

QUESTAR CORP
Form 10-Q
November 03, 2006

**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 quarter ended September 30, 2006

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

For the transition period from ___ to ___

Commission File Number 1-8796

QUESTAR CORPORATION

(Exact name of registrant as specified in charter)

STATE OF UTAH

(State or other jurisdiction of
incorporation or organization)

87-0407509

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

180 East 100 South Street, P.O. Box 45433 Salt Lake City, Utah 84145-0433

(Address of principal executive offices)

Registrant's telephone number, including area code **(801) 324-5000**

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

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

On October 31, 2006, 85,865,721 shares of the registrant's common stock, without par value, were outstanding.

#

Questar Corporation

Form 10-Q for the Quarter Ended September 30, 2006

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

QUESTAR CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	3 Months Ended September 30,		9 Months Ended September 30,	
	2006	2005	2006	2005
	(in thousands, except per share amounts)			
REVENUES				
Market Resources	\$427,907	\$446,746	\$1,227,094	\$1,105,980
Questar Pipeline	25,793	22,584	76,147	59,583
Questar Gas	98,975	109,575	747,767	604,308
Corporate and other operations	2,468	4,005	11,738	13,572
TOTAL REVENUES	555,143	582,910	2,062,746	1,783,443
OPERATING EXPENSES				
Cost of natural gas and other products sold	183,684	271,724	867,318	836,106
Operating and maintenance	69,514	67,057	211,867	187,116
General and administrative	34,083	31,112	96,693	93,842
Production and other taxes	27,832	30,864	87,168	83,499
Depreciation, depletion and amortization	78,808	63,542	224,831	182,174
Exploration	16,847	2,574	30,247	9,423
Abandonment and impairment of gas, oil and other properties	1,955	1,712	5,497	4,610
TOTAL OPERATING EXPENSES	412,723	468,585	1,523,621	1,396,770
OPERATING INCOME	142,420	114,325	539,125	386,673

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Net gain on asset sales	25,328	1,128	25,509	4,722
Interest and other income	3,709	3,935	9,685	5,914
Income from unconsolidated affiliates	1,801	1,910	5,333	5,131
Net unrealized mark-to-market loss on basis swaps net	(5,140)		(10,754)	
Loss on early extinguishment of debt			(1,746)	
Interest expense	(17,814)	(17,869)	(55,006)	(51,234)
INCOME BEFORE INCOME TAXES	150,304	103,429	512,146	351,206
Income taxes	55,248	37,672	189,572	129,551
NET INCOME	\$ 95,056	\$ 65,757	\$ 322,574	\$ 221,655
EARNINGS PER COMMON SHARE				
Basic	\$ 1.11	\$ 0.78	\$ 3.78	\$ 2.62
Diluted	1.08	0.75	3.68	2.55
Weighted average common shares outstanding				
Used in basic calculation	85,544	84,930	85,388	84,674
Used in diluted calculation	87,706	87,353	87,558	87,043
Dividends per common share	\$ 0.235	\$ 0.225	\$ 0.695	\$ 0.665

See notes accompanying the consolidated financial statements

QUESTAR CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2006	December 31, 2005
	(in thousands)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 77,707	\$ 13,360
Accounts receivable, net	223,507	355,810
Unbilled gas accounts receivable	13,947	86,161
Federal income tax recoverable	18,940	11,274
Derivative collateral deposits		5,150
Fair value of derivative contracts	104,709	1,972
Inventories, at lower of average cost or market		
Gas and oil storage	81,193	90,718
Materials and supplies	64,734	34,699
Prepaid expenses and other	24,045	30,110
Purchased-gas adjustments		39,852
Deferred income taxes - current		86,734
Total current assets	608,782	755,840
Property, plant and equipment	6,086,099	5,527,997
Less accumulated depreciation, depletion and amortization	2,251,751	2,100,455
Net property, plant and equipment	3,834,348	3,427,542
Investment in unconsolidated affiliates	37,437	30,681
Goodwill	70,719	71,260
Fair value of derivative contracts	51,990	
Regulatory assets	34,017	32,767
Other noncurrent assets, net	39,852	38,983
	\$4,677,145	\$4,357,073
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Short-term debt		\$ 94,500
Accounts payable and accrued expenses	\$ 373,500	526,196
Questar Gas customer-credit balances	32,367	30,829
Fair value of derivative contracts	13,201	222,049
Purchased-gas adjustments	29,292	

