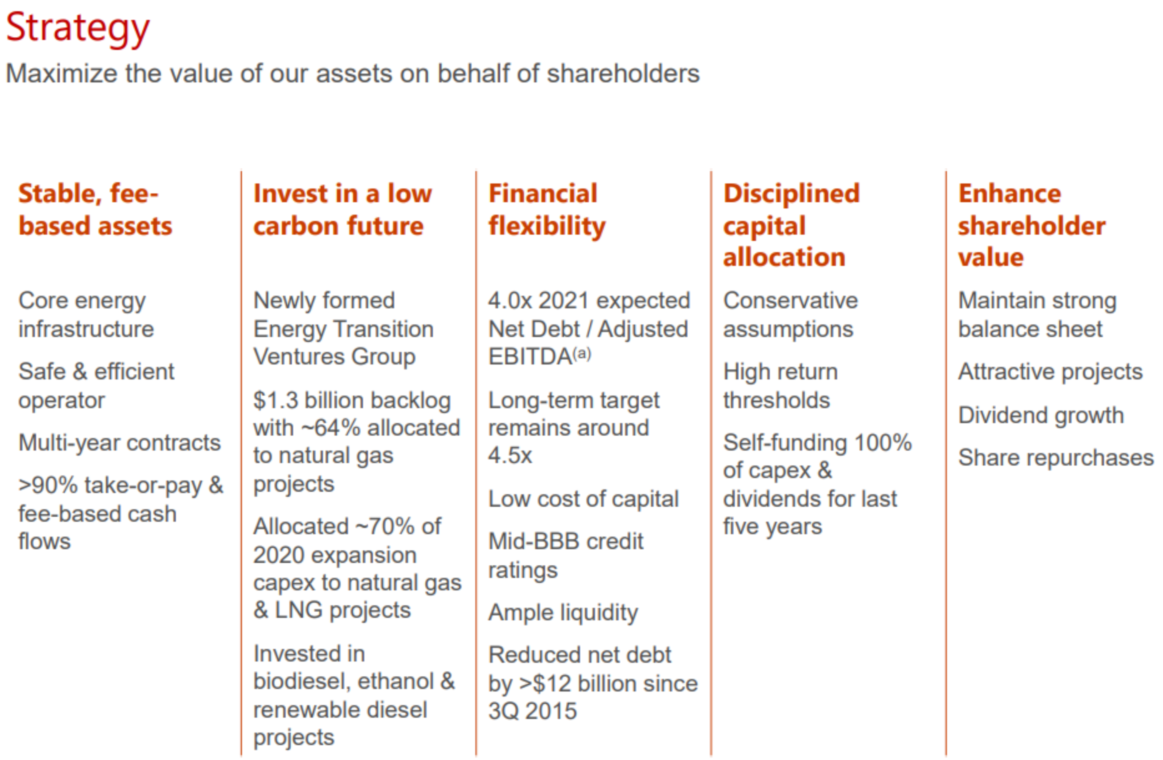


Natural gas demand outlook – Source: [EIA Annual Energy Outlook 2021]

As shown above, in the worst-case scenario, there might be no growth ahead for natural gas, which could bring to new difficult times for KMI in relation to pricing power and returns on the investments made. On the other hand, in the best-case scenario, KMI's toll-like pipelines will print money for decades and achieve great returns for investors. Let's look at financials to get the right inputs for a KMI stock valuation.

