Recent Mergers and Acquisitions of Natural Gas Companies

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The energy industry is undergoing a period of unprecedented change. Energy companies are faced with a variety of issues that are reshaping traditional business models. Electric utilities must deal with stagnant growth, low natural gas prices, distributed generation, and emissions mandates. Both electric and gas utilities must address falling allowable returns, aging infrastructure, and rising operating costs. Merger and acquisition (M&A) has reemerged as a strategy to address these issues and relieve earnings pressures. In particular, M&A activity involving natural gas local distribution companies (LDCs) has increased over the past few years.

RECENT ACTIVITY

Since 2014, there have been seven significant transactions involving gas LDCs with a deal value of more than $45 billion.

Recent Transactions Involving Natural Gas Companies

Acquirer/Target	Rationale	Deal Value*	Date Announced/ Close Date	
Dominion Resources/ Questar	▪ Geographic diversity ▪ Additional transmission assets for Dominion's MLP business ▪ Expected growth opportunities in midstream	$4.4B	Feb. 2016	4Q 2016
Southern Company/ AGL Resources	▪ Established gas infrastructure – supports Southern's shift to more gas-fired generation and compliance with federal CO_2 emissions mandates ▪ Complementary expertise and geographic diversity ▪ Growth opportunities in midstream and merchant generation ▪ Risk mitigation through a more diversified project portfolio	$12B	Aug. 2015	Jul. 2016
Duke Energy/ Piedmont Natural Gas	▪ Infrastructure investment opportunities ▪ Established gas infrastructure – supports Duke's shift to more gas-fired generation ▪ Expected operational improvements from Piedmont's gas expertise ▪ Growing markets in the Carolinas and Nashville ▪ Attractive returns from stable gas business	$6.7B	Oct. 2015	4Q 2016
Emera/ TECO Energy	▪ Expansion into growth markets with constructive regulatory jurisdictions ▪ "Geographic, regulatory, and business mix diversification" ▪ Supportive of regulated growth strategy	$10.4B	Sep. 2015	1H 2016

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Acquirer/Target	Rationale	Deal Value*	Date Announced/ Close Date	
Black Hills Corporation/ Source Gas	▪ Larger scale (>50% increase in customer base) and adjacent territories ▪ Source Gas' favorable regulatory environments and customer growth ▪ Significant rate base growth opportunities ▪ Greater geographic and regulatory diversity	$1.9B	Jul. 2015	1H 2016
WEC Energy/ Integrys Energy	▪ Expected growth in gas customers ▪ Combined scale and expertise ▪ "Complementary geographic footprints"	$9.1B	Jun. 2014	Jun. 2015
Spire/ Alabama Gas	▪ Regulated growth from increased customer base and assets ▪ Combined scale and expertise ▪ Geographic and regulatory diversity	$1.6B	Apr. 2014	Sep. 2014

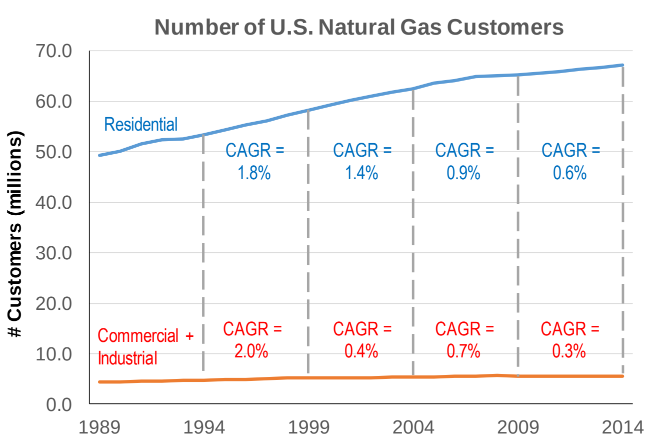
* Represents total transaction value, including assumed debt
Sources: SNL, PR Newswire, Financier Worldwide

