Kinder Morgan Back on Track But We're Watching Financial Statements Closely

publication date: Apr 18, 2018 | author/source: Brian Nelson, CFA
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Kinder Morgan says it is paying dividends out of internal free cash flow generation, which should remove capital-market dependency risk. Shares look attractive in the mid-teens, though we're not in any hurry to add them to either newsletter. We'll be watching its financial statements closely through the course of the year.

By Brian Nelson, CFA

After the market closed April 18, Kinder Morgan (KMI) reported decent first-quarter 2018 results that showed operating income of $949 million, slightly lower than the $977 million achieved in the year-ago period, but pre-tax income that advanced 2.2%. Net income increased to $542 million from $445 million, but the vast majority of the improvement came from a lower effective tax rate thanks to the new tax laws coming into play for the new year. Short- and long-term debt were $2.5 billion and $34.7 billion at the end of the quarter, while the company's cash balance remained minimal at just under $300 million, good for $37 billion in net debt, including 50% of KML preferred shares. Net debt to adjusted EBITDA was 5.1x at the end of the period.

The organic performance was as-expected, in our view, and the company's leverage is still a bit on the high end of what we would like, but Kinder Morgan has always been a debt-fueled "story." The lower tax bill helped Kinder Morgan raise its dividend 60%, to $0.20 per quarter ($0.80 annualized), and we like that its income performance is getting back on track following the "cut heard 'round the world." In 2015, Kinder Morgan once paid a quarterly dividend of $0.51 per share. Executive Chairman Richard Kinder is optimistic that even with the dividend hike, the company expects to internally fund its growth. We take this to mean that Kinder Morgan's free cash flow generation, as measured by cash flow from operations less all capital spending, will be greater than future expected cash dividends paid.

For 2018, Kinder Morgan is looking to achieve adjusted EBITDA of $7.5 billion, and the company is on pace to exceed that level on the basis of its reported adjusted EBITDA of $1.9 billion during the first quarter of 2018. The pipeline giant expects to spend as much as $2.3 billion in growth projects this year, and management reiterated that it will not require outside capital to do so. We'll be paying close attention to the balance sheet and cash flow statement through the course of the year. Total debt should not increase, and net new equity issuance should not show up in the financing section of the cash flow statement.

We think Kinder Morgan ripped the Band-Aid off at the beginning of 2016 to start its rebuilding campaign, and thus far, things are looking up. We think the company is better insulated from any disruptions in the capital markets because of its more conservative internal growth financing, and in the event that energy markets swoon, Kinder Morgan is better positioned than its midstream MLP brethren given that it is no longer capital-market dependent, though its huge debt load still presents leverage/refinancing risks. Our fair value estimate for shares stands at $20.

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