

QUESTAR CORP
Form 10-Q
November 04, 2005

**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, 2005

**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 of other jurisdiction of
incorporation or organization)

87-0407509

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

Edgar Filing: QUESTAR CORP - Form 10-Q

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**

Not Applicable

(Former name or former address, if changed since last report)

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

No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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.

Class

Outstanding as of October 31, 2005

Common Stock, without Par

85,280,492 Shares

Value with attached Common

Stock Purchase Rights

Questar Corporation

Form 10-Q for the Quarterly Period Ended September 30, 2005

TABLE OF CONTENTS

Page No.

NATURE OF BUSINESS

3

FORWARD-LOOKING STATEMENTS AND RISK FACTORS

3

GLOSSARY OF COMMONLY USED TERMS

5

SEC FILINGS AND WEBSITE INFORMATION

8

PART I.

FINANCIAL INFORMATION

9

Item 1.

Financial Statements

9

Consolidated Statements of Income for the three and nine months ended

September 30, 2005 and 2004

9

Condensed Consolidated Balance Sheets at September 30, 2005

and December 31, 2004

10

Condensed Consolidated Statements of Cash Flows for the nine months ended

September 30, 2005 and 2004

11

Notes Accompanying the Consolidated Financial Statements

12

Item 2.

Management's Discussion and Analysis of Financial Condition and

Results of Operations

18

Item 3.

Quantitative and Qualitative Disclosures about Market Risk

33

Item 4.

Controls and Procedures

36

PART II.

OTHER INFORMATION

Item 1.

Legal Proceedings

36

Item 2.

Unregistered Sales of Equity Securities and Use of Proceeds

36

Item 6.

Exhibits

37

Signatures

37

NATURE OF BUSINESS

Questar Corporation (Questar or the Company), is a natural gas-focused energy company with three principal lines of business – gas and oil exploration and production, interstate gas transportation, and retail gas distribution. Questar Market Resources (Market Resources) subsidiaries engage in gas and oil exploration; development and production; gas gathering and processing; wholesale gas and oil marketing; and gas storage. Questar Pipeline Company (Questar Pipeline) provides interstate natural gas transportation and storage services. Questar Gas Company (Questar Gas) provides retail natural gas distribution.

Questar is a holding company, as that term is defined in the Public Utility Holding Company Act of 1935, because Questar Gas is a natural gas utility. Questar, however, qualifies for and claims an exemption from provisions of the act applicable to registered holding companies. Questar conducts most of its operations through subsidiaries. The parent-holding company performs certain management, legal, tax, administrative and other services for its subsidiaries.

Questar operates in the Rocky Mountain and Midcontinent regions of the United States of America and is headquartered in Salt Lake City, Utah. Shares of Questar common stock trade on the New York Stock Exchange under the symbol STR.

FORWARD-LOOKING STATEMENTS AND RISK FACTORS

This report includes forward-looking statements within the meaning of Section 27(a) of the Securities Act of 1933, as amended, and Section 21(e) of the Securities Exchange Act of 1934 as amended. All statements other than statements of historical facts included or incorporated by reference in this report, including, without limitation, statements regarding the Company's future financial position, business strategy, budgets, projected costs and plans and objectives of management for future operations, are forward-looking statements. In addition forward-looking statements generally can be identified by the use of forward-looking terminology such as may, will, could, expect, intend, estimate, anticipate, believe, forecast, or continue or the negative thereof or variations thereon or similar terminology. Although these statements are made in good faith and are reasonable representations of Questar's expected performance at the time, actual results may vary from management's stated expectations and projections due to a variety of factors.

Important assumptions and other significant factors that could cause actual results to differ materially from those expressed or implied in forward-looking statements include, but are not limited to, the following:

Questar subsidiaries find, produce and sell natural gas, oil and natural gas liquids (NGL)

Edgar Filing: QUESTAR CORP - Form 10-Q

Natural gas, oil and NGL prices are volatile and, therefore, Questar revenues, cash flow and earnings can be volatile. The Company cannot predict future natural gas, oil and NGL prices, which are subject to forces beyond its control such as:

- Domestic and foreign supply of and demand for natural gas and oil;
- Regional basis differential due to pipeline-capacity constraints;
- Domestic and global economic conditions;
- Weather;
- Domestic and foreign government regulations;
- The price and availability of alternative fuels; and
- The costs and availability of drilling rigs and other materials and services.

