Midstream/MLP Energy

Company and Permian macro takeaways from Kinetik investor meetings

Industry Overview

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Equity
Americas
Master Limited Partnerships

Table of Contents

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Recapping highlights from our KNTK meetings

We accompanied KNTK CFO, Trevor Howard, to investor meetings last week. The meetings were timely as we enter 3Q earnings reporting season, given the operational issues plaguing Permian midstream in 2Q/3Q23 from extreme heat and supply chain issues. Key topics for KNTK were timing and value of its pending GCX sale, the resulting inflection for its balance sheet and KNTK's processing super-system's ability to handle volumes this summer. We maintain our Buy rating and $39 PO on KNTK on continued volume growth w/ improving leverage.

GCX sale: Announcement imminent w/ enhanced value

KNTK noted it expects to announce the sale of its 16% interest in the GCX gas pipeline around the time of its 3Q call. The FID of the Phase I 2.5 Bcf/d NextDecade Rio Grande facility brought attention to Corpus Christi being short gas in '27, when the facility is in-service. As such, operator KMI could decide to expand the pipe by 0.5 Bcf/d by YE23. And given GCX's high EBITDA-to-FCF conversion ratio and lower tariff rates compared to greenfield pipes, we see more value for the pipe than we initially expected. The incremental positives outweigh higher interest rates, and we see KNTK's GCX stake selling for 10.75x EBITDA, netting ~$550mm.

Latent capacity+young fleet minimize summer heat issues

Processing capacity in the Delaware is tight, with most operators running at near full capacity. And the heat during 2Q/3Q impacted every operator, as plants failed to operate at full capacity. Then tying compression to new plants was also an issue. But KNTK is one of the few operators with latent processing capacity (300 MMcf/d), so it was able to wheel volumes around its system when specific plants were affected. And KNTK's weighted average fleet age is <5 years.

LA LNG seeking Permian gas given H'ville inventory ?'s

LNG facilities need flow assurance and source gas from two basins. Questions about the duration of economic Haynesville inventory are causing LNG facilities to seek more Permian gas. In '22, WMB agreed to move 364 MMcf/d from South TX to the LA LNG corridor along Transco beginning in '25. But additional compression is limited for existing interstate pipes. So the last two Permian pipes (2-2.5 Bcf/d Matterhorn Express and the 550 MMcf/d Permian Highway expansion) will be needed. And Whitewater's proposed Blackfin pipeline would move Houston area gas to the TX/LA border, where LNG companies like Cheniere look to build 3.5 Bcf/d, five-mile pipelines that move the gas across the border, and then can follow more easily permitted intrastate routes.

Targeting N. Delaware as privates exploring S. Delaware

KNTK won a contract to process ~125-150 MMcf/d of volumes in the NM Delaware and is building a ~300 MMcf/d pipe down from NM to the TX super-system, where the gas will be processed. So now KNTK has latent capacity on its NM pipeline, where it can not only target volumes along state lines but also farther north, where there is less competition. Last, KNTK noted several upstream private companies that have geographical stay-out clauses and are exploring completion designs in the gassier S. Delaware, on KNTK's acreage dedications.

Abbreviations:

KNTK: Kinetik Holdings Inc.

CFO: Chief Financial Officer

PO: Price objective

GCX: Gulf Coast Express Pipeline

FID: Final investment decision

EBITDA: Earnings before interest, taxes, depreciation, amortization

FCF: Free cash flow

H'ville: Haynesville

KMI: Kinder Morgan Inc.

LNG: Liquefied natural gas

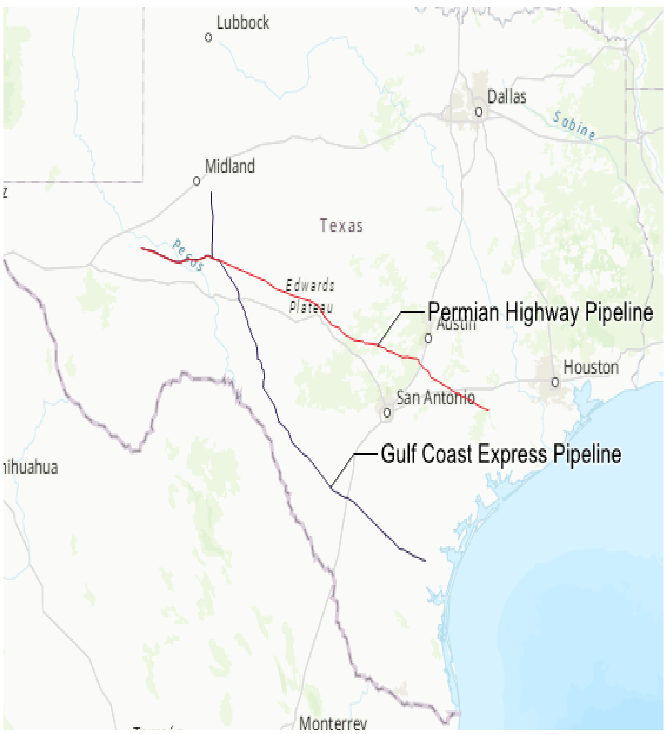
WMB: Williams Companies Inc.

