



Moody's Investors Service

## Credit Opinion: **Southern Star Central Corp.**

Global Credit Research - 28 Jan 2010

*Owensboro, Kentucky, United States*

### Ratings

Category	Moody's Rating
Outlook	Stable
Corporate Family Rating	Ba1
Senior Unsecured	Ba2/LGD5
<b>Southern Star Central Gas Pipeline, Inc.</b>	
Outlook	Stable
Senior Unsecured	Baa3

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### Opinion

#### Rating Drivers

- Contract portfolio that generates stable revenues
- Small company in a mature market
- Increasing supply diversity
- Stable financial performance but leveraged with holding company debt
- Credit quality reflecting sponsors' financial policies

#### Corporate Profile

Southern Star Central Corp. (Southern Star; Ba1 Corporate Family Rating, stable outlook) is the holding company for Southern Star Central Gas Pipeline, Inc. (Central Pipeline; Baa3 senior unsecured, stable outlook), a natural gas pipeline system located mostly in Kansas, Missouri, and Oklahoma. Southern Star in turn is a subsidiary of EFS-SSCC Holdings, LLC, a joint venture between GE Energy Financial Services (EFS; 60% interest), a subsidiary of General Electric, and Caisse de Depot et Placement du Quebec (CDP; 40% interest).

#### SUMMARY RATING RATIONALE

The Ba1 Corporate Family Rating reflects Southern Star's leveraged but very stable consolidated financial profile. The company has only a single operating asset, but its business risk is low. Its rates are regulated by the Federal Energy Regulatory Commission. Its revenues are highly predictable, coming from fixed reservation charges under multi-year contracts with longstanding utility customers. The modest organic growth potential in its mature service area and lack of earnings retention restrain credit accretion. While Central Pipeline is a relatively old pipeline, its operating record in its present corporate form as a standalone entity and under current ownership is not long.

## **DETAILED RATING CONSIDERATIONS**

### **CONTRACT PORTFOLIO THAT GENERATES STABLE CASH FLOW**

Southern Star has a contract portfolio that generates highly predictable cash flow. Substantially all its revenue comes from fixed reservation charges, which the shipper pays monthly regardless of volumes shipped. The majority of contracts is at the maximum allowed rates with creditworthy utility shippers. Over the last few years, the average life of Southern Star's contracts has decreased from six to five years, below Moody's pipeline peer group average of eight years. Two shippers - Missouri Gas Energy (subsidiary of Southern Union Company) and Kansas Gas Service Company (a subsidiary of ONEOK, Inc.) -- account for more than half its revenues, posing rollover risk when their contracts expire in 2013.

Moody's notes, however, that Southern Star's franchise has high barriers to entry, having been built specifically to serve the utilities that remain its primary customers. Its web-like system has hundreds of delivery points and 43 billion cubic feet of storage near its markets. This configuration allows the company to provide a premium swing service, in which the pipeline quickly increases deliveries in extreme temperatures. Southern Star's assets are highly depreciated, which results in rates that are well below those of other area pipelines. These competitive advantages help to keep the pipeline almost fully subscribed and to mitigate contract rollover risk.

### **SMALL COMPANY IN A MATURE MARKET**

Southern Star's rating is limited by its single-asset operations and lower market diversity. Compared to those of its larger multi-regional peers, Southern Star's market area (primarily in Kansas and Missouri with its largest markets being Kansas City and Joplin/Springfield, Missouri and Wichita, Kansas) is more geographically concentrated and less densely populated which presents smaller organic growth opportunities.

### **INCREASING SUPPLY DIVERSITY**

Southern Star has historically drawn most of its gas supply from mature, Mid-continent basins including the Hugoton Basin in Kansas and also Oklahoma and Texas. However, the pipeline has been able to replace and diversify its supply sources to offset the natural decline in supply from those areas. Over the last several years, it has imported more Rockies gas through its interconnection with a third-party pipeline. More recently, the development of shale plays in various parts of the Mid-continent promises to further diversify its supply sources.