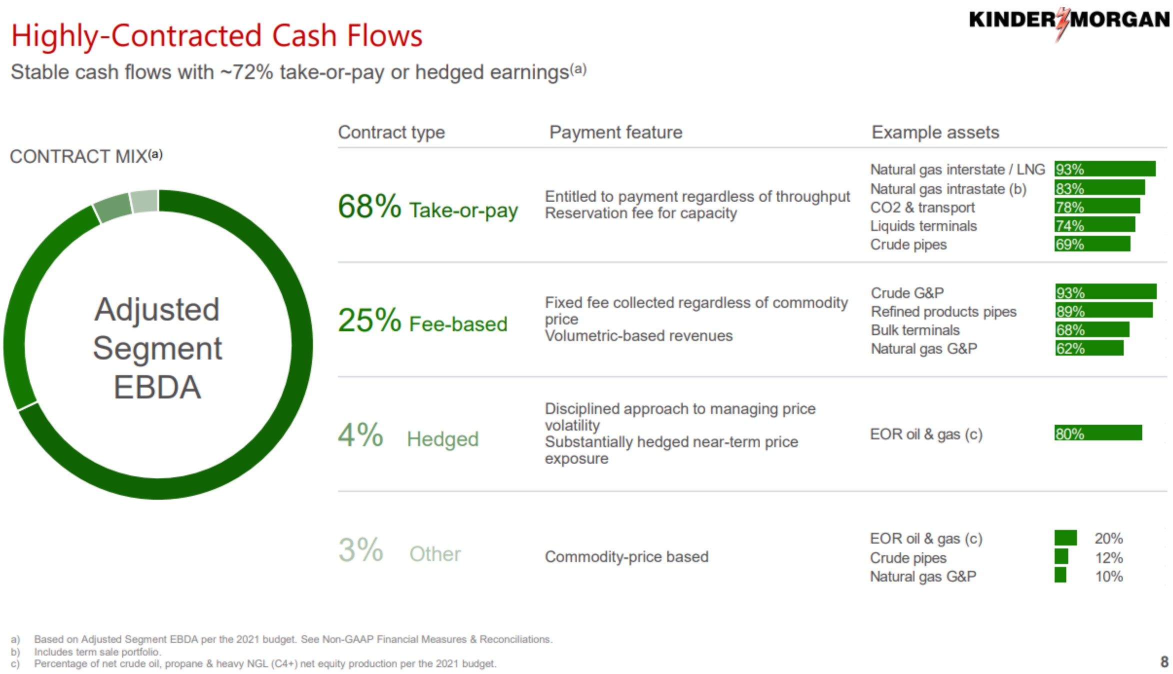
KMI Stock Analysis – Financials

The key factors when it comes to KMI financials are: cash flows, growth ahead and especially long-term business sustainability alongside the debt.



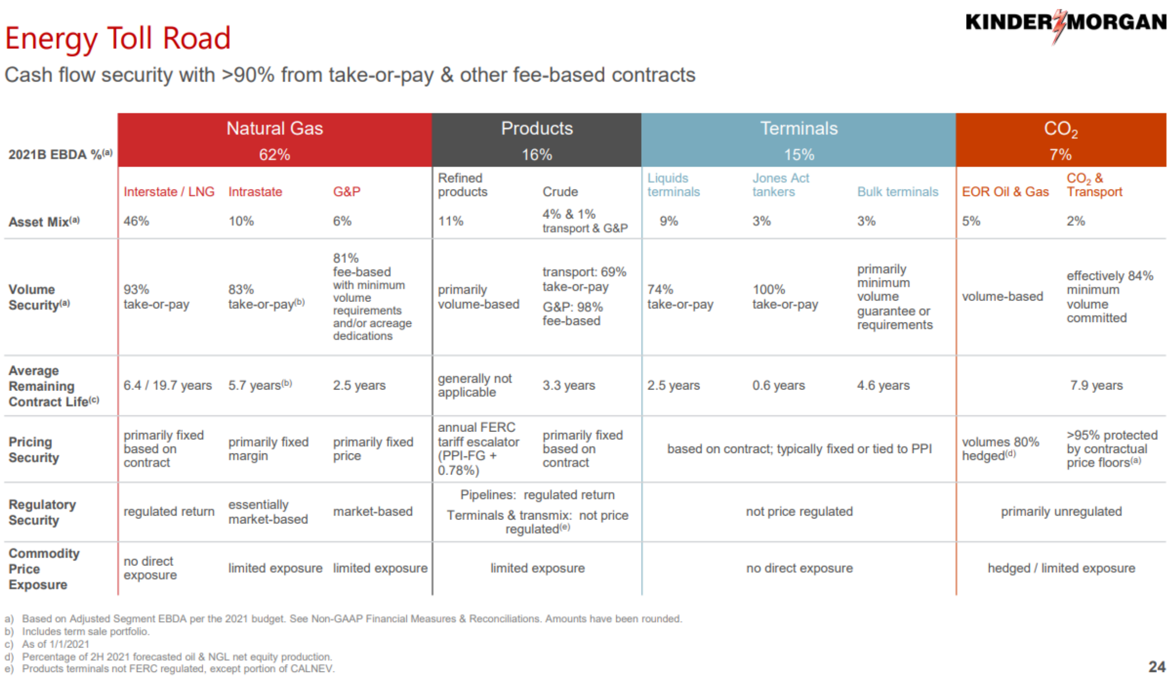
Kinder Morgan Financial Strategy – Source: [KMI Stock Presentation 2021]

The company is focused on natural gas growth, keeping debt levels stable and rewarding shareholders through dividends and buybacks.



