

CASCADE NATURAL GAS CORP
Form 10-Q
May 12, 2003

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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

For the quarterly period ended March 31, 2003

Commission file number: 1-7196

CASCADE NATURAL GAS CORPORATION

(Exact name of Registrant as specified in its charter)

Washington

(State or other jurisdiction of
incorporation or organization)

91-0599090

(I.R.S. Employer
Identification No.)

222 Fairview Avenue North, Seattle, WA

(Address of principal executive offices)

98109

(Zip code)

(Registrant's telephone number including area code)

(206) 624-3900

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

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Title	Outstanding
Common Stock, Par Value \$1 per Share	11,077,749 as of April 30, 2003

CASCADE NATURAL GAS CORPORATION

Index

Part I. Financial Information

Item 1. Financial Statements

Consolidated Condensed Statements of Income

Consolidated Condensed Balance Sheets

Consolidated Condensed Statements of Cash Flows

Notes to Consolidated Condensed Financial Statements

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Item 4. Controls and Procedures

Part II. Other Information

Item 1. Legal Proceedings

Item 2. Changes in Securities

Item 4. Submission of Matters to a Vote of Security Holders.

Item 5. Other Information

Item 6. Exhibits and Reports on Form 8-K

Signature

Certifications

PART I. Financial Information

Item 1. Financial Statements

CASCADE NATURAL GAS CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF INCOME

(unaudited)

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	Mar 31, 2003	Mar 31, 2002	Mar 31, 2003	Mar 31, 2002
	(thousands except per share data)			
Operating revenues	\$ 109,286	\$ 122,361	\$ 209,782	\$ 225,122
Less: Gas purchases	72,126	80,462	136,829	148,283
Revenue taxes	7,513	8,443	13,797	14,740
Operating margin	29,647	33,456	59,156	62,099
Cost of operations:				
Operating expenses	10,398	10,148	21,110	21,177
Depreciation and amortization	3,842	3,702	7,620	7,398
Property and payroll taxes	1,509	1,432	2,808	2,617
	15,749	15,282	31,538	31,192
Income from operations	13,898	18,174	27,618	30,907
Less interest and other deductions - net	3,112	3,247	6,311	6,148
Income before income taxes	10,786	14,927	21,307	24,759
Income taxes	3,937	5,448	7,777	9,037
Net Income	6,849	9,479	13,530	15,722
Weighted average common shares outstanding	11,057	11,045	11,051	11,045
Net earnings per common share,				
Basic	\$ 0.62	\$ 0.86	\$ 1.22	\$ 1.42
Diluted	\$ 0.62	\$ 0.86	\$ 1.22	\$ 1.42
Cash dividends per share	\$ 0.24	\$ 0.24	\$ 0.48	\$ 0.48

The accompanying notes are an integral part of these financial statements

CASCADE NATURAL GAS CORPORATION
CONSOLIDATED CONDENSED BALANCE SHEETS

(Dollars in Thousands)

	Mar 31, 2003 (Unaudited)	Sep 30, 2002
ASSETS		
Utility Plant, net of accumulated depreciation of \$221,024 and \$213,476	\$ 295,419	\$ 291,650
Construction work in progress	7,305	7,974
	302,724	299,624
Other Assets:		
Investments in non-utility property	202	202
Notes receivable, less current maturities	121	127
	323	329
Current Assets:		
Cash and cash equivalents	22,230	3,688
Accounts receivable and current maturities of notes receivable, less allowance of \$1,156 and \$1,126 for doubtful accounts	40,038	14,547
Materials, supplies and inventories	5,476	14,556
Prepaid expenses and other assets	4,213	6,515
Deferred income taxes	1,661	1,648
	73,618	40,954
Deferred Charges		
Gas cost changes	11,026	18,788
Other	7,591	7,968
	18,617	26,756
	\$ 395,282	\$ 367,663

