

Spectra Energy Corp.
Form 10-Q
November 07, 2008
[Index to Financial Statements](#)

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

FORM 10-Q

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

For the quarterly period ended September 30, 2008

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 1-33007

SPECTRA ENERGY CORP

(Exact Name of Registrant as Specified in its Charter)

Edgar Filing: Spectra Energy Corp. - Form 10-Q

Delaware
(State or other jurisdiction of incorporation)

20-5413139
(IRS Employer Identification No.)

5400 Westheimer Court

Houston, Texas 77056

(Address of principal executive offices, including zip code)

713-627-5400

(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 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 Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

Number of shares of Common Stock, \$0.001 par value, outstanding as of October 31, 2008: 611,049,032

Index to Financial Statements

SPECTRA ENERGY CORP
FORM 10-Q FOR THE QUARTER ENDED

September 30, 2008

INDEX

	Page
PART I. FINANCIAL INFORMATION	
Item 1. <u>Financial Statements (Unaudited)</u>	4
<u>Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2008 and 2007</u>	4
<u>Condensed Consolidated Balance Sheets as of September 30, 2008 and December 31, 2007</u>	5
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2008 and 2007</u>	7
<u>Condensed Consolidated Statements of Stockholders' Equity for the nine months ended September 30, 2008 and 2007</u>	8
<u>Notes to Condensed Consolidated Financial Statements</u>	9
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	35
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	49
Item 4. <u>Controls and Procedures</u>	49
PART II. OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	50
Item 1A. <u>Risk Factors</u>	50
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	50
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	50
Item 6. <u>Exhibits</u>	51
<u>Signatures</u>	52

Index to Financial Statements

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This document includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based on management's beliefs and assumptions. These forward-looking statements are identified by terms and phrases such as anticipate, believe, intend, estimate, expect, continue, should, could, may, plan, project, predict, will, potential, forecast, and similar expressions. Forward-looking statements involve risks and uncertainties that may cause actual results to be materially different from the results predicted. Factors that could cause actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

state, federal and foreign legislative and regulatory initiatives that affect cost and investment recovery, have an effect on rate structure, and affect the speed at and degree to which competition enters the natural gas industries;

outcomes of litigation and regulatory investigations, proceedings or inquiries;

weather and other natural phenomena, including the economic, operational and other effects of hurricanes and storms;

the timing and extent of changes in commodity prices, interest rates and foreign currency exchange rates;

general economic conditions, including any potential effects arising from terrorist attacks and any consequential or other hostilities;

changes in environmental, safety and other laws and regulations;

results of financing efforts, including the ability to obtain financing on favorable terms, which can be affected by various factors, including credit ratings and general market and economic conditions;

increases in the cost of goods and services required to complete capital projects;

declines in the market prices of equity and debt securities and resulting funding requirements for defined benefit pension plans;

growth in opportunities, including the timing and success of efforts to develop domestic and international pipeline, storage, gathering, processing and other infrastructure projects and the effects of competition;

the performance of natural gas transmission and storage, distribution, and gathering and processing facilities;

the extent of success in connecting natural gas supplies to gathering, processing and transmission systems and in connecting to expanding gas markets;

the effect of accounting pronouncements issued periodically by accounting standard-setting bodies;

Edgar Filing: Spectra Energy Corp. - Form 10-Q

conditions of the capital markets during the periods covered by the forward-looking statements; and

the ability to successfully complete merger, acquisition or divestiture plans; regulatory or other limitations imposed as a result of a merger, acquisition or divestiture; and the success of the business following a merger, acquisition or divestiture.

