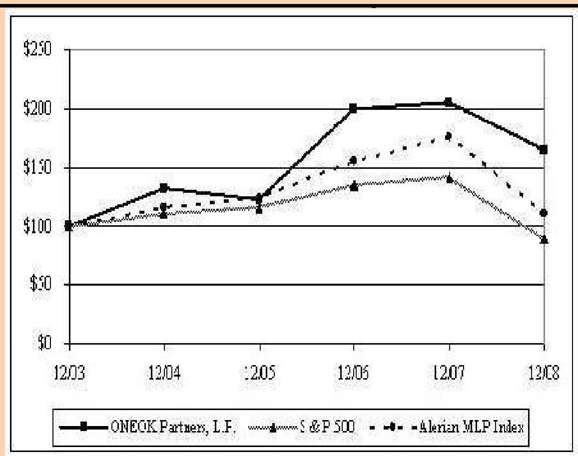
Group 5
Bill Beck – Luke McKee – Roah Sham – Grant Taylor

ONEOK Partners, LP (OKS)

KU SCHOOL OF BUSINESS
The University of Kansas
APPLIED • PORTFOLIO • MANAGEMENT

May 1, 2009

Recommendation	BUY
Ticker	NYSE: OKS
Current Price ($)	46.6
52-Week Range	33.9 – 64.9
Target Price ($)	54.00
Enterprise Value ($M)	7881.1
Market Cap ($M)	4911.3
Shares Outstanding (M)	105.3



This graph shows the performance of ONEOK Partners' common equity compared to the S&P 500 and Alerian MLP Index. They have been outperforming the indices since Dec 2003.

Ratios	Comps	OKS
P/E (ttm)	16.65	7.76
P/E (Dec-2010)	11.92	12.37
Dividend Yield	7.38%	9.2%
TEV/EBITDA	10.41	10.96
ROA (ttm)	4.49%	7.4%
ROE (ttm)	14.7%	18.42%

We place a **BUY** recommendation on ONEOK Partners, LP.

Investment Thesis

- ONEOK Partners has a history of strong dividend yields, and has projected dividends of $3.30, $3.40, & $3.40 in 2009, 2010, & 2011. This dividend income has proven to be recession resistant, as ONEOK Partners has posted dividends higher than earnings per unit in Q4 2008 ($1.10) and Q1 2009 ($1.10). Based on their projected dividend yield, ONEOK Partners has a price target of $53.30.
- ONEOK Partners operates four unique business segments, which diversify their client base and helps to eliminate risk. The strong organic and M&A growth within ONEOK Partners' natural gas liquids segments has boosted their total assets from $2,528 million in 2005 to $7,254 million in 2008 or 287%. Facilities upgrades, new markets, & acquisitions project to increase their total assets to $10,305 million by 2011.
- ONEOK Partners' revenues are highly correlated with the price of crude oil. The current price of a barrel of crude oil is $52.61. The current prices of crude oil futures suggest that by the end of 2011, the price of oil will be $70.32. This represents an increase of 10.2% CAGR.

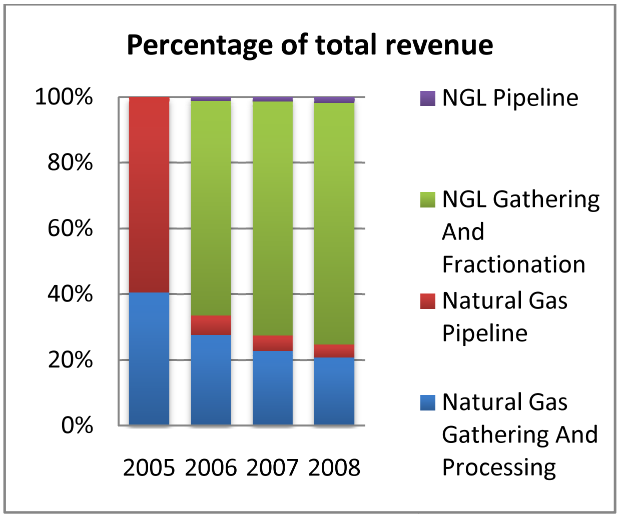
Overview

ONEOK Partners, LP engages in the ownership and management of natural gas gathering, processing, storage, and interstate and intrastate pipeline assets, as well as natural gas liquids (NGLs) gathering and distribution pipelines, and storage and fractionators in the United States[1]. They separate their business into four major segments in order to diversify their customer base and to eliminate cyclical risk. Their segments are Natural Gas Gathering and Processing, Natural Gas Pipelines, NGL Gathering and Fractionation, and NGL Pipelines.

