

SOUTHERN Co GAS  
Form 10-Q  
November 04, 2016

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2016

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-14174

SOUTHERN COMPANY GAS  
(Exact name of registrant as specified in its charter)

Georgia 58-2210952  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

Ten Peachtree Place NE, Atlanta, Georgia 30309  
(Address of principal executive offices)

404-584-4000  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Description of Common Stock	Shares Outstanding as of September 30, 2016
Par Value \$0.01 Per Share	100

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September 30, 2016

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DEFINITIONS

Term	Meaning
ASU	Accounting Standards Update
Atlanta Gas Light	Atlanta Gas Light Company
Atlantic Coast Pipeline	Atlantic Coast Pipeline, LLC
Central Valley CUB	Central Valley Gas Storage, LLC Citizens Utility Board
Dalton Pipeline	A 50% undivided ownership interest in a pipeline facility in Georgia
EPA	U.S. Environmental Protection Agency
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
Fitch	Fitch Ratings, Inc.
Form 10-K	Annual Report on Form 10-K of Southern Company Gas for the year ended December 31, 2015
GAAP	U.S. generally accepted accounting principles
Georgia PSC	Georgia Public Service Commission, the state regulatory agency for Atlanta Gas Light
GNG	Georgia Natural Gas Company
Golden Triangle	Golden Triangle Storage, Inc.
Heating Degree Days	A measure of weather, calculated when the average daily temperatures are less than 65 degrees Fahrenheit
Heating Season	The period from November through March when natural gas usage and operating revenues are generally higher
Horizon Pipeline	Horizon Pipeline Company, LLC
Illinois Commission	Illinois Commerce Commission, the state regulatory agency for Nicor Gas
Jefferson Island	Jefferson Island Storage & Hub, LLC
LOCOM	Lower of weighted average cost or current market price
Merger	The merger of AMS Corp., a wholly-owned, direct subsidiary of Southern Company, with and into Southern Company Gas, effective July 1, 2016, with Southern Company Gas continuing as the surviving corporation and a wholly-owned, direct subsidiary of Southern Company
mmBtu	Million British thermal units
Moody's	Moody's Investors Service, Inc.
New Jersey BPU	New Jersey Board of Public Utilities, the state regulatory agency for Elizabethtown Gas
Nicor Gas	Northern Illinois Gas Company, doing business as Nicor Gas Company
Nicor Gas Credit Facility	\$700 million credit facility entered into by Nicor Gas to support its commercial paper program
NYMEX	New York Mercantile Exchange, Inc.
PennEast Pipeline	PennEast Pipeline Company, LLC
Piedmont	Piedmont Natural Gas Company, Inc.
Pivotal Utility Holdings	Pivotal Utility Holdings, Inc., doing business as Elizabethtown Gas, Elkton Gas and Florida City Gas
PRP	Pipeline Replacement Program, Atlanta Gas Light's 15-year infrastructure replacement program, which ended in December 2013
S&P	S&P Global Ratings, a division of S&P Global Inc.
SEC	U.S. Securities and Exchange Commission
Sequent	Sequent Energy Management, L.P.
SNG	Southern Natural Gas Company L.L.C.
Southern Company	The Southern Company
Southern Company Gas	Southern Company Gas (formerly known as AGL Resources Inc.) and its subsidiaries

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Southern Company Gas Capital	Southern Company Gas Capital Corporation (formerly known as AGL Capital Corporation), a wholly-owned subsidiary of Southern Company Gas
Southern Company Gas Credit Facility	\$1.3 billion credit agreement entered into by Southern Company Gas Capital to support its commercial paper program
SouthStar	SouthStar Energy Services, LLC
Triton	Triton Container Investments, LLC
VIE	Variable interest entity
Virginia Commission	Virginia State Corporation Commission, the state regulatory agency for Virginia Natural Gas
Virginia Natural Gas	Virginia Natural Gas, Inc.
WACOG	Weighted average cost of gas