In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than Spectra Energy Corp has described. Spectra Energy Corp undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Index to Financial Statements

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

SPECTRA ENERGY CORP

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In millions, except per-share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Operating Revenues				
Transportation, storage and processing of natural gas	\$ 586	\$ 557	\$ 1,764	\$ 1,616
Distribution of natural gas	213	207	1,239	1,161
Sales of natural gas liquids	219	127	623	371
Other	62	59	187	169
Total operating revenues	1,080	950	3,813	3,317
Operating Expenses				
Natural gas and petroleum products purchased	231	164	1,127	963
Operating, maintenance and other	304	276	919	797
Depreciation and amortization	144	135	437	382
Property and other taxes	61	50	186	139
Total operating expenses	740	625	2,669	2,281
Gains on Sales of Other Assets and Other, net		5	32	6
Operating Income	340	330	1,176	1,042
Other Income and Expenses				
Equity in earnings of unconsolidated affiliates	273	175	725	394
Other income and expenses, net	9	11	30	37
Total other income and expenses	282	186	755	431
Interest Expense	163	156	470	467
Minority Interest Expense	15	15	46	41
Earnings From Continuing Operations Before Income Taxes	444	345	1,415	965
Income Tax Expense From Continuing Operations	145	110	453	312
Income From Continuing Operations	299	235	962	653
Income (Loss) From Discontinued Operations, net of tax	(3)	3	(4)	17
Income Before Extraordinary Items	296	238	958	670

Edgar Filing: Spectra Energy Corp. - Form 10-Q

Extraordinary Items, net of tax		(4)		(4)
Net Income	\$ 296	\$ 234	\$ 958	\$ 666
Common Stock Data				
Weighted-average shares outstanding				
Basic	615	632	626	632
Diluted	617	635	629	635
Earnings per share from continuing operations				
Basic	\$ 0.49	\$ 0.37	\$ 1.54	\$ 1.03
Diluted	\$ 0.48	\$ 0.37	\$ 1.53	\$ 1.03
Earnings per share total				
Basic	\$ 0.48	\$ 0.37	\$ 1.53	\$ 1.05
Diluted	\$ 0.48	\$ 0.37	\$ 1.52	\$ 1.05
Dividends per share	\$ 0.25	\$ 0.22	\$ 0.71	\$ 0.66

See Notes to Condensed Consolidated Financial Statements

Index to Financial Statements

SPECTRA ENERGY CORP
CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In millions)

	September 30, 2008	December 31, 2007
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 281	\$ 94
Receivables, net	795	907
Inventory	470	287
Assets held for sale	123	
Other	149	91
Total current assets	1,818	1,379
Investments and Other Assets		
Investments in and loans to unconsolidated affiliates	2,089	1,780
Goodwill	3,767	3,948
Other	516	631
Total investments and other assets	6,372	6,359
Property, Plant and Equipment		
Cost	18,490	18,154
Less accumulated depreciation and amortization	4,129	3,854
Net property, plant and equipment	14,361	14,300
Regulatory Assets and Deferred Debits	956	932
Total Assets	\$ 23,507	\$ 22,970

See Notes to Condensed Consolidated Financial Statements

Index to Financial Statements**SPECTRA ENERGY CORP****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)****(In millions, except per-share amounts)**

	September 30, 2008	December 31, 2007
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Accounts payable	\$ 349	\$ 363
Short-term borrowings and commercial paper	913	715
Taxes accrued	145	85
Interest accrued	160	146
Current maturities of long-term debt	221	338
Other	767	775
Total current liabilities	2,555	2,422
Long-term Debt	9,369	8,345
Deferred Credits and Other Liabilities		
Deferred income taxes	2,894	2,883
Regulatory and other	1,567	1,657
Total deferred credits and other liabilities	4,461	4,540
Commitments and Contingencies		
Minority Interests	701	806
Stockholders Equity		
Preferred stock, \$0.001 par, 22 million shares authorized, no shares outstanding		
Common stock, \$0.001 par, 1 billion shares authorized, 611 million and 632 million shares outstanding at September 30, 2008 and December 31, 2007, respectively	1	1
Additional paid-in capital	4,098	4,658
Retained earnings	882	368
Accumulated other comprehensive income	1,440	1,830
Total stockholders equity	6,421	6,857
Total Liabilities and Stockholders Equity	\$ 23,507	\$ 22,970