The accompanying notes are an integral part of these financial statements

	Mar 31, 2003 (Unaudited)	Sep 30, 2002
COMMON SHAREHOLDERS EQUITY AND LIABILITIES		
Common Shareholders Equity:		
Common stock, par value \$1 per share		
Authorized 15,000,000 shares		
Issued and outstanding 11,070,705, and 11,045,095 shares	\$ 11,071	\$ 11,045
Additional paid-in capital	97,815	97,360
Accumulated other comprehensive income (loss)	(11,748)	(11,748)
Retained earnings	25,746	17,524
	122,884	114,181
Long-term Debt	164,930	164,930
Current Liabilities:		
Accounts payable	21,800	12,597
Property, payroll and excise taxes	8,264	5,777
Dividends and interest payable	7,894	7,872
Other current liabilities	12,753	9,466
	50,711	35,712
Deferred Credits and Other	56,757	52,840
Commitments and Contingencies	\$ 395,282	\$ 367,663

The accompanying notes are an integral part of these financial statements

CASCADE NATURAL GAS CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

	SIX MONTHS ENDED	
	(dollars in thousands)	
	Mar 31, 2003	Mar 31, 2002
Operating Activities		
Net income	\$ 13,530	\$ 15,722
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,620	7,398
Deferrals of gas cost changes	3,727	8,636
Amortization of gas cost changes	4,035	5,328
Other deferrals and amortizations	2,488	891
Deferred income taxes and tax credits - net	1,850	614
Change in current assets and liabilities	890	(11,955)
Net cash provided by operating activities	34,140	26,634
Investing Activities		
Capital expenditures	(10,808)	(10,390)
Customer contributions in aid of construction	30	592
Other	7	39
Net cash used by investing activities	(10,771)	(9,759)
Financing Activities		
Proceeds from long-term debt, net		38,740
Proceeds from issuance of stock, net	481	
Changes in notes payable and commercial paper, net		(40,000)
Dividends paid	(5,308)	(5,302)
Net cash used by financing activities	(4,827)	(6,562)
Net Increase in Cash and Cash Equivalents	18,542	10,313
Cash and Cash Equivalents		
Beginning of year	3,688	422
End of period	\$ 22,230	\$ 10,735

The accompanying notes are an integral part of these financial statements

CASCADE NATURAL GAS CORPORATION

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

THREE AND SIX MONTHS ENDED MARCH 31, 2003

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The preceding statements were taken from the books and records of the Company and reflect all adjustments which are, in the opinion of management, necessary for a fair statement of the results for the interim periods. All adjustments were of a normal and recurring nature. Because of the highly seasonal nature of the natural gas distribution business, earnings or loss for any portion of the year are disproportionate in relation to the full year.

Reference is directed to the Notes to Consolidated Financial Statements contained in the 2002 Annual Report on Form 10-K for the fiscal year ended September 30, 2002, and comments included therein under Management's Discussion and Analysis of Financial Condition and Results of Operations .

Earnings Per Share.

The following table sets forth the calculation of earnings per share as prescribed in Statement of Financial Accounting Standards (FAS) No. 128.

	Quarter Ended March 31		Six Months Ended March 31	
	2003	2002	2003	2002
	(in thousands except per-share data)			
Net Income	\$ 6,849	\$ 9,479	\$ 13,530	\$ 15,722
Weighted average shares outstanding	11,057	11,045	11,051	11,045
Basic earnings per share	\$ 0.62	\$ 0.86	\$ 1.22	\$ 1.42
Weighted average shares outstanding	11,057	11,045	11,051	11,045
Plus: Issued on assumed exercise of stock options	19	24	18	24
Weighted average shares outstanding assuming dilution	11,076	11,069	11,069	11,069
Diluted earnings per share	\$ 0.62	\$ 0.86	\$ 1.22	\$ 1.42

