

NATIONAL FUEL GAS CO
Form 10-Q
February 07, 2014
Table of Contents

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, 2013

OR

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 1-3880

NATIONAL FUEL GAS COMPANY

Edgar Filing: NATIONAL FUEL GAS CO - Form 10-Q

(Exact name of registrant as specified in its charter)

New Jersey
(State or other jurisdiction of
incorporation or organization)

13-1086010
(I.R.S. Employer
Identification No.)

6363 Main Street
Williamsville, New York
(Address of principal executive offices)

14221
(Zip Code)

(716) 857-7000

(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 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" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer

Non-Accelerated Filer

(Do not check if a smaller reporting company)

Accelerated
Filer
Smaller
Reporting
Company

Edgar Filing: NATIONAL FUEL GAS CO - Form 10-Q

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, par value \$1.00 per share, outstanding at January 31, 2014: 83,771,511 shares.

Table of Contents

GLOSSARY OF TERMS

Frequently used abbreviations, acronyms, or terms used in this report:

National Fuel Gas Companies

Company	The Registrant, the Registrant and its subsidiaries or the Registrant's subsidiaries as appropriate in the context of the disclosure
Distribution Corporation	National Fuel Gas Distribution Corporation
Empire	Empire Pipeline, Inc.
Horizon Power	Horizon Power, Inc.
Midstream Corporation	National Fuel Gas Midstream Corporation
National Fuel	National Fuel Gas Company
NFR	National Fuel Resources, Inc.
Registrant	National Fuel Gas Company
Seneca	Seneca Resources Corporation
Supply Corporation	National Fuel Gas Supply Corporation

Regulatory Agencies

CFTC	Commodity Futures Trading Commission
EPA	United States Environmental Protection Agency
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
NYDEC	New York State Department of Environmental Conservation
NYPSC	State of New York Public Service Commission
PaDEP	Pennsylvania Department of Environmental Protection
PaPUC	Pennsylvania Public Utility Commission
SEC	Securities and Exchange Commission

Other

Edgar Filing: NATIONAL FUEL GAS CO - Form 10-Q

Bbl	Barrel (of oil)
Bcf	Billion cubic feet (of natural gas)
Bcfe (or Mcfe) – represents Bcf (or Mcf) Equivalent	The total heat value (Btu) of natural gas and oil expressed as a volume of natural gas. The Company uses a conversion formula of 1 barrel of oil = 6 Mcf of natural gas.
Btu	British thermal unit; the amount of heat needed to raise the temperature of one pound of water one degree Fahrenheit
Capital expenditure	Represents additions to property, plant, and equipment, or the amount of money a company spends to buy capital assets or upgrade its existing capital assets.
Cashout revenues	A cash resolution of a gas imbalance whereby a customer pays Supply Corporation and/or Empire for gas the customer receives in excess of amounts delivered into Supply Corporation's and Empire's systems by the customer's shipper.
Degree day	A measure of the coldness of the weather experienced, based on the extent to which the daily average temperature falls below a reference temperature, usually 65 degrees Fahrenheit.
Derivative	A financial instrument or other contract, the terms of which include an underlying variable (a price, interest rate, index rate, exchange rate, or other variable) and a notional amount (number of units, barrels, cubic feet, etc.). The terms also permit for the instrument or contract to be settled net and no initial net investment is required to enter into the financial instrument or contract. Examples include futures contracts, options, no cost collars and swaps.

Table of Contents

Development costs	Costs incurred to obtain access to proved oil and gas reserves and to provide facilities for extracting, treating, gathering and storing the oil and gas
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act.
Dth	Decatherm; one Dth of natural gas has a heating value of 1,000,000 British thermal units, approximately equal to the heating value of 1 Mcf of natural gas.
Exchange Act	Securities Exchange Act of 1934, as amended
Expenditures for long-lived assets	Includes capital expenditures, stock acquisitions and/or investments in partnerships.
Exploration costs	Costs incurred in identifying areas that may warrant examination, as well as costs incurred in examining specific areas, including drilling exploratory wells.
FERC 7(c) application	An application to the FERC under Section 7(c) of the federal Natural Gas Act for authority to construct, operate (and provide services through) facilities to transport or store natural gas in interstate commerce.
Firm transportation and/or storage	The transportation and/or storage service that a supplier of such service is obligated by contract to provide and for which the customer is obligated to pay whether or not the service is utilized.
GAAP	Accounting principles generally accepted in the United States of America
Goodwill	An intangible asset representing the difference between the fair value of a company and the price at which a company is purchased.
Hedging	A method of minimizing the impact of price, interest rate, and/or foreign currency exchange rate changes, often times through the use of derivative financial instruments.
Hub	Location where pipelines intersect enabling the trading, transportation, storage, exchange, lending and borrowing of natural gas.
ICE	Intercontinental Exchange. An exchange which maintains a futures market for crude oil and natural gas.
Interruptible transportation and/or storage	The transportation and/or storage service that, in accordance with contractual arrangements, can be interrupted by the supplier of such service, and for which the customer does not pay unless utilized.
LDC	Local distribution company
LIBOR	London Interbank Offered Rate
LIFO	Last-in, first-out
Marcellus Shale	A Middle Devonian-age geological shale formation that is present nearly a mile or more below the surface in the Appalachian region of the United States, including much of Pennsylvania and southern New York.
Mbbl	Thousand barrels (of oil)
Mcf	Thousand cubic feet (of natural gas)
MD&A	Management's Discussion and Analysis of Financial Condition and Results of Operations
MDth	Thousand decatherms (of natural gas)
MMBtu	Million British thermal units (heating value of one decatherm of natural gas)
MMcf	Million cubic feet (of natural gas)
NGA	The Natural Gas Act of 1938, as amended; the federal law regulating interstate natural gas pipeline and storage companies, among other things, codified beginning at 15 U.S.C. Section 717.
NYMEX	New York Mercantile Exchange. An exchange which maintains a futures market for crude oil and natural gas.

