

Inergy Holdings LP

Inergy Holdings LP (NRGP) operates as a Master Limited Partnership (MLP) and controls the general partner of Inergy, LP (NRGY), including incentive distribution rights. A Master Limited Partnership is a limited partnership that is publicly traded on a securities exchange. Because MLPs are a partnership, they avoid the corporate income tax, on both a state and federal basis. Additionally, the limited partner (investor) may also record a pro-rated share of the MLPs depreciation on tax forms to reduce liability. This is the primary benefit of MLPs and gives MLPs relatively cheap funding costs.¹ The relationship between Inergy Holdings LP and Inergy LP follows this structure; the operating company being Inergy LP (owning and operating all the assets to generate revenue) to supply Inergy Holdings LP with the profits (in the form of dividends). Inergy Holdings LP currently hold an aggregate 10.3% interest in Inergy LP, of which 0.9% ownership is in the general partner and 9.4% ownership is in the limited partner.

Due to a rising demand for petroleum products, many pipeline operators (including Inergy LP) are growing earnings and dividends either by acquiring existing pipelines from third parties, building new pipelines, or by increasing the capacity of existing facilities. Currently, most MLPs are paying dividends equating to 5% to 9% dividend yields.²

Bear/Bull Case

The catalyst of growth for Inergy LP is its ability to continue to find and make profit generating acquisitions. Within the last three years, Inergy LP has acquired more than 30 companies and has committed \$125 million per year to fund future acquisitions.³ In our Bear Case, we assume that Inergy LP is not able to find as many profitable acquisitions which will limit their ability to continue to grow revenue at the same rate they have over the previous five years. Our Bull Case assumes that the current pace of acquisitions will continue; however, in the long term we anticipate that the number of acquisitions will

begin to decrease as Inergy LP commands a larger share of the market.

Valuation

Shares of NRGP are currently trading at \$25 per share (as of 10/17/2008). Using a Dividend Discount Model, we developed Bear and Bull price targets of \$40 and \$57, respectively. To derive these target prices, we first forecasted future revenues, gross margins and earnings for the company. In doing so, we believe that revenues will continue to grow at a compounded annual growth rate of 15% through the fiscal year ending 2012. Similarly, we estimate that earnings will grow at a compounded annual growth rate of 16% through fiscal year ending 2012, as seen in the Pro Forma below.

Distributions (dividends) paid to shareholders over the most recent four quarters have been relatively stable, with increases ranging from 6.6% to 4.3%, as seen in the Dividends chart below. It is our estimation that these dividends will continue to follow this trend downwards to an average 3.0% increasing quarterly dividend into perpetuity in our Bear case and 5.0% in our Bull case. Using a Beta of 1.1, market risk premium of 6.0% and a risk free rate of 4.0%, we were able to derive a cost of equity equal to 10.6%. Next, we employed a dividend discount model and discounted the expected dividends back to the current quarter. To establish a terminal value, we assumed a long term stable growth rate of 3.0% for the Bear case and 5.0% for the Bull case.

Recommendation

With the current price of \$25, a Bear Case Target Price of \$40 and a Bull Case Target Price of \$57 this stock appears to be 39% to 56% undervalued and thus we recommend a BUY for NRGP.

Pro Forma NRGP	ACTUAL					PROJECTED				
	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Revenue										
Propane	343.6	431.2	851.6	1,072.3	1,150.4	1,405.8	1,616.7	1,818.8	2,000.7	2,100.7
Growth		25.5%	97.5%	25.9%	7.3%	96.0%	15.0%	12.5%	10.0%	5.0%
Other	19.8	51.3	93.1	93.1	332.7	558.1	669.8	770.2	858.8	918.9
Growth		159.2%	81.5%	0.0%	257.4%	86.6%	20.0%	15.0%	11.5%	7.0%
Total	363.4	482.5	944.7	1,165.4	1,483.1	1,964.0	2,286.5	2,589.0	2,859.5	3,019.6
Growth		32.9%	95.9%	23.3%	27.2%	85.7%	16.4%	13.2%	10.4%	5.6%
Gross Margins										
Propane	24.6%	22.5%	30.3%	27.3%	28.7%	25.7%	23.0%	24.0%	26.5%	29.0%
Other	59.4%	51.6%	-40.5%	-126.3%	39.4%	31.4%	28.0%	31.0%	35.0%	37.5%
Total	26.6%	25.7%	34.7%	34.3%	31.1%	26.0%	24.5%	26.1%	29.1%	31.6%
Net Income	3.0	0.1	8.3	14.4	102.6	50.8	93.4	118.4	169.9	223.2
Growth		-96.7%	8200.0%	73.5%	612.5%	-50.4%	83.7%	26.8%	43.5%	31.4%

Dividends NRGP	ACTUAL					PROJECTED				
	Q3 2007	Q4 2007	Q1 2008	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009	Q4 2009
BEAR										
NRGP Dividends	0.51	0.54	0.56	0.59	0.61	0.65	0.68	0.71	0.74	0.76
Quarterly Growth		4.9%	4.7%	4.5%	4.3%	6.6%	5.0%	4.5%	4.0%	3.0%
BULL										
NRGP Dividends	0.51	0.54	0.56	0.59	0.61	0.65	0.69	0.73	0.77	0.81
Quarterly Growth		4.9%	4.7%	4.5%	4.3%	6.6%	6.5%	6.0%	5.5%	5.0%

¹ http://en.wikipedia.org/wiki/Master_limited_partnership

² <http://www.winninginvesting.com/mlps.htm>

³ <http://seekingalpha.com/article/99472-inergy-stock-falling-is-further-evidence-of-current-market-insanity>