The Company uses financial contracts to hedge its exposure to volatile natural gas, oil and NGL prices and to protect cash flow, returns on capital, net income and credit ratings from downward commodity-price movements. While hedging reduces the impact of declining prices, it may also limit future revenues from favorable price movements. Questar believes the Company's regulated businesses—interstate natural gas transportation and retail gas distribution and its Wexpro subsidiary generate revenues that are not significantly sensitive to short-term fluctuations in natural gas, oil and NGL prices.

Questar's profitability depends not only on prevailing prices for natural gas, oil and NGL, but also the Company's ability to find, develop and acquire gas and oil reserves that are economically recoverable. Substantial capital expenditures are required to find, develop and acquire gas and oil reserves to replace those depleted by production.

Estimating gas and oil reserves, production and future net cash flow is difficult

Questar Exploration and Production's proved natural gas and oil reserve estimates are prepared annually by independent reservoir-engineering consultants. Gas and oil reserve estimates are subject to numerous uncertainties inherent in estimating quantities of proved reserves, projecting future rates of production and timing of development expenditures. The accuracy of these estimates depends on the quality of available data and on engineering and geological interpretation and judgment. Reserve estimates are imprecise and will change as additional information becomes available. Estimates of economically recoverable reserves and future net cash flows prepared by different engineers, or by the same engineers at different times may vary significantly. Results of subsequent drilling, testing and production may cause either upward or downward revisions of previous estimates. In addition the estimates of future net revenues from proved reserves and the present value of those reserves are based upon certain assumptions about production levels, prices and costs, which may change. The volumes considered to be commercially recoverable fluctuate with changes in prices and operating costs. The meaningfulness of such estimates depends on the accuracy of the assumptions upon which they were based. Actual results may differ materially from the estimated results.

Drilling is a high-risk activity

Operating risks include: blow-outs; fire; unexpected drilling conditions such as uncontrollable flows of gas, oil, formation water or drilling fluids; abandonment costs; explosions; pipe, cement or casing failures; oil spills; natural gas leaks and discharges of toxic gases. The Company could incur substantial losses as a result of injury or loss of life; environmental damage; destruction of property; fines; or curtailment of operations. The Company maintains insurance against some, but not all, of these potential risks and losses.

Questar must comply with numerous regulations from the federal, state and local level

Questar is subject to federal, state and local environmental, health and safety laws and regulations. Environmental laws and regulations are complex, change frequently and have become more onerous over time. In addition to the costs of compliance, the Company may incur substantial costs to take corrective actions at both owned and previously owned facilities. Accidental spills and leaks requiring cleanup may occur in the ordinary course of business. As standards change the Company may incur significant costs in cases where past operations followed practices that were considered acceptable at the time but that now require remedial work to meet current standards. Failure to comply with these laws and regulations may result in fines, significant costs for remedial activities, or injunctions.

Questar must comply with numerous and complex regulations governing activities on federal and state lands in the Rocky Mountain region, notably the National Environmental Policy Act, the Endangered Species Act and the National Historic Preservation Act. Federal and state agencies frequently impose conditions on the Company's activities. These restrictions tend to become more stringent over time, and can limit or prevent the Company from exploring for, finding and producing natural gas, oil and NGL on its Rockies leaseholds. Certain environmental groups oppose drilling on some of the Company's federal and state leases.

Various federal agencies within the U.S. Department of the Interior, particularly the Minerals Management Service and the Bureau of Indian Affairs, along with each Native American tribe, promulgate and enforce regulations pertaining to gas and oil operations on Native American tribal lands. These regulations include such matters as lease provisions, drilling and production requirements, environmental standards and royalty considerations. In addition each Native American tribe is a sovereign nation having the right to enforce laws and regulations independent from federal, state and local statutes and regulations. These tribal laws and regulations include various taxes, fees, requirements to employ Native American tribal members, and other conditions that apply to lessees, operators and contractors conducting operations on Native American tribal lands. Finally lessees and operators conducting operations on tribal lands are generally subject to the Native American tribal court system. One or more of these factors may increase Questar's costs of doing business on Native American tribal lands and have an impact on the viability of its gas and oil operations on such lands.

Questar Pipeline's natural gas transportation and storage operations are regulated by the Federal Energy Regulatory Commission (FERC) under the Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978. The FERC has authority to: set rates for natural gas transportation, storage and related services; set rules governing business relationships between the pipeline subsidiary and its affiliates; approve new pipeline and storage-facility construction; and establish policies and procedures for accounting, purchase, sale, abandonment and other activities. FERC policies may adversely affect Questar Pipeline profitability. The FERC also has various affiliate rules that may cause the Company to incur additional costs of compliance.

