

CORNING NATURAL GAS CORP
Form 10-Q
February 14, 2007

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 December 31, 2006

Commission File Number 000-00643

CORNING NATURAL GAS CORPORATION

(Exact name of Registrant as specified in its charter)

New York

16-0397420

(State of incorporation)

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

330 West William Street, Corning New York 14830

(Address of principal executive offices) (Zip Code)

(607) 936-3755

(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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non-accelerated Filer

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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 [x]

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

Common Stock, \$5.00 par value	506,918
Class	Shares outstanding as of February 12, 2007

As used in this Form 10-Q, the terms "Company," "Corning," "Registrant," "we," "us," and "our" mean Corning Natural Gas Corporation and its consolidated subsidiaries, taken as a whole, unless the context indicates otherwise. Except as otherwise stated, the information contained in this Form 10-Q is as of December 31, 2006.

PART I. FINANCIAL INFORMATION

- Item 1. Financial Statements (Unaudited)
- 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 1A. Risk Factors
- Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
- Item 3. Defaults upon Senior Securities
- Item 4. Other Information
- Item 5. Exhibits

SIGNATURES

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements.

CORNING NATURAL GAS CORPORATION AND SUBSIDIARY				
Condensed Consolidated Statements of Income				
Unaudited				
Form 10 Q				
			Quarter Ended	
			December 31, 2006	December 31, 2005
Utility Operating Revenues			<u>\$6,002,068</u>	<u>\$7,273,639</u>
Cost and Expense				
Natural Gas Purchased			3,402,037	5,314,765
Operating & Maintenance Expense			1,487,432	1,487,184
Taxes other than Federal Income Taxes			378,954	283,978
Depreciation			154,641	112,425
Other Deductions, Net			<u>161,196</u>	<u>7,625</u>
Total Costs and Expenses			<u>5,584,260</u>	<u>7,205,977</u>
Utility Operating Income (Loss)			417,808	67,662
Other Income and (Expense)				
Interest Expense			(385,777)	(363,892)
Interest Income			<u>36,022</u>	<u>67,254</u>
Net Income (Loss) from Utility Operations, Before Income Tax			68,053	(228,976)

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	Federal Income Tax (Expense) Benefit		(11,709)	153,624
	Income from Non-Utility Operations, Net of Income Tax		0	0
	Net Income (Loss) from Continued Operations		56,344	(75,352)
	Income (Loss) from Discontinued Operations, Net of Income Tax		(8,888)	(28,139)
	Net Income (Loss)		47,456	(103,491)
	Other Comprehensive Income (Loss)		59,779	(19,891)
	Total Comprehensive Income (Loss)		\$107,235	(\$123,382)
	Weighted average earnings per share-			
	basic & diluted:			
	From Continued Operations		\$0.111	(\$0.149)
	From Discontinued Operations		(\$0.018)	(\$0.056)
			\$0.094	(\$0.204)
	Weighted average shares outstanding		506,918	506,918

CORNING NATURAL GAS CORPORATION AND SUBSIDIARY			
Consolidated Balance Sheets			
Assets		December 31, 2006	September 30, 2006
Plant:			
Utility property, plant and equipment		\$28,729,731	\$28,480,707
Non-utility property, plant and equipment		0	0
Non-utility assets - discontinued operations net		17,725	177,230

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Less: accumulated depreciation		<u>10,935,611</u>		<u>(10,770,476)</u>
Total plant utility and non-utility net		<u>17,811,845</u>		<u>17,887,461</u>
Investments:				
Marketable securities available-for-sale at fair value		<u>2,766,570</u>		<u>2,662,009</u>
Investment in joint venture and associated companies		0		0
Total investments		<u>2,766,570</u>		<u>2,662,009</u>
Current assets:				
Cash and cash equivalents		635,579		1,170,070
Customer accounts receivable, (net of allowance for uncollectible accounts of \$34,837 and \$97,000)		2,610,225		1,460,621
Gas stored underground, at average cost		1,152,294		0
Gas inventories		330,027		343,286
Prepaid expenses		568,774		717,023
Current assets - discontinued operations		<u>89,524</u>		<u>46,113</u>
Total current assets		<u>5,386,423</u>		<u>3,737,113</u>
Deferred debits and other assets:				
Regulatory assets:				
Unrecovered gas costs		3,322,633		2,391,749
Deferred pension and other		200,714		202,448
Goodwill (net of accumulated amortization of \$521,294 for both periods)		0		0
Unamortized debt issuance cost (net of accumulated amortization of \$275,851 and \$269,849)		230,141		236,143
Other		182,762		184,437
Discontinued Operations- other		<u>78,468</u>		<u>36,602</u>
Total deferred debits and other assets		<u>4,014,718</u>		<u>3,051,379</u>
Total assets		<u>\$29,979,556</u>		<u>\$27,337,962</u>
See accompanying notes to consolidated financial statements.				