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#### CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This Quarterly Report on Form 10-Q contains forward-looking statements. Forward-looking statements include, among other things, statements concerning regulatory matters, the strategic goals for Southern Company Gas, economic conditions, regulatory and environmental cost recovery and other rate actions, current and proposed environmental regulations and related compliance plans and estimated expenditures, pending or potential litigation matters, access to sources of capital, projections for the qualified pension plan contributions, financing activities, completion dates of construction projects, filings with state and federal regulatory authorities, and estimated other plans and expenditures. In some cases, forward-looking statements can be identified by terminology such as "may," "will," "could," "should," "expects," "plans," "anticipates," "believes," "estimates," "projects," "predicts," "potential," or "continue" or the negative of these terms or other similar terminology. There are various factors that could cause actual results to differ materially from those suggested by the forward-looking statements; accordingly, there can be no assurance that such indicated results will be realized. These factors include:

- the impact of recent and future federal and state regulatory changes, including legislative and regulatory initiatives regarding deregulation and restructuring of the natural gas utility industry, environmental laws, and also changes in tax and other laws and regulations to which Southern Company Gas and its subsidiaries are subject, as well as changes in application of existing laws and regulations;
- current and future litigation, regulatory investigations, proceedings, or inquiries, including, without limitation, IRS and state tax audits;
- the effects, extent, and timing of the entry of additional competition in the markets in which Southern Company Gas' subsidiaries operate;
- variations in demand for natural gas, including those relating to weather, the general economy and recovery from the last recession, population and business growth (and declines), the effects of energy conservation and efficiency measures, including from the development and deployment of alternative energy sources, and any potential economic impacts resulting from federal fiscal decisions;
- available sources and costs of natural gas;
- limits on pipeline capacity;
- effects of inflation;
- the ability to control costs and avoid cost overruns during the development and construction of facilities;
- investment performance of Southern Company Gas' employee and retiree benefit plans;
- advances in technology;
- state and federal rate regulations and the impact of pending and future rate cases and negotiations, including rate actions relating to natural gas and other cost recovery mechanisms;
- the ability to successfully operate the natural gas distribution and storage facilities and the successful performance of necessary corporate functions;
- the inherent risks involved in transporting and storing natural gas;
- the performance of the non-utility businesses and the success of efforts to invest in and develop new opportunities;
- internal restructuring or other restructuring options that may be pursued;
- potential business strategies, including acquisitions or dispositions of assets or businesses, which cannot be assured to be completed or beneficial to Southern Company Gas or its subsidiaries;
- the possibility that the anticipated benefits from the Merger cannot be fully realized or may take longer to realize than expected, the possibility that costs related to integration with Southern Company will be greater than expected, the ability to retain and hire key personnel and maintain relationships with customers, suppliers, or other business partners, and the diversion of management time on integration related issues;
- the ability of counterparties of Southern Company Gas and its subsidiaries to make payments as and when due and to perform as required;
- the direct or indirect effect on Southern Company Gas' business resulting from cyber intrusion or terrorist incidents and the threat of terrorist incidents;
- interest rate fluctuations and financial market conditions and the results of financing efforts;
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changes in Southern Company Gas' and any of its subsidiaries' credit ratings, including impacts on interest rates, access to capital markets, and collateral requirements;

- the impacts of any sovereign financial issues, including impacts on interest rates, access to capital markets, impacts on currency exchange rates, counterparty performance, and the economy in general;
- catastrophic events such as fires, earthquakes, explosions, floods, hurricanes and other storms, droughts, pandemic health events such as influenzas, or other similar occurrences;
- the direct or indirect effects on Southern Company Gas' business resulting from incidents affecting the U.S. natural gas pipeline infrastructure or operation of storage resources;
- the effect of accounting pronouncements issued periodically by standard-setting bodies; and
- the other factors discussed elsewhere herein and in other reports (including the Form 10-K) filed by Southern Company Gas from time to time with the SEC.

Southern Company Gas expressly disclaims any obligation to update or revise any forward-looking statements.

