

CORNING NATURAL GAS CORP
Form 10-Q
February 06, 2009

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, 2008

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

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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

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

Common Stock, \$5.00 par value	820,900
Class	Shares outstanding as of February 6, 2008

As used in this Form 10-Q, the terms "Company," "Corning," "Registrant," "we," "us," and "our" mean Corning Natural Gas Corporation and its subsidiary, 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, 2008.

PART I
FINANCIAL INFORMATION

Item 1. Financial Statements.

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 principles 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 consolidated financial statements have not been audited by a firm of certified public accountants.

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

Note B - New Accounting Standards

In December 2007, FASB issued SFAS No. 141(R), "Business Combinations". SFAS 141(R) establishes principles and requirements for how the acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. As such, the Company is required to adopt these provisions at the beginning of the fiscal year ended September 30, 2010. The Company is currently evaluating the impact of SFAS 141(R) on its consolidated financial statements but does not expect it to have a material effect.

In December 2007, FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51." SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. As such, the Company is required to adopt these provisions at the beginning of the fiscal year ended September 30, 2010. The Company is currently evaluating the impact of SFAS 160 on its consolidated financial statements but does not expect it to have a material effect.

Note C - Other Comprehensive Income Statement

Note D - Pension and Other Post-retirement Benefit Plans

Components of Net Periodic Benefit Cost:

Contributions

The Company expects to contribute \$900,000 to its Pension Plan and \$84,334 to its other Post Retirement Benefit Plan in fiscal year 2009. A total of \$26,009 has been paid for the first three months of this fiscal year.

Note E - Segment Overview

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

Note F - Rate Case

On September 24, 2008, Corning filed a base rate case with the New York Public Service Commission ("NYPSC") (Case 08-G-1137) requesting the approval of a base rate increase of \$1,689,911, using as a rate year the twelve month period ended June 30, 2010. This increase represents a 7.02 percent average increase on total firm full-service gas customer and firm transportation customers (including an equivalent level of gas supply costs). Corning seeks to implement a multi year rate plan for the Rate Year and two subsequent 12-month periods ending June 30, 2011 and 2012. Such a multi year plan would provide necessary revenue requirements for the rate year along with \$830,306 and \$784,716 for the years ending June 30, 2011 and June 30, 2012 respectively. The statutory review and approval

process can take up to eleven months from the date of filing. The NYPSC can approve, reject or modify the Company's request.

Note G - Financing Activities

On May 7, 2008, we entered into a credit agreement with M & T Bank to provide for a \$6.0 million note for the purpose of retiring a \$3.1 million first mortgage and an unsecured senior note in the amount of \$1.5 million. The remaining proceeds were used to fund construction projects related to furnishing natural gas within the Company's service area. This note was converted to a long term loan on October 16, 2008, with an interest rate of 5.96%. In October 2008, we obtained \$1.0 million of financing in a form of Demand Note from M&T Bank to help with the cost of our new construction. Interest on this loan is payable on the monthly basis at the rate equal to 1% above the Prime Rate. The initial interest rate on this loan was 5.5% and was reduced to 4.25% at the end of December of 2008.

Note H - Director Compensation

On April 1, 2008, the board of directors agreed to increase the compensation for all board members from 50 shares of our restricted common stock for each quarter of service as a director to 150 shares of our restricted common stock for each quarter of service as a director. The shares awarded will become unrestricted upon a director leaving the board. Directors who also serve as officers of Corning are not compensated for their service as directors. In fiscal 2009, directors were issued compensatory shares for service from January 2007 through May 2008. Directors have not yet been issued compensatory shares for service after May 2008. Information regarding shares of restricted stock awarded to directors in fiscal 2009 is summarized below.

Note I - Fair Value Measurements

The Company has determined the fair value of certain assets through application of SFAS No. 157, *Fair Value Measurements*.

Fair value of assets and liabilities measured on a recurring basis at December 31, 2008 and 2007 are as follows:

Gains and losses (realized and unrealized) included in earnings for the periods reported in investment income as follows:

Financial assets and liabilities valued using level 1 inputs are based on unadjusted quoted market prices within active market.

Note J - Stock Options

On November 5, 2007, the Board of Directors granted stock options totaling 75,000 shares. 25,000 of the stock options were vested immediately and 25,000 additional options vest on each of the 1st and 2nd anniversary of the grant date. The Company is recognizing \$29,157 quarterly, a total of \$116,628 expense for the year, using the Black-Scholes option pricing model for the 25,000 shares that vested on November 5, 2008.