CORNING NATURAL GAS CORPORATION AND SUBSIDIARY					
Consolidated Balance Sheets					
				December 31, 2006	September 30, 2006
<u>Capitalization and liabilities:</u>					
Common stockholders' equity:					
Common stock (common stock \$5.00 par value per share. Authorized 1,000,000 shares; issued and outstanding 507,000 shares at December 31, 2006 and September 30, 2006)					
				\$2,534,590	\$2,534,590
Other paid-in capital					
				959,512	959,512
Retained earnings					
				(608,773)	(656,229)
Accumulated other comprehensive loss					
				<u>(132,801)</u>	<u>(192,580)</u>
Total common stockholders' equity					
				<u>2,752,528</u>	<u>2,645,293</u>
Long-term debt, less current installments					
				8,590,000	8,590,000
Long-term debt, less current installments - discontinued operations					
				<u>0</u>	<u>56,842</u>
Total Long-term debt					
				8,590,000	8,646,842
Current liabilities:					
Current portion of long-term debt					
				455,000	455,000
Demand Note Payable					
				1,361,661	1,456,662
Borrowings under lines-of-credit					
				6,580,000	6,550,000
Accounts payable					
				3,609,413	1,333,940
Accrued expenses					
				1,220,895	1,184,617
Customer deposits and accrued interest					
				1,117,898	1,025,907
Deferred income taxes					
				465,787	434,635
Other current liabilities - discontinued operations					
				<u>13,891</u>	<u>(63,795)</u>
Total current liabilities					
				<u>14,824,545</u>	<u>12,376,966</u>
Deferred credits and other liabilities:					

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Deferred income taxes			280,672		275,320
Deferred compensation			2,168,750		2,157,407
Deferred pension costs & post-retirement benefits			691,822		620,504
Other			643,889		577,820
Other deferred liabilities - deferred federal income taxes discontinued operations			0		0
Other deferred credits and other liabilities - discontinued operations			<u>27,350</u>		<u>37,810</u>
Total deferred credits and other liabilities			<u>3,812,483</u>		<u>3,668,861</u>
Concentrations and commitments					
Total capitalization and liabilities			<u>\$29,979,556</u>		<u>\$27,337,962</u>
See accompanying notes to consolidated financial statements.					

CORNING NATURAL GAS CORPORATION AND SUBSIDIARY					
Consolidated Statements of Cash Flows					
For the Quarter Ended December 31, 2006 and 2005					
				<u>2006</u>	<u>2005</u>
Cash flows from operating activities:					
Net income (loss)				\$47,456	(\$103,491)
Adjustments to reconcile net income (loss) to net cash used in operating activities:					
Depreciation and amortization				165,135	177,227
Unamortized debt issuance cost				6,002	248
(Gain) Loss on sale of marketable securities				(44,782)	(63,055)
Deferred income taxes				5,352	(35,094)
(Gain) loss on sale of discontinued operations				0	0