Kinder Morgan Cash Flows – Source: KMI Stock Presentation 2021

A high level of contracted cash flows offers stability and less volatility over the natural commodity cycles. Of course, when prices are low, KMI will have to make cheaper long-term contracts and vice versa, but given the low maintenance costs, it should make money.



Energy Toll Road

KINDER MORGAN

Cash flow security with >90% from take-or-pay & other fee-based contracts

2021B EBDA %(a)	Natural Gas 62%			Products 16%		Terminals 15%			CO_2 7%	
	Interstate / LNG	Intrastate	G&P	Refined products	Crude	Liquids terminals	Jones Act tankers	Bulk terminals	EOR Oil & Gas	CO_2 & Transport
Asset Mix(a)	46%	10%	6%	11%	4% & 1% transport & G&P	9%	3%	3%	5%	2%
Volume Security(a)	93% take-or-pay	83% take-or-pay(b)	81% fee-based with minimum volume requirements and/or acreage dedications	primarily volume-based	transport: 69% take-or-pay G&P: 98% fee-based	74% take-or-pay	100% take-or-pay	primarily minimum volume guarantee or requirements	volume-based	effectively 84% minimum volume committed
Average Remaining Contract Life(c)	6.4 / 19.7 years	5.7 years(b)	2.5 years	generally not applicable	3.3 years	2.5 years	0.6 years	4.6 years	7.9 years	
Pricing Security	primarily fixed based on contract	primarily fixed margin	primarily fixed price	annual FERC tariff escalator (PPI-FG + 0.78%)	primarily fixed based on contract	based on contract; typically fixed or tied to PPI			volumes 80% hedged(d)	>95% protected by contractual price floors(a)
Regulatory Security	regulated return	essentially market-based	market-based	Pipelines: regulated return Terminals & transmix: not price regulated(e)		not price regulated			primarily unregulated	
Commodity Price Exposure	no direct exposure	limited exposure	limited exposure	limited exposure		no direct exposure			hedged / limited exposure	

a) Based on Adjusted Segment EBDA per the 2021 budget. See Non-GAAP Financial Measures & Reconciliations. Amounts have been rounded.
b) Includes term sale portfolio.
c) As of 1/1/2021
d) Percentage of 2H 2021 forecasted oil & NGL net equity production.
e) Products terminals not FERC regulated, except portion of CALNEV.

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Kinder Morgan Cash Flows – Source: KMI Stock Presentation 2021

The only long-term issue would be less and less natural gas production and consumption but that is not a scenario that is likely at the moment, especially if we focus on the EIA projections, but it is something to keep in mind. If cash flows start to decline, then the debt would immediately become an issue again, like it was the case in 2015/2016.

KINDER MORGAN, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In millions, except per share amounts, unaudited)

	June 30, 2021	December 31, 2020
Total current liabilities	5,059	5,074
Long-term liabilities and deferred credits		
Long-term debt		
Outstanding	30,008	30,838
Debt fair value adjustments	1,069	1,293
Total long-term debt	31,077	32,131
Other long-term liabilities and deferred credits	2,216	2,202
Total long-term liabilities and deferred credits	33,293	34,333
Total Liabilities	38,352	39,407
Commitments and contingencies (Notes 3 and 9)		
Redeemable Noncontrolling Interest	683	728
Stockholders' Equity		
Class P shares, $0.01 par value, 4,000,000,000 shares authorized, 2,264,604,747 and 2,264,257,336 shares, respectively, issued and outstanding	23	23
Additional paid-in capital	41,793	41,756
Accumulated deficit	(10,496)	(9,936)
Accumulated other comprehensive loss	(609)	(407)
Total Kinder Morgan, Inc.'s stockholders' equity	30,711	31,436
Noncontrolling interests	429	402
Total Stockholders' Equity	31,140	31,838
Total Liabilities, Redeemable Noncontrolling Interest and Stockholders' Equity	$ 70,175	$ 71,973

The accompanying notes are an integral part of these consolidated financial statements.

KMI Q2 2021 financials statements – Source: KMI investor relations

Kinder Morgan has been lowering debt since the 2015 extreme levels, but the $30 billion currently on the balance sheet are still a mountain of debt, especially for a company that has very long dated assets.