Both Questar Pipeline and Questar Gas incur significant costs to comply with federal pipeline-safety regulations. Questar may also be affected by possible future regulations requiring the tracking, reporting and reduction of greenhouse-gas emissions.

State agencies regulate the distribution of natural gas

Questar Gas's natural gas-distribution business is regulated by the Public Service Commission of Utah (PSCU) and the Public Service Commission of Wyoming (PSCW). These commissions set rates for distribution services and establish policies and procedures for services, accounting, purchase, sale and other activities. PSCU and PSCW policies may adversely affect Questar Gas profitability.

Other factors may affect Questar's results

Other factors may affect Questar's results such as changes in general economic conditions; changes in regulation; availability and economic viability of gas and oil properties for sale or exploration; creditworthiness of counterparties; rate of inflation and interest rates; assumptions used in business combinations; weather and natural disasters; changes in customers' credit ratings; competition from other forms of energy, other pipelines and storage facilities; effects of accounting policies issued periodically by accounting standard-setting bodies; terrorist attacks or acts of war; changes in the business or financial condition of the Company; changes in credit ratings; and availability of financing for Questar and its subsidiaries.

The Company cannot predict these factors nor can it assess the impact, if any, of such factors on its financial position or its results of operations. Accordingly forward-looking statements should not be relied upon as a predictor of actual results. Questar undertakes no obligation to update any forward-looking statement provided in this report.

GLOSSARY OF COMMONLY USED TERMS

bbl

Barrel, which is equal to 42 U.S. gallons and is a common unit of measurement of crude oil.

basis

The difference between a reference or benchmark-commodity price and the corresponding sales price at various regional sales points.

bcf

One billion cubic feet, a common unit of measurement of natural gas.

bcfe

One billion cubic feet of natural gas equivalents. Oil volume is converted to natural gas equivalent using the ratio of one barrel of crude oil to 6,000 cubic feet of natural gas.

Btu

One British thermal unit – a measure of the amount of energy required to raise the temperature of one pound of water one degree Fahrenheit at sea level.

cash-flow hedge

A derivative instrument that complies with Statement of Financial Accounting Standards (SFAS) 133, as amended, and is used to reduce the exposure to variability in cash flows from the forecasted physical sale of gas and oil production whereby the gains (losses) on the derivative transaction are anticipated to offset the losses (gains) on the forecasted physical sale.

cf

Cubic foot is a common unit of gas measurement. One standard cubic foot equals the volume of gas in one cubic foot measured at standard conditions a temperature of 60 degrees Fahrenheit and a pressure of 30 inches of mercury (approximately 14.73 pounds per square inch).

development well

A well drilled into a known producing formation in a previously discovered field.

dew point

A specific temperature and pressure at which hydrocarbons condense to form a liquid.

dry hole

A well drilled and found to be incapable of producing hydrocarbons in sufficient quantities such that proceeds from the sale of production exceed expenses and taxes.

dth

Decatherms or ten therms. One dth equals one million Btu or approximately one Mcf.

exploratory well

A well drilled into a previously untested geologic prospect to determine the presence of gas or oil.

finding costs

Finding costs are the sum of costs incurred for gas and oil exploration and development activities; including leasehold acquisitions, seismic, geological and geophysical, development and exploration drilling and asset-retirement obligations for a given period, divided by the total amount of estimated net proved reserves added through discoveries,

positive and negative revisions of previous estimates and purchases in place for the same period. The Company expresses finding costs in dollars per Mcfe averaged over a five-year period.

frac spread

The difference in sales price of NGL s extracted from the gas stream and the prices of a Btu-equivalent volume of gas to replace the extracted liquids.

futures contract

An exchange-traded legal contract to buy or sell a standard quantity and quality of a commodity at a specified future date and price.

gas

All references to gas in this report refer to natural gas.

gross

Gross natural gas and oil wells or gross acres equal the total number of wells or acres in which the Company has a working interest.

heating-degree days

A measure of the number of degrees the average-daily outside temperature is below 65 degrees Fahrenheit.

hedging

The use of derivative-commodity and interest-rate instruments to reduce financial exposure to commodity-price and interest-rate volatility.