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Changes in assets and liabilities:								
(Increase) decrease in:								
Accounts receivable				(1,149,604)		(2,352,085)		
Gas stored underground				(1,152,294)		2,493,627		
Gas inventories				13,259		(7,879)		
Prepaid expenses				148,249		125,412		
Unrecovered gas costs				(930,884)		(1,748,935)		
Deferred pension and other				1,734		22,004		
Other				8,757		40,260		
Increase (decrease) in:								
Accounts payable				2,275,473		3,691,423		
Accrued expenses				36,278		(502,047)		
Customer deposit liability				91,991		274,777		
Deferred income taxes				31,152		85,344		
Deferred compensation				11,343		59,433		
Deferred pension & post-retirement benefits				71,318		204,973		
Other liabilities and deferred credits				40,936		(2,072)		
Net cash (used in) provided by operating activities				(323,129)		2,360,070		
Cash flows from investing activities:								
Purchase of securities available-for-sale				(357,617)		(89,942)		
Sale of securities available-for-sale				357,617		89,942		
Capital expenditures				(89,519)		(687,343)		
Cash received from sale of discontinued operations				0		0		
Net cash (used in) provided by investing activities				(89,519)		(687,343)		
Cash flows from financing activities:								
Proceeds under lines-of-credit				30,000		4,598,170		
Repayment of lines-of-credit				0		(5,425,000)		
Proceeds under long-term debt				0		0		
Repayment of long-term debt				(151,843)		(187,419)		
Net cash (used in) provided by financing activities				(121,843)		(1,014,249)		
Net (decrease) increase in cash				(534,491)		658,478		
Cash and cash equivalents at beginning of period								
				1,170,070		255,037		
Cash and cash equivalents at end of period								
				\$635,579		\$913,515		

Supplemental disclosures of cash flow information:							
Cash paid during the period for:							
Interest					<u>\$349,517</u>		<u>\$341,383</u>
Income taxes					<u>\$6,000</u>		<u>\$3,000</u>

Notes to Consolidated Financial Statements

Note A - Basis of Presentation

The information furnished herewith reflects all adjustments, which are in the opinion of management necessary to a fair statement of the results for the period. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principals generally accepted in the United States of America have been condensed or omitted pursuant to SEC rules and regulations, although the Company believes the disclosures which are made are adequate to make the information presented not misleading.

The condensed consolidated financial statements contained herein should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's latest annual report on Form 10-K. These unaudited interim financial statements have not been audited or certified by a firm of certified public accountants.

It is the Company's policy to reclassify amounts in the prior year financial statements to conform with the current year presentation.

Note B - New Accounting Standards

In May 2005, the FASB issued SFAS 154. SFAS 154 replaces APB 20 and SFAS 3 and changes the requirements for the accounting for and reporting of a change in accounting principle. The Company is required to adopt SFAS 154 for accounting changes and corrections of errors that occur in 2007. The Company's financial condition and results of operations will only be impacted by SFAS 154 if there are any accounting changes or corrections or errors in the future.

In July 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes." FIN No. 48 heightens the threshold for recognizing and measuring tax benefits and requires enterprises to make explicit disclosures about uncertainties in their income tax positions, including a detailed rollforward of tax benefits taken that do not qualify for financial statement recognition. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the potential impact FIN No. 48 will have on the Company's financial position, results of operations and cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standard ("SFAS") No. 157, Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 applies to other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements. SFAS

157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. The Company is currently evaluating the effect of the guidance contained in SFAS 157 and does not expect the implementation to have a material effect on the Company's financial statements.

In September 2006, the FASB also issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," an amendment of SFAS Nos. 87, 88, 106 and 132R. SFAS No. 158 requires the recognition of the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in the statement of financial position and changes in that funded status in the year in which the changes occur through comprehensive income. SFAS No. 158 also requires the funded status of a plan be measured as of the date of its year-end statement of financial position. SFAS No. 158 is effective for fiscal years ending after December 15, 2006. We are currently evaluating the potential impact SFAS No. 158 will have on our financial position and cash flows.

Note C - Pension and Other Post-retirement Benefit Plans

The Company uses June 30 as the measurement for its plans.

Components of Net Periodic Benefit Cost:

										Three months ended December 31, 2006									
										Pension Benefits			Other Benefits						
										2007		2006		2007		2006			
Service cost			\$	67,706	\$	100,885	\$	4,526	\$	7,806									
Interest cost				186,808		167,911		14,926		14,317									
Expected return on plan assets				(198,038)		(186,271)		0		0									
Amortization of prior service cost				7,038		10,093		12,187		12,186									
Amortization of net (gain) loss				73,867		110,399		(10,860)		(5,675)									
Net periodic benefit cost			\$	<u>137,381</u>	\$	<u>203,017</u>	\$	<u>20,779</u>	\$	<u>28,634</u>									

Pension Plan Assets

The Company's pension plan weighted-average asset allocations at December 31, 2006 and 2005 by asset category are as follows:

	Plan Assets

Asset Category	At December 31	
	<u>2006</u>	<u>2005</u>
Equity Securities	58%	54%
Debt Securities	40%	43%
Other	<u>2%</u>	<u>3%</u>
	100%	100%

There is no Company common stock included in the plan assets.

