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Kinder Morgan, Southern to create pipeline JV, furthering merger trend

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In a deal that marks the further consolidation of natural gas and power industries in the US Southeast, Southern Company and Kinder Morgan announced a gas pipeline joint venture, in which the former company will buy a 50% interest in Kinder Morgan's Southern Natural Gas pipeline system for $1.47 billion in cash.

Houston-based Kinder Morgan will continue to operate the 7,600-mile system, which connects gas supply basins in Texas, Louisiana, Mississippi, Alabama and the Gulf of Mexico with markets in Louisiana, Mississippi, Alabama, Florida, Georgia, South Carolina and Tennessee, the companies said in a July 10 joint statement.

In addition, the two companies agreed "to cooperatively pursue specific growth opportunities to develop natural gas infrastructure for the strategic venture."

The announcement of the JV comes on the heels of the closing earlier in July of Southern Company's $8 billion acquisition of AGL Resources (see story, this issue). That deal gave the Atlanta-based company access to AGL's gas marketing division, widespread regional pipeline infrastructure and gas utility assets.

In a July 11 conference call with analysts, Kinder Morgan officials cited Southern Company's position astride the gas and power markets in the Southeast as a key factor in pursuing the joint venture.

"We're just very happy to do this transaction with Southern Company," Kinder Morgan Chairman Richard Kinder said.

"They have a similar outlook on the world as we do, that natural gas is the future for electric generation. This just positions us much better in the most prolific natural gas usage area for electric generation, the Southeast," he said.

Kinder Morgan CEO Steven Kean cited Southern Company's importance as a gas customer in the Southeast as well as other regions.

"They're a huge customer where the market for natural gas is growing," he said.

Southern makes up almost half of SNG demand: Kean

With the recent acquisition of AGL, Southern Company represents almost half of the demand for gas on the SNG system, he said.

While Kinder Morgan expects to use the proceeds of the deal to pay down its debt, accumulated over the past year and a half or so period of lower energy prices, company officials said they have been looking to make a similar deal with Southern Company for more than a year.

For its part, Southern Company views the acquisition of a 50% interest in the SNG system as a way to secure access to gas for is growing gas-fired generation fleet.

The company has seen its generation fuel mix flipped on its head the past seven years. With roughly 42,000 MW in 2009, coal-fired generation represented 57% of the mix and gas 16%.

Today, with a total of 44,220 MW of capacity, coal-fired generation is 33% while gas is 47%. Southern has seen a jump from 6,720 MW of gas-fired generation to 20,774 MW since 2009.

"This transaction is consistent with the infrastructure development strategy we have discussed for well over a year," Southern Chairman and CEO Thomas Fanning said in the joint statement.

"The company's strategic venture with Kinder Morgan, combined with our recent additions, AGL Resources and PowerSecure, underscore Southern Company's leadership position in electricity and natural gas and our commitment to developing America's energy infrastructure," he said.

JV stake to enhance Southern's access to gas: Fanning

"Our new ownership stake in SNG will position Southern Company for future growth opportunities and enhanced access to natural gas, which are expected to benefit customers and investors alike," he added.

Inclusive of existing SNG debt, the transaction equates to an SNG total enterprise value of about $4.15 billion, which implies a value of $1.47 billion for Southern Company's 50% share of the equity interest.

Southern Company said it expects to finance the initial purchase, as well as any related future growth opportunities related to the formation of the JV "in a credit-supportive manner."

With the exception of the notification and clearance and reporting requirements under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, the transaction is not subject to any regulatory approvals and the companies expect to complete the deal in the third quarter or early in the fourth quarter of this year.

The deal is expected to add to the gas marketing clout of Southern Company, which with a projected regulated rate base of about $50 billion, is the second largest utility company in the US in terms of customer base. Only Duke Energy is larger.

With its recent acquisition of AGL, Southern now owns eight gas distribution companies that have a combined 80,000 miles of gas pipelines. These companies are: AGL Resources, Atlanta Gas Light, Chattanooga Gas, Elizabethtown Gas, Elkton Gas, Florida City Gas, Nicor Gas and Virginia Natural Gas.

Southern's 44,220 MW of power generation capacity and 1,500 Bcf of combined natural gas consumption and throughput serve a total of 9 million electricity and gas utility customers through its subsidiaries. Its four electric utilities are Alabama Power, Georgia Power, Gulf Power and Mississippi Power.

Southern planning more gas-fired generation

For years, Georgia Power operated some of the country's largest coal-fired facilities, such as the 3,600-MW Scherer facility in Juliette, Georgia. However, over the past five years the Southern subsidiary has reduced its coal-fired generation by nearly half by switching fuel and retiring some facilities.

In 2011, Georgia Power retired its 1,000-MW, two-unit McDonough-Atkinson coal-fired facility in Smyrna, Georgia, and replaced it with a three-unit, 2,520-MW natural gas-fired facility.

Southern has said that for the McDonough-Atkinson facility to operate it had to install a pipeline to transport natural gas to the plant from the Southern Natural Gas system north of Union City, Georgia.

"The deal continues Southern's focus on expanding its natural gas exposure and on energy infrastructure-oriented investments," Christopher Muir, an analyst with S&P Global Equity Research, said in a July 11 email statement.

S&P Global Equity Research, like Platts, is a subsidiary of S&P Global Corp.

Stewart Glickman, group head of energy equity research for S&P Global Market Intelligence, said the deal appears to represent a positive from Kinder Morgan's standpoint. “KMI will use proceeds to cut debt, although its net debt-to-capital ratio of 55% is actually better than its peers,” said in a July 11 note to analysts.

He added that coal plant retirements scheduled to occur in 2018 “may have boosted [Southern Company's] interest in natural gas.”

In a July 11 statement, Fitch Ratings said it expects the transaction to be credit positive for Kinder Morgan, but it would not change the company's current ratings and outlook.

More utility consolidation likely: Worms

Michael Worms, managing director at BMO Capital Markets, who predicted more convergence among gas and power companies in a report last September, said the trend of electric utilities buying gas utilities is likely to continue.

“We think there's more to come,” he said in an interview. The need to expand through acquisitions is especially felt by a pure utility company, for which there is only one avenue for growth.

“If you're a utility company you need to grow from your rate base and get your earnings from that. But, if you've got other businesses, similar business, you've got options,” Worms said.

“One business may not be growing quickly, and then maybe another is growing faster, so they kind of offset each other,” he said.

Another driver of the trend for electric utilities to acquire gas assets is the rising demand for gas-fired power generation, as power companies retire aging coal plants.

“The switch to natural gas is part of the environmental push that we're seeing right now,” Worms said. He pointed to the Environmental Protection Agency's adoption of the Mercury and Air Toxics and Cross-state rules as giving electric utilities the incentive to move away from coal-fired generation and toward cleaner-burning gas.

“Now we have the proposed Clean Power Plan. In the meantime, companies are voluntarily shutting down coal plants,” Worms said.

However, Michelle Foss, chief energy economist at the University of Texas at Austin's Bureau of Economic Geology, said whether or not the trend of electric utility companies acquiring gas assets continues is entirely dependent upon the utilities' ability to pay to acquire the assets.

“Midstream asset owners need fresh capital but few utilities have the ability to make large acquisitions or even cover substantial joint ventures. Worldwide the utility industry is in terrible financial shape,” she said in an email.

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Southern Natural Gas Route/Southern Co. Service Areas|graph Source: Southern Company, Kinder Morgan

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