Mbbl

One thousand barrels.

Mcf

One thousand cubic feet.

Mcfe

One thousand cubic feet of natural gas equivalents.

Mdth

One thousand decatherms.

Mdthe

One thousand decatherms of natural gas equivalents.

MMbbl

One million barrels.

MMBtu

One million British thermal units.

MMcf

One million cubic feet.

MMcfe

One million cubic feet of natural gas equivalents.

MMdth

One million decatherms.

MMgal

One million U. S. gallons.

natural gas liquids

Liquid hydrocarbons that are extracted and separated from the natural gas

(NGL)

stream. NGL products include ethane, propane, butane, natural gasoline and heavier hydrocarbons.

net

Net gas and oil wells or net acres are determined by the sum of the fractional ownership working interest the Company has in those gross wells or acres.

production

The production replacement ratio is calculated by dividing the net proved

replacement ratio

reserves added through discoveries, positive and negative revisions of previous estimates and purchases and sales in-place for a given period by the production for the same period, expressed as a percentage. The production replacement ratio is typically reported on an annual basis.

proved reserves

Those quantities of natural gas, crude oil, condensate and NGL on a net revenue interest basis, which geological and engineering data demonstrate with reasonable certainty to be recoverable under existing economic and operating conditions. See 17 C.F.R. Section 4-10(a)(2) for a complete definition.

proved developed

Reserves that include proved developed producing reserves

reserves

and proved developed behind-pipe reserves. See 17 C.F.R. Section 4-10(a)(3).

proved developed

Reserves expected to be recovered from existing completion intervals in

producing reserves

existing wells.

proved undeveloped

Reserves expected to be recovered from new wells on proved undrilled acreage

reserves

or from existing wells where a relatively major expenditure is required for recompletion. See 17 C.F.R. Section 4-10(a)(4).

psia

Equals gauge pressure (see psig) plus local atmospheric pressure (in pounds per square inch). At sea level and standard temperature the absolute pressure is 14.7 pounds per square inch.

psig

Pounds per square inch gauge. The pressure in pounds per square inch as measured by a gauge.

reservoir

A porous and permeable underground formation containing a natural accumulation of producible natural gas and/or oil that is confined by impermeable rock or water barriers and is separate from other reservoirs.

wet gas

Unprocessed natural gas that contains a mixture of heavier hydrocarbons including ethane, propane, butane and natural gasoline.

working interest

An interest that gives the owner the right to drill, produce and conduct operating activities on a property and receive a share of any production.

SEC FILINGS AND WEBSITE INFORMATION

Questar, Market Resources, Questar Pipeline and Questar Gas file annual, quarterly, and current reports with the Securities and Exchange Commission (SEC). Questar also regularly files proxy statements and other documents with the SEC. Investors can read and copy any materials filed with the SEC at its Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549, and can obtain information about the operations of the Public Reference Room by calling the SEC at 1-800-SEC-0300. The SEC also maintains a website that contains information filed electronically that can be accessed over the Internet at www.sec.gov.

Investors can also access financial and other information for Questar at Questar's website at www.questar.com. Questar's website contains Statements of Responsibility for Board Committees, Corporate Governance Guidelines and its Business Ethics and Compliance Policy.

Questar and each of its reporting subsidiaries make available, free of charge, through the website copies of Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and any amendments to such reports and all reports filed by executive officers and directors under Section 16 of the Exchange Act reporting transactions in Questar securities. Access to these reports is provided as soon as reasonably practical after such reports are electronically filed with the SEC.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

QUESTAR CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	3 Months Ended		9 Months Ended	
	September 30,		September 30,	
	2005	2004	2005	2004
	(in thousands, except per share amounts)			
REVENUES				
Market Resources	\$446,746	\$255,264	\$1,105,980	\$ 733,678
Questar Pipeline	22,584	18,345	59,583	54,227
Questar Gas	109,575	80,962	604,308	490,076
Corporate and other operations	4,005	5,654	13,572	15,375
TOTAL REVENUES	582,910	360,225	1,783,443	1,293,356
OPERATING EXPENSES				
Cost of natural gas and other products sold	271,724	127,170	836,106	515,019
Operating and maintenance	98,169	81,313	280,958	242,296
Production and other taxes	30,864	22,087	83,499	67,581
Depreciation, depletion and amortization	63,542	52,566	182,174	160,243
Exploration	2,574	1,346	9,423	3,699
Abandonment and impairment of gas, oil and other properties	1,712	2,848	4,610	9,541
Questar Gas rate-refund obligation		1,095		4,090
TOTAL OPERATING EXPENSES	468,585	288,425	1,396,770	1,002,469
OPERATING INCOME	114,325	71,800	386,673	290,887
Interest and other income	5,063	1,835	10,636	4,725
Earnings from unconsolidated affiliates	1,910	1,021	5,131	3,595
Debt expense	(17,869)	(16,753)	(51,234)	(51,324)
INCOME BEFORE INCOME TAXES	103,429	57,903	351,206	247,883
Income taxes	37,672	20,962	129,551	92,253
NET INCOME	\$ 65,757	\$ 36,941	\$ 221,655	\$ 155,630