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SOUTHERN COMPANY GAS AND SUBSIDIARY COMPANIES  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Successor For the Three Months Ended September 30, 2016 (in millions)	Predecessor For the Three Months Ended September 30, 2015 (in millions)	Successor July 1, 2016 through September 30, 2016 (in millions)	Predecessor January 1, 2016 through June 30, 2016 (in millions)	For the Nine Months Ended September 30, 2015
Operating Revenues:					
Natural gas revenues (includes revenue taxes of \$9, \$9, \$9, \$57, and \$83 for the periods presented, respectively)	\$ 518	\$ 553	\$ 518	\$1,841	\$ 2,887
Other revenues	25	31	25	64	92
Total operating revenues	543	584	543	1,905	2,979
Operating Expenses:					
Cost of natural gas	133	140	133	755	1,282
Cost of other sales	2	6	2	14	21
Other operations and maintenance	216	218	216	454	676
Depreciation and amortization	116	98	116	206	293
Taxes other than income taxes	29	28	29	99	142
Merger-related expenses	35	35	35	56	35
Total operating expenses	531	525	531	1,584	2,449
Operating Income	12	59	12	321	530
Other Income and (Expense):					
Allowance for equity funds used during construction	—	1	—	2	3
Interest expense, net of amounts capitalized	(39 )	(43 )	(39 )	(96 )	(129 )
Earnings from equity method investments	29	2	29	2	4
Other income (expense), net	9	—	9	3	3
Total other income and (expense)	(1 )	(40 )	(1 )	(89 )	(119 )
Earnings Before Income Taxes	11	19	11	232	411
Income taxes	7	7	7	87	150
Consolidated Net Income	4	12	4	145	261
Less: Net income attributable to noncontrolling interest	—	1	—	14	15
Consolidated Net Income Attributable to Southern Company Gas	\$ 4	\$ 11	\$ 4	\$131	\$ 246

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SOUTHERN COMPANY GAS AND SUBSIDIARY COMPANIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Successor For The Three Months Ended September 30, 2016  (in millions)	Predecessor For The Three Months Ended September 30, 2015  (in millions)	Successor July 1, 2016 through September 30, 2016  (in millions)	Predecessor January 1, 2016 through June 30, 2016  (in millions)	For The Nine Months Ended September 30, 2015
Consolidated Net Income	\$ 4	\$ 12	\$ 4	\$145	\$ 261
Other comprehensive income (loss):					
Qualifying hedges:					
Changes in fair value, net of tax of \$(2), \$(18), \$(2), \$(23) and \$(1), respectively	(3 )	(30 )	(3 )	(41 )	(3 )
Reclassification adjustment for amounts included in net income, net of tax of less than \$1 for each period presented	—	1	—	1	5
Pension and other post retirement benefit plans:					
Reclassification adjustment for amounts included in net income, net of tax of \$0, \$2, \$0, \$4 and \$6, respectively	—	2	—	5	9
Total other comprehensive income (loss)	(3 )	(27 )	(3 )	(35 )	11
Less: Comprehensive income attributable to noncontrolling interest	—	—	—	14	15
Consolidated Comprehensive Income (Loss) Attributable to Southern Company Gas	\$ 1	\$ (15 )	\$ 1	\$96	\$ 257

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SOUTHERN COMPANY GAS AND SUBSIDIARY COMPANIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Successor July 1, 2016 through September 30, 2016  (in millions)	Predecessor January 1, 2016 through June 30, 2016  (in millions)	For the Nine Months Ended September 30, 2015
<b>Operating Activities:</b>			
Consolidated net income	\$ 4	\$145	\$ 261
Adjustments to reconcile consolidated net income to net cash provided from operating activities —			
Depreciation and amortization, total	116	206	293
Deferred income taxes	(30 )	8	38
Stock based compensation expense	11	20	22
Hedge settlements	(35 )	(26 )	—
Pension, postretirement, and other employee benefits	(123 )	5	18
Goodwill impairment	—	—	14
Other, net	(30 )	80	117
Changes in certain current assets and liabilities —			
-Receivables	(18 )	181	761
-Natural gas for sale	(222 )	273	62
-Other current assets	(35 )	188	168
-Accounts payable	78	43	(313 )
-Accrued taxes	(11 )	41	(19 )
-Accrued compensation	(36 )	(21 )	(20 )
-Other current liabilities	(11 )	(30 )	8
Net cash provided from (used for) operating activities	(342 )	1,113	1,410
<b>Investing Activities:</b>			
Property additions	(287 )	(509 )	(677 )
Cost of removal, net of salvage	(21 )	(32 )	(68 )
Change in construction payables, net	9	(7 )	—
Investment in unconsolidated subsidiaries	(1,421 )	(14 )	(8 )
Returned investment in unconsolidated subsidiaries	2	3	11
Other investing activities	3	—	1
Net cash used for investing activities	(1,715 )	(559 )	(741 )
<b>Financing Activities:</b>			
Increase (decrease) in notes payable, net	472	(896 )	(289 )
Proceeds —			
First mortgage bonds	—	250	—
Senior notes	900	350	—
Capital contributions from parent company	1,089	—	—
Redemptions and repurchases —			
First mortgage bonds	—	(125 )	—
Senior notes	(300 )	—	(200 )
Distribution to noncontrolling interest	—	(19 )	(18 )