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Deferred income taxes - current	20,446	
Total current liabilities	468,806	873,574
Long-term debt, less current portion	1,032,394	983,200
Deferred income taxes	763,888	624,187
Asset retirement obligations	110,224	78,123
Pension and post-retirement benefits	56,692	61,049
Fair value of derivative contracts	176	99,044
Other long-term liabilities	113,289	88,093
Common shareholders' equity		
Common stock	403,942	383,298
Retained earnings	1,648,832	1,385,783
Accumulated other comprehensive income (loss)	78,902	(219,278)
Total common shareholders' equity	2,131,676	1,549,803
	\$4,677,145	\$4,357,073

See notes accompanying the consolidated financial statements

QUESTAR CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	9 Months Ended September 30, 2006 2005 (in thousands)	
OPERATING ACTIVITIES		
Net income	\$ 322,574	\$ 221,655
Adjustments to reconcile net income to net cash provided from operating activities:		
Depreciation, depletion and amortization	230,895	187,293
Deferred income taxes	65,166	72,997
Share-based compensation	6,907	2,990
Abandonment and impairment of gas, oil and other properties	5,497	4,610
Income from unconsolidated affiliates	(5,333)	(5,131)
Distributed income from unconsolidated affiliates	4,902	4,342
Net gain on asset sales	(25,509)	(4,722)
Net unrealized mark-to-market loss on basis swaps	10,754	
Loss on early extinguishment of debt	1,746	
Ineffective portion of fixed-price swaps	(106)	390
Changes in operating assets and liabilities	116,499	(179,313)
NET CASH PROVIDED FROM OPERATING ACTIVITIES	733,992	305,111
INVESTING ACTIVITIES		
Capital expenditures		
Property, plant and equipment	(597,716)	(481,124)
Other investments	(6,325)	(6,787)
Total capital expenditures	(604,041)	(487,911)
Proceeds from disposition of assets	29,489	15,960
NET CASH USED IN INVESTING ACTIVITIES	(574,552)	(471,951)
FINANCING ACTIVITIES		
Common stock issued	9,272	15,809
Common stock repurchased	(5,469)	(9,246)
Long-term debt issued, net of issue costs	246,953	200,000
Long-term debt repaid	(200,012)	(8)
Early extinguishment of debt costs	(1,746)	

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Change in short-term debt	(94,500)	24,000
Dividends paid	(59,525)	(56,432)
Excess tax benefits from share-based compensation	9,934	
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	(95,093)	174,123
	64,347	7,283
Change in cash and cash equivalents		
Beginning cash and cash equivalents	13,360	3,681
Ending cash and cash equivalents	\$ 77,707	\$ 10,964

See notes accompanying the consolidated financial statements

NOTES ACCOMPANYING THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Nature of Business

Questar Corporation (Questar or the Company) is a natural gas-focused energy company with four major lines of business – gas and oil exploration and production, midstream field services, interstate gas transportation, and retail gas distribution – which are conducted through its three principal subsidiaries:

Questar Market Resources, Inc. (Market Resources) is a sub-holding company that operates through four principal subsidiaries. Questar Exploration and Production Company (Questar E&P) explores for, acquires, develops and produces natural gas, oil and NGL. Wexpro Company (Wexpro) manages, develops and produces cost-of-service reserves for gas utility affiliate Questar Gas. Questar Gas Management Company (Gas Management) provides midstream field services including natural gas-gathering and processing services for affiliates and third parties. Questar Energy Trading Company (Energy Trading) markets equity and third-party natural gas and oil, provides risk-management services and owns and operates an underground gas-storage reservoir.

Questar Pipeline Company (Questar Pipeline) provides interstate natural gas transportation and storage services.

Questar Gas Company (Questar Gas) provides retail natural gas distribution.