ONEOK Partners was first formed as a limited partnership in 1993, and is a wholly owned subsidiary of ONEOK, Inc (OKE). Through a series of mergers and acquisitions, ONEOK Partners has become one of the largest limited partnerships in the country and has accumulated a wide variety of Mid-

[1] Yahoo! Finance Company Summary

Continent and Rocky Mountain natural gas and natural gas liquid assets. They currently have operations in 17 states, covering the area in between Montana, Tennessee, and Texas.[2]



In 2006, ONEOK Partners' business model was altered by their acquisition of their natural gas liquid operation. Their NGL gathering and fractionation segment is now their main revenue driver. While, both pipeline segments contribute significantly less revenue.[3]

Segments Description & Analysis

Natural Gas and Processing Segment

This segment contributed to 20% of the company's revenues in 2008. ONEOK collects unprocessed natural gas from Oklahoma, Kansas, Montana and Wyoming. The unprocessed natural gas is taken and compressed on site, then transported to processing facilities. During the processing, natural gas liquids are separated from the gas and are then shipped to facilities that convert the substance into marketable products like propane, butane, and gasoline. [4]

This segment processes gas using three different kinds of contracts. The first method is a Percent-of-Proceeds, where ONEOK has the option to retain a portion of the natural gas that it sends to the producer. This exposes them to natural gas and natural gas liquid commodity prices. The second method involves a fixed fee that is paid for a predetermined amount of unprocessed natural gas. This type of contract prevents commodity price risk. The final method is the Keep-Whole processing contract. Under this contract ONEOK extracts the Natural Gas Liquids before sending it to the producer. They retain the NGLs and send the producer more natural gas to keep the amount whole. The contract distribution for 2008 was: 34% for Percent-of-Proceeds, 58% fixed fee, and 8% for the Keep-Whole method.[5]

This segment is affected by market conditions such as commodity prices as well as supply and demand. High commodity prices during most of 2008 led to an increase in drilling in the Rocky Mountains region, Kansas, and Oklahoma. A reduction in price for natural gas during the 4th quarter 2008 resulted in a decrease in drilling activity. Seasonality is also a factor that affects demand. Cold temperatures drive the demand for natural gas, which is used to heat homes and commercial properties. Warmer temperatures increase demand for natural gas used in electric generation for air conditioning.[6] Competition in the industry has led ONEOK to increase capital investments in an effort to improve plant processing operations.

Natural Gas Gathering and Processing			
(in $1000's)	2006	2007	2008
Revenue	1476090	1458650	1756239
EBIT	180615	187815	247148
EBIT margin	12.2%	12.9%	14.1%
Total Assets	1447238	1251514	1613903
Capex	80982	83820	146249

[2] ONEOK Partnerships, Inc. 10-K, Filed 2/25/09. Pg 5
[3] ONEOK Partnerships, Inc. 10-K, Dec 2007 and Dec 2008
[4] ONEOK Partnerships, Inc. 10-K, Filed 2/25/09. Pg 7
[5] ONEOK Partnerships, Inc. 10-K, Filed 2/25/09. Pg 7-8
[6] ONEOK Partnerships, Inc. 10-K, Filed 2/25/09. Pg 9

This segment has an average EBIT, which is about 13% historically. The revenue has grown steadily since 2006. Due to the recent economic downturn, we expect negative revenue growth (-30%) in 2009, followed by positive growth rates of 15% & 15% in 2010 & 2011. Additionally, we expect the segment's gross margin to gradually decrease from 24.8% in 2008 to 22% in 2011 and their operating margin to decrease from 14.1% in 2008 to 12.5% in 2011.

Natural Gas Pipelines Segment

This segment contributed 4% of the company's revenues in 2008. ONEOK Partners owns and operates pipelines for natural gas in the central United States. These pipelines connect natural gas producing areas with gas gathering facilities and gas processing facilities. The natural gas transportation contracts are based on rates that are regulated by the state. The natural gas pipeline revenues come from firm service contracts and interruptible service contracts. Under the firm service contracts customers pay for a specific quantity of pipeline to use and then pay commodity charges for the actual volume of natural gas they transport. Interruptible service contracts maintain that the customer is charged on their actual usage and are not guaranteed use of pipelines unless there is excess capacity available.[7]

The interstate natural gas pipelines are regulated by the Natural Gas Act and Natural Gas Policy Act. The Federal Energy Regulatory Commission (FERC) oversees and regulates the transportation of natural gas, the rates and charges, new construction, depreciation, and facility acquisitions.

