Kinder Morgan, Inc.

Kinder Morgan's strategy pairs focused capital investment program and fiscal discipline with long-term commitment to energy transition

America is an entrepreneurial nation, and that's spurred a fascination with the visionary pioneers who changed the course of the U.S. economy, ranging from industrial tycoons Andrew Carnegie, John D. Rockefeller, and Henry Ford to current technology titans Bill Gates, Elon Musk, and Jeff Bezos. Although not household names, certain notable entrepreneurs have shaped today's oil and gas industry, among them midstream pioneer Richard Kinder. After resigning his position as president and chief operating officer of Enron in 1996 when his focus on hard assets conflicted with founder Kenneth Lay's growing fascination with financial and marketing schemes, Kinder and partner William Morgan conceived and formed a rapidly growing pipeline company, Kinder Morgan (KMI), using the master limited partnership (MLP) structure to attract funding from high yield-seeking investors, a concept that soon dominated the industry. In 2006, Kinder was a first mover in tapping massive private equity funds raised by investment banks to take the company private in a $22 billion leveraged buyout, the first of $415 billion in such deals that year. In 2011, Kinder Morgan went public again in the largest private equity-backed U.S. IPO and a year later used equity funding to acquire El Paso Corp. to become the largest American midstream firm. In 2014, Kinder Morgan became the first of many competitors to simplify its corporate structure and abandon the MLP structure to become a C-Corp to broaden its investment base and increase its access to capital. The company's market cap soared from $20 billion at the IPO to $93 billion in early 2015.

Shortly after, Kinder's company was caught in the maelstrom resulting from the severe plunge in crude oil prices and found itself unable to fund growth as its stock price cratered and debt soared. The only option was to slash its quarterly dividend by 75%, from $0.50 per share to $0.125 per share. Although many other midstream firms also slashed dividends, disappointed investors began referring to the process as being "Kindered," reflecting a feeling that KMI and its chairman had breached their trust. The company's new strategy of funding growth from cash flow, reducing debt, and streamlining operations restored financial stability by 2018, allowing a 60% quarterly dividend increase to $0.20 per share. However, the oil price decline in late 2019 and the onset of the pandemic wiped out most of a planned 2020 dividend, and the company's market cap sagged to a current $38 billion. That's little changed from five years ago and shows a recovery that has lagged several competitors, indicating some lingering trust issues in the investment community. This stock market performance belies the fact that Kinder Morgan has an impressive portfolio of profitable assets anchored by natural gas pipelines that move 40% of U.S. natural gas. The company has restored a solid balance sheet and completed a growth program that included two major Permian pipelines and a Gulf Coast LNG liquefaction facility. And opportunities will continue to present themselves, particularly if recent price levels are maintained and incentivize growth from the major basins. However, justifying and funding major additional organic growth projects is more difficult today than it was in the early days of Kinder Morgan, when shale-driven supply growth necessitated a massive midstream buildout and regulators and investors were amenable.

In this environment, Kinder and KMI are pursuing a twofold strategy. The first element, a common strategy across the energy space currently, is a smaller, focused capital investment program combining high-return incremental expansions of its existing infrastructure with opportunistic acquisitions that meet rigid return criteria. The financial discipline allows the company to fund 100% of capex from cash flow, fund dividend growth and share repurchases, and maintain a strong balance sheet after reducing net debt by $12 billion in the last five years. The second element, which KMI hopes will be a differentiator, is a broad, long-term commitment to environmental, social, and governance (ESG) issues highlighted by a focus on transitioning the company to a low-carbon future. KMI has formed an Energy Transition Ventures Group to oversee acquisitions and initiatives in renewable natural gas (RNG), renewable diesel, renewable power, and carbon capture and sequestration outside of its existing asset base, while business segments are pursuing their own transition opportunities on existing assets, such as conversion of terminals to biofuels and transportation of responsibly sourced gas (RSG). To date, the company's ESG efforts rank 1st, 2nd, and 7th among a broad universe of oil and gas pipeline and refining companies by three different agencies, which has led to a 2.5x increase in KMI shares held by ESG-mandated investment funds.

The key question for the future is whether the company's current asset base can generate sufficient strong returns to allow promised dividend growth and a share repurchase program, pursue opportunistic acquisitions and joint ventures, and fund a growing slate of energy transition initiatives. East Daley's exhaustive analysis of Kinder Morgan Inc. provides detailed forecasts, including the following conclusions:

- Kinder Morgan EBDA is forecast to decline approximately 1% per year from $7,390 million in 2021 to $7,251 million in 2024 largely on modest declines in its Natural Gas Pipelines and CO_2 segment results.
- The Natural Gas Pipelines segment will fall 3% over the next four years on lower earnings from interstate pipelines serving declining gas production regions and the impact of FERC rate cases.
- Terminal segment earnings will be stable as increased earnings from coal and bulk product terminals offset declines from certain petroleum products infrastructure.
- Product Pipeline segment earnings will increase slightly on continued high utilization.
- CO_2 segment earnings are forecast to fall 9% as lower oil and gas output from KMI's EOR fields and declines in CO_2 pipeline revenues will be partially offset by earnings from a recently acquired RNG-focused subsidiary.
- KMI's move into renewable fuels, RNG production, and RSG transportation will accelerate under its newly created Energy Transition Ventures unit.

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1. Spotlight Reports from RBN Energy and East Daley Capital

1.1 What is Spotlight?

Spotlight reports provide a deep dive into the fundamentals that shape the outlook for midstream energy companies. Our goal is to provide a comprehensive, fundamentals-based view of our Spotlight companies built on a bottoms-up analysis of their assets and operations. We tear apart their asset structure to reveal what volumes are flowing, what rates are (and can be) charged, how they are exposed to commodity price risk, how their assets fit together, and what aspects of their operations provide competitive advantages in today's extremely volatile energy marketplace.

Spotlight is a joint venture of RBN Energy and East Daley Capital. We have joined together with the support of Oil & Gas Financial Analytics LLC to provide a comprehensive, detailed insight into the companies we select for our analysis. Our combined teams leverage deep experience to analyze publicly available data to get to the answers that can be overlooked in the more generalized assessments that are more common in the marketplace today. Instead of such a high-level approach, we get into the micro-level detail, integrating fundamentals analysis, market information, and company data in a comprehensive model that provides a clear picture of the company and its prospects.

As with all energy fundamental analysis, Spotlight reports rely on estimates and approximations of volumes, throughputs and fees. No non-public data from the subject company or any other source has been used in the preparation of this report.

1.2 How Can I Get Spotlight?

Spotlight reports are available to RBN Backstage Pass subscribers. Non-subscribers may purchase individual company Spotlight reports separately. For more information about Spotlight, go to rbnenergy.com/spotlight.