YE: year-end

N
GCX sale nearing close w/enhanced value

Investors were expecting KNTK to announce a sale of its 16% interest in the Gulf Coast Express (GCX) natural gas pipeline on its 2Q call, but the announcement is now likely to come on its 3Q call, and with good reason. For background, KNTK has two equity stakes in Permian-to-Gulf Coast gas pipelines: Permian Highway (PHP) at ~53% and GCX at 16%. PHP is a core asset for KNTK given its higher ownership stake, use of the pipeline to move customer and equity volumes, and participation in its expansion scheduled to come online in early 4Q. However, GCX is a smaller stake with a 16% interest and KNTK does not send its customer or equity volumes through GCX. And because KNTK has a funding need, selling GCX to eliminate the DRIP (distribution reinvestment plan) and work towards a 3.5x leverage target is a value-added strategic move, in our view.

Exhibit 1: KNTK JV gas takeaway pipelines
PHP and GCX move Permian gas to the Gulf Coast



Source: S&P Capital Markets

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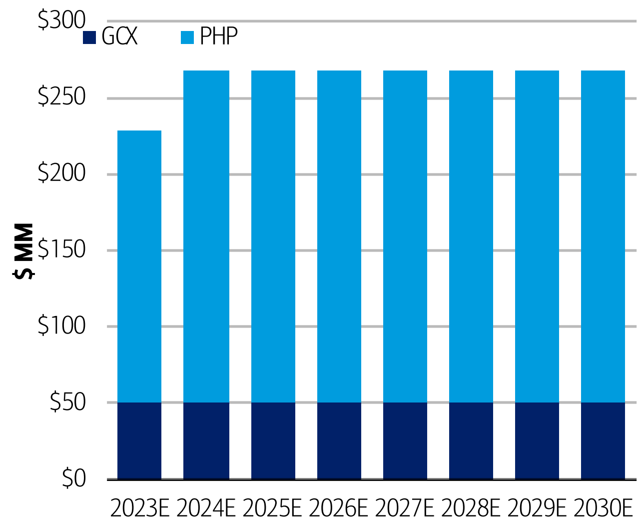
Exhibit 2: KNTK Permian gas pipeline interest
GCX contributes ~$51mm per year with its 16% interest



Source: BofA Global Research estimates

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Agua Dulce is short volumes and a potential expansion is needed

As the last two Permian-East TX expansions (PHP and Matterhorn) have been to Houston, the Corpus Christi market is seeing only 0.5 Bcf/d of new supply from the Whistler expansion. And now with Rio Grande LNG Phase 1 moving forward with 2.5 Bcf/d of gas demand in '27, the need for Corpus Christi expansions increases.

Exhibit 3: Permian to Gulf Coast pipes
Houston bound pipes will move to Louisiana

Source: S&P Capital Markets

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Exhibit 4: Whitewater's Blackfin pipeline
Pipeline moving volumes to LA energy corridor

Source: Texas Railroad Commission

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In addition, projects like the LA Energy Pathway are taking gas from Agua Dulce up to LA, taking legacy Eagle Ford gas capacity out of the market. Whitewater's proposed Blackfin pipeline would pull gas from the endpoint of Matterhorn Express and PHP up to the Texas-Louisiana border to feed Louisiana LNG projects instead of being moved South to the Agua Dulce market.