Natural Gas Pipeline			
(in $1000's)	2006	2007	2008
Revenue	317008	301964	342123
EBIT	237330	112212	133188
EBIT margin	74.9%	37.2%	38.9%
Total Assets	1075811	1241507	1477301
Capex	48598	138919	267029

As the table shows, the revenue growth has been sluggish since 2006. This segment does, however, have a very good EBIT margin. The company has invested heavily in this segment, especially in 2008 where capital expenditures were over $267 million. The total assets increased significantly, growing 37.3% from 2006 to 2008.

We expect the revenue of this segment to steadily increase, despite the economic downturn. For 2009, 2010, & 2011, this segment looks to garner revenue growth of 14%, 15%, & 15%. The segment's gross margin is expected to decrease from 75.3% in 2008 to 74% in 2011, and the operating margin is expected to decrease from 39.1% in 2008 to 35% in 2011.

Natural Gas Liquids Gathering and Fractionation

This segment represents 73% of ONEOK Partners' revenue stream in 2008. The Natural Gas Liquids Gathering and Fractionation segment separates the NGLs from the Natural Gas mixture for the purpose of converting them into marketable products. Unprocessed natural gas is taken from the wellhead and transported to fractionators, which applies heat and pressure to separate the components. This process creates economic value by producing ethane, butane, propane, iso-butane and natural gasoline. The NGL products can be shipped to natural gas liquid market centers in Mont Belvieu, Texas or Conway, Kansas. OKS decides which region to send the products to depending on the price differentials between the local regions.[8]

For most of 2008, the price of ethane provided a positive spread over the price of natural gas. The company expects the price of ethane to be lower than natural gas for 2009. This will affect the output of the processing plants. When the price of natural gas is higher than the price of natural gas liquids, NGL production will decline and impact the exchange services revenue.[9]

[7] ONEOK Partnerships, Inc. 10-K, Filed 2/25/09. Pg 10

[8] ONEOK Partnerships, Inc. 10-K, Filed 2/25/09. Pg 11

[9] ONEOK Partnerships, Inc. 10-K, Filed 2/25/09. Pg 12-13

NGL Gathering and Fractionation			
(in $1000's)	2006	2007	2008
Revenue	3492976	4587293	6269735
EBIT	88779	111976	204413
EBIT margin	2.5%	2.4%	3.3%
Total Assets	1458818	1880602	1717550
Capex	21761	123555	169510

Although this segment is the largest revenue generator of the company, it is not the most profitable. As the table shows, the EBIT margin is about 3%, which is very low.

We expect a 30% decline in revenues in 2009, due to negative effects of commodity prices. The segment is expected to rebound with revenue growth in 2010 (15%) and 2011 (15%), respectively. The segment's gross margin is expected to decline from 5.1% in 2008 to 4.9% in 2011, and their operating margin is expected to decline from 3.3% in 2008 to 2.2% in 2011.

Natural Gas Liquids Pipelines

This segment represents 2% of the revenue stream into ONEOK Partners in 2008. ONEOK Partners has pipelines that distribute unfractionated NGLs to fractionation facilities in Oklahoma and Kansas. The acquisition of Kinder Morgan Energy increased the scope of the pipeline distribution system and connected them with essential markets, such as Chicago, Illinois. This segment draws revenues from regulated tariffs similar to those of the natural gas pipelines. The Federal Energy Regulatory Commission (FERC) sets the cost for transportation, service fees, and depreciation policies.[10]

NGL Pipelines			
(in $1000's)	2006	2007	2008
Revenue	66496	91835	157091
EBIT	29086	39460	60550
EBIT margin	43.7%	43.0%	38.5%
Total Assets	514164	1185513	1903568
Capex	49322	363460	670926

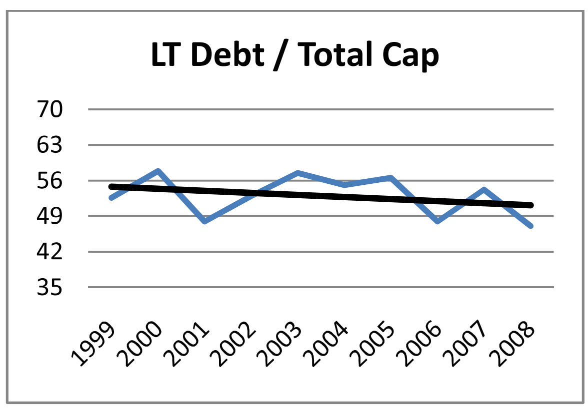
[10] ONEOK Partnerships, Inc. 10-K, Filed 2/25/09. Pg 13-14

The growth of revenue in this segment is 53% since 2006, which is significantly high. The EBIT margin is about 41%. We expect that the company will continue to focus on the development of this segment based on the growth of the segment's total assets and the capital expenditure.