KMI debt levels – Source: [Macrotrends]

For me, of the non MLP companies, Kinder Morgan nudges it. Kinder appears fairly ok across debt measurements. Notice I said ok, not great. Rating agency [Fitch in 2020 rated Kinder's] debt with a "generic bankruptcy assumption". This has recently been removed in 2021. To me, they do not look like they are going bust soon. But in past difficulties they have cut their dividends by around 70%. Could this happen again? My guess is they would have done it by now if they were going to but I still feel the burden of the debt hanging above KMI.

KMI Stock Valuation

However, from a cash flow perspective, KMI looks attractive at current prices.

Kinder Morgan Inc Class P KMI | ★★★★

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Financials

Export Ascending

	2011-12	2012-12	2013-12	2014-12	2015-12	2016-12	2017-12	2018-12	2019-12	2020-12	TTM
Revenue USD Mil	8,264	9,973	14,070	16,226	14,403	13,058	13,705	14,144	13,209	11,700	14,395
Gross Margin %	40.2	55.1	49.8	48.7	55.4	56.3	51.8	52.5	57.0	59.8	54.7
Operating Income USD Mil	1,532	2,580	3,891	4,723	4,513	3,958	3,556	3,958	3,928	3,492	4,473
Operating Margin %	18.5	25.9	27.7	29.1	31.3	30.3	25.9	28.0	29.7	29.8	31.1
Net Income USD Mil	594	315	1,193	1,026	253	708	183	1,609	2,190	119	1,714
Earnings Per Share USD	0.74	0.35	1.15	0.89	0.10	0.25	0.01	0.66	0.96	0.05	0.76
Dividends USD	0.74	1.34	1.56	1.70	1.93	0.50	0.50	0.72	0.95	1.04	1.06
Payout Ratio % *	82.5	239.2	143.8	139.1	413.3	—	89.3	—	100.0	—	139.1
Shares Mil	708	908	1,036	1,137	2,193	2,230	2,230	2,216	2,264	2,263	2,264
Book Value Per Share * USD	4.30	13.39	12.87	5.90	15.93	15.52	15.89	14.80	14.85	13.94	13.55
Operating Cash Flow USD Mil	2,365	2,795	4,064	4,467	5,303	4,787	4,601	5,043	4,748	4,550	5,629
Cap Spending USD Mil	-1,200	-2,022	-3,369	-3,617	-3,896	-2,882	-3,188	-2,924	-2,270	-1,707	-1,289
Free Cash Flow USD Mil	1,165	773	695	850	1,407	1,905	1,413	2,119	2,478	2,843	4,340
Free Cash Flow Per Share * USD	1.43	0.85	0.72	0.96	0.27	1.03	0.71	0.68	1.04	1.33	—
Working Capital USD Mil	-2,865	-1,535	-2,207	-2,610	-1,241	-2,695	-3,466	-1,835	-1,862	-1,871	—

KMI stock financials – Source: [Morningstar]

As the project pipeline has been lowered to $1.3 billion per year compared to much higher levels in the last 10 years, even reaching $4 billion in 2015, excluding acquisitions, we could estimate the company to reach free cash flows in line with those of the last 12 months, or $4.3 billion per year.

KINDER MORGAN

2021 Forecast as of August 2021

Committed to maintaining a strong balance sheet & returning value to shareholders

Key metrics	2021 Forecast	Variance to 2021 Budget	
Net income	$1.7 billion	-$0.4 billion	Due primarily to 2Q $1.6 billion S Texas G&P impairment, partially offset by 1Q $1.1 billion Uri benefit
Adjusted EBITDA	$7.9 billion	+$1.1 billion	Due primarily to one-time benefit from Winter Storm Uri, as well as partial year contribution from Stagecoach acquisition
Distributable Cash Flow (DCF)	$5.4 billion	+$1.0 billion	
Discretionary capital[(a)]	$2.4 billion	+$1.6 billion	Due to $1.2 billion Stagecoach acquisition and $0.4 billion Kinetrex acquisition and expansion capital
Dividend / share	$1.08	-	
Year-end Net Debt / Adj. EBITDA	4.0x	-0.6x	

~$0.6 billion DCF in excess of discretionary capital[(a)] & dividends

~3% Dividend increase from 2020

Note: See Non-GAAP Financial Measures & Reconciliations.
a) Includes growth capital & JV contributions for expansion capital, debt repayments & net of partner contributions for our consolidated JVs.