Note 2 Summary of Significant Accounting Policies

Basis of Presentation of Interim Consolidated Financial Statements

The interim consolidated financial statements contain the accounts of Questar and its majority-owned or controlled subsidiaries. The consolidated financial statements were prepared in accordance with U.S. generally accepted accounting principles (GAAP) and with the instructions for quarterly reports on Form 10-Q and Regulations S-X and S-K. All significant intercompany accounts and transactions have been eliminated in consolidation.

The consolidated financial statements reflect all normal, recurring adjustments and accruals that are, in the opinion of management, necessary for a fair presentation of financial position and results of operations for the interim periods presented. Interim consolidated financial statements do not include all of the information and notes required by GAAP for audited annual consolidated financial statements. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005. Certain reclassifications were made to prior period financial statements to conform with the current presentation.

The preparation of consolidated financial statements and notes in conformity with GAAP requires that management make estimates and assumptions that affect the amounts of assets and liabilities and disclosure of contingent assets and liabilities. Actual results could differ from estimates. The results of operations for the nine months ended September 30, 2006, are not necessarily indicative of the results that may be expected for the year ending December 31, 2006, due to a variety of factors discussed in the Forward-Looking Statements located in Item 3 of this report.

Derivative Collateral Deposits

Derivative collateral deposits represent cash collateral deposited with counterparties under the terms of derivative agreements. Some counterparties may require the Company to deposit cash collateral when the derivatives under these agreements are out-of-the-money by an amount that exceeds counterparty credit limits. The deposits are restricted until either the derivative transaction returns to in-the-money status or the open position is settled.

Investment in Unconsolidated Affiliates

Questar uses the equity method to account for investment in unconsolidated affiliates where it does not have control, but has significant influence. Generally, the investment in unconsolidated affiliates on the Company's Consolidated Balance Sheets equals the Company's proportionate share of equity reported by the unconsolidated affiliates. Investment is assessed for possible impairment when events indicate that the fair value of the investment may be below the Company's carrying value. When such a condition is deemed to be other than temporary, the carrying value of the investment is written down to its fair value, and the amount of the write-down is included in net income.

Property, Plant and Equipment

Capitalized exploratory well costs

The Company capitalizes exploratory well costs until it determines whether the well is commercial or noncommercial. If the Company deems the well commercial, capitalized costs are depreciated on a field basis using the unit-of-production method and the estimated proved developed gas and oil reserves. If the Company concludes that the well is noncommercial, well costs are immediately charged to exploration expense. Exploratory well costs capitalized for a period greater than one year since the completion of drilling are expensed unless the Company remains engaged in substantial activities to assess whether the well is commercial.

Depreciation, depletion and amortization

Capitalized proved leasehold costs are depleted on a field-by-field basis using the unit-of-production method and the estimated proved gas and oil reserves. Oil and NGL volumes are converted to natural gas equivalents using the ratio of one barrel of crude oil, condensate or NGL to 6,000 cubic feet of natural gas. Capitalized costs of exploratory wells that have found proved gas and oil reserves and capitalized development costs are depreciated using the unit-of-production method based on estimated proved developed reserves on a field basis. The Company capitalizes an estimate of the fair value of future abandonment costs. Future abandonment costs, less estimated future salvage values, are depreciated over the life of the related asset using a unit-of-production method.

Note 3 Earnings Per Share (EPS)

Basic EPS is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the reporting period. Diluted EPS includes the potential increase in the number of outstanding shares that could result from the exercise of in-the-money stock options plus an estimated number of nonvested restricted shares:

3 Months Ended	9 Months Ended
September 30,	September 30,

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	2006	2005	2006	2005
	(in thousands)			
Weighted-average basic common shares				
outstanding	85,544	84,930	85,388	84,674
Potential number of shares issuable from exercising stock options and from nonvested restricted shares	2,162	2,423	2,170	2,369
Weighted-average diluted common shares				
outstanding	87,706	87,353	87,558	87,043

Questar issued 614,000 and 964,000 shares for the Long-Term Stock Incentive Plan (LTSIP) and other plans in the first nine months of 2006 and 2005, respectively.

Employee Investment Plan (EIP)

The EIP allows eligible employees to purchase shares of Questar common stock or other investments through payroll deduction at the current fair market value on the transaction date. The

Company currently contributes an overall match of 80% of employees pre-tax purchases up to a maximum of 6% of their qualifying earnings. In addition, the Company contributes \$200 annually to the EIP for each eligible employee. The EIP trustee purchases Questar shares on the open market as cash contributions are received. The Company recognizes expense equal to its contributions which amounted to \$4.9 million and \$4.5 million for the nine months ended September 30, 2006 and 2005, respectively.

