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RECOMMENDATION: Hold

NRGY FUNDAMENTALS			
Price (11/18/05) ¹	\$26.25	Dividend Yield ¹	7.90%
Target Price	\$27.33	ROE ¹	8.97%
Market Cap. ¹	\$863 M	ROA ¹	5.06%
EV ¹	\$1.38 B	EPS ¹	\$0.90
Cash and Equiv. ¹	\$21.06 M	% of Portfolio ³	1.34%
P/S ¹	0.91	Shares Outstanding ¹	32.88 M

Highlights:

- NRGY and NRGP are two separate securities that both trade on the NASDAQ
- MLPs provide investors significant tax advantages and can provide diversification in a portfolio.
- Stagecoach is positioned to add additional value to Inergy in the near future.
- Using a discount rate of 12%, we derived a target price of \$27.33. We currently feel that the APM position, 1.34% of its portfolio, is adequate and are recommending a hold.

Inergy Profile

Inergy trades under two separate securities on the NASDAQ, Inergy, L.P. (NRGY) and Inergy Holdings, L.P. (NRGP). The securities offer investors different ways to invest their money. Inergy, L.P. is a distribution and marketing company that provides over 600,000 customers with propane in the United States. Inergy L.P. sells to retail customers under different regional brand names that the company has acquired through acquisitions. The retail customers include residential, commercial, industrial, and agricultural businesses. Inergy Holdings, L.P. main goal is to

increase the dividends that the shareholders receive though "ownership of partnership interest in Inergy."¹³

Competition

Inergy is in the basic materials wholesale industry.¹ Two main competitors of the company are AmeriGas Partners LP (APU) and Ferrellgas Partners LP (FGP). AmeriGas is America's largest marketer of propane, propane equipment and related services. Ferrellgas started in Atchison, Kansas, and now has operations in all fifty states, unlike Inergy and AmeriGas. The table below displays the major fundamentals about the companies.

	NRGY ¹	APU ¹	FGP ¹
Market Cap (\$)	863.0 M	1.55 B	1.28 B
Gross Margin (%)	28.58	38.68	33.54
Net Income (\$)	25.78 M	61.06 M	-23.50 M
EBITDA (\$)	103.99 M	241.12 M	180.98 M
P/E	29.23	25.48	14.26
Revenue (\$)	947.63 M	1.92 B	1.75 B

Acquisitions

On November 18, 2004, Inergy announced that it would purchase 100% of the 6th largest propane retailer in the United States, Star Gas Partners, L.P.⁵ This acquisition made Inergy America's 5th largest retail propane operator. Equity and debt will be used to finance the transaction. On December 21, 2004, Inergy borrowed \$375 million under a 364-day credit facility. A private placement of \$425 million of 6.875% senior unsecured notes due 2014 was completed December 22, 2004. This capital raised in the private placement was used to fully repay the \$375 million. In addition to the debt used, 3,568,159 common units were issued to unrelated parties to help Inergy fund the purchase of Star Energy for 487.7 million, net of acquired cash.⁸

On July 11, 2005, Inergy announced that it would purchase the Stagecoach natural gas storage facility in Tioga County, New York. The purchase price was in the ballpark \$205 million, with another \$25 million for the rights to Phase II expansion. Stagecoach is a state of the art "high performance, multi-cycle natural gas storage facility."⁶ The facility's working gas capacity is 13.6 Bcf, maximum inject capability is 250 MMcf/day, and the maximum withdrawal capability is 500 MMcf/day. If an expansion is done on Stagecoach's facility it is estimated that working gas capacity would increase by 13 Bcf. Approximately 800,000 special units are expected to be purchased with cash from Inergy L.P. by Inergy Holdings, L.P. The extra common

units that are being used to finance the Phase II expansion rights are not entitled to cash distributions, however, the units are convertible to Inergy, L.P. common units when the expansion is complete. The special units will give Inergy L.P. a 12% paid-in kind return until the expansion is complete and the units become convertible. A revolving credit facility will be used to finance Inergy, L.P.'s \$205 million contribution, while the \$25 million addition from Inergy Holdings, L.P. will be financed through bank borrowings. Long term capital is expected to be financed using a similar structure that the company currently used with equity and debt. It is expected that EBITDA will increase \$20 million for fiscal year 2006 due to the Stagecoach acquisition. When the Phase II expansion is completed in 2008, Inergy expects that EBITDA will increase to \$40 to \$45 million. Inergy expects that it will invest a total of \$350 million in Stagecoach after the Phase II expansion is complete.⁹ Stagecoach appears to be a new line of business for Inergy. Instead of distributing propane, this state of the art facility stores natural gas for third parties. This investment has the potential to be risky since Inergy cash flows come about from other companies that store their natural gas in the storage facility.⁹ However, Stagecoach has sold 100 percent of the facility's capacity ahead of schedule. The company believes that this shows the demand in the Northeast for this type of operation. Since the expansion has not started yet, it also allows Inergy to see if the demand is constant before adding additional capacity. Problems could arise since Stagecoach is a new line of business for Inergy. The company may not be completely equipped and they may not know how to correctly handle problems. Even though Stagecoach could pose potential problems, we think that it was a good acquisition. Stagecoach has positioned itself in a manner that should bring in steady cash flow from the third parties that signed contracts with the company. The Phase II expansion option also allows the company to increase the capacity, which is expected to increase the EBITDA in the future.