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

Overview

Our primary business is natural gas distribution. We serve approximately 14,500 customers through 400 miles of pipeline in the Corning and Hammondsport, New York areas. Residential growth in our service territory is dependent on overall economic activity. Corning Inc., the largest employer in our service area, has recently announced a significant reduction in work force locally. The Company has not seen any meaningful change in billing to large customers to date. The Company's major growth opportunities exist in extending our mains to areas not currently served by natural gas, as well as connecting to local gas production. We continue to focus on improving the efficiency of our operations. We are also in the process of making capital investments to improve our infrastructure including upgrading our distribution system through replacement of distribution mains and customer service lines.

Our key performance indicators are net income, stockholders' equity and the safety of our system.

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Results of Operations

For the three months ended December 31, 2008 results improved over the same period in 2007. Higher earnings in 2008 were primarily the result of a rate increase that went in to effect December 17, 2007. The other taxes and depreciation expenses were higher in 2008 due to significant investment in infrastructure.

As a regulated utility company, stockholders' equity is an important performance indicator. The NYPSC allows us to earn a just and reasonable return on stockholders' equity. Stockholders' equity is therefore a precursor of future earnings potential. For the 2009 fiscal year to date, stockholders' equity increased by \$154,925 due to an increase in retained earnings. We currently plan to continue our focus on building stockholders' equity.

Other indicators that we track are the safety and efficiency of our operations. These include leak repair, main and service replacements and customer service metrics. During 2008 we made a significant effort to improve our infrastructure and we are continuing this program in 2009. During the first fiscal quarter of 2009 we repaired 60 leaks and replaced 105 bare steel services and 3.97 miles of bare steel main.

During the first three months of fiscal 2009, we began construction on a 1.8 mile long 10" steel distribution pipe to serve customers in the Town of Caton and to interconnect with a local production gas well located in Pennsylvania. We also began construction on a 1.2 mile long 6" high density polyethylene distribution pipe to feed a commercial asphalt plant in the Town of Bath. Both projects will be completed early in the second quarter. We have also designated seven miles of bare steel pipe and 400 bare steel services for replacement during the calendar year of 2009 in addition to replacing and/or upgrading portions of two supply mains to major customers. Additionally, we will continue on our goal to end the calendar year with 10 or less repairable leaks remaining on our books.

Gas supply is our largest expense. We entered into a gas management agreement with Atmos Energy Marketing, LLC starting July 1, 2008 that continues until March 31, 2010.

Earnings

Earnings increased to \$264,266 for the three months ended December 31, 2008 compared to \$154,547 for the same period last year. We believe the increase is primarily attributable to our rate increase, approved by the NYSPSC, that went into effect in December 2007.

Utility operating revenue increased \$1,304,975 in the three months ended December 31, 2008 compared to the same period last year, again due to our rate increase approved by the NYPSC, that went into effect in December 2007, and higher gas cost.

The following table summarizes our operating revenue:

Margin

Margin increased \$207,490 for the three months ended December 31, 2008 compared to the same period last year again because of the December 2007 rate increase and local production revenues. Our margin decreased 4.93% for the quarter ended December 31, 2008 compared to the quarter ended December 31, 2007 mainly due to higher storage gas withdrawal cost and volumes.

Operating Expenses

Purchased gas expense increased \$1,097,485 to \$4,355,067 in the three months ended December 31, 2008 compared to \$3,257,582 in the same period last year due primarily to higher gas cost. Other operating and maintenance expense increased in the first quarter of fiscal 2009 to \$1,496,152 compared to \$1,441,404 in the same quarter of 2008 due primarily to expense recognized this year for stock options. Depreciation expense increased to \$183,988 in this quarter of 2009 from \$172,992 in 2008 due to increased investment in plant property and equipment. Interest expense decreased from \$301,765 to \$247,400. This decrease was primarily due to refinancing activities and lower interest rates on variable rate debt.

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 and deferred income taxes. Over or under recovered gas costs significantly impact cash flow. In addition, there are significant year-to-year changes in regulatory assets that impact cash flow.