Competitive rates + likely expansion offset higher interest rates

TRGP (Targa Resources) sold its 25% interest in GCX in early '22 for 10.75x EBITDA. Since then, interest rates have spiked, which lowers the selling multiple for the pipe. But GCX has factors working in its favor:

- The expansion optionality adds EBITDA potential. The gas is needed in '27 and KMI (the operator) would need 18-24 mo. from FID to in-service, as securing compression is still long dated with supply chain constraints. So, we expect that KMI could FID the expansion as early as 4Q23.
- Rates on GCX are significantly cheaper than newbuild rates at <50c/Mcf with opportunity to recontract at fixed rates for over a decade.
- GCX is a newer pipe with its initial in-service in mid '19 so maintenance capex is lower than older pipes that have recently transacted. It's EBITDA-to-FCF rate is ~90% vs. older, recently transacted pipes like NGPL and Columbia Gas/Gulf with higher maintenance capex and a conversion ratio of 65 to 75%.

So, with the tailwinds from Agua Dulce LNG demand pull and competitive rates offsetting higher interest rates, we see KNTK receiving a similar 10.75x EBITDA multiple as TRGP for its 16% stake in GCX, or ~$550mm in net proceeds.

'24 is a FCF inflection year for KNTK

KNTK's top two priorities are to (1) turn off its DRIP, which is essentially issuing equity to its legacy sponsors to fund capex; and (2) work towards a 3.5x leverage ratio. While

KNTK experienced strong legacy + new contract growth in '23, the EBITDA growth has come with significant capex. In '23, we expect KNTK to generate $837mm. But with capex at $540mm, FCF before dividends fails to cover the dividend. So, the DRIP program has been utilized to fund the capex. But '24 is an inflection story as:

- The GCX sale of ~$550mm would allow KNTK to immediately turn off the DRIP. We expect that means it is officially turned off in 1Q24 when the proceeds come in. This would put KNTK on equal footing with peer midstream companies that are internally funding growth without needing external capital markets.
- We forecast $929mm of EBITDA including GCX in '24. So, backing out $51mm of GCX contribution means '24 EBITDA of $878mm. But KNTK is sticking with total '24 capex of $150mm, so '24 EBITDA – capex is $728mm vs. $297mm. So '24 will generate ~$430mm of incremental cash flow y/y.
- We expect KNTK to bump the dividend modestly to $3.15/sh. So with 146mm shares outstanding (including Class A and C), KNTK's annual dividend cash payout would be $460mm.
- The inflection in FCF would essentially pay for the cash dividend in '24 leaving $100mm to de-lever. And then the $550mm in GCX proceeds would further reduce net leverage to ~$3bn. So, this would enable KNTK to hit its 3.5x leverage target by YE24, if it can keep capex at or under $150mm.

Exhibit 5: GCX sales & potential '23/'24 leverage
YE24 leverage could hit 3.4x

No Sale Leverage			
YE23 Net Debt	$3,618	YE24 Net Debt	$3,502
23 EBITDA	$837	24 EBITDA	929
Leverage ratio	**4.3x**	**Leverage ratio**	**3.8x**
Post-Sale Leverage			
KNTK GCX EBITDA	$51	KNTK GCX EBITDA	$51
Sale Multiple	10.75x	Sale Multiple	10.75x
Value	**$547**	**Value**	**$547**
Adj. YE '23 Net Debt	$3,072	Adj. YE '24 Net Debt	$2,956
Adj. '23 EBITDA	$786	Adj. '24 EBITDA	$878
Adj. Leverage ratio	**3.9x**	**Adj. Leverage ratio**	**3.4x**

Source: BofA Global Research estimates

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Exhibit 6: KNTK
Corporate priorities

Source: Company filings

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Super-system and latent capacity limit operational issues during 2Q/3Q23

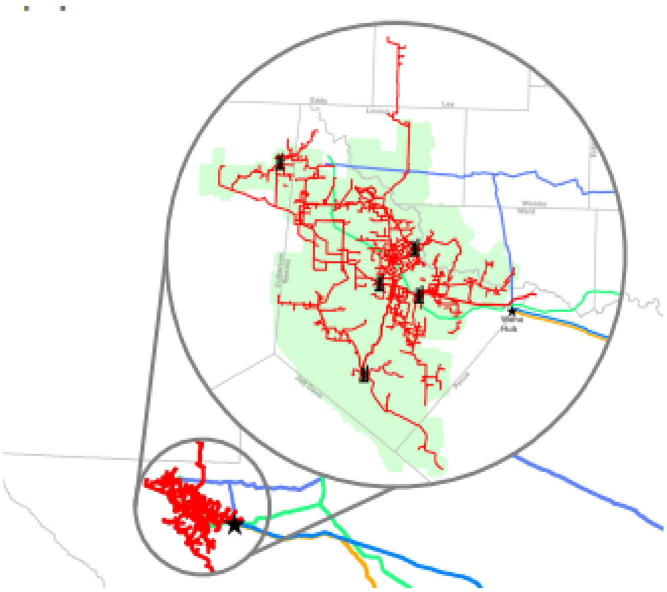
In general, 3Q23 experienced the same Permian operational difficulties as 2Q:

- Extreme heat through August caused processing facilities to run at sub-optimal levels.
- The processors with the most scale in the Permian are operating at near full capacity. And new processing is coming on-line just in time with new production. Heat combined with supply chain delays with compression have caused delays in new processing capacity coming online.
- Outbound Permian to East TX gas pipe outages caused some supply to back up to wellhead, losing, in aggregate, one day of supply.

