

SOUTHWEST GAS CORP
Form 10-Q
August 06, 2014

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 June 30, 2014

Commission File Number 1-7850

SOUTHWEST GAS CORPORATION
(Exact name of registrant as specified in its charter)

California
(State or other jurisdiction of
incorporation or organization)
5241 Spring Mountain Road

88-0085720
(I.R.S. Employer
Identification No.)
89193-8510

Post Office Box 98510

Las Vegas, Nevada
(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (702) 876-7237

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, non-accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

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

Common Stock, \$1 Par Value, 46,512,597 shares as of July 29, 2014.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SOUTHWEST GAS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Thousands of dollars, except par value)

(Unaudited)

	JUNE 30, 2014	DECEMBER 31, 2013
ASSETS		
Utility plant:		
Gas plant	\$ 5,398,729	\$ 5,252,469
Less: accumulated depreciation	(1,928,978)	(1,868,504)
Acquisition adjustments, net	640	730
Construction work in progress	74,884	101,413
Net utility plant	3,545,275	3,486,108
Other property and investments	267,763	260,871
Restricted cash	16,649	
Current assets:		
Cash and cash equivalents	26,890	41,077
Accounts receivable, net of allowances	183,472	219,469
Accrued utility revenue	31,600	72,700
Income taxes receivable, net	4,283	3,790
Deferred income taxes		31,130
Deferred purchased gas costs	80,441	18,217
Prepays and other current assets	83,805	108,289
Total current assets	410,491	494,672
Deferred charges and other assets	322,111	323,523
Total assets	\$ 4,562,289	\$ 4,565,174

CAPITALIZATION AND LIABILITIES

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Capitalization:

Common stock, \$1 par (authorized - 60,000,000 shares; issued and outstanding - 46,503,111 and 46,356,125 shares)	\$ 48,133	\$ 47,986
Additional paid-in capital	844,851	840,521
Accumulated other comprehensive income (loss), net	(39,638)	(41,698)
Retained earnings	613,760	567,714
Total Southwest Gas Corporation equity	1,467,106	1,414,523
Noncontrolling interest	(2,214)	(2,128)
Total equity	1,464,892	1,412,395
Long-term debt, less current maturities	1,365,926	1,381,327
Total capitalization	2,830,818	2,793,722
Current liabilities:		
Current maturities of long-term debt	23,741	11,105
Accounts payable	94,400	183,511
Customer deposits	72,896	73,367
Accrued general taxes	35,657	39,681
Accrued interest	18,187	17,920
Deferred income taxes	5,566	
Other current liabilities	132,165	108,580
Total current liabilities	382,612	434,164
Deferred income taxes and other credits:		
Deferred income taxes and investment tax credits	663,470	674,411
Taxes payable		284
Accumulated removal costs	291,000	279,000
Other deferred credits	394,389	383,593
Total deferred income taxes and other credits	1,348,859	1,337,288
Total capitalization and liabilities	\$ 4,562,289	\$ 4,565,174

The accompanying notes are an integral part of these statements.

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SOUTHWEST GAS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

(Unaudited)

	THREE MONTHS ENDED		SIX MONTHS ENDED		TWELVE MONTHS ENDED	
	JUNE 30,		JUNE		JUNE 30,	
	2014	2013	2014	2013	2014	2013
Operating revenues:						
Gas operating revenues	\$ 271,479	\$ 238,869	\$ 757,972	\$ 732,469	\$ 1,325,657	\$ 1,267,567
Construction revenues	181,674	172,705	303,577	292,610	661,595	617,877
Total operating revenues	453,153	411,574	1,061,549	1,025,079	1,987,252	1,885,444
Operating expenses:						
Net cost of gas sold	97,985	69,388	289,362	269,996	455,367	414,892
Operations and maintenance	97,620	94,935	200,028	192,022	392,920	374,267
Depreciation and amortization	62,186	58,570	125,077	117,503	244,391	231,225
Taxes other than income taxes	10,965	11,073	22,421	22,868	45,104	44,131
Construction expenses	157,642	148,700	270,841	255,388	588,737	532,106
Total operating expenses	426,398	382,666	907,729	857,777	1,726,519	1,596,621
Operating income	26,755	28,908	153,820	167,302	260,733	288,823
Other income and (expenses):						
Net interest deductions	(17,305)	(15,290)	(34,824)	(31,168)	(67,356)	(63,777)
Other income (deductions)	2,863	1,452	4,475	5,521	11,254	6,994
Total other income and (expenses)	(14,442)	(13,838)	(30,349)	(25,647)	(56,102)	(56,783)
Income before income taxes	12,313	15,070	123,471	141,655	204,631	232,040
Income tax expense	2,686	5,003	43,147	50,914	70,175	83,607
Net income	9,627	10,067	80,324	90,741	134,456	148,433
Net income (loss) attributable to noncontrolling interest		(41)	(86)	(140)	(393)	(536)
	\$ 9,627	\$ 10,108	\$ 80,410	\$ 90,881	\$ 134,849	\$ 148,969