Stock-Based Compensation

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The Company accounts for stock-based compensation using Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees . Under this method, compensation cost is recognized on the excess, if any, of the market price of the stock at grant date over the exercise price of the option. The exercise price of each grant issued by the Company was equal to the market price at the respective grant date, therefore no compensation expense has been recorded in connection with the Plan. Under FAS No. 123, Accounting for Stock-Based Compensation, compensation expense is determined based on the fair value of the award and is recognized over the vesting period. Had compensation expense been measured in accordance with FAS 123, the Company's net income would have been as follows:

	Quarter Ended March 31		Six Months Ended March 31	
	2003	2002	2003	2002
(in thousands except per-share data)				
Amounts as reported, reflecting stock-based employee compensation cost determined under APB No. 25:				
Stock-based employee compensation cost, net of tax effect	\$	\$	\$	\$
Net income	\$ 6,849	\$ 9,479	\$ 13,530	\$ 15,722
Basic earnings per share	\$ 0.62	\$ 0.86	\$ 1.22	\$ 1.42
Diluted earnings per share	\$ 0.62	\$ 0.86	\$ 1.22	\$ 1.42
Proforma amounts, reflecting stock-based employee compensation cost as if determined under fair value (FAS 123) method:				
Stock-based employee compensation cost, net of tax effect	\$ 27	\$ 26	\$ 55	\$ 51
Net income	\$ 6,822	\$ 9,453	\$ 13,475	\$ 15,671
Basic earnings per share	\$ 0.62	\$ 0.86	\$ 1.22	\$ 1.42
Diluted earnings per share	\$ 0.62	\$ 0.85	\$ 1.22	\$ 1.42

Commitments and Contingencies

Enron Contract Termination

During fiscal 2002, Cascade terminated two contracts for the purchase of gas from Enron based upon Enron's insolvency and concerns about its ability to perform. Enron Canada, the supplier for one of the contracts, disputed the Company's position and claimed \$3.4 million in termination charges. Recognizing the complexity of the issues and the uncertainties of potential litigation, the Company recorded a charge to earnings of \$2.8 million in fiscal 2002. In December 2002, the bankruptcy estate of Enron asserted a claim of \$1.4 million as a termination payment for the second contract, of which Enron North America was the supplier. Based upon an assessment of both Enron claims made after investigation of the Enron North America demands, Cascade recorded an additional charge of \$865,000 in fiscal 2003 second quarter. After the end of the second quarter, the Company settled the Enron North America claim, by paying \$1,050,000. Management believes the remaining reserves are adequate.

Environmental Matters

There are two claims against the Company for as yet unknown costs for clean up of alleged environmental contamination related to manufactured gas plant sites that were previously operated by companies, which were subsequently merged into Cascade.

The first claim was received in 1995, and relates to a site in Oregon. An investigation has shown that contamination does exist, but there is currently not enough information available to estimate the potential liability associated with this claim. It is expected that other parties will participate in the clean up costs. Through the end of the fiscal year the amounts spent, primarily on investigation and containment, have been immaterial.

The second claim was received in 1997, and relates to a site in Washington. An investigation has determined there is evidence of contamination at the site, but there is also evidence of an oil line crossing the property, operated by an unrelated party, which may have also contributed to the contamination. There is currently not enough information available to estimate the potential liability associated with this claim. The party who originally made this claim has not been actively pursuing it.

Management intends to pursue reimbursement from its insurance carriers, and recovery from its customers through increased rates, for any remediation costs for which the Company is determined to be liable. There is precedent for such recovery through increased rates, as both the Washington Utilities and Transportation Commission (WUTC) and the Oregon Public Utilities Commission (OPUC) have previously allowed regulated utilities to increase customer rates to recover similar costs.

Litigation and Other Contingencies

Various lawsuits, claims, and contingent liabilities may arise from time to time from the conduct of the Company's business.