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Payment of common stock dividends	(63 )	(128 )	(183 )
Other financing activities	(8 )	10	9
Net cash provided from (used for) financing activities	2,090	(558 )	(681 )
Net Change in Cash and Cash Equivalents	33	(4 )	(12 )
Cash and Cash Equivalents at Beginning of Period	15	19	31
Cash and Cash Equivalents at End of Period	\$ 48	\$15	\$ 19
Supplemental Cash Flow Information:			
Cash paid (received) during the period for —			
Interest (net of \$2, \$3, and \$3 capitalized, respectively)	\$ 86	\$119	\$ 145
Income taxes, net	54	(100 )	(26 )
Noncash transactions — Accrued property additions at end of period	50	41	31

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SOUTHERN COMPANY GAS AND SUBSIDIARY COMPANIES  
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	Successor At September 30, 2016 (in millions)	Predecessor At December 31, 2015 (in millions)
Assets		
Current Assets:		
Cash and cash equivalents	\$ 48	\$ 19
Receivables —		
Energy marketing receivable	526	445
Customer accounts receivable	190	316
Unbilled revenues	63	140
Other accounts and notes receivable	55	68
Accumulated provision for uncollectible accounts	(29 )	(29 )
Materials and supplies	27	29
Natural gas for sale	627	622
Assets from risk management activities, net of collateral	98	206
Prepaid expenses	76	218
Other regulatory assets, current	69	68
Other current assets	9	13
Total current assets	1,759	2,115
Property, Plant, and Equipment:		
In service	14,267	12,152
Less accumulated depreciation	4,384	2,775
Plant in service, net of depreciation	9,883	9,377
Construction work in progress	434	414
Total property, plant, and equipment	10,317	9,791
Other Property and Investments:		
Goodwill	5,937	1,813
Other intangible assets, net of amortization of \$20 and \$68 at September 30, 2016 and December 31, 2015, respectively	380	109
Equity investments in unconsolidated subsidiaries	1,531	80
Miscellaneous property and investments	22	23
Total other property and investments	7,870	2,025
Deferred Charges and Other Assets:		
Other regulatory assets, deferred	1,105	670
Other deferred charges and assets	134	153
Total deferred charges and other assets	1,239	823
Total Assets	\$ 21,185	\$ 14,754