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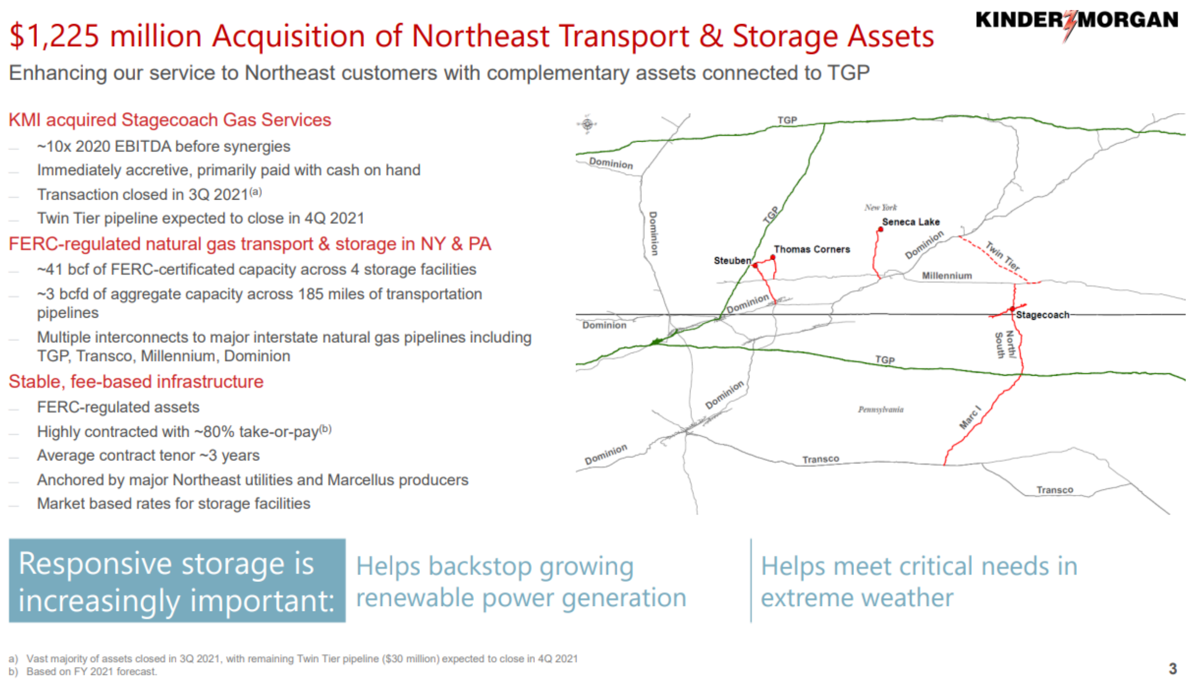
KMI 2021 financials – Source: [KMI investor presentation]

If I adjust the above for the Winder Storm Uri benefit and the Stagecoach acquisition, we get to $4.3 billion of distributable cash flows per year. That is just shy of a 10% FCF yield on the current market capitalization of $45 billion.

KMI will likely pay $2.6 billion for 2021 dividends and do buybacks alongside the acquisitions it made. Now, we have to find the best metric to use for a KMI stock valuation. One can use free cash flows but in this case, I will use dividends as pipelines are usually looked at through their yield. I will also keep in consideration the buybacks as those, if continued, will increase the dividend per share in the future.

KMI has distributable cash flows of $4.4 billion, thus that should be the value created through either dividends, buybacks, debt repayments or new acquisitions. The last acquisition was made at 10 times EBITDA which is not cheap as Buffett paid 4 times EBITDA but while also assuming the debt. If we take KMI's cash purchase, then it is equal to what Buffett paid as there was no debt involved.



KMI $1.225 billion acquisition – Source: KMI investor presentation

I am going to take the $1.08 dividend as a starting point which leaves around $2 billion of distributable cash flows per year. I will assume one billion will be used for organic growth and investments while one for acquisitions. A billion of buybacks a year gives a 2.2% buyback yield, a rate at which I will increase the dividend payment per year. $1 billion of investments at an EBITDA rate of 10 should likely return $70 million per year in distributable cash flows, or another 2.8% growth in dividend yield. If we assume another 2.5% inflationary growth, KMI stock now offers a 5.7% yield that is likely to grow at 2.8% thanks to buybacks and 2.5% thanks to investments for a total dividend growth rate of 5.3%.