Capital expenditures are the principal use of internally generated cash flow. Capital expenditures have historically exceeded \$1.0 million annually and will increase significantly due to an infrastructure investment mandate in our December 2007 rate order. In the first three months of fiscal year 2009 alone we have invested \$1.8 million to improve our infrastructure, including upgrading our distribution system through replacing mains and customer service lines as well as two major expansion projects.

Cash flows from financing activities consist of repayment of long-term debt and borrowings and repayments under our lines-of-credit. For our consolidated operations, we have a \$8 million line of credit with an interest rate of 1.35 basis points above LIBOR. The amount outstanding under this line on December 31, 2008 was \$6.7 million. As security for the line of credit, collateral assignments have been executed which assign to the lender various rights in the investment trust account. In addition, our lender has a purchase money interest in and to all natural gas purchases by us utilizing funds advanced by the bank under the line-of-credit agreement and all proceeds of sale thereof and accounts receivable pertaining to such sale. We rely heavily on our credit lines to finance gas purchases that we place in storage.

We have \$10.4 million in long term debt outstanding. We repaid \$158,609 in the first three months of 2008 consistent with the requirements of our debt instruments and refinancing activities. On May 7, 2008, we entered into a credit agreement with M & T Bank to provide for a \$6.0 million note for the purpose of retiring a \$3.1 million first mortgage and an unsecured senior note in the amount of \$1.5 million. The remaining proceeds were used to fund construction projects related to furnishing natural gas within the Company's service area. This note was converted to a long term loan on October 16, 2008, with an interest rate of 5.96%. Great West Life & Annuity Insurance Company, the holder of the Company's \$4.7 million 7.9% Senior Notes dated as of September 1, 1997, believes that the refinancing with M&T Bank may breach the negative covenants contained in the 1997 note agreement. As a result, Great West claims that the note holders are entitled to share in the security interest the Company has granted to M&T Bank. Great West has not called a default under the 1997 note agreement and is currently in discussion with the Company.

During the first quarter of 2009 we mainly withdrew gas from storage and by December 31, 2008, had a balance of \$4,058,416 worth of gas in storage. We have entered into a new asset management arrangement effective July 1, 2008, with Atmos Energy Marketing, LLC and we anticipate that we will have sufficient gas to supply our customers for the 2008-2009 winter season.

Off Balance Sheet Arrangements

We have no off balance sheet arrangements.

Contractual Obligations

In September 2008, we refinanced a line of credit and a term loan with banks in order to increase our credit limit and decrease interest expense. The limit on the line of credit was increased from \$7.0 million to \$8.0 million. The interest rate on the line of credit is 30 days LIBOR plus 1.35 basis points. The interest rate on this loan will be adjusted monthly and was 3.26125% at December 31, 2008. We believe we are in compliance with the financial covenants in these debt instruments as of June 30, 2008.

In October 2008, we obtained \$1.0 million of financing in a form of Demand Note from M&T Bank to help with the cost of our new construction. Interest on this loan is payable on the monthly basis at the rate equal to 1% above the Prime Rate. The initial interest rate on this loan was 5.5% and was reduced to 4.25% at the end of December of 2008.

Regulatory Matters

On June 23, 2008 the NYPSC issued an order in Case 07-M-0548 Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard ("EEPS"). In that order, as amended on July 3, 2008, the NYPSC determined that a Gas System Benefits Charge ("GSBC") should be established for New York gas utilities that have 14,000 customers or more. As such, Corning was required to establish a GSBC effective October 1, 2008 and collect from its customers \$148,647 annually until December 31, 2011. One quarter of the annual amount was collected from October to December of 2008. These funds will be used for NYPSC approved energy efficiency initiatives in the Corning franchise area. Once the NYPSC approves the Company's plan, the funds collected will be disbursed and reconciled to energy efficiency expenditures annually. Any over or under collection will be included in the GSBC rate determination for the following year. The additional revenues collected through the GSBC will not impact income from operations.

On August 22, 2008 in Case 06-G-1266 the NYPSC approved our request filed on October 16, 2006 for deferral of uncollectible cost in excess of the amount allowed in rates for the fiscal year ended September 30, 2006. The deferral authorization was \$271,090. The recovery of this amount will occur over a commission approved recovery plan to be deferred in rate case 08-G-0708. This will have no impact on the Company's earnings.

