Berkshire
DIVIDEND STRATEGY

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"Casual Friday" Commentary

Casual Friday: New Portfolio Purchase - Kinder Morgan (KMI) - *November 30th, 2018*

New Portfolio Purchase: **Kinder Morgan (KMI)**
After a tremendous bear market for energy related transport companies and years of painful restructuring, we believe a new and improved KMI has emerged.

Old business model:
- Sign transport contracts
- Increase leverage
- Expand capacity
- Pay "distributions" with borrowed funds (generating K-1 tax documents)

New business model:
- Sign transport contracts
- Maximize free cash flow
- Expand selectively
- Fund dividends and buybacks from excess cash flow (no K-1 tax document)

Under the old business model, pipeline business basics include constructing a pipeline, and signing customers to long-term transport contracts to move oil and gas. The company can collect a relatively predictable income stream and pay healthy distributions to shareholders. The old business model appeared attractive to retail investors because of relatively high yields and payout ratios. They appeared attractive to professional investors because they scored well on investment screens that focused on historical dividend increases as well as other quantitative measures.

The problem with "the old business model"? In the past, many pipeline operators, working through a tax advantaged Master Limited Partnership Structure (MLP) would use the recurring revenue from long term contracts to leverage the balance sheet and build ever more capacity. As long as oil prices remained within a reasonable band and producers were fulfilling transport contracts, leverage wasn't a problem – even if it meant borrowing to pay distributions / dividends.

But when oil prices crashed in 2016, the cash flow was not sufficient to pay debt service or dividends. Their ability to access equity and debt markets – critical to the expansion model - vanished. Stock prices crashed forcing painful restructuring across the industry.

Now, after asset sales, write offs, and large dividend cuts, Kinder Morgan has created what we believe is a much more sustainable business model as listed above.

Positives:
- Recent dividend yield = 4.5%
- Management estimates dividend growth rate approximates 20%
    - ($.73 in 2018, to $.95 in 2019 to $1.19 in 2020)
- The company paid down a great deal of debt, with an increasingly favorable credit rating outlook
- Additional assets sales could decrease leverage even more
- Dividend coverage ratios have increased
- Stock once traded at $45, now trades in the mid-teens

Risks:
- Could be viewed as interest rate sensitive although escalators in their contracts and potential dividend increases should offset those fears

Berkshire is a fee-based, SEC registered advisory firm serving the portfolio management needs of high net worth and institutional clients. Over the past 30 years, we have successfully implemented highly focused equity, fixed income and balanced portfolios. Our guiding principle is a belief that success is achieved by combining rigorous, well-crafted investment processes with an exceptional level of client service and attention to detail. Asset Management with a Difference... Diligence, Integrity, and Focus.

Dividend Highlights

- Dividend growth can often provide transparent insight into a company's fundamentals and vitality.
- Dividend growth can provide an attractive stream of increasing cash flow to satisfy many financial objectives.

- Large and sustained decline in energy prices
- Counter party risk (customers don’t fulfill contracts)
- Management abandons capital discipline

Give us a call with questions or comments! Best Regards,
Gerry

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