Kinder Morgan

STOCK VALUE LIST'!A1

												Terminal Value	Growth rate	
Scenario 1	DIVIDEND PER SHARE	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2031	5%	next 5 years
normal case	1.08	1.14	1.20	1.26	1.33	1.40	1.47	1.55	1.63	1.72	1.81	34.38	5%	5 to 10 years
	10%)	1.03	0.99	0.95	0.91	0.87	0.83	0.80	0.76	0.73	0.70	13.26	10%	Discount rate
	INTRINSIC VALUE	21.82											20.0	Terminal multiple

												Terminal Value	Growth rate	
Scenario 2	DIVIDEND PER SHARE	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2031	8%	next 5 years
best case	1.08	1.17	1.26	1.36	1.47	1.59	1.71	1.85	2.00	2.16	2.33	53.97	8%	5 to 10 years
0	10%)	1.06	1.04	1.02	1.00	0.99	0.97	0.95	0.93	0.92	0.90	20.81	10%	Discount rate
	Present value sum	30.59											25.0	Terminal multiple

												Terminal Value	Growth rate	
Scenario 3	DIVIDEND PER SHARE	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2031	0%	next 5 years
worst case	1.08	1.08	1.08	1.08	1.08	1.08	1.08	1.08	1.08	1.08	1.08	16.20	0%	5 to 10 years
0	10%)	0.98	0.89	0.81	0.74	0.67	0.61	0.55	0.50	0.46	0.42	6.25	10%	Discount rate
	Present value sum	12.88											15.0	Terminal multiple

Scenario	Probability	PV	Part
Scenario 1 (normal case)	0.6	21.82	13.09
Scenario 2 (best case)	0.2	30.59	6.12
Scenario 3 (worst case)	0.2	12.88	2.58
		Sum	21.78

SVEN CARLIN
RESEARCH PLATFORM

Disclaimer: This is just for educational purposes and not for investing advice!

MADE BY STOCK MARKET RESEARCH PLATFORM

KMI stock valuation – Source: Sven Carlin Research Platform (downloadable template)

For an expected 10% return, which is the discount rate I used, with a long-term expected dividend yield of 5%, KMI is slightly undervalued as a stock. However, the above valuation implies that in 10 years, KMI will still be pumping gas and that the valuation will remain close to the current one which is also the biggest risk I perceive when it comes to investing in KMI stock – an increase in the market's required yield from KMI due to long-term fossil fuel outlook reasons or due to an increase in interest rates that would also put pressure on KMI's debt costs.

KMI stock risk and reward investing thesis

The reward side of investing in KMI stock is pretty clear, if things work out well, you will be rewarded with an increasing dividend and stock price. There will definitely be periods of exuberance when your returns might be higher and you might want to rebalance but there will also be periods of pessimism where you will be able to reinvest the dividend at higher expected long-term returns. This is typical for a cyclical stock where I would argue we are in the middle of the cycle with KMI at the moment (analysis written October 2021).

On the risk side, what if all looks well for the first 10 years, but then natural gas demand starts declining due to maybe a new technology that will be developed, you never know. If that happens, the terminal multiple on the dividend might be even higher lower than 10, especially if we see higher interest rates in general, which is another risk for KMI because of their debt and contractual cash flows.

If you invest in KMI, you have to keep in mind the two possible scenarios, the positive and the negative one and then balance your exposure accordingly.

However, given the current situation within the energy sector, it is likely for KMI stock to do well over the short to medium term, which makes it a relatively good buy. However, as a value investor, I prefer investments without the long-term structural risks that might affect them. If I would have to estimate, I would say there is a 60% change KMI does really well over the next decade, but that there is also a 20% chance it does badly.

Therefore, the key things to consider before investing in KMI stock are:

- Your portfolio exposure in relation to the above risks.
- The timeline of the materialization of risks – if your investment horizon is shorter than forever and you are happy switching to something else if KMI stock goes up, then the upside is even more positive as the business develops in a stable environment.
- How are you happy with holding KMI from a business perspective for the dividend and dividend growth alongside the debt? If it is better than other things in your portfolio thanks to the likely 11% long-term yearly total return – then it might be for you.

On a personal note, I have put KMI stock on my watch list, and will check it here and there, you never know but for now I have better.