Amounts recognized in the Statement of Financial Position consist of:

	<u>Pension Benefits</u>				<u>Other Benefits</u>			
	<u>2007</u>		<u>2006</u>		<u>2007</u>		<u>2006</u>	
Prepaid Benefit Cost								
Accrued Benefit Cost	\$ (660,553)	\$	(1,402,418)	\$	(1,133,252)	\$	(1,105,386)	
Intangible Assets	139,600		167,751		0		0	
Accumulated Other								
Comprehensive Income	<u>180,486</u>		<u>507,705</u>		<u>0</u>		<u>0</u>	
Net Amount Recognized	\$ <u>(340,467)</u>	\$	<u>(726,962)</u>	\$	<u>(1,133,252)</u>	\$	<u>(1,105,386)</u>	

The accumulated benefit obligation for all defined benefit pension plans is \$11,487,883 at September 30, 2007 and \$11,171,030 at September 30, 2006, respectively.

Information for pension plans with an accumulated benefit obligation in excess of plan assets:

	September 30			
		<u>2007</u>		<u>2006</u>
Projected Benefit Obligation	\$	12,639,060	\$	12,290,456
		11,487,883		11,171,030

Accumulated Benefit Obligation			
Fair Value of Plan Assets		10,827,330	9,768,612

The plan objective is to provide real (inflation adjusted) growth in assets vs. benchmark over a complete market cycle. The plan's objective assumes asset growth will meet or exceed 8% of (risk adjusted) growth over a complete market cycle.

Investment guidelines are based upon an investment horizon of greater than five years. There is a requirement to maintain sufficient liquid reserves to provide for payment of retirement benefits.

The asset allocation guidelines for the plan are as follows:

	Minimum	Maximum
Domestic Common Stock		
Large/Mid Cap	15%	50%
Small Cap	5%	15%
Reits	0%	20%
International Common Stock	10%	20%
Total Equities	30%	75%
Total Fixed Income	20%	60%
Cash	0%	10%

These asset allocation guidelines reflect the plan's desire for investment return. They also reflect the full discretion of the Investment Manager to shift the asset mix within the specified ranges.

The desired investment objective is a long-term rate of return on assets that is approximately 8%. The target rate of return for the plan has been based upon the assumption that future real returns will approximate the long-term rates of return experienced for each asset class of the Investment Policy Statement over a complete business cycle. The plan's overall annualized total return after deducting advisory, money management and custodial fees, as well as total transaction costs should perform above an index comprised of market indices weighted by the strategic asset allocation of the plan.

In order to accomplish the investment goals, the Investment Committee believes that the investments of the plan must be diversified to provide the Investment Manager with the flexibility to invest in various types of assets. The Investment Committee recognizes that a moderate amount of risk must be assumed to achieve the Plan's long-term objectives. The Investment Committee believes that the Company's prospects for the future, current financial conditions, and several other factors suggest collectively that the plan can tolerate some interim fluctuations in market value and rates of return in order to achieve long-term objectives.

Contributions

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The Company expects to contribute \$936,017 to its Pension Plan in 2007. The Post Retirement Benefit Plan is not funded.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	Pension	Other
	<u>Benefits</u>	<u>Benefits</u>
2007	726,700	61,677
2008	705,492	61,764
2009	685,389	63,001
2010	714,732	65,542
2011	762,835	71,402
Years 2012 - 2016	4,421,532	367,659

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effect:

	1 - Percentage-	1 - Percentage-
	<u>Point Increase</u>	<u>Point Decrease</u>
Effect on total of service and interest cost	\$2,597	(\$2,268)
Effect on postretirement benefit obligation	\$36,128	(\$31,640)

Note D - Segment Overview

The following table reflects the results of the segments consistent with the Company's internal financial reporting process. The following results are used in part, by management, both in evaluating the performance of, and in allocating resources to, each of these segments.