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SOUTHERN COMPANY GAS AND SUBSIDIARY COMPANIES  
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	Successor At September 30, 2016 (in millions)	Predecessor At December 31, 2015 (in millions)
Liabilities and Stockholders' Equity		
Current Liabilities:		
Securities due within one year	\$ 142	\$ 545
Notes payable	586	1,010
Energy marketing trade payables	533	418
Accounts payable	276	255
Customer deposits	172	165
Accrued taxes —		
Accrued income taxes	29	13
Other accrued taxes	60	46
Accrued interest	46	49
Accrued compensation	35	92
Liabilities from risk management activities, net of collateral	47	44
Other regulatory liabilities, current	62	81
Accrued environmental remediation liabilities, current	59	67
Mandatorily redeemable noncontrolling interest	174	—
Other current liabilities	100	133
Total current liabilities	2,321	2,918
Long-term Debt	5,272	3,275
Deferred Credits and Other Liabilities:		
Accumulated deferred income taxes	1,900	1,943
Accumulated deferred investment tax credits	19	20
Employee benefit obligations	564	515
Other cost of removal obligations	1,609	1,591
Other regulatory liabilities, deferred	51	53
Accrued environmental remediation liabilities, deferred	374	364
Other deferred credits and liabilities	40	100
Total deferred credits and other liabilities	4,557	4,586
Total Liabilities	12,150	10,779
Common Stockholders' Equity:		
Common stock — September 30, 2016: par value \$0.01 per share		
— December 31, 2015: par value \$5 per share		
Authorized — September 30, 2016: 100 million shares		
— December 31, 2015: 750 million shares		
Outstanding — September 30, 2016: 100 shares		
— December 31, 2015: 120.4 million shares		
Treasury — September 30, 2016: no shares		
— December 31, 2015: 0.2 million shares		
Par Value	—	603
Paid-in capital	9,097	2,099
Treasury, at cost	—	(8
Retained earnings (accumulated deficit)	(59	) 1,421

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Accumulated other comprehensive loss	(3	)	(186	)
Total Common Stockholders' Equity	9,035		3,929	
Noncontrolling Interest	—		46	
Total Stockholders' Equity	9,035		3,975	
Total Liabilities and Stockholders' Equity	\$ 21,185		\$ 14,754	

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SOUTHERN COMPANY GAS AND SUBSIDIARY COMPANIES  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS  
THIRD QUARTER 2016 vs. THIRD QUARTER 2015  
AND  
COMBINED YEAR-TO-DATE 2016 vs. YEAR-TO-DATE 2015  
OVERVIEW

Southern Company Gas (formerly known as AGL Resources Inc.) is an energy services holding company whose primary business is the safe, reliable, and cost-effective distribution of natural gas in seven states – Illinois, Georgia, Virginia, New Jersey, Florida, Tennessee, and Maryland – through seven utilities. Southern Company Gas is also involved in several other complementary businesses.

In conjunction with the Merger, Southern Company Gas changed the names of its reportable segments to better align with its new parent company. Southern Company Gas has four reportable segments – gas distribution operations (formerly referred to as distribution operations), gas marketing services (formerly referred to as retail operations), wholesale gas services (formerly referred to as wholesale services), and gas midstream operations (formerly referred to as midstream operations) – and one non-reportable segment – other. For additional information on these reportable segments, see Note (J) to the Condensed Consolidated Financial Statements herein and "Business" of Southern Company Gas in Item 1 of the Form 10-K.

Many factors affect the opportunities, challenges, and risks of Southern Company Gas' business. These factors include the ability to maintain a constructive regulatory environment, to maintain and grow natural gas sales, and to effectively manage and secure timely recovery of costs. Southern Company Gas has various regulatory mechanisms that operate to address cost recovery.

Southern Company Gas' operating results can vary significantly from quarter to quarter due to seasonal fluctuations in natural gas sales and other factors. Operating results for the interim periods presented are not necessarily indicative of the results to be expected for the full fiscal period. During the Heating Season, natural gas usage and operating revenues are generally higher, as more customers are connected to the gas distribution systems and natural gas usage is higher in periods of colder weather. Alternatively, Southern Company Gas' base operating expenses, excluding cost of natural gas, revenue taxes, and certain incentive compensation costs, are incurred relatively evenly over any given year, resulting in variability in the quarterly pattern of earnings.

#### Merger With Southern Company

On July 1, 2016, Southern Company Gas completed the Merger, which was accounted for by Southern Company using the acquisition method of accounting whereby the assets acquired and liabilities assumed were recognized at fair value as of the acquisition date. Pushdown accounting was applied to Southern Company Gas, which created a new cost basis assigned to assets, liabilities, and equity as of the acquisition date. Accordingly, the successor financial statements reflect a new basis of accounting and successor and predecessor period financial results (separated by a heavy black line) are presented, but are not comparable.