We expect this segment will continue its exceptional revenue growth in 2009 (50%), and will maintain positive growth rates in 2010 (20%) and 2011 (20%). The segment's gross margin is expected to decrease from 84.6% in 2008 to 83% in 2011 and their operating margin is expected to decrease from 39.0% in 2008 to 36.5% in 2011.

Capital Structure

In March 2009, ONEOK Partnership, Inc. issued senior notes due in 2019 with interest rate of 8.625%[11]. The bond issued is used for repaying the outstanding debt under their Partnership Credit Agreement. In addition, they have $436.7 million outstanding due to be paid in March 2012[1].



In February of 2009, ONEOK repaid their matured long term debt, which caused their retained cash inventory to drop significantly for the first quarter of the 2009 fiscal year[12]. ONEOK Partnership, Inc. uses

[11] ONEOK Partnership, Inc 10-Q, filed 3/31/09

[12] ONEOK Partnership, Inc. 10-Q Filed 3/31/09, Pg. 46

a high level of financial leverage with regard to their business operations in order to offset their large amount of capital expenditures over the past years, specifically the $1.25 billion in CapEx in 2008.

From historical data, their long term debt to total capital ratio is about 53% on average. When compared to some of the various competing companies, such as Copano Energy and PNM resources Inc, the ratio is relatively high. Copano and PNM operate with 42% and 46% long term debt to total capital ratios, respectively.

When a company operates with such a high level of financial leverage, various problems or issues could arise for the company. The obligation of interest payments and the repayment of debt at maturity could deduct the retained cash which will decrease the company's overall liquidity, which in turn, the high financial leverage may increase the risk of default. ONEOK is a good example of a company with low liquidity and high default risk since their retained cash levels have dropped significantly from $177M to $1M between the end of the fiscal year 2008 and the first quarter of 2009.[13] They also issued new debt to cover the payment of the old debt that was paid off in February, which may harm their credit rating if this practice continues in the future.

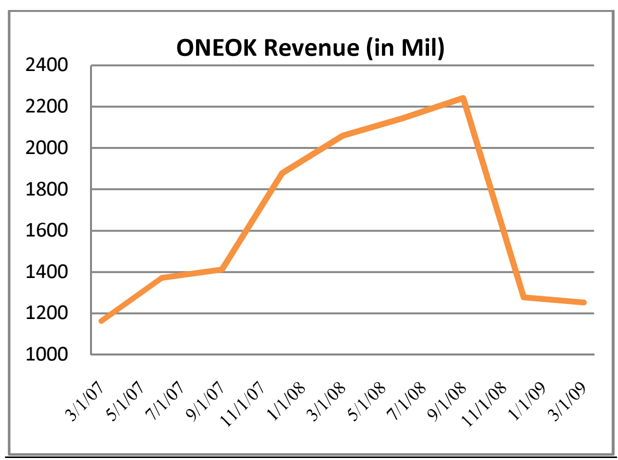
We expect that they will decrease their capital expenditures in the future since the construction of the Overland Pass Pipeline and the expansion of other plants are completed. Therefore, the ratio of long term debt in total capital will decrease in the future. If the capital expenditures drop to the $500 million level, as expected, we forecast the debt to total capital ratio to be between 40 and 45%.

Commodity Price Volatility

As a company with major operating segments in natural gas gathering and processing, and NGL (natural gas liquid) gathering and fractionation, their revenue is mainly driven by the crude oil price. The price of crude oil has been extremely volatile, especially in the recent years.

The accompanying charts show the oil price from May 2007 through the end of January, 2009, and the revenue of ONEOK Partnership, Inc from Q1 2007 to Q1 2009. The price of oil was at its peak in June 2009 and dropped dramatically at the end of 2008. When the two charts are compared, a high correlation between revenue and oil price can easily be seen. As a result of the high correlation, ONEOK has faced a decrease in total revenue for last 2 quarters due to the large drop in the price of crude oil.