See Notes to Condensed Consolidated Financial Statements

Index to Financial Statements**SPECTRA ENERGY CORP****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)****(In millions)**

	Nine Months Ended September 30,	
	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 958	\$ 666
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	445	393
Deferred income tax expense	61	157
Minority interest expense	46	49
Equity in earnings of unconsolidated affiliates	(725)	(394)
Distributions received from unconsolidated affiliates	691	379
Other	(80)	(398)
Net cash provided by operating activities	1,396	852
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(1,038)	(779)
Investments in and loans to unconsolidated affiliates	(497)	(161)
Acquisition of Spectra Energy Income Fund	(274)	
Purchases of available-for-sale securities	(1,289)	(1,181)
Proceeds from sales and maturities of available-for-sale securities	1,354	978
Distributions received from unconsolidated affiliates	180	
Other		26
Net cash used in investing activities	(1,564)	(1,117)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from the issuance of long-term debt	2,972	720
Payments for the redemption of long-term debt	(1,801)	(487)
Net increase in short-term borrowings and commercial paper	204	19
Distributions to minority interests	(50)	(36)
Contributions from minority interests	112	
Proceeds from Spectra Energy Partners, LP initial public offering		230
Repurchases of Spectra Energy common shares	(600)	
Dividends paid	(444)	(418)
Other	(39)	11
Net cash provided by financing activities	354	39
Effect of exchange rate changes on cash	1	62
Net increase (decrease) in cash and cash equivalents	187	(164)
Cash and cash equivalents at beginning of period	94	299
Cash and cash equivalents at end of period	\$ 281	\$ 135

Edgar Filing: Spectra Energy Corp. - Form 10-Q

See Notes to Condensed Consolidated Financial Statements

Index to Financial Statements

SPECTRA ENERGY CORP

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(Unaudited)

(In millions)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Members Equity	Accumulated Other Comprehensive Income Net Gains (Losses)			Total
					Foreign Currency Adjustments	on Cash Flow Hedges	Other	
December 31, 2007	\$ 1	\$ 4,658	\$ 368	\$	\$ 2,033	\$ (8)	\$ (195)	\$ 6,857
Net income			958					958
Foreign currency translation adjustments					(411)			(411)
Unrealized mark-to-market net loss on hedges						(9)		(9)
Reclassification of cash flow hedges into earnings						1		1
Pension and benefits impact of SFAS 158							29	29
Common stock repurchases		(600)						(600)
Dividends on common stock			(444)					(444)
Stock-based compensation		32						32
Other		8						8
September 30, 2008	\$ 1	\$ 4,098	\$ 882	\$	\$ 1,622	\$ (16)	\$ (166)	\$ 6,421
December 31, 2006	\$	\$	\$	\$ 4,598	\$ 1,156	\$ (6)	\$ (109)	\$ 5,639
Conversion to Spectra Energy Corp	1	4,597		(4,598)				
Net income			666					666
Foreign currency translation adjustments					910			910
Reclassification of cash flow hedges into earnings						(2)		(2)
Pension and benefits impact of SFAS 158			(5)				26	21
FIN 48 implementation			(26)					(26)
Transfer of net assets and liabilities from Duke Energy		8					(100)	(92)
Dividends on common stock			(418)					(418)
Stock-based compensation		11						11
September 30, 2007	\$ 1	\$ 4,616	\$ 217	\$	\$ 2,066	\$ (8)	\$ (183)	\$ 6,709

See Notes to Condensed Consolidated Financial Statements

Index to Financial Statements

SPECTRA ENERGY CORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. General

Nature of Operations. Spectra Energy Corp, through its subsidiaries and equity affiliates (collectively, Spectra Energy), owns and operates a large and diversified portfolio of complementary natural gas-related energy assets. Spectra Energy operates in three key areas of the natural gas industry: gathering and processing, transmission and storage, and distribution. Spectra Energy provides transportation and storage of natural gas to customers in various regions of the northeastern and southeastern United States, the Maritime Provinces in Canada and the Pacific Northwest in the United States and Canada, and in the province of Ontario, Canada. Spectra Energy also provides natural gas sales and distribution services to retail customers in Ontario, and natural gas gathering and processing services to customers in Western Canada. In addition, Spectra Energy owns a 50% interest in DCP Midstream, LLC (DCP Midstream), one of the largest natural gas gatherers and processors in the United States.