Settlement in Fatality Case: In the fourth quarter of fiscal 2002 a fatal accident occurred involving facilities owned by the Company, located on the property of one of the Company's commercial customers. In December 2002 a settlement of all plaintiffs' claims was agreed to in consideration of a \$750,000 payment. The Company and its co-defendant have each paid \$375,000, and have agreed to resolve the allocation of the total settlement payment between them in future negotiations or proceedings.

No claims now pending, including those mentioned in preceding paragraphs, in the opinion of management, are expected to have a material effect on the Company's financial position, results of operations, or liquidity.

New Accounting Standards

Effective October 1, 2002, the Company adopted accounting standards prescribed under FAS Nos. 142, 143, 144, and 145, the effects of which are described in the following paragraphs.

FAS No. 142, Goodwill and Other Intangible Assets. This standard addresses how intangible assets that are acquired individually or with a group of other assets should be accounted for in financial statements upon their acquisition. This Statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. Adoption of this standard did not have an impact on the Company's financial statements.

FAS No. 143, Accounting for Asset Retirement Obligations. This standard requires companies to record a liability to recognize future obligations to remove assets. The Company has reviewed its franchises and significant easements and other documents to determine whether any include provisions requiring removal of assets. No significant obligations have been identified, and adoption of this standard did not have a significant impact on the Company's financial statements.

FAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. This standard provides for the recognition and measurement of an impairment loss if it is determined the carrying amount of a long-lived asset is not recoverable, and exceeds its fair value. It also identifies events or changes in circumstances that would require a test for recoverability. Adoption of this standard did not have a significant impact on the Company's financial statements.

FAS No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections. Adoption of this standard did not have an impact on the Company's financial statements.

The Company has subsequently adopted FAS Nos. 146 and 148, and FASB Interpretation Nos. 45 and 46, as follows:

The FASB has issued FAS No. 146, titled *Accounting for Costs Associated with Exit or Disposal Activities*. This standard is effective for exit or disposal activities initiated after December 31, 2002, and has been adopted by the Company effective January 1, 2003. Adoption of this standard did not have an impact on the Company's financial statements.

On December 31, 2002, the Financial Accounting Standards Board (FASB) issued FAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*. This Statement amends FASB Statement No. 123, *Accounting for Stock-Based Compensation*, to provide alternative methods of transition for companies that voluntarily change to the fair-value-based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has adopted the quarterly disclosures under this standard, as reflected above under **Stock-Based Compensation**.

In November 2002, the FASB issued Interpretation 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. The Interpretation elaborates on the existing disclosure requirements for most guarantees, including loan guarantees such as standby letters of credit. It also clarifies that at the time a company issues a guarantee, the company must recognize an initial liability for the fair value, or market value, of the obligations it assumes under the guarantee and must disclose that information in its interim and annual financial statements. The provisions related to recognizing a liability at inception of the guarantee for the fair value of the guarantor's obligations does not apply to product warranties or to guarantees accounted for as derivatives. The initial recognition and initial measurement provisions apply on a prospective basis to guarantees issued or modified after December 31, 2002. Adoption of this standard as of January 1, 2003 did not have an impact on the Company's financial statements.

In January 2003, the FASB issued Interpretation 46, *Consolidation of Variable Interest Entities*. The Interpretation addresses consolidation by business enterprises of variable interest entities which have one or both of the following characteristics:

- 1) The equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, which is provided through other interests that will absorb some or all of the expected losses of the entity.
- 2) The equity investors lack one or more of the following essential characteristics of a controlling financial interest:
 - a. The direct or indirect ability to make decisions about the entity's activities through voting rights or similar rights
 - b. The obligation to absorb the expected losses of the entity if they occur, which makes it possible for the entity to finance its activities
 - c. The right to receive the expected residual returns of the entity if they occur, which is the compensation for the risk of absorbing the expected losses.

Adoption of Interpretation 46 as of February 1, 2003 did not have an impact on the Company's financial statements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is management's assessment of the Company's financial condition and a discussion of the principal factors that affected consolidated results of operations and cash flows for the three-month and six-month periods ended March 31, 2003 and March 31, 2002.