	Utility	Discontinued Operations						
	Gas Company	(5) Corning Realty	(5) Corning Mortgage	(2) Appliance	(3) Tax Center	(4) Foodmart Plaza	Subtotal	Total Consolidated
Revenue:(1)								
2006	\$ 6,002,068	\$ 0	\$ 0	\$ 15,918	\$ 0	\$ 0	\$15,918	\$6,017,986
2005	7,273,639	882,861	290	24,168	0	0	907,319	8,180,958

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Transportation Revenue:									
2006	1,038,014	0	0	0	0	0	0	1,038,014	
2005	698,290	0	0	0	0	0	0	698,290	
Net income (loss):(1)									
2006	56,344	0	0	(8,888)	0	0	(8,888)	47,456	
2005	(75,352)	6,868	(13,690)	(21,317)	0	0	(28,139)	(103,491)	
Interest income:(1)									
2006	36,022	0	0	31,975	0	0	31,975	67,997	
2005	67,254	0	0	24,928	0	0	24,928	92,182	
Interest expense:(1)									
2006	269,357	0	0	365	0	0	365	269,722	
2005	363,892	16,038	2,475	1,787	0	0	20,300	384,192	
Total assets:									
2006	29,730,397	0	0	249,159	0	0	249,159	29,979,556	
2005	31,686,080	1,711,573	178,805	979,028	0	0	2,869,406	34,555,486	
Capital Expenditures:									
2006	89,519	0	0	0	0	0	0	89,519	
2005	686,615	864	0	0	0	0	864	687,479	
Federal income tax expense:									
2006	11,709	0	0	(4,579)	0	0	(4,579)	7,130	
2005	(153,624)	7,402	(7,052)	(10,982)	0	0	(10,632)	(164,256)	

(1) Before elimination of intercompany interest.

(2) The Appliance Co. discontinued operations in September 2003.

(3) Tax Center International discontinued operations in October 2004.

(4) Foodmart discontinued operations in July 2004.

(5) Corning Realty and Corning Mortgage discontinued operations in August 2006.

Interest income and expense have been displayed in the segment in which it has been earned or incurred. Segment interest expense other than the Gas Company is included within unregulated expenses in the consolidated statements of income.

There were no sales of unregistered securities (debt or equity) during the quarter ended December 31, 2006.

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

Overview

The company's primary business is natural gas distribution. We serve approximately 14,500 customers through 400 miles of pipeline. Our service territory is saturated with very little residential growth. Growth opportunities exist in the industrial market, as well as connecting to local gas production. Increased focus will be given to efficient operations and improving infrastructure. Key performance indicators are net income, cash flow and rate of return. Other indicators that are tracked include leak repair, main and service replacements and customer service metrics.

Earnings

2006 compared with 2005

A consolidated gain amounted to \$47,456 or \$.094 per share in 2006 compared to a consolidated loss amounted to \$103,491 or (\$.204) per share in 2005. The increase is the result of the successful rate case filing.

Earnings (Loss) by Segment			
For the quarter ended December 31:		<u>2006</u>	<u>2005</u>
Utility (continued operation)		\$ 56,344	\$ (75,352)
Discontinued Operations		<u>(8,888)</u>	<u>(28,139)</u>
Total Consolidated		\$ 47,456	\$ (103,491)

Revenue

Utility Operating Revenue		<u>2006</u>	<u>2005</u>
Retail Revenue:			
Residential		\$ 3,228,965	\$ 4,023,407
Commercial		642,891	893,004
Industrial		<u>62,042</u>	<u>88,330</u>
		3,933,898	5,004,741
Transportation		1,038,014	698,290
Wholesale		962,155	1,362,568
Local Production		--	103,910
Other		<u>68,001</u>	<u>104,130</u>
		\$ 6,002,068	\$ 7,273,639

2006 compared with 2005

Utility operating revenue decreased \$1,271,571 or 17 percent due primarily to lower gas costs. Gas costs are pass through to customers through the Company's Gas Adjustment Clause.

Non-Utility Revenue

2006 compared to 2005

The non utility operations were sold in fiscal year 2006 and the results were included in "Discontinued Operation" segment.

The sale of the Miracle Mile property was completed on December 13, 2006. The sale price was \$125,000 with a net cash transaction due to the company of \$41,633.75 after repayment of the mortgage. The property was purchased by WKG Properties, LLC.

Operating Expenses

Utility

2006 compared with 2005

Purchase gas expense decreased \$1,912,728 or 64 percent in 2006 due primarily to reduced gas purchases. Other operating and maintenance expense increased 6 percent due to increased focus on infrastructure. Depreciation expense increased to \$154,641 due to increased investment in plant property and equipment.