On October 3, 2005, Inergy agreed to purchase Atlas Gas Products, Inc. located in Costonia, Ohio. About 7,000 people receive propane from Atlas Gas Products from the company's three retail locations.¹¹ On October 4, 2005, Inergy announced that it would purchase the 12th largest propane retailer in the United States, Dowdle Gas located in Columbus, Mississippi. Dowdle delivers over 50 million gallons of retail propane to 120,000 customers in the southeast United States.¹⁰ On October 5, 2005, Graeber Brothers, Inc agreed to be purchased by Inergy, L.P. Graeber

Brothers is located in northern Mississippi and delivers retail propane to about 14,000 customers.¹²

Master Limited Partnerships

Master Limited Partnerships (MLP) are limited partnerships that are publicly traded. MLPs are in the business of natural gas, propane, coal, crude oil, or refined petroleum products. MLPs are set up to distribute the majority of earnings to unitholders and are not subject to corporate taxation. Owners of MLPs enjoy significant tax benefits because cash disbursements are partially tax-deferred. The amount of money that is tax-deferred is treated as return on capital which reduces the investor's tax basis for the investment. The rest of the distribution is taxed at the owner's regular income tax rate. Also, if the owner sells the MLP for a gain, it is taxed at the regular income tax rate. This is much different from owning shares in a stock because gains are taxed at a higher rate.⁶

However, there are also some disadvantages to owning an MLP as opposed to regular shares. A limited partnership is not a separate legal entity, like a corporation. Therefore, partners in an MLP can be held liable. This is a major disadvantage when compared to being a shareholder in a corporation. MLP unitholders can be held liable for the amount that they invested. Creditors can seek the return of capital distributed if the liability for which payment is sought occurred before the distribution. Basically if an MLP incurred a liability and then paid out earnings to unitholders, the creditor has a right to take those funds back in order to pay the liability. Even if a unitholder sells their interest, they could still be liable for substantial tax liabilities. Another disadvantage of MLPs is that they are very sensitive to the overall economic environment, especially interest rates. As interest rates increase, the yield spread decreases and this causes a decline in asset prices.

There are several important advantages for companies that choose to operate as an MLP instead of as a regular corporation. The main one is tax-related. Since corporations are distinct legal entities, they must pay taxes on income. However, MLPs are not considered distinct legal entities. This means that no tax is paid on the partnership level. MLPs are not subject to the double taxation that regular corporations are. Tax is incurred only once and that is for each individual partner. Another advantage of operating as an MLP is the liquidity aspect. MLPs are publicly traded which makes them liquid. Regular limited partnerships are extremely illiquid and this is a big disadvantage. By taking a regular partnership public, the disadvantage becomes an advantage.⁷

There are also disadvantages to operating as an MLP instead of a corporation. One disadvantage is that investors may not feel as comfortable investing in an MLP. MLP unitholders are subject to more risk because of their

liability then shareholders of a corporation. Also, operating as an MLP may make it harder for a company to grow. Corporations can easily borrow money and issue equity, but this may not be as easy for an MLP.⁶

GP IPO

Inergy, L.P. had an initial public offering of Inergy Holdings, L.P. in June of 2005. Inergy Holdings engages in the ownership and management of Inergy, L.P. (Inergy). Inergy Holdings through direct and indirect ownership currently own approximately 12.8% of Inergy; including 100% membership of Inergy G.P. and Inergy Partners.¹ The majority of Inergy Holdings' cash flows come indirectly from the sale of propane by Inergy. For the first quarter of 2005, about 73% of total revenue came from propane sales.

Inergy Holdings is an MLP. The reason that the company did this was to establish cash-generating assets made up of partnerships. By taking the holding company public, the partnerships became liquid since they are now traded on the NASDAQ market. Also, as an MLP, the company is only subject to taxation at the individual level. The GP IPO also helped the company in several other ways. The MLP provides the company with cash. Most of it is paid out to the unitholders, but not all. Inergy can use this money to help grow the business and make acquisitions. The MLP also takes the liability away from the company and puts it on the partners. Each partner takes a share of the liability risk according to his own investment. These are ways the MLP can be used to help leverage the company.