### **STABLE FINANCIAL PERFORMANCE BUT LEVERAGED WITH HOLDING COMPANY DEBT**

Almost half of Southern Star's consolidated debt is at Central Pipeline -- a single \$230 million debt issue. Central Pipeline maintains its own capital structure for ratemaking purposes. The pipeline's standalone credit metrics are strong: debt-to-capitalization is in the mid to upper 20% range, funds flow from operations (FFO)-to-debt is in the upper 20% range with FFO interest coverage in the 5 to 6 times range.

The remaining half of the debt resides at the Southern Star level (two issues totaling \$250

million), which results in a fairly leveraged consolidated credit profile that is slightly weaker than those of its Baa3-rated peers: debt-to-book capitalization of about 50% (compared to the peer average of about 45%), FFO-to-debt in the low to mid teens (peer average range of mid to high teens), and FFO interest coverage around 3 times (peer average of about 4 times).

Since its recapitalization in 2006, Southern Star's consolidated metrics have held steady from the stable cash flow generated by its contracts with some top-line growth from numerous small expansion projects and a rate case in 2008. The company is required to make another general rate filing in 2013.

#### CREDIT QUALITY REFLECTING SPONSORS' FINANCIAL POLICY

EFS and CDP have been supportive of Southern Star's credit quality, given their substantial financial resources and the reasonable financial policies they have adopted for Southern Star. Under their ownership, Southern Star's capitalization has remained relatively unchanged, with dividends kept generally in line with net income.

Since being sold by the Williams Companies in 2002, Southern Star has changed owners twice among financial investors, each time precipitating a recapitalization of the company. EFS and CDP have owned Southern Star since 2005. Southern Star's ratings are based on our understanding that the sponsors view the company as a stable investment, not as an acquisition vehicle, and that they will maintain a management strategy and financial policies that maintain Southern Star's credit metrics around current levels.

#### **Liquidity Profile**

Southern Star generates enough cash flow to cover its operations, working capital needs, and normal capital expenditures. In recent years, cash flow from operations has ranged between \$60 to \$70 million, its capital expenditures, between \$40 to \$60 million (about \$40 million of which is for maintenance), and dividends in the \$20 million range. Growth projects tend to be under \$10 million, although the company is currently pursuing a somewhat larger Elk City storage expansion.

As is not unusual in the sector, Southern Star does not have a credit facility. It typically maintains a significant amount of cash, ranging from \$20 to \$40 million the last several years, depending on the level of growth spending. The company faces refinancing risk and another recapitalization in 2016 when all \$480 million of its capital markets debt at both Southern Star and Central Pipeline come due.

#### **Rating Outlook**

The stable rating outlook reflects Southern Star's steady financial performance and low business risk that mitigate its leveraged financial profile. The ratings are based on its ownership structure and the sponsors' continuing a financial policy and business strategy that maintain Southern Star's credit quality and sufficient liquidity.

#### **What Could Change the Rating - Up**

Southern Star's ratings may be upgraded if the company demonstrates a stable management strategy and credit-friendly financial policies that sustains improved financial performance, including FFO-to-debt in the mid to high 20% range.

#### **What Could Change the Rating - Down**

A downgrade is possible in event of a major investment or transaction, or change in financial policies that raise Southern Star's business risk or weakens its financial profile, including FFO-to-debt sustained near the 10% level.

## Rating Factors

### Southern Star Central Corp.

North American Natural Gas Pipelines	Aaa	Aa	A	Baa	Ba	B
<b>Market Position</b>						
a) Market Position (20%)					X	
<b>Quality of Supply Sources</b>						
a) Quality of Supply Sources (20%)				X		
<b>Contract Quality</b>						
a) Contract Quality (20%)			X			
<b>Financial Strength</b>						
a) Funds from Operations + Interest to Interest (10%)				X		
b) Funds from Operations to Debt (10%)					X	
c) Debt to Book Capitalization (10%)				X		
d) Operating Margin (10%)					X	
<b>Rating:</b>						
a) Methodology Model Implied Senior Unsecured Rating				<b>Baa3</b>		
b) Actual Corporate Family Rating				<b>Ba1</b>		



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