Increasing Clarity, Increasing Dividends & Stock Buybacks

VALUEx Vail 2018

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- Just buy this stock—I'll show you why!

What is Kinder Morgan (NYSE: KMI)?

- An energy toll road: pipelines and terminals
- Largest:
  - natural gas pipeline network in the US (56% of EBDA)
  - non-captive transporter of petroleum products in North America (15%)
  - independent operator of terminals in US (15%)
  - transporter of CO_2 in North America (11%)
- 70% owner of Kinder Morgan Canada (TO:KML, 3%)
  - Main asset: Trans Mountain Pipeline (“TMP”), recently (5/29/18) under contract to be sold to the Canadian national government for C$4.5 billion
  - KML created in ‘17 to fund now-moot TMP expansion

KMI Shares Should Not Offer Value

- KMI's business and prospects should not be misunderstood
- A $38 billion market cap stock
- Well covered by sell-side analysts (11)
- Mgt. not shy about telling its story (more than 4 conferences/year, annual investor day, long Ccalls)
- Broad institutional ownership (64% by 1300+)
- Usual valuation metrics imply fair-to-full valuation:
  - 21x P:E, 4.7% dividend; 10x EV/EBITDA; 98% D:E

Then, Why is KMI a Value Security?

- Past management actions have kept investors wary and stock in "penalty box" for last two years
  - KMP (KMI's former MLP) holders burned in 2014 merger
    - LPs bore tax burden and suffered a 28.5% dividend cut
  - 2015 strategy shift to internal CAPEX funding
    - Dividend cut further 75%, traditional individual holder base disappointed, distrust of management increased
  - Historically an even more leveraged balance sheet
  - Historically a serial issuer of shares for growth CAPEX
- Uncertainty regarding TMP expansion project

Unfolding Events Create Opportunity

- Shares ought to re-rate as Mr. Market gives KMI credit for:
- The end of dilutive share issuance: none since 2015
  - CAPEX funded from internal cash flow for past 2.5 years
- Deleveraging (from 5.6x D:Adj.EBITDA to 5.1x ; goal of 5.0x)
- Management implementing plans (announced 7/17) to:
  - Increase dividend in each of next two years (25% compound rate on current 4.5% yield)
  - Buyback $2 billion of KMI shares; $500 million purchased 12/17
- Closing of TMP sale to Canadian Government (by early 4Q18)
  - will net KMI a further $2 billion
  - More buybacks, deleveraging likely
- Opportunities to expand US pipeline network
  - more cash flow, lower leverage, greater returns to shareholders

Additional Considerations

- Company has reliable and growing cash flows
- Insider alignment with shareholders
- Discount to peers ought to dissipate as management executes on goals and as TMP sale closes

Reliable and Growing Cash Flows

- 90% of EBDA is fee-based long-term contracts
  - 66% is take-or-pay, 24% is from dependable volumes
  - Contract renewals in 2019-2021 expected to have less than 2% negative impact to segment EBDA
- Remaining 10% split between
  - 6% hedged cash flows
  - Only 4% tied to commodity prices
- 2018 company guidance:
  - 4% Adjusted EBITDA growth
  - 2% increase in distributable cash flow
  - 3% increase in DCF/share
- Growth projects in ‘19, ‘20 include two new pipelines
  - Permian oil production growth is constrained by NG takeaway capacity; KMI has 50% interest in GCX and PHP

Insider Alignment With KMI Shareholders

- Directors and management own 14% of KMI
  - Director/Founder Rich Kinder: 246 mm shares (11% of company)
  - Director Fayez Sarofim: >38 mm shares (1.75%)
  - Director C. Park Shaper: >9.5 mm shares
  - CEO Steven Kean: nearly 8 mm shares
- They don't own <u>any</u> shares of KML, but KMI controls KML through 70% ownership of KML
  - Whose interests are they going to promote and protect?

Substantial Discount to Peers

	KMI	PEER AVERAGE
DCFPS/share:	13%	9%
EV/EBITDA:	10.1x	11.9x
Dividend Coverage:	2.6x	1.3x
Div Coverage (adj.)*:	1.7x	

*adjusted for 2020 dividend of $1.25 and assuming no increase in adjusted EBITDA

Base Case

- TMP closes by 4Q18
- Dividend increases to $1.00 in ‘19, $1.25 in ‘20
- $500 MM in buybacks in each of ‘18, ‘19 & ’20
- Shippers get reductions in contract renewals- reduction of 1.7% in segment EBDA
- US 10-year Treasury 3.5%, and average 300 bps spread to KMI dividend yield of $1.25, implies ~$20+ price per share (assumes no buyback benefit)
- Buy and hold to 1/21: $2.54 in dividends + $3 capital gain = $5.54 return or 34% total return over ~2-1/2 years, ~12% annual compound return

“Meh” Case

- Management executes on all promises, TMP closes, but Mr. Market doesn’t bid up shares
- 7.35% yield in ‘20 if no increase in $17.00 share price, $2.54 return (all dividends)
- 14.9% total return, 5.7% compounded

Downside Cases - Events That Would Negate Investment Thesis

- 10 year US Treasury note yields 4.5%+
- Dividends not increased beyond current $0.80
- No further stock buybacks
- TMP sale close delayed beyond early 2019
- One or more of above would negate thesis, sell

Additional Risk Factors

- Rising interest rates:
  - competition from bonds
  - Refinancing costs higher for substantial KMI debt load
- TMP sale funds used for dilutive acquisition
- Natural gas demand decline/significant recession
- Environmental-pipeline ruptures, etc.
- Steel tariffs-cost increase to any new pipelines
- Decline in CAD/USD FX before TMP sales closes
- Shippers begin to win substantial reductions in contract renewals
- FERC rulings materially reduce rates KMI charges
- Retaliatory tariffs on exported US LNG/oil/products
- Declining oil prices-barely material but stock correlation

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