EARNINGS PER COMMON SHARE

Edgar Filing: QUESTAR CORP - Form 10-Q

Basic	\$ 0.78	\$ 0.44	\$ 2.62	\$ 1.86
Diluted	0.75	0.43	2.55	1.82
Weighted average common shares outstanding				
Used in basic calculation	84,930	83,864	84,674	83,627
Used in diluted calculation	87,353	85,882	87,043	85,496
Dividends per common share	\$ 0.225	\$ 0.215	\$ 0.665	\$ 0.635

See notes accompanying the consolidated financial statements

QUESTAR CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2005	December 31, 2004
	(Unaudited)	
	(in thousands)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 10,964	\$ 3,681
Accounts receivable, net	268,586	262,373
Unbilled gas accounts receivable	17,475	59,160
Hedging collateral deposits	243,270	
Fair value of hedging contracts	30	9,334
Inventories, at lower of average cost or market		
Gas and oil storage	77,173	66,944
Materials and supplies	31,675	18,993
Prepaid expenses and other	19,730	23,690
Purchased-gas adjustments	18,301	35,853
Deferred income taxes - current	151,945	6,968
Total current assets	839,149	486,996
Property, plant and equipment	5,322,500	4,877,771
Less accumulated depreciation, depletion and amortization	2,045,649	1,893,111

Edgar Filing: QUESTAR CORP - Form 10-Q

Net property, plant and equipment	3,276,851	2,984,660
Investment in unconsolidated affiliates	40,805	33,229
Goodwill	71,260	71,260
Regulatory assets	31,284	32,120
Other noncurrent assets, net	35,327	45,361
	\$4,294,676	\$3,653,626
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Short-term debt	\$ 92,000	\$ 68,000
Accounts payable and accrued expenses	369,220	348,264
Questar Gas customer-credit balances	36,061	24,771
Rate-refund obligations	1,009	25,343
Fair value of hedging contracts	420,580	64,179
Total current liabilities	918,870	530,557
Long-term debt, less current portion	1,133,200	933,195
Deferred income taxes	581,908	553,401
Asset-retirement obligations	72,722	67,288
Pension and post-retirement benefits	43,133	47,919
Fair value of hedging contracts	147,545	14,471
Other long-term liabilities	81,764	67,237
Common shareholders' equity		
Common stock	379,507	358,017
Retained earnings	1,300,941	1,135,718
Accumulated other comprehensive loss	(364,914)	(54,177)
Total common shareholders' equity	1,315,534	1,439,558
	\$4,294,676	\$3,653,626

See notes accompanying the consolidated financial statements

QUESTAR CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

Edgar Filing: QUESTAR CORP - Form 10-Q

9 Months Ended
September 30,
2005 2004
(in thousands)

OPERATING ACTIVITIES

Net income	\$ 221,655	\$ 155,630
Adjustments to reconcile net income to net cash provided from operating activities:		
Depreciation, depletion and amortization	185,856	167,615
Deferred income taxes	72,997	65,064
Amortization of nonvested shares	2,990	1,723
Abandonment and impairment of gas, oil and other properties	4,610	9,541
Earnings from unconsolidated affiliates, net of cash distributions	(789)	1,046
Net gain from asset sales	(4,722)	(76)
Other	390	218
	482,987	400,761
Changes in operating assets and liabilities	(177,876)	(6,479)
NET CASH PROVIDED FROM OPERATING ACTIVITIES	305,111	394,282

INVESTING ACTIVITIES

Capital expenditures		
Property, plant and equipment	(481,124)	(265,593)
Other investments	(6,787)	(1,000)
Total capital expenditures	(487,911)	(266,593)
Proceeds from disposition of assets	15,960	