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Net income attributable to Southwest Gas Corporation												
Basic earnings per share	\$	0.21	\$	0.22	\$	1.73	\$	1.96	\$	2.91	\$	3.22
Diluted earnings per share	\$	0.21	\$	0.22	\$	1.71	\$	1.95	\$	2.88	\$	3.19
Dividends declared per share	\$	0.365	\$	0.330	\$	0.730	\$	0.660	\$	1.390	\$	1.250
Average number of common shares outstanding		46,502		46,331		46,471		46,291		46,407		46,214
Average shares outstanding (assuming dilution)		46,948		46,757		46,910		46,704		46,860		46,654

The accompanying notes are an integral part of these statements.

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SOUTHWEST GAS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Thousands of dollars)

(Unaudited)

	THREE MONTHS ENDED		SIX MONTHS ENDED		TWELVE MONTHS ENDED	
	JUNE 30, 2014	JUNE 30, 2013	JUNE 30, 2014	JUNE 30, 2013	JUNE 30, 2014	JUNE 30, 2013
Net income	\$ 9,627	\$ 10,067	\$ 80,324	\$ 90,741	\$ 134,456	\$ 148,433
Other comprehensive income (loss), net of tax						
Defined benefit pension plans:						
Net actuarial gain (loss)					62,214	(46,409)
Amortization of prior service cost	55	54	110	109	221	109
Amortization of transition obligation						270
Amortization of net actuarial loss	3,666	5,298	7,333	10,596	17,927	18,530
Prior service cost						(1,502)
Regulatory adjustment	(3,210)	(4,702)	(6,420)	(9,404)	(73,667)	24,366
Net defined benefit pension plans	511	650	1,023	1,301	6,695	(4,636)
Forward-starting interest rate swaps:						
Amounts reclassified into net income	519	519	1,037	1,037	2,074	2,074
Net forward-starting interest rate swaps	519	519	1,037	1,037	2,074	2,074
Total other comprehensive income (loss), net of tax	1,030	1,169	2,060	2,338	8,769	(2,562)
Comprehensive income	10,657	11,236	82,384	93,079	143,225	145,871
Comprehensive income (loss) attributable to noncontrolling interest		(41)	(86)	(140)	(393)	(536)
Comprehensive income attributable to Southwest Gas Corporation	\$ 10,657	\$ 11,277	\$ 82,470	\$ 93,219	\$ 143,618	\$ 146,407

The accompanying notes are an integral part of these statements.

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SOUTHWEST GAS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Thousands of dollars)

(Unaudited)

	SIX MONTHS ENDED JUNE 30		TWELVE MONTHS ENDED JUNE 30	
	2014	2013	2014	2013
CASH FLOW FROM OPERATING ACTIVITIES:				
Net income	\$ 80,324	\$ 90,741	\$ 134,456	\$ 148,433
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	125,077	117,503	244,391	231,225
Deferred income taxes	24,493	45,781	47,351	73,824
Changes in current assets and liabilities:				
Accounts receivable, net of allowances	35,997	36,649	(23,208)	(5,436)
Accrued utility revenue	41,100	41,600	(1,200)	(1,200)
Deferred purchased gas costs	(62,224)	(64,376)	(108,991)	(88,324)
Accounts payable	(91,674)	(53,924)	(10,082)	22,746
Accrued taxes	(4,801)	(2,452)	(1,424)	4,100
Other current assets and liabilities	46,238	24,088	27,234	(23,204)
Gains on sale	(4,137)	(2,285)	(5,964)	(7,031)
Changes in undistributed stock compensation	3,766	3,855	6,869	5,839
AFUDC and property-related changes	(1,024)	(1,002)	(2,296)	(2,231)
Changes in other assets and deferred charges	(15,150)	(16,393)	(20,476)	(22,582)
Changes in other liabilities and deferred credits	19,462	(4,564)	41,775	3,931
Net cash provided by operating activities	197,447	215,221	328,435	340,090
CASH FLOW FROM INVESTING ACTIVITIES:				
Construction expenditures and property additions	(175,444)	(151,877)	(387,843)	(371,207)
Restricted cash	(16,649)		(16,649)	
Changes in customer advances	8,947	3,127	13,593	13,900
Miscellaneous inflows	7,060	4,905	10,620	13,766
Miscellaneous outflows				(969)
Net cash used in investing activities	(176,086)	(143,845)	(380,279)	(344,510)
CASH FLOW FROM FINANCING ACTIVITIES:				
Issuance of common stock, net	237	1,357	515	1,626
Dividends paid	(32,316)	(28,947)	(62,904)	(56,169)