CRITICAL ACCOUNTING POLICIES

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). In following GAAP, management exercises judgment in selection and application of accounting principles. Management considers Critical Accounting Policies to be those where different assumptions regarding application could result in material differences in financial statements.

Revenue Recognition

The Company recognizes operating revenues based on deliveries of gas and other services to customers. This includes estimated revenues for gas delivered but not billed to residential and commercial customers from the latest meter reading date to the end of the accounting period.

Regulatory Accounting

The Company's accounting policies and practices are generally the same as used by unregulated companies for financial reporting under GAAP. However, Statement of Financial Accounting Standards (FAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*, requires regulated companies to apply accounting treatment to reflect the financial impact of regulation. For example, in establishing the rates to be charged to the Company's retail customers, the Washington Utilities and Transportation Commission (WUTC) and the Oregon Public Utility Commission (OPUC) may not allow the Company to charge its customers for recovery of certain expenses in the same period they are incurred. Instead, rates are established in the future to recover costs that were incurred in a prior period. In this situation, FAS No. 71 requires the Company to defer these costs and include them as regulatory assets on the balance sheet. In the subsequent period when these costs are recovered from customers, the Company then amortizes these costs as expense in the income statement, in an amount equivalent to the amounts recovered. Similarly, certain revenue items, or cost reductions may be deferred as regulatory liabilities, which are later amortized to the income statement as customer rates are reduced.

In order to apply the provisions of FAS No. 71, the following conditions must apply:

An independent regulator approves the Company's customer rates.

The rates are designed to recover the company's costs of providing the regulated services or products.

There is sufficient demand for the regulated service to reasonably assure that rates can be set at a level to recover the costs.

The Company periodically assesses whether conditions merit the continued applicability of FAS No. 71. In the event the Company should determine in the future that all or a portion of its regulatory assets and liabilities no longer meet the above criteria, it would be required to write off the related balances of its regulatory assets and liabilities, and reflect the write off in its income statement. At March 31, 2003 there were \$15,418,000 of regulatory assets and \$5,991,000 of regulatory liabilities.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The Company has used estimates in measuring certain deferred charges and deferred credits related to items subject to approval of the WUTC and the OPUC. Estimates are also used in the development of discount rates and trend rates related to the measurement of retirement

benefit obligations and accrual amounts, allowances for doubtful accounts, estimates of unbilled revenue, accruals necessary for contingencies, and in the determination of depreciable lives of utility plant. On an ongoing basis, management evaluates the estimates used, based on historical experience, current conditions and on various other assumptions believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

Derivatives

The company records derivative transactions according to the provisions of FAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by FAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*. These standards require that the fair value of all derivative financial instruments be recognized as either assets or liabilities on the Company's balance sheet. Changes during a period in the fair value of a derivative instrument would be included in earnings or other comprehensive income for the period.

The Company did not enter into derivative transactions during the first two quarters of fiscal 2003, and as of March 31, 2003, does not have any derivative assets or liabilities. The Company's contracts for purchase of natural gas are not derivative instruments because they are considered normal purchases under the provisions of FAS Nos. 133 and 138.

NEW ACCOUNTING STANDARDS

Effective October 1, 2002, the Company adopted accounting standards prescribed under FAS Nos. 142, 143, 144, and 145, the effects of which are described in the following paragraphs.

FAS No. 142, *Goodwill and Other Intangible Assets.* This standard addresses how intangible assets that are acquired individually or with a group of other assets should be accounted for in financial statements upon their acquisition. This Statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. Adoption of this standard did not have an impact on the Company's financial statements.

FAS No. 143, *Accounting for Asset Retirement Obligations.* This standard requires companies to record a liability to recognize future obligations to remove assets. The Company has reviewed its franchises and significant easements and other documents to determine whether any include provisions requiring removal of assets. No significant obligations have been identified, and adoption of this standard did not have a significant impact on the Company's financial statements.

FAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* This standard provides for the recognition and measurement of an impairment loss if it is determined the carrying amount of a long-lived asset is not recoverable, and exceeds its fair value. It also identifies events or changes in circumstances that would require a test for recoverability. Adoption of this standard did not have a significant impact on the Company's financial statements.

FAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections.* Adoption of this standard did not have an impact on the Company's financial statements.

The Company has subsequently adopted FAS Nos. 146 and 148, and FASB Interpretation Nos. 45 and 46, as follows:

*The FASB has issued FAS No. 146, titled *Accounting for Costs Associated with Exit or Disposal Activities.* This standard is effective for exit or disposal activities initiated after December 31, 2002, and has been adopted by the Company effective January 1, 2003. Adoption of this standard did not have an impact on the Company's financial statements.*

On December 31, 2002, the FASB issued FAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*. This Statement amends FASB Statement No. 123, *Accounting*

for *Stock-Based Compensation*, to provide alternative methods of transition for companies that voluntarily change to the fair-value-based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has adopted the quarterly disclosures under this standard, as reflected in the financial statement footnotes under **Stock-Based Compensation**.

In November 2002, the FASB issued Interpretation 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. The Interpretation elaborates on the existing disclosure requirements for most guarantees, including loan guarantees such as standby letters of credit. It also clarifies that at the time a company issues a guarantee, the company must recognize an initial liability for the fair value, or market value, of the obligations it assumes under the guarantee and must disclose that information in its interim and annual financial statements. The provisions related to recognizing a liability at inception of the guarantee for the fair value of the guarantor's obligations does not apply to product warranties or to guarantees accounted for as derivatives. The initial recognition and initial measurement provisions apply on a prospective basis to guarantees issued or modified after December 31, 2002. Adoption of this standard as of January 1, 2003 did not have an impact on the Company's financial statements.

In January 2003, the FASB issued Interpretation 46, *Consolidation of Variable Interest Entities*. The Interpretation addresses consolidation by business enterprises of variable interest entities which have one or both of the following characteristics:

- 1) The equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, which is provided through other interests that will absorb some or all of the expected losses of the entity.
- 2) The equity investors lack one or more of the following essential characteristics of a controlling financial interest:
 - a. The direct or indirect ability to make decisions about the entity's activities through voting rights or similar rights
 - b. The obligation to absorb the expected losses of the entity if they occur, which makes it possible for the entity to finance its activities
 - c. The right to receive the expected residual returns of the entity if they occur, which is the compensation for the risk of absorbing the expected losses.

Adoption of Interpretation 46 as of February 1, 2003 did not have an impact on the Company's financial statements.

RESULTS OF OPERATIONS

NEW ACCOUNTING STANDARDS

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Net income for the second quarter of fiscal 2003 (quarter ended March 31, 2003) was \$6,849,000, or \$0.62 per share, basic and diluted, compared to \$9,479,000, or \$0.86 per share, basic and diluted, for the quarter ended March 31, 2002. This represents a 28% decline in second quarter earnings per share from second quarter 2002 results. For the six month period ended March 31, 2003, net income was \$13,530,000, or \$1.22 per share, basic and diluted, compared to \$15,722,000, or \$1.42 per share, basic and diluted, for the six months ended March 31, 2002. The reduction in net income for the quarter and year-to-date periods is primarily from lower operating margins (revenue minus gas cost and revenue taxes).

Operating Margin

Residential and Commercial Margin. Operating margins derived from sales to residential and commercial customers were as set forth in the following table:

	Second Quarter of Fiscal		Percent Change	Year to Date March 31		Percent Change
	2003	2002		2003	2002	
	(dollars in thousands)			(dollars in thousands)		
Degree Days	2,049	2,351	-12.8%	4,076	4,389	-7.1%
Average Number of Customers						
Residential	178,586	171,041	4.4%	176,881		