The heat impacted nearly everyone, but KNTK was less impacted than peers given its latent capacity, newer plants, and super-header system that allows it to move processing volumes from one plant to another if there are operational and/or economic advantages.

- Note that KNTK still has 300 MMcf/d of latent capacity on its plants. So KNTK could handle any operational issues by moving volumes to other plants on its super-system to minimize outages. Its 3Q volumes should be in line with pre-quarter expectations and 4Q exit volumes are still on pace to hit 1.6 Bcf/d.

Exhibit 7: KNTK super system in TX Delaware
Connecting plants have 300 MMcf/d of latent capacity



Source: Company filings

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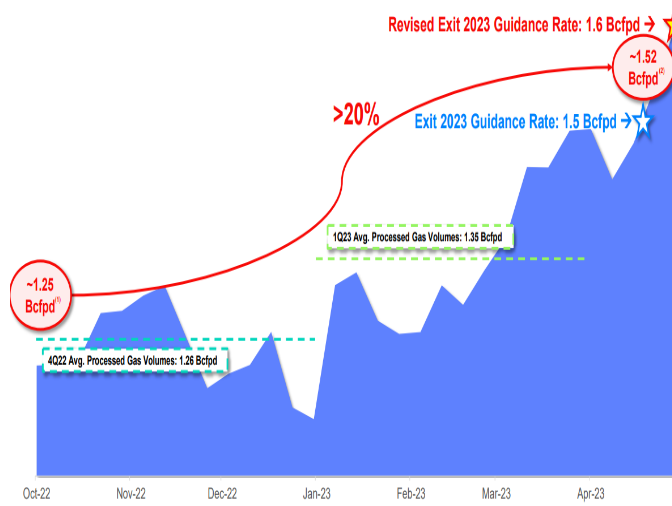
Exhibit 8: KNTK '23 volume growth
Exit volume rate of 1.6 Bcf/d



Source: Company filings

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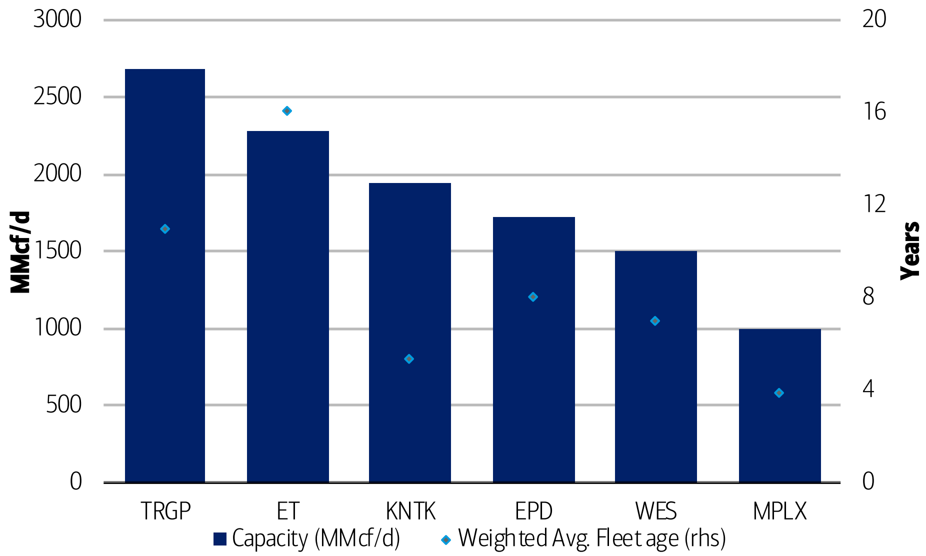
- The weighted average age of KNTK's processing plants in the Delaware is only ~4 years, more modern than any other fleet except MPLX. And MPLX outperformed competitors in 2Q with strong processing volumes, as others have seen operational issues. All KNTK's processing facilities (Diamond, East Toyah, Pecos, Pecos Bend, and Sierra Grande) are under 10 years old.