Note 4 Share-Based Compensation

Questar issues stock options and restricted shares to certain officers, employees and non-employee directors under its LTSIP. Prior to January 1, 2006, the Company accounted for share-based compensation using the intrinsic value method prescribed by Accounting Principles Board Opinion (APBO) 25 Accounting for Stock Issued to Employees and related interpretations. No compensation cost was recorded for stock options issued because the exercise price equaled the market price on the date of grant. The granting of restricted shares resulted in recognition of compensation cost. Restricted shares are valued at the grant-date market price and amortized to expense over the vesting period.

The Company implemented Statement of Financial Accounting Standards 123R Share Based Payment, (SFAS 123R) effective January 1, 2006, and chose the modified prospective phase-in method. The modified prospective phase-in method requires recognition of compensation costs for all share-based payments granted, modified or settled after January 1, 2006, as well as for any awards that were granted prior to the implementation date for which the required service has not yet been performed. As a result of adopting SFAS 123R, the Company's income before income taxes and net income for the nine months ended September 30, 2006, were approximately \$1.3 million and \$0.8 million lower, respectively, than if the Company had continued to account for share-based compensation under APBO 25. Share-based compensation reduced basic and diluted earnings per share for the nine months ended September 30, 2006, by \$0.05 per share. Share-based compensation associated with unvested restricted shares for the nine months ended September 30, 2006 and 2005, amounted to \$5.6 million and \$3.0 million, respectively. At September 30, 2006, deferred share-based compensation amounted to \$15.7 million, of which \$3.6 million was attributed to unvested stock options.

SFAS 123R requires the benefits of tax deductions in excess of recognized compensation expense resulting from the exercise of share-based awards be reported in the financing activities section of the Condensed Consolidated Statements of Cash Flow. For the nine months ended September 30, 2006, this requirement reduced net cash provided from operating activities and reduced net cash used in financing activities by \$9.9 million.

The following table shows pro forma net income had stock options been expensed in the prior period based on a fair value calculated using the Black-Scholes-Merton model:

3 Months Ended	9 Months Ended
September 30,	September 30,

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	2005	2005
	(in thousands)	
Net income, as reported	\$65,757	\$221,655
Deduct after-tax share-based compensation		
expense under fair-value based method	(402)	(1,206)
Pro forma net income	\$65,355	\$220,449

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Earnings per share

Basic, as reported	\$ 0.78	\$ 2.62
Basic, pro forma	0.77	2.60
Diluted, as reported	0.75	2.55
Diluted, pro forma	\$ 0.75	\$ 2.53

Long-Term Stock Incentive Plan

There were 5,352,091 shares available for future grant at September 30, 2006. The Company granted restricted shares but did not grant stock options in the first nine months of 2006. Transactions involving stock options in the LTSIP in the first nine months of 2006 are summarized below:

	Outstanding Options	Price Range	Weighted- Average Price
Balance at January 1, 2006	3,251,988	\$15.00 - \$77.14	\$27.82
Exercised	(482,445)	15.00 - 35.10	\$3.87
Balance at September 30, 2006	2,769,543	\$15.00 - \$77.14	\$28.51

Unvested stock options declined by 230,686 to 232,689 in the first nine months of 2006.

Range of exercise prices	Options Outstanding			Options Exercisable		Unvested Options	
	Number outstanding at Sept. 30, 2006	Weighted-average remaining term in years	Weighted-average exercise price	Number exercisable at Sept. 30, 2006	Weighted-average exercise price	Number unvested at Sept. 30, 2006	Weighted average exercise price
\$15.00 \$17.00	435,052	3.2	\$15.43	435,052	\$15.43		
19.13 23.95	632,420	4.7	22.75	632,420	22.75		
	1,438,132	5.5	27.48	1,438,132	27.48		

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27.11							
29.71							
\$35.10	263,939	6.6	69.52	31,250	45.95	232,689	\$72.69
77.14							
	2,769,543	5.1					