On August 22, 2008 in Case 06-G-0064 the NYPSC denied our request filed on January 12, 2007 for deferral of interest cost in excess of the amount allowed in rates for the fiscal year ended September 30, 2006. The deferral request was \$573,183. The Company on September 14, 2008 petitioned for re-hearing of the Commission decision in Case 06-G-0064 on the grounds that the Commission erred in its conclusion the interest expense was neither incremental nor extraordinary and therefore did not qualify for deferral and recovery under current Commission guidelines. Action by the Commission on the Company's re-hearing request is still pending and is unknown at this time.

On September 16, 2008 we filed a petition with the NYPSC to remove the restriction on Corning from paying common stock dividends and repurchasing common stock imposed in Case 07-G-0772. We believe that the Commission may act on our request in March 2009.

Critical Accounting Policies

Our significant accounting policies are described in the notes to the Consolidated Financial Statements. It is increasingly important to understand that 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. The most significant principles that impact us are discussed below.

Accounting for Utility Revenue and Cost of Gas Recognition.

We record 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. We do not accrue revenue for gas delivered but not yet billed. We do not currently anticipate adopting unbilled revenue recognition and we do not believe it would have a material impact on our financial results. Our tariffs contain mechanisms that provide for the recovery of the cost of gas applicable to firm customers, which includes estimates. Under these mechanisms, we periodically adjust our rates to reflect increases and decreases in the cost of gas. Annually, we reconcile the difference between the total gas costs collected from customers and the cost of gas. We defer any excess or deficiency and subsequently either recover it from, or refund 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 our business is subject to regulation. Our regulated utility records the results of its regulated activities in accordance with 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 our financial statements related to pension and other post-retirement benefits are determined on an actuarial basis, therefore certain assumptions are required to calculate those 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. However, we expect to recover our entire net periodic pension and other post-retirement benefit costs attributed to employees in our utility segment in accordance with the applicable NYPSC 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. Although we believe that the expectations reflected in these forward-looking statements are based on reasonable assumptions, we can give no assurance that our expectations will be achieved. As forward looking statements, these statements involve risks, uncertainties and other factors that could cause actual results to differ materially from the expected results. Accordingly, actual results may differ materially from those expressed in any forward looking statements. Factors that could cause results to differ materially from our management's expectations include, but are not limited to, those listed under Item 1A - "Risk Factors" of our Form 10-K, in addition to:

- * the effect of any interruption in our supply of natural gas or a substantial increase in the price of natural gas,
- * our ability to successfully negotiate new supply agreements for natural gas as they expire, on terms favorable to us, or at all,
- * the effect on our operations of weather conditions and conservation efforts by our customers,
- * the effect on our operations of any action by the New York Public Service Commission,
- * the effect on our operations of unexpected changes in any other applicable legal or regulatory requirements,
- * our ability to obtain additional equity or debt financing,
- * our ability to retain the services of our senior executives and other key employees, and
- * our vulnerability to adverse general economic and industry conditions and competition.

Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update any forward-looking statement in light of new information or future events.

Item 4T - Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of December 31, 2008, the Company's management, with the participation of the Company's chief executive officer and chief financial officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Based upon the Company's evaluation, the Company's chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures are effective as of December 31, 2008.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that was conducted during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

The Company's management, including our chief executive officer and chief financial officer, do not expect that our disclosure controls or our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II.

OTHER INFORMATION

Item 1. Legal Proceedings

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We did not become a party to or settle any legal proceedings in the quarter ended December 31, 2008.

Item 1A. Risk Factors.

Please refer to the Company's Form 10-K for the year ended September 30, 2008 for disclosure relating to certain risk factors applicable to the Company. The Company has no material changes to the risk factor disclosure contained in its Form 10-K for the year ended September 30, 2008.

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

None

Item 3. Defaults Upon Senior Securities.

None

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

None

Item 5. Other Information.

None

Item 6. Exhibits.

31.1* Certification of the Chief Executive Officer and President pursuant to 17 CFR Section 240.13a-14

K1.2* Certification of the Chief Financial Officer and Treasurer pursuant to 17 CFR Section 240.13a-14

K2.1* Certification of the Chief Executive Officer and the 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.

CORNING NATURAL GAS CORPORATION

Date: February 6, 2008 _____

By Michael I.
German, Chief
Executive Officer
and President

Date: February 6, 2008 _____

By Firouzeh
Sarhangi, Chief
Financial Officer
and Treasurer