In order to present MANAGEMENT'S DISCUSSION AND ANALYSIS in a way that offers users a meaningful period-to-period comparison, the RESULTS OF OPERATIONS and FINANCIAL CONDITION AND LIQUIDITY reported herein include disclosure of the combined successor and predecessor results of operations and cash flows. The combined data consists of predecessor information for the period January 1, 2016 through June 30, 2016 and successor information for the period July 1, 2016 through September 30, 2016. The combined presentation is considered a non-GAAP disclosure. Southern Company Gas has included such disclosure to facilitate the comparison of the operating and financial performance for the nine months ended September 30, 2016 to the comparable period in 2015, as the core operations of Southern Company Gas have not changed as a result of the Merger. The combined information does not purport to represent what Southern Company Gas' consolidated results of operations would have been if the successor had actually been formed on January 1, 2016, nor has Southern Company Gas made any attempt to either include or exclude expenses or income that would have resulted had the acquisition actually occurred on January 1, 2016.

Southern Company Gas' results for the successor period July 1, 2016 through September 30, 2016 and combined year-to-date 2016 include a \$17 million decrease in net income due to pushdown accounting that is comprised of

reduced revenues and increased amortization expense, partially offset by lower interest expense, all of which is a result of the new basis of assets and liabilities to reflect their fair values.

In the third quarter and combined year-to-date 2016, Merger-related expenses were \$35 million and \$91 million, respectively, compared to \$35 million for each of the corresponding periods in 2015. See RESULTS OF OPERATIONS herein for information related to Merger-related expenses. Also, see Note (I) to the Condensed Consolidated Financial Statements herein for additional information relating to the Merger.

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## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Investment in SNG

On September 1, 2016, Southern Company Gas paid approximately \$1.4 billion to acquire a 50% equity interest in SNG, which is the owner of a 7,000-mile pipeline system connecting natural gas supply basins in Texas, Louisiana, Mississippi, and Alabama to markets in Louisiana, Mississippi, Alabama, Florida, Georgia, South Carolina, and Tennessee. The investment in SNG is accounted for using the equity method. Southern Company Gas recorded pre-tax earnings of \$27 million (\$16 million, net of tax) from this investment in September 2016. See Notes (I) and (K) to the Condensed Consolidated Financial Statements herein for additional information.

### Other Matters

On February 12, 2016, Southern Company Gas entered into an agreement with Piedmont to purchase its 15% interest in SouthStar for \$160 million. This transaction was contingent upon the closing of the merger between Piedmont and Duke Energy Corporation, which occurred on October 3, 2016. On the same day, Southern Company Gas completed its purchase of Piedmont's interest in SouthStar. Beginning in the fourth quarter 2016 SouthStar will be fully consolidated with Southern Company Gas. See Note (K) to the Condensed Consolidated Financial Statements herein for additional information.

### Performance and Non-GAAP Measures

Southern Company Gas evaluates segment performance using the measures of earnings before interest and taxes (EBIT) and operating margin. EBIT includes operating income and other income and (expense) and excludes interest expense, net of amounts capitalized and income taxes, which Southern Company Gas evaluates on a consolidated basis. Southern Company Gas uses EBIT herein to discuss the results of its segments, as EBIT is the primary measure of segment profit or loss; however, the use of consolidated EBIT herein is considered a non-GAAP measure. Southern Company Gas believes the presentation of consolidated EBIT provides useful information regarding a consolidated measure of profit or loss. The reconciliation of consolidated EBIT to consolidated net income attributable to Southern Company Gas under GAAP is provided within RESULTS OF OPERATIONS – "Combined Operating Results" herein. Operating margin is a non-GAAP measure that is calculated as operating revenues minus cost of natural gas, cost of other sales, and revenue tax expense. Operating margin excludes other operations and maintenance expenses, depreciation and amortization, taxes other than income taxes, and Merger-related expenses, which are included in the calculation of operating income as calculated in accordance with GAAP and reflected in the Condensed Consolidated Statements of Income. Southern Company Gas believes that the presentation of operating margin provides useful information regarding the contribution resulting from customer growth in the gas distribution operations segment since the cost of natural gas and revenue tax expense can vary significantly and are generally billed directly to customers. Southern Company Gas further believes that operating margin at the gas marketing services, wholesale gas services, and gas midstream operations segments allows it to focus on a direct measure of operating margin before overhead costs.