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Issuance of long-term debt, net	17,719	41,673	287,336	130,387
Retirement of long-term debt	(10,716)	(101,269)	(46,460)	(205,269)
Change in credit facility and commercial paper	(10,000)	8,000	(119,000)	119,000
Other	(472)		1,527	
Net cash provided by (used in) financing activities	(35,548)	(79,186)	61,014	(10,425)
Change in cash and cash equivalents	(14,187)	(7,810)	9,170	(14,845)
Cash and cash equivalents at beginning of period	41,077	25,530	17,720	32,565
Cash and cash equivalents at end of period	\$ 26,890	\$ 17,720	\$ 26,890	\$ 17,720
Supplemental information:				
Interest paid, net of amounts capitalized	\$ 31,787	\$ 29,116	\$ 61,401	\$ 60,103
Income taxes paid	12,246	3,531	15,565	4,608

The accompanying notes are an integral part of these statements.

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June 30, 2014**Note 1 Nature of Operations and Basis of Presentation**

Nature of Operations. Southwest Gas Corporation and its subsidiaries (the Company) consist of two segments: natural gas operations (Southwest or the natural gas operations segment) and construction services. Southwest is engaged in the business of purchasing, distributing, and transporting natural gas for customers in portions of Arizona, Nevada, and California. Public utility rates, practices, facilities, and service territories of Southwest are subject to regulatory oversight. All of Southwest's service territories have decoupled rate structures, which are designed to mitigate the impacts of weather variability and conservation on operating margin. The timing and amount of rate relief can materially impact results of operations. Natural gas sales are seasonal, peaking during the winter months; therefore, results of operations for interim periods are not necessarily indicative of results for a full year. Natural gas purchases and the timing of related recoveries can materially impact liquidity. NPL Construction Co. (NPL or the construction services segment), a wholly owned subsidiary, is a full-service underground piping contractor that primarily provides utility companies with trenching and installation, replacement, and maintenance services for energy distribution systems. Typically, NPL revenues are lowest during the first quarter of the year due to unfavorable winter weather conditions. Operating revenues typically improve as more favorable weather conditions occur during the summer and fall months.

Basis of Presentation. The condensed consolidated financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to such rules and regulations. The preparation of the condensed consolidated financial statements 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. Actual results could differ from those estimates. In the opinion of management, all adjustments, consisting of normal recurring items and estimates necessary for a fair presentation of results for the interim periods, have been made. It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the 2013 Annual Report to Shareholders, which is incorporated by reference into the 2013 Form 10-K, and the first quarter 2014 Form 10-Q.

Prepays and other current assets. Prepays and other current assets includes gas pipe inventory and operating supplies of \$23 million at June 30, 2014 and \$21 million at December 31, 2013.

Cash and Cash Equivalents. For purposes of reporting consolidated cash flows, cash and cash equivalents include cash on hand and financial instruments with a purchase-date maturity of three months or less. Cash and cash equivalents fall within Level 1 (quoted prices for identical financial instruments) of the three-level fair value hierarchy that ranks the inputs used to measure fair value by their reliability. Upon contract expiration, customer advances of approximately \$5.6 million and \$4.8 million, during the first six months of 2014 and 2013, respectively, were applied as contributions toward utility construction activity and represent non-cash investing activity.

Intercompany Transactions. NPL recognizes revenues generated from contracts with Southwest (see **Note 3 - Segment Information** below). Accounts receivable for these services are presented in the table below (thousands of dollars):

	June 30, 2014	December 31, 2013
Accounts receivable for NPL services	\$ 10,786	\$ 10,787

The accounts receivable balance, revenues, and associated profits are included in the condensed consolidated financial statements of the Company and were not eliminated during consolidation in accordance with accounting treatment for rate-regulated entities.

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Other Property and Investments. Other property and investments includes (millions of dollars):

	June 30, 2014	December 31, 2013
NPL property and equipment	\$ 332	\$ 320
NPL accumulated provision for depreciation and amortization	(172)	(163)
Net cash surrender value of COLI policies	96	93
Other property	12	11
Total	\$ 268	\$ 261

Other Income (Deductions). The following table provides the composition of significant items included in Other income (deductions) in the condensed consolidated statements of income (thousands of dollars):

	Three Months Ended June 30		Six Months Ended June 30		Twelve Months Ended June 30	
	2014	2013	2014	2013	2014	2013
Change in COLI policies	\$ 2,300	\$ 1,800	\$ 3,200	\$ 5,600	\$ 10,000	\$ 8,900
Interest income	612	144	1,109	264	1,306	683
Pipe replacement costs		(36)		(121)	(11)	(1,759)
Miscellaneous income and (expense)	(49)	(456)	166	(222)	(41)	(830)
Total other income (deductions)	\$ 2,863	\$ 1,452	\$ 4,475	\$ 5,521	\$ 11,254	\$ 6,994