Source: http://www.livecharts.co.uk



Source: Thomson One Analytics

When looking to forecast ONEOK'S future revenues, a rough approximation can be estimated using the price that crude oil futures are trading at. As the table below shows, the market is expecting the oil price per barrel to increase throughout 2011.

[13] ONEOK Partners 10-Q, Filed 3/31/09. Pg 6

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Symbol	Name	Last Trade
CLM09.NYM	Crude Oil Jun 09	**53.20** May 1
CLZ09.NYM	Crude Oil Dec 09	**59.56** May 1
CLM10.NYM	Crude Oil Jun 10	**63.89** May 1
CLZ10.NYM	Crude Oil Dec 10	**66.91** May 1
CLM11.NYM	Crude Oil Jun 11	**68.95** Apr 30
CLZ11.NYM	Crude Oil Dec 11	**70.32** May 1

Source: Yahoo! Finance

When compared to the current oil price of $52.61, the price of crude oil is expected to increase almost $10 per barrel by December of 2009 and continue to increase to a price of $70.32 per barrel by December of 2011. If this increase does in fact occur, and if all else remains the same operationally for ONEOK, we expected their total revenue to continue increasing as the oil prices continue to increase.

Bull Case

Commodity prices increase by more than expected, causing ONEOK's revenues to increase in the Natural Gas and Natural Gas Liquids segments. The economy begins to strengthen throughout the year, causing demand to increase as well. They further increase their margins by improving the fractionation process efficiency. With all these improvements, their stock price goes up beyond the $55 point. ONEOK would continue to expand organically and with M&A due to this equity infusion and cheaper credit in order to grow their network of pipelines.

Bear Case

The economy remains in recession for longer than expected causing a decreased demand for products that use Natural Gas and Natural Gas Liquids. Also, as the recession is drawn out, futures prices remain low, indicating that revenues will not improve. A mild summer ensues further driving down natural gas demand for commercial systems used to cool businesses. In the first quarter ONEOK has already used about half of their originally estimated CapEx for the year. If they continue to spend money at that rate, they will miss revenue targets. FERC could create tariffs that will regulate ONEOK's pipeline operations more heavily. With all of these factors, investors see the natural gas and natural gas liquids businesses to be poor investments, causing the stock price to fall below $45 per share.

Relative Valuation

RELATIVE VALUATION

		Mrkt. Cap	Price 5/1/09	Shares Out	2009 Rev	2010 EPS	2010 P/E
NG Production	Ticker	$MM	$	$MM	$MM		
	CPNO	969	15.75	62	1,340	1.25	12.60
	EP	5,211	7.09	735	4,877	0.71	9.99
	AVG	**3,090**	**11.42**	**398**	**3,109**	**0.98**	**11.29**
	OKS	**4,911**	**46.64**	**105**	**603**	**1.75**	
NG Pipeline		$MM	$	$MM	$MM		
	KMP	12,969	47.54	273	10,340	2.03	17.48
	TRP	15,820	25.57	619	8,654	2.41	9.61
	TCLP	1,063	30.48	35	32	2.22	12.70
	AVG	**9,951**	**34.53**	**309**	**6,342**	**2.22**	**13.26**
	OKS	**4,911**	**46.64**	**105**	**282**	**1.54**	
NGL Gathering		$MM	$	$MM	$MM		
	KGS	321	13.46	24	24	1.31	9.27
	WMB	8,167	14.10	579	6,781	1.05	11.43
	AVG	**4,244**	**13.78**	**302**	**3,402**	**1.18**	**10.35**
	OKS	**4,911**	**46.64**	**105**	**4,157**	**1.08**	
NGL Pipeline		$MM	$	$MM	$MM		
	DEP	1,762	18.55	95	2,158	0.87	14.57
	DPM	515	16.19	32	302	1.43	10.95
	AVG	**1,139**	**17.37**	**63**	**1,230**	**1.15**	**12.76**
	OKS	**4,911**	**46.64**	**105**	**224**	**1.01**	