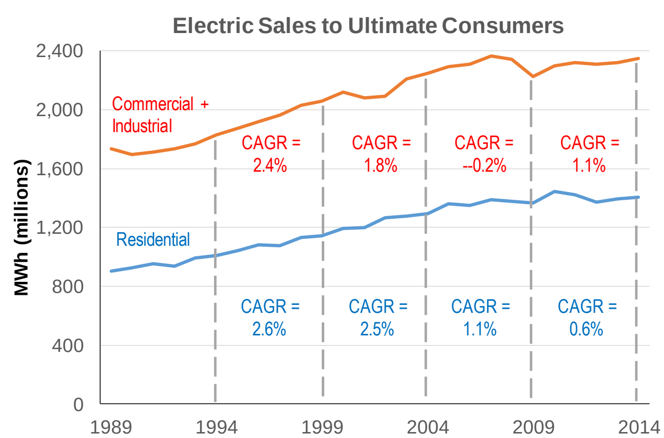
DRIVERS OF M&A

While specific drivers for these deals depend on the acquiring company's strategy and the nature of the transaction, they typically fall into the following categories:

- Growth opportunities
- Diversification (business mix, geography)
- Leveraging of synergies
- Compliance with environmental mandates

A desire for growth is one of the most common M&A drivers. Organic growth rates, in terms of gas customers and electric load, have decreased over the past several years. Between 2009 and 2014, gas customer growth was less than 1%, and growth in electric sales was similar.

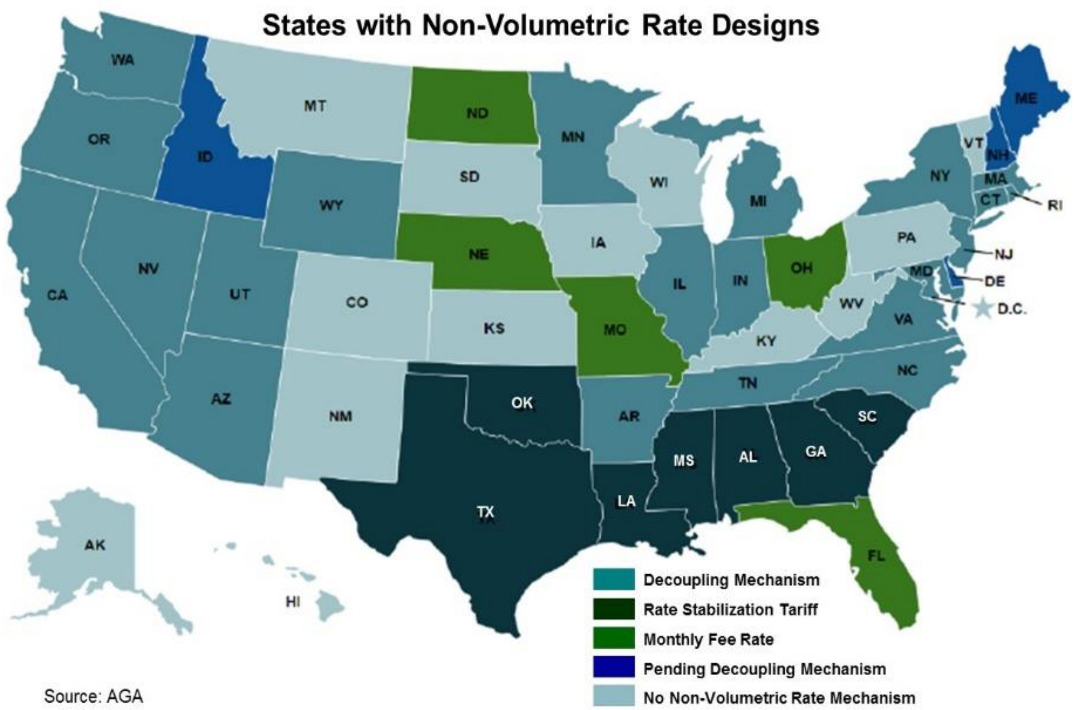




Source: EIA

Due to the slow growth rates in customers and load, M&A is becoming an alternate means to achieve earnings growth. For example, prospective buyers seeking utility-side growth may be attracted to companies with service territories in expanding markets or with capital investment opportunities. Growth in non-utility businesses can be realized through acquisitions of gas transmission or storage assets that provide long-term, predicable cash flows.