Consolidated EBIT and operating margin should not be considered alternatives to, or more meaningful indicators of, Southern Company Gas' operating performance than consolidated net income attributable to Southern Company Gas or operating income as determined in accordance with GAAP. In addition, Southern Company Gas' operating margin may not be comparable to similarly titled measures of other companies.

### Operating Metrics

Southern Company Gas continues to focus on several operating metrics, which include Heating Degree Days, customer count, volumes of natural gas sold, and natural gas capacity under firm subscription. For additional information on these indicators, see Results of Operations – "Operating Metrics" of Southern Company Gas in Item 7 of the Form 10-K.

### Heating Degree Days

Southern Company Gas measures weather and the effect on its business using Heating Degree Days. With the exception of Southern Company Gas' utilities in Illinois and Florida, Southern Company Gas has various regulatory mechanisms, such as weather normalization mechanisms, which limit its exposure to weather changes within typical ranges in each of its utilities' respective service areas. However, the utility customers in Illinois and the gas marketing services customers primarily in Georgia can be impacted by warmer- or colder-than-normal weather. The following

table presents the Heating Degree Days information for those locations.

	2016	2016		2016	2016
Year-to-Date	vs.	vs.	2015	normal	
Normal	2016	2015	warmer	warmer	
Illinois <sup>(b)</sup>	3,816	3,353	3,918	(14 )%	(12 )%
Georgia	1,639	1,449	1,654	(12 )%	(12 )%

Normal represents the 10-year average from January 1, 2006 through September 30, 2015 for Illinois at Chicago (a)Midway International Airport and for Georgia at Atlanta Hartsfield-Jackson International Airport, based on information obtained from the National Oceanic and Atmospheric Administration, National Climatic Data Center.

<sup>(b)</sup> The 10-year average Heating Degree Days established by the Illinois Commission in Nicor Gas' last rate case is 3,580 for the first nine months from 1998 through 2007.

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## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Weather did not have a significant impact on Southern Company Gas' consolidated EBIT during the third quarter 2016 and 2015. For combined year-to-date 2016, the unfavorable EBIT impact from the warmer-than-normal weather was \$8 million, net of the impact of weather hedging, compared to an \$11 million favorable weather impact for the corresponding period in 2015, when weather was significantly colder than normal.

## Customer Count

The number of customers at gas distribution operations and energy customers at gas marketing services can be impacted by natural gas prices, economic conditions, and competition from alternative fuels. The customer metrics presented in the following table highlight the average number of customers to which Southern Company Gas provided services for the specified periods.

	Third Quarter		2016 vs. 2015	Year-to-Date		2016 vs. 2015
	2016	2015	% change	2016	2015	% change
	(in thousands)			(in thousands)		
Gas distribution operations	4,525	4,488	0.8 %	4,559	4,526	0.7 %
Gas marketing services						
Energy customers	626	642	(2.5)%	642	646	(0.6)%
Service contracts	1,191	1,164	2.3 %	1,198	1,159	3.4 %
Market share of energy customers in Georgia	29.4 %	29.7 %		29.3 %	29.8 %	

Southern Company Gas anticipates overall customer growth trends at gas distribution operations for 2016 to continue improving based on an expectation of continued improvement in the new housing market and low natural gas prices. Gas marketing services' market share in Georgia has decreased slightly primarily as a result of a highly competitive marketing environment, which Southern Company Gas expects for the foreseeable future. Southern Company Gas will continue efforts in its gas marketing services segment to enter into targeted markets and expand its energy customers and service contracts.

## Volumes of Natural Gas Sold

Southern Company Gas' natural gas volume metrics for gas distribution operations and gas marketing services, as shown in the following table, illustrate the effects of weather and customer demand for natural gas compared to the prior year. Wholesale gas services' physical sales volumes represent the daily average natural gas volumes sold to customers.