Basis of Presentation. The Condensed Consolidated Financial Statements include the accounts of Spectra Energy Corp, its majority-owned subsidiaries where Spectra Energy has control and those variable interest entities, if any, where Spectra Energy is the primary beneficiary. These interim financial statements should be read in conjunction with the consolidated financial statements included in Spectra Energy's Annual Report on Form 10-K for the year ended December 31, 2007, and reflect all normal recurring adjustments that are, in the opinion of management, necessary to fairly present Spectra Energy's results of operations and financial position. Amounts reported in the Condensed Consolidated Statements of Operations are not necessarily indicative of amounts expected for the respective annual periods due to the effects of seasonal temperature variations on energy consumption, primarily in the gas distribution operations of Spectra Energy, as well as changing commodity prices on certain of the processing operations and other factors.

Use of Estimates. To conform with generally accepted accounting principles (GAAP) in the United States, management makes estimates and assumptions that affect the amounts reported in the Condensed Consolidated Financial Statements and Notes to Condensed Consolidated Financial Statements. Although these estimates are based on management's best available knowledge at the time, actual results could differ.

Recasts and Reclassifications. The Condensed Consolidated Statements of Operations and all related information contained in this report have been re-cast to reflect the operating results of certain natural gas gathering and processing facilities within the Western Canada Transmission & Processing segment as discontinued operations for all periods presented. See Note 7 for further discussion. In addition, the components of Operating Revenues on the Condensed Consolidated Statement of Operations for the 2007 periods have been reclassified to conform to the current reporting presentation.

Spin-off from Duke Energy Corporation. In conjunction with the spin-off of Spectra Energy from Duke Energy Corporation (Duke Energy) on January 2, 2007, Duke Energy transferred to Spectra Energy the assets and liabilities, including related tax effects, associated with Spectra Energy's employee benefits and captive insurance positions, as well as miscellaneous corporate assets and liabilities. The net effect of these non-cash transfers during the nine-month period ended September 30, 2007 is reflected as an increase of \$8 million to Additional Paid-in Capital and a decrease of \$100 million to Accumulated Other Comprehensive Income in the Condensed Consolidated Statements of Stockholders Equity.

Index to Financial Statements**2. Acquisitions and Dispositions**

Acquisition Spectra Energy Income Fund. On May 1, 2008, Westcoast Energy Inc. (Westcoast), a subsidiary of Spectra Energy, acquired the 24.4 million units of the Spectra Energy Income Fund (Income Fund) that were held by non-affiliated holders at a purchase price of 11.25 Canadian dollars per unit, for a total purchase price of 279 million Canadian dollars (approximately \$274 million). Westcoast now owns 100% of the Midstream operations. Prior to the acquisition, the Income Fund indirectly held 54% of Spectra Energy's consolidated Midstream operations and Westcoast indirectly held the remaining 46%. The Income Fund is included in the Western Canada Transmission & Processing business segment. The transaction, primarily driven by changes in Canadian federal tax rules as related to income trusts, was accounted for as a step acquisition, using the purchase method of accounting in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations.

The following table summarizes the preliminary fair values of the assets acquired and liabilities assumed as of May 1, 2008. The amount assigned to Goodwill increased \$17 million from the amount estimated at June 30, 2008. Subsequent adjustments may be recorded upon the completion of the valuation and the final determination of the purchase price allocation.