Non-Utility

2006 compared with 2005

The non-utility operations were sold in fiscal year ending September 2006 and the results are included in Discontinued Operation section. Therefore the periods are not comparable.

Interest Income

Interest income decreased by \$31,232 to \$36,022 in 2006 versus \$67,254 in 2005. The decrease in 2006 was due to changes in interest bearing gas cost reconciliation amounts due from customers.

Operating Segments

Note D to the financial statements, which also contain the results by segment for the quarters ended December 31, 2006 and 2005.

Liquidity and Capital Resources

Internally generated cash from operating activities consists of net income, adjusted for non-cash expenses and changes in operating assets and liabilities. Non-cash items include depreciation and amortization; gain on sale of securities, deferred income taxes and losses on sale of discontinued operations. In the utility segment, over or under recovered gas costs significantly impacts cash flow. In addition, there are significant year-to-year changes in regulatory assets that impact cash flow. Cash flows from investing activities consist primarily of capital expenditures. Capital expenditures have historically exceeded \$1 million annually and the same is expected in the coming year. Cash flows from financing activities consist of repayment of long-term debt and borrowings and repayments under our lines-of-credit. For consolidated operations, the Company had \$6,600,000 during 2006 available through lines of credit at local banks, the terms of which are disclosed in note 6 to the financial statements in the company's latest annual report on Form 10-K.

The Company has outstanding \$10,406,661 in long term debt. In order to purchase gas supplies for the winter 2006-2007 season, the Company entered in to a gas asset management contract with Virginia Power Energy Marketing Inc. where VPEM purchased gas on behalf of the Company and injected that gas in to storage. At the request of VPEM on November 30th, 2006 Richard Osborne, Chairman of the Company, posted a letter of credit with VPEM to facilitate the payment for gas. This letter of credit has allowed the Company to resume a normal payment schedule for its gas purchases. The Company has no off balance sheet requirements.

Regulatory Matters

On October 31, 2005, the Company filed with the PSC a request to increase its rates for natural gas service by approximately \$3.46 million or 16.2 percent. Ordinarily, major rate increases are not permitted by the PSC to take effect for approximately 11 months after filing, which, in this case, would be on or about October 1, 2006. In an effort to realize the benefits of the proposed increase as soon as possible, however, the Company moved for the establishment of the increased rates on an emergency temporary basis to take effect by May 2006.

On May 22, 2006, the New York Public Service Commission (the "Commission") issued a decision in three proceedings involving the Company: Case 05-G-1359, to examine the Company's October 31, 2005 filing for increased rates; Case 05-G-1268, to review the Company's practices particularly relating to natural gas supply and Case 04-G-1032 to consider the Company's request for deferral and recovery of costs formerly allocated to the appliance business that has been sold in 2003. The decision, entitled "Order Setting Gas Delivery Service Rates, Adopting Performance Targets and Incentives, Allowing Deferral and Rate Recovery of Certain Costs, and Crediting Customers with \$1.4 Million of Prior Gas Commodity Costs" (the "May Order"), resolved the issues presented in the three proceedings.

In its May Order, the Commission authorized the Company to increase its base rates for natural gas service by approximately \$2.7 million. The May Order allowed rates to become effective as of June 1, 2006. For financial purposes rates went in to effect October 1, 2006 and revenues collected as a result of early implementation (June 1st through September 30th) are subject to refund in 2007. The Commission granted recovery of approximately \$2.63 million of deferred costs associated with appliance business, offsetting that against a \$1.4 million one time gas supply disallowance expense. This expense was recognized in the quarter and fiscal year ended September 30th, 2006.

Critical Accounting Policies

The Company's most significant accounting policies are described below. The application of generally accepted accounting principles involve certain assumptions, judgments and estimates that affect reported amounts of assets, liabilities, revenues and expenses. Thus, the application of these principles can result in varying results from company to company.

Accounting for Utility Revenue and Cost of Gas Recognition.

The Company records revenues from residential and commercial customers based on meters read on a cycle basis throughout each month, while certain large industrial and utility customers' meters are read at the end of each month. The Company does not accrue revenue for gas delivered but not yet billed, as the New York PSC requires that such accounting must be adopted during a rate proceeding, which the Company has not done. The Company's tariffs contain mechanisms that provide for the recovery of the cost of gas applicable to firm customers, which includes estimates. Under these mechanisms, the Company periodically adjusts its rates to reflect increases and decreases in the cost of gas. Annually, the Company reconciles the difference between the total gas costs collected from customers and the cost of gas. The Company defers any excess or deficiency and subsequently either recovers it from, or refunds it to, customers over the following twelve-month period. To the extent estimates are inaccurate; a regulatory asset on the balance sheet is increased or decreased.