Included in the table above is the change in cash surrender values of company-owned life insurance (COLI) policies (including net death benefits recognized). These life insurance policies on members of management and other key employees are used by Southwest to indemnify itself against the loss of talent, expertise, and knowledge, as well as to provide indirect funding for certain nonqualified benefit plans. Current tax regulations provide for tax-free treatment of life insurance (death benefit) proceeds. Therefore, changes in the cash surrender value components of COLI policies, as they progress towards the ultimate death benefits, are also recorded without tax consequences. Pipe replacement costs include amounts associated with certain Arizona non-recoverable pipe replacement work. The replacement program work subject to non-recoverability was substantially completed in 2012.

Reclassifications. A reclassification was made to the prior year's financial information between two categories on the Condensed Consolidated Statements of Comprehensive Income to present it on a basis comparable with the current year's presentation, with no impact on comprehensive income overall.

Recently Issued Accounting Standards Update. In May 2014, the Financial Accounting Standards Board (FASB) issued the update Revenue from Contracts with Customers (Topic 606). The update replaces much of the current guidance regarding revenue recognition including most industry-specific guidance. The core principle of the update is

that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. An entity will be required to identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the entity satisfies a performance obligation. In addition to the new revenue recognition requirements, entities will be required to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Entities may choose between two retrospective transition methods when applying the update. The Company plans to adopt this update, as required, on January 1, 2017 for interim and annual reporting periods. Early adoption is not permitted. The Company is evaluating what impact this standard might have on its consolidated financial statements and disclosures.

Note 2 Components of Net Periodic Benefit Cost

Southwest has a noncontributory qualified retirement plan with defined benefits covering substantially all employees and a separate unfunded supplemental retirement plan (SERP) which is limited to officers. Southwest also provides postretirement benefits other than pensions (PBOP) to its qualified retirees for health care, dental, and life insurance.

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Net periodic benefit costs included in the table below are components of an overhead loading process associated with the cost of labor. The overhead process ultimately results in allocation of net periodic benefit costs to the same accounts to which productive labor is charged. As a result, net periodic benefit costs become components of various accounts, primarily operations and maintenance expense, net utility plant, and deferred charges and other assets.

Qualified Retirement Plan
Period Ended June 30,

(Thousands of dollars)	Three Months		Six Months		Twelve Months	
	2014	2013	2014	2013	2014	2013
Service cost	\$ 5,340	\$ 5,764	\$ 10,680	\$ 11,528	\$ 22,208	\$ 21,688
Interest cost	10,860	9,402	21,721	18,803	40,525	37,936
Expected return on plan assets	(13,335)	(12,460)	(26,671)	(24,920)	(51,591)	(47,810)
Amortization of net actuarial loss	5,718	8,065	11,436	16,131	27,566	28,072
Net periodic benefit cost	\$ 8,583	\$ 10,771	\$ 17,166	\$ 21,542	\$ 38,708	\$ 39,886

SERP
Period Ended June 30,

(Thousands of dollars)	Three Months		Six Months		Twelve Months	
	2014	2013	2014	2013	2014	2013
Service cost	\$ 73	\$ 93	\$ 146	\$ 187	\$ 332	\$ 324
Interest cost	436	384	872	767	1,640	1,582
Amortization of net actuarial loss	196	243	392	486	877	827
Net periodic benefit cost	\$ 705	\$ 720	\$ 1,410	\$ 1,440	\$ 2,849	\$ 2,733

PBOP
Period Ended June 30,

(Thousands of dollars)	Three Months		Six Months		Twelve Months	
	2014	2013	2014	2013	2014	2013
Service cost	\$ 275	\$ 305	\$ 551	\$ 610	\$ 1,161	\$ 1,098
Interest cost	708	621	1,415	1,241	2,656	2,515
Expected return on plan assets	(816)	(706)	(1,632)	(1,412)	(3,044)	(2,614)
Amortization of prior service cost	88	88	177	177	355	177
Amortization of transition obligation						434
Amortization of net actuarial loss		237		473	472	988
Net periodic benefit cost	\$ 255	\$ 545	\$ 511	\$ 1,089	\$ 1,600	\$ 2,598

Note 3 Segment Information

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The following tables present revenues from external customers, intersegment revenues, and segment net income (thousands of dollars):

	Natural Gas Operations	Construction Services	Total
Three months ended June 30, 2014			
Revenues from external customers	\$ 271,479	\$ 156,966	\$ 428,445
Intersegment revenues		24,708	24,708
		 	