Geographic or business mix diversification is another key driver, as it mitigates risk related to earnings, customer base, local economies, cost recovery, and weather.



For utilities pursuing a regulated business growth strategy, geographic diversification can be especially important. State regulatory environments vary widely, and an acquisition can provide a presence in a more constructive ratemaking state. In a supportive jurisdiction, utilities can more easily develop rate mechanisms, such as non-volumetric designs, that reduce regulatory lag and increase rate base.

Synergies gained from increased scale, overlapping or adjacent service territories, and complementary expertise continue to be cited as rationale for M&A. These synergies are expected to lower operating costs. Lowering operating costs can mitigate impacts to rates for companies that desire additional capital investments.

For electric utilities, compliance with environmental regulations can be a factor. The EPA's proposed Clean Power Plan (CPP); which places limits on air emissions from power plants, makes natural gas an attractive fuel due to its lower carbon footprint. Acquiring a company with an established natural gas infrastructure can support a shift to more gas-fired generation and help electric utilities and merchant operators meet air emission standards.

KEY CHARACTERISTICS OF TARGETS

Given these factors, a key question is "what characteristics make a company an acquisition target?"

- **Prospects for growth** – The existence of well-run pipeline safety improvement programs make gas LDCs attractive, as they can provide rate base additions that will be sustainable for the foreseeable future. Additionally, there are pockets of organic customer growth that may be appealing
- **Small geographic footprint** – Typically, larger service territories span multiple regulatory jurisdictions, and each jurisdiction represents a hurdle for approval. Regulatory approvals often drive the overall timeline for transaction close
- **Relatively low debt** – The buyer may have to incur their own debt to finance the transaction. Minimizing debt assumed from an acquisition helps lessen the impact to credit ratings
- **Less expensive valuation** – Some recent deals have involved premiums of 30-40%, which suggest that buyers place high value on growth potential and diversification. In today's environment, determining what is "expensive" may be difficult

M&A activity is expected to continue due, in large part, to flat growth, low gas prices, and environmental mandates. While the recent U.S. Supreme Court stay of the CPP may slow the pace on some M&A activity, the other factors should be compelling enough for future deals to occur.

ABOUT SCOTTMADDEN'S NATURAL GAS PRACTICE

ScottMadden helps companies adapt to rapid change in the natural gas industry by providing strategic and operational improvements that deliver value to clients.

We have deep experience in assisting our clients with managing the gas business through a variety of services, including strategic analysis, business planning, operations management, organization design and staffing, business process improvement, mergers and acquisitions, rates and finance strategy, and performance benchmarking.

We have provided consulting support across major functions, including field operations, construction, maintenance, supply chain, customer service, gas supply, regulatory, and sales and marketing.

ABOUT SCOTTMADDEN'S ENERGY PRACTICE

We know energy from the ground up. Since 1983, we have been energy consultants. We have served more than 300 clients, including 20 of the top 20 energy utilities. We have performed more than 2,400 projects across every energy utility business unit and every function. We have helped our clients develop strategies, improve operations, reorganize companies, and implement initiatives. Our broad and deep energy utility expertise is not theoretical—it is experience based.

ABOUT THE AUTHORS

Ed Baker (edbaker@scottmadden.com) is a partner in ScottMadden's Atlanta office. Jason Davis (jgdavis@scottmadden.com) is a director in the Atlanta office. Together they lead the firm's gas practice.

Sources:

- SNL
- Advanced Energy Economy
- Bloomberg