Accounting for Regulated Operations - Regulatory Assets and Liabilities

. All of the Company's business is subject to regulation. The Company's regulated utility records the results of its regulated activities in accordance with Statement of Financial Accounting Standards (SFAS) No. 71, Accounting for the Effects of Certain Types of Regulation, which results in differences in the application of generally accepted accounting principles between regulated and non-regulated businesses. SFAS No. 71 requires the recording of regulatory assets and liabilities for certain transactions that would have been treated as revenue and expense in non-regulated businesses. In certain circumstances, SFAS No. 71 allows entities whose rates are determined by third-party regulators to defer costs as "regulatory" assets in the balance sheet to the extent that the entity expects to recover these costs in future rates. Management believes that currently available facts support the continued application of SFAS No. 71 and that all regulatory assets and liabilities are recoverable or refundable through the regulatory environment.

Pension and Post-Retirement Benefits.

The amounts reported in the Company's financial statements related to its pension and other post-retirement benefits are determined on an actuarial basis, which uses many assumptions in the calculation of such amounts. These assumptions include the discount rate, the expected return on plan assets, the rate of compensation increase and, for other post-retirement benefits, the expected annual rate of increase in per capita cost of covered medical and prescription benefits. Changes in actuarial assumptions and actuarial experience could have a material impact on the amount of pension and post-retirement benefit costs and funding requirements experienced by the Company. However, the Company expects to recover substantially its entire net periodic pension and other post-retirement benefit costs attributed to employees in its Utility segment in accordance with the applicable regulatory commission authorization. For financial reporting purposes, the difference between the amounts of such costs as determined under applicable accounting principles is recorded as either a regulatory asset or liability.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This report contains statements which, to the extent they are not recitations of historical facts, constitute "forward-looking statements" within the meaning of the Securities Litigation Reform Act of 1995 (Reform Act). In this respect, the words "estimate", "project", "anticipate", "expect", "intend", "believe" and similar expressions are intended to identify forward-looking statements. All such forward-looking statements are intended to be subject to the safe harbor protection provided by the Reform Act. A number of important factors affecting the Company's business and financial results could cause actual results to differ materially from those stated in the forward-looking statements.

Item 3 - Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

The Company's exposure to interest rate risk arises from borrowing under short-term debt instruments. At December 31, 2006, these instruments consisted of a term loan and bank credit line borrowings outstanding of \$6,580,000. The interest rate (prime rate) on this loan and these lines was 8.25 percent at December 31, 2006.

Item 4 - Controls and Procedures

a. Evaluation of Disclosure Controls and Procedures. As of the end of the period covered by this quarterly report Form 10-Q the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 Rules 13a-15). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective to ensure that material information relating to us and our consolidated subsidiaries is recorded, processed, summarized and reported in a timely manner.

b. Changes in Internal Controls. There have been no changes in our internal controls over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting

PART II.

OTHER INFORMATION

Item 1. Legal Proceedings.

The Company is not a party to any material pending legal proceedings, nor is the Company aware of any problems of any consequence which it anticipates may result in legal proceedings.

Item 1A. Risk Factors.

Our operations could be adversely affected by fluctuations in the price of natural gas.

Prices for natural gas are subject to volatile fluctuations in response to changes in supply and other market conditions. While these costs are usually passed on to customers pursuant to natural gas adjustment clauses and therefore do not pose a direct risk to earnings, we are unable to predict what effect a sharp increase in natural gas prices may have on our customers' energy consumption or ability to pay. Higher prices to customers can lead to higher bad debt expense and customer conservation resulting in reduced margins to the

Company.

Operational issues beyond our control could have an adverse effect on our business.

Our ability to provide natural gas depends on the operations of our facilities. Secondly, we are dependent upon third parties, including local gas producers and natural gas pipeline operators for gas supply. The loss of use or destruction of our facilities or the facilities of third parties due to extreme weather conditions, breakdowns, war, acts of terrorism or other occurrences could greatly reduce potential earnings and cash flows and increase our costs of repairs and/or replacement of assets. While we carry property insurance to protect certain assets our losses may not be fully recoverable through insurance.