	Purchase Price Allocation (in millions)
Purchase price	\$ 274
Current assets	20
Property, plant and equipment, net	340
Current liabilities	(11)
Long-term debt (intercompany)	(89)
Deferred credits and other liabilities	(9)
Deferred income taxes	(43)
Total assets acquired/liabilities assumed	208
Goodwill	\$ 66

Disposition Saltville Gas Storage Company L.L.C. and P-25 pipeline. In April 2008, Spectra Energy completed the sale of Saltville Gas Storage Company L.L.C. and the P-25 pipeline to Spectra Energy Partners, LP (Spectra Energy Partners) for \$107 million. Proceeds from the sale consisted of 4,207,641 Spectra Energy Partners common units, 85,870 general partner units and \$5 million in cash. Spectra Energy's ownership of Spectra Energy Partners increased from 83% to 84% as a result of the issuance of the new common and general partner units. No gain or loss was recognized on the disposition since this transaction represented a transfer of entities under common control.

3. Business Segments

Spectra Energy manages its business in four reportable segments: U.S. Transmission, Distribution, Western Canada Transmission & Processing and Field Services. The remainder of Spectra Energy's business operations is presented as Other, and consists of unallocated corporate costs, wholly owned captive insurance subsidiaries, employee benefit plan assets and liabilities, and other miscellaneous activities.

Spectra Energy's chief operating decision maker regularly reviews financial information about each of these business units in deciding how to allocate resources and evaluate performance. All of the business units are considered reportable segments under SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. There is no aggregation within Spectra Energy's defined business segments.

Index to Financial Statements

U.S. Transmission provides transportation and storage of natural gas for customers in various regions of the eastern and southeastern United States and the Maritime Provinces in Canada. The natural gas transmission and

storage operations in the U.S. are primarily subject to the Federal Energy Regulatory Commission's (FERC's) rules and regulations.

Distribution provides retail natural gas distribution service in Ontario, as well as natural gas transportation and storage services to other utilities and energy market participants. These services are provided by Union Gas Limited (Union Gas), and are primarily subject to the rules and regulations of the Ontario Energy Board (OEB).

Western Canada Transmission & Processing provides transportation of natural gas, natural gas gathering and processing services, and natural gas liquids (NGLs) extraction, fractionation, transportation, storage and marketing to customers in western Canada and the northern tier of the United States. This segment conducts business primarily through the BC Pipeline and BC Field Services operations, the Empress System and the Midstream business, which includes the Income Fund discussed in Note 2. The BC Pipeline and BC Field Services operations are primarily subject to the rules and regulations of Canada's National Energy Board (NEB).

Field Services gathers and processes natural gas and fractionates, markets and trades NGLs. It conducts operations through DCP Midstream, which is owned 50% by Spectra Energy and 50% by ConocoPhillips. Field Services gathers raw natural gas through gathering systems located in eight major natural gas producing regions: Mid-Continent, Rocky Mountains, East Texas-North Louisiana, Barnett Shale, Gulf Coast, South Texas, Central Texas, and Permian Basin.

Spectra Energy's reportable segments offer different products and services and are managed separately as business units. Management evaluates segment performance based on earnings before interest and taxes (EBIT) from continuing operations, after deducting minority interest expense related to those profits.

On a segment basis, EBIT excludes discontinued operations, represents all profits from continuing operations (both operating and non-operating) before deducting interest and taxes, and is net of the minority interest expense related to those profits. Cash, cash equivalents and short-term investments are managed centrally by Spectra Energy, so the associated realized and unrealized gains and losses from foreign currency transactions, and interest and dividend income on those balances are excluded from the segments' EBIT.

Transactions between reportable segments are accounted for on the same basis as with unaffiliated third parties.

Index to Financial Statements**Business Segment Data (a)**

	Unaffiliated Revenues	Intersegment Revenues	Total Revenues (in millions)	Segment EBIT/ Consolidated Earnings from Continuing Operations before Income Taxes
Three Months Ended September 30, 2008				
U.S. Transmission	\$ 401	\$ 1	\$ 402	\$ 213
Distribution	280		280	44
Western Canada Transmission & Processing	397		397	113
Field Services				239
Total reportable segments	1,078	1	1,079	609
Other	2	9	11	(9)
Eliminations				