Valuation

NRGY – DCF Derived Fair Market Value Matrix
(in \$ Thousands)

FCF Growth Rate	1%	2%	3%
PV of FCF (2004)	48,548	48,548	48,548
PV of FCF ('05E-'10E)	3,649	3,649	3,649
PV of Terminal Value	843,393	936,918	1,051,226
Aggregate Value	1,256,817	1,350,342	1,464,650
Aggregate value per share	24.49	27.33	30.81

In our valuation of Inergy, we used both the Discounted Cash Flow analysis and a Dividend Growth analysis. In the Discounted Cash Flow analysis we set

our discount rate at 12% and derived a target price of \$27.33. The \$27.33 target price relates to Inergy's current market price being undervalued by 4.1%. In the Dividend Growth model analysis we are projecting the forward dividend rate to be 2.08 and growing at 3.5% which derived us a target price of \$24.47. The Dividend Growth model target price relates to Inergy's current market price being overvalued by 7.3%.¹ Although, the Discounted Cash Flow analysis and the Dividend Growth analysis produced conflicting conclusions it is of no importance. Whether under or overvalued, Inergy's current market price is not significantly above or below the company's fair market price to warrant a buy or sell recommendation. Therefore we are recommending a hold for Inergy L.P.

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Inergy, L.P. and Subsidiary - Discounted Cash Flow and Dividend Growth Model (in \$thousands)

Income Statement Projections	Years Ended September 30,								
	2003	2004	n=2005Q1	12005E	22006E	32007E	42008E	52009E	62010E
Propane	343,578	431,202	127,493	560,563	728,731	910,914	1,138,643	1,366,371	1,366,371
Other	19,787	51,294	46,109	153,882	461,646	1,154,115	1,731,173	2,163,966	2,163,966
Total Revenues	363,365	482,496	173,602	714,445	1,190,377	2,065,029	2,869,815	3,530,337	3,530,337
COGS	267,010	359,053	122,998	521,545	868,975	1,548,772	2,152,361	2,647,753	2,647,753
Gross Profits	96,355	123,443	50,604	192,900	321,402	516,257	717,454	882,584	882,584
Operating and administrative	59,249	81,296	52,078	228,622	357,113	516,257	573,963	600,157	529,551
Total Operating Expenses	59,249	81,296	52,078	228,622	357,113	516,257	573,963	600,157	529,551
Operating Income	37,106	42,147	-1,474	-35,722	-35,711	0	143,491	282,427	353,034
Dep.& Amortization	13,843	21,089	13,865	20,000	20,000	20,000	20,000	20,000	20,000
Taxes	103	167	24	170	170	170	170	170	170
Interest Expense	9,982	27,043	9,144	30,000	30,000	30,000	30,000	30,000	30,000
Capital Expenditures	6,230	14,521	25,049	30,000	25,000	20,000	15,000	15,000	15,000
Free Cash Flow	44,616	48,548	-12,682	-45,892	-40,881	-170	148,321	287,257	357,864
Distributable Cash Flow	20,791	416	-35,691	-95,892	-90,881	-50,170	98,321	237,257	307,864
PV of Free Cash Flow				-40,975	-32,590	-121	94,261	162,997	181,305
PV of Terminal Value									936,918

PV of FCFs	\$413,424
PV of Terminal Value	\$936,918
Total Value	\$1,350,342
Less:	
Total Debt	\$530,091
Plus:	
Cash	\$78,399
Total Fair Market Value	\$898,650
Diluted Shares Outstanding	32,880
Fair Market Value/Share	\$27.33

WACC	12.0%
Long Term Growth Rate	2.0%

Current Price	\$26.25
DCF Derived Target Price	\$27.33
% Undervalued	4.1%
Annual Dividend Rate	2.01
Annual Dividend Yield	7.64%
Projected Dividend Rate	2.08
Projected Dividend Yield	7.90%
Dividend Model Derived Target Price	24.47
% Overvalued	7.3%

Operating Assumptions	2003	2004	2005Q1	2005E	2006E	2007E	2008E	2009E	2010E
Propane	-	25.5%	-	30.0%	30.0%	25.0%	25.0%	20.0%	0.0%
Other	-	159.2%	-	200.0%	200.0%	150.0%	50.0%	25.0%	0.0%
Revenue Growth	-	32.8%	-	48.1%	66.6%	73.5%	39.0%	23.0%	0.0%
Gross Margins	26.5%	25.6%	29.1%	27.0%	27.0%	25.0%	25.0%	25.0%	25.0%
Operating Expenses as % of Rev.	16.3%	16.8%	30.0%	32.0%	30.0%	25.0%	20.0%	17.0%	15.0%