Significantly warmer-than-normal weather conditions may affect the sale of natural gas and adversely impact our financial position and the results of our operations.

The demand for natural gas is directly affected by weather conditions. Significantly warmer-than-normal weather conditions in our service areas could greatly reduce our earnings and cash flows as a result of lower gas sales levels. While we have mitigated the risk of warmer winter weather by having a weather normalization clause, the weather mitigation rate design provides only partial protection for warmer than normal weather.

There are inherent risks associated with storing and transporting natural gas, which could cause the Company to incur significant financial losses.

There are inherent hazards and operations risks in gas distribution activities, such as leaks, accidental explosions and mechanical problems that could cause substantial financial losses. In addition, these risks could result in the loss of human life, significant damage to property, environmental pollution, and impairment of operations and substantial losses to the Company. The location of pipelines and storage facilities near populated areas, including residential areas, commercial business centers and industrial sites, could increase the level of damages resulting from these risks. These activities may subject the Company to litigation and administrative proceedings that could result in substantial monetary judgments, fines or penalties against the Company. To the extent that the occurrence of any of these events is not fully covered by insurance, they could adversely affect the Company's financial position and results of operations.

Changes in regional economic conditions could reduce the demand for natural gas.

Our business follows the economic cycle of the customers in the regions that we serve Corning, Bath and Hammondsport, New York. A falling, slow or sluggish economy that would reduce the demand for natural gas in the areas in which we are doing business by forcing temporary plant shutdowns, closing operations, population out-migration or slow economic growth would reduce our earnings potential.

Many of the Company's commercial and industrial customers use natural gas in the production of their products. During economic downturns, these customers may see a decrease in demand for their products, which in turn may lead to a decrease in the amount of natural gas they require for production. In addition, it is possible some of our largest customers could look to by-pass our system.

Our earnings may decrease in the event that the Company is unable to obtain approval for rate increases.

Our operations are subject to the jurisdiction of the New York Public Service Commission ("NYPSC"). The NYPSC, among other things, approves the rates that the Company may charge to its customers. If the Company is required in a rate proceeding to reduce the rates it charges its customers, or if the Company is unable to obtain approval for rate relief from the NYPSC, particularly when necessary to cover increased

costs (including costs that may be incurred in connection with mandated infrastructure improvements, our earnings may decrease.)

Cash Flow

The Company has a high debt to equity ratio. This has resulted in high interest expense and very limited access to capital markets. Given its cash requirements, including repayment of certain debt, the seasonal need to purchase gas to inject in storage and necessary infrastructure improvement expenditures, the Company may have a liquidity problem if it can not access the equity markets.

We will need additional equity or debt financing to meet all of our cash needs.

We do not generate sufficient cash flows to meet all of our cash needs. Historically, we have made large capital expenditures in order to finance the expansion and upgrading of our distribution system. We have also purchased and will continue to purchase natural gas to store in inventory. The successful continuation of our business will be dependent upon our ability to obtain additional equity or debt financing. The sale of additional equity securities could result in dilution to our shareholders. The incurrence of debt would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations.

Our ability to obtain additional equity or debt financing on acceptable terms is subject to a variety of uncertainties.

We need additional equity or debt financing to meet all of our cash needs. Additional financing may have unacceptable terms or may not be available at all for reasons relating to:

- * our future results of operations, financial condition and cash flows,
- * our inability to meet our business plan,
- * investors' perception of, and demand for, securities of natural gas utilities, and
- * conditions of the capital markets in which we may seek to raise funds.

If we cannot raise additional capital on acceptable terms, we may not be able to finance the expansion and upgrading of our distribution system, take advantage of future opportunities or respond to competitive pressures or unanticipated capital requirements.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

The Company has nothing to report under this item.

Item 3. Defaults Upon Senior Securities.

The Company has nothing to report under this item.

Item 4. Other Information.

The Company has nothing to report under this item

Item 5 Exhibits.

K1.1* Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

K1.2* Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

K2.1* Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

K2.2* Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed or furnished herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

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CORNING NATURAL GAS CORPORATION

Date: February 14, 2007

By Michael
I. German,
Chief
Executive
Officer and
President

Date: February 14, 2007

By Firouzeh
Sarhangi,
Chief
Financial
Officer and
Treasurer