Since ONEOK Partners has four main operating segments that they operate in, the relative valuation has to be split into segments, as well. For the competitors in the Natural Gas Production and Exploration segment, Copano Energy (Ticker: CPNO) and El Paso Corporation (Ticker: EP) were used as they both have large segments within their operations for natural gas exploration. In the Natural Gas Pipeline segment, we found TransCanada Corporation (Ticker: TRP), Kinder Morgan Energy (Ticker: KMP), and TC Pipelines (Ticker: TCLP) to be adequate due to the success of their pipeline segments. The two comparables we used for the Natural Gas Liquids Gathering segment were Williams Companies (Ticker: WMB) and Quicksilver Gas Services (Ticker: KGS). For the Natural Gas Liquid Pipeline segment, we used Duncan Energy Partners (Ticker: DEP) and DCP Midstream Partners (Ticker: DPM). After analyzing the segment P/E ratios for each competitor, we averaged them by segment to determine P/E multiples of 11.29, 13.26, 10.35, and 12.76 for the Natural Gas Processing and Exploration segment, Natural Gas Pipeline segment, Natural gas Liquids Gathering segment, and Natural Gas Liquids pipeline segment, respectively. Given the P/E multiples by segment, we multiplied it by the per-share earnings by segment and found an intrinsic price of $64. With that price, ONEOK Partners stock is undervalued by more than 37%.

DCF Analysis

According to our Discounted Cash Flow (DCF) analysis, ONEOK's shares are undervalued by 16%. For 2009, we have projected lower free cash flows than previous years. This is partially attributed to a large swing in net working capital between 2007 and 2008 as they went from positive working capital to negative. In 2008, their working capital was negative by more than a billion dollars as their liabilities greatly exceeded their current assets. Under the assumption that they will continue operating with greater liabilities than assets, as they have every year in the past with few exceptions, the working capital shifts will be of less magnitude causing the free cash flows to increase yearly. The reduced capital expenditures expected also causes increases in the future free cash flows.

FREE CASH FLOW

	Actual		Estimated			
($M)	2007	2008	2009	2010	2011	2012
Net Revenue	5,835	7,724	10,058	12,971	16,527	20,039
Revenue Growth	23%	32%	30%	29%	27%	21%
EBITDA	595	801	664	779	893	1,117
EBITDA Growth	-10%	35%	-17%	17%	15%	25%
CapEx	710	1,254	514	477	518	596
Free Cash Flow	**884**	**841**	**-142**	**485**	**628**	**763**
FCF Growth	-198%	-5%	-117%	241%	30%	21%

Using the previous free cash flow forecasts, and the assumptions listed in the table below, we calculated our terminal value for ONEOK Partners to be $54. Using the stock closing price on 5/1/09 of $46.64, ONEOK's shares are undervalued by almost 16%.

DCF ASSUMPTIONS

	Cost	Weight
Debt	8.4%	41%
Equity	10.4%	59%
WACC		8.96%
Terminal Growth		2.00%

Dividend Discount Model

In the past, ONEOK Partners has paid generous dividends to their shareholders. Since 2001, they have paid out an average of $3.32 per share, and that number has increased as of late. With our expected free cash flows forecast to be low 2009 and 2010, we expect their dividend per share to remain the same, $3.30, as it was in 2008. Once ONEOK's free cash flows increase to larger amounts, as expected in 2011 and 2012, we expect them to increase their dividend beyond $3.30 per share. The chart below details our dividend expectations throughout 2012. With those expectations, and an assumed average future growth rate of 2.2% and a WACC of 8.96%, we calculated and intrinsic value for ONEOK Partners to be $53 per share. Given the closing price of the stock on 5/1/09, ONEOK is undervalued by 14%.

DIVIDEND DISCOUNT MODEL				
	2009	2010	2011	2012
Expected Div/Share	3.3	3.3	3.4	3.6
Dividend Growth	0.0%	0.0%	3.0%	5.9%
Present Value of Div	3.30	3.03	2.86	2.78
2009 Intrinsic Value				**$53.30**
Current Price (5/1/09)				**$46.64**

Conclusion

We recommend a **BUY** for ONEOK Partners, LP.

ONEOK Partners is a well diversified company with four segments that have a proven track record of profitability. Given ONEOK Partners' commitment to their strong dividends, despite economic duress, they appear to be a great value company within the oil and gas industry. Additionally, their strong track record of organic and M&A growth makes them appear to be a growth company. Their total assets have increased 287% from 2005 to 2008. Lastly, commodity prices, which appear to have placated them in recent quarters are projected to return to favorable levels in the coming years. The price of a barrel of crude oil looks to increase from $52.61 to $70.32 by the end of 2011. This represents an increase of 10.2% CAGR. All things considered, ONEOK Partners offers great dividends, exceptional growth, and positive forward looking economics.