Exhibit 9: Weighted average processing plant age in Delaware
KNTK and MPLX have the youngest fleets



Source: S&P Capital Markets, BofA Global Research

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Price objective basis & risk

Kinetik Holdings Inc. (KNTK, $34.45, C-1-7)

Our PO of $39 is derived from our Discounted Cash Flow Valuation which implies a 10.2x 2024 EV/EBITDA multiple. We forecast a ten-year outlook, which we believe is the limit of market recognition and then forecast a terminal decline of 2.5% while using a 7.5% weighted-average cost of capital (WACC).

Upside risks to our price objective are 1) higher commodity prices, 2) increased rich gas production on KNTK's contracted acreage, 3) winning acreage dedications at pace faster than modeled.

Downside risks to our price objective are 1) US economic weakness and/or commodity prices, 2) slower Permian production growth, 3) inability to win new acreage dedications.

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Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
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	Enterprise Products Partners, L.P.	EPD	EPD US	Neel Mitra, CFA
	Kinetik Holdings Inc.	KNTK	KNTK US	Neel Mitra, CFA
	Kodiak Gas Services, Inc.	KGS	KGS US	Neel Mitra, CFA
	Targa Resources Corp.	TRGP	TRGP US	Neel Mitra, CFA
	The Williams Companies, Inc.	WMB	WMB US	Neel Mitra, CFA
	Western Midstream Partners, LP	WES	WES US	Neel Mitra, CFA
NEUTRAL				
	Kinder Morgan Inc	KMI	KMI US	Neel Mitra, CFA
	ONEOK Inc	OKE	OKE US	Neel Mitra, CFA
	Plains All American Pipeline, L.P.	PAA	PAA US	Neel Mitra, CFA
	Plains GP Holdings, L.P.	PAGP	PAGP US	Neel Mitra, CFA
UNDERPERFORM				
	Equitrans Midstream Corporation	ETRN	ETRN US	Neel Mitra, CFA
	MPLX LP	MPLX	MPLX US	Neel Mitra, CFA
RVW				
	Golar LNG Limited	GLNG	GLNG US	Neel Mitra, CFA

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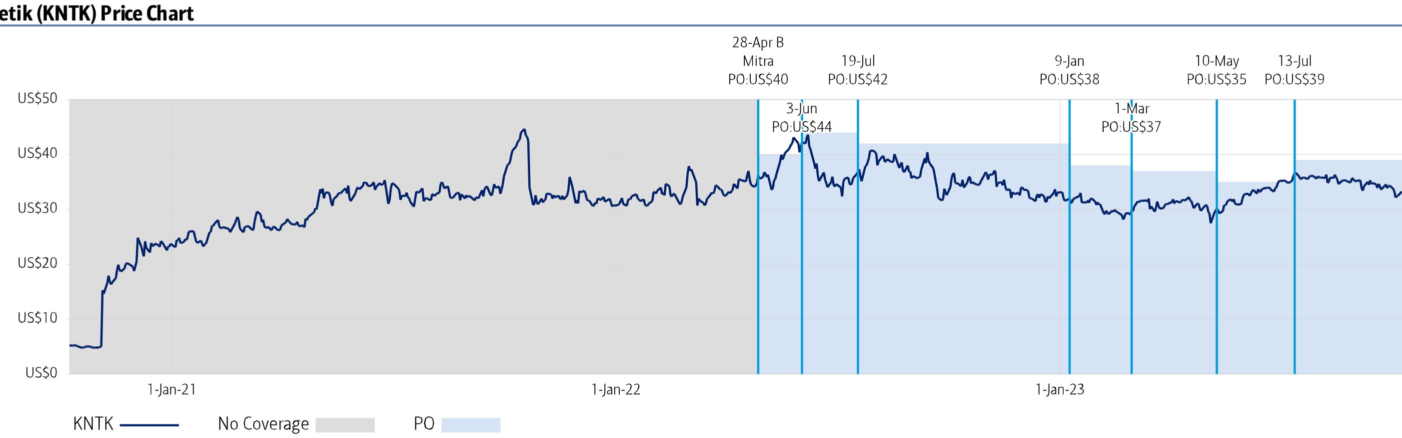
Kinetik (KNTK) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Buy	78	58.21%	Buy	59	75.64%
Hold	33	24.63%	Hold	25	75.76%
Sell	23	17.16%	Sell	14	60.87%

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