	Third Quarter		2016 vs. 2015	Year-to-Date		2016 vs. 2015
	2016	2015	% change	2016	2015	% change
Gas distribution operations (mmBtu in millions)						
Firm	71	75	(5.3 )%	467	519	(10.0)%
Interruptible	22	23	(4.3 )	71	74	(4.1 )
Total	93	98	(5.1 )%	538	593	(9.3 )%
Gas marketing services (mmBtu in millions)						
Firm:						
Georgia	3	4	(25.0)%	25	27	(7.4 )%
Illinois	1	1	—	8	10	(20.0)
Other emerging markets	2	1	100.0	9	8	12.5
Interruptible:						
Large commercial and industrial	3	3	—	10	11	(9.1 )
Total	9	9	— %	52	56	(7.1 )%
Wholesale gas services						

Daily physical sales (mmBtu in millions/day)      7.6   6.4   18.8   %   7.6      6.7      13.4   %  
Natural Gas Capacity Under Firm Subscription

Within gas midstream operations, Southern Company Gas' natural gas storage business seeks to have a significant portion of its working natural gas capacity under firm subscription, but also takes into account current and expected market conditions. The prices for natural gas storage capacity have increased in 2016 relative to the last few years, which is expected to continue as supply and demand quantities reach equilibrium with sustained economic improvement, expected exports of liquefied natural gas, and projected demand increases in response to low prices and expanded uses for natural gas. The following table illustrates the overall monthly average firm subscription rates per storage facility and the amount of firm capacity subscription for the periods presented. The amounts shown exclude 2.8 million mmBtu contracted by Sequent at September 30, 2016, at an average monthly rate of \$0.054 and 5.0 million mmBtu contracted by Sequent at September 30, 2015, at an average monthly rate of \$0.080.

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## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

	September 30, 2016		September 30, 2015	
	Average rates	Firm capacity under subscription (per (mmBtu in dekatherm) millions)	Average rates	Firm capacity under subscription (per (mmBtu in dekatherm) millions)
Jefferson Island	\$ 0.103	2.2	\$ 0.092	4.2
Golden Triangle	0.059	4.8	0.041	5.0
Central Valley	0.058	2.5	0.047	4.0

## RESULTS OF OPERATIONS

## Combined Operating Results

The results reported herein include disclosure of the combined successor and predecessor results of operations. The combined data consists of predecessor information for the period January 1, 2016 through June 30, 2016 and successor information for the period July 1, 2016 through September 30, 2016. See OVERVIEW – "Merger With Southern Company" herein for additional information.

Results for combined year-to-date 2016 reflect certain Merger-related expenses, which are not expected to have a continuing impact on the results going forward, and those amounts are discussed in the results below.

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## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Southern Company Gas' results of operations for the successor third quarter 2016, combined year-to-date 2016, and the predecessor third quarter and year-to-date 2015 are as follows:

	Successor Third Quarter 2016  (in millions)	Predecessor Third Quarter 2015  (in millions)	Combined Year-to-Date 2016  (in millions)	Predecessor Year-to-Date 2015  (in millions)
<b>Operating Revenues:</b>				
Natural gas revenues	\$ 518	\$553	\$ 2,359	\$ 2,887
Other revenues	25	31	89	92
Total operating revenues	543	584	2,448	2,979
Cost of natural gas	133	140	888	1,282
Cost of other sales	2	6	16	21
Total cost of sales	135	146	904	1,303
Revenue tax expense (*)	(8 )	(8 )	(64 )	(81 )
Operating Margin	400	430	1,480	1,595
<b>Other Operating Expenses:</b>				
Other operations and maintenance	216	218	670	676
Depreciation and amortization	116	98	322	293
Taxes other than income taxes	29	28	128	142
Merger-related expenses	35	35	91	35
Revenue tax expense (*)	(8 )	(8 )	(64 )	(81 )
Total other operating expenses	388	371	1,147	1,065
Operating Income	12	59	333	530
<b>Other Income and (Expense):</b>				
Allowance for equity funds used during construction	—	1	2	3
Earnings from equity method investments	29	2	31	4
Other income (expense), net	9	—	12	3
Total other income and (expense)	38	3	45	10
EBIT	50	62		