Table of Contents

Open Season	A bidding procedure used by pipelines to allocate firm transportation or storage capacity among prospective shippers, in which all bids submitted during a defined time period are evaluated as if they had been submitted simultaneously.
Precedent Agreement	An agreement between a pipeline company and a potential customer to sign a service agreement after specified events (called “conditions precedent”) happen, usually within a specified time.
Proved developed reserves	Reserves that can be expected to be recovered through existing wells with existing equipment and operating methods.
Proved undeveloped (PUD) reserves	Reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a

Reserves	relatively major expenditure is required to make these reserves productive. The unproduced but recoverable oil and/or gas in place in a formation which has been proven by production.
Revenue decoupling mechanism	A rate mechanism which adjusts customer rates to render a utility financially indifferent to throughput decreases resulting from conservation.
S&P	Standard & Poor's Rating
SAR	Service Stock appreciation right
Service agreement	The binding agreement by which the pipeline company agrees to provide service and the shipper agrees to pay for the service.
Stock acquisitions	Investments in corporations
VEBA	Voluntary Employees' Beneficiary Association
WNC	Weather normalization clause; a clause in utility rates which adjusts customer rates to

allow a utility to recover its normal operating costs calculated at normal temperatures. If temperatures during the measured period are warmer than normal, customer rates are adjusted upward in order to recover projected operating costs. If temperatures during the measured period are colder than normal, customer rates are adjusted downward so that only the projected operating costs will be recovered.

Table of Contents

INDEX

<u>Part I. Financial Information</u>	Page
<u>Item 1. Financial Statements (Unaudited)</u>	
<u>a. Consolidated Statements of Income and Earnings Reinvested in the Business - Three Months Ended December 31, 2013 and 2012</u>	6
<u>b. Consolidated Statements of Comprehensive Income – Three Months Ended December 31, 2013 and 2012</u>	7
<u>c. Consolidated Balance Sheets – December 31, 2013 and September 30, 2013</u>	8 – 9
<u>d. Consolidated Statements of Cash Flows – Three Months Ended December 31, 2013 and 2012</u>	10
<u>e. Notes to Condensed Consolidated Financial Statements</u>	11 – 27
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	27 – 45
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	46
<u>Item 4. Controls and Procedures</u>	46
 <u>Part II. Other Information</u>	
<u>Item 1. Legal Proceedings</u>	46
<u>Item 1 A. Risk Factors</u>	46
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	47
<u>Item 3. Defaults Upon Senior Securities</u>	•
<u>Item 4. Mine Safety Disclosures</u>	•
<u>Item 5. Other Information</u>	•
<u>Item 6. Exhibits</u>	47 – 48
<u>Signatures</u>	49

•The Company has nothing to report under this item.

Reference to "the Company" in this report means the Registrant or the Registrant and its subsidiaries collectively, as appropriate in the context of the disclosure. All references to a certain year in this report are to the Company’s fiscal year ended September 30 of that year, unless otherwise noted.

Table of Contents

Part I. Financial Information

Item 1. Financial Statements

National Fuel Gas Company

Consolidated Statements of Income and Earnings

Reinvested in the Business

(Unaudited)

(Thousands of Dollars, Except Per Common Share Amounts)	Three Months Ended	
	December 31, 2013	2012
INCOME		
Operating Revenues	\$ 550,072	\$ 452,854
Operating Expenses		
Purchased Gas	167,605	121,919
Operation and Maintenance	107,846	107,732
Property, Franchise and Other Taxes	20,926	19,664
Depreciation, Depletion and Amortization	93,114	72,331
	389,491	321,646
Operating Income	160,581	131,208
Other Income (Expense):		
Interest Income	702	1,386
Other Income	228	1,415
Interest Expense on Long-Term Debt	(22,885)	(21,448)
Other Interest Expense	(949)	(1,068)
Income Before Income Taxes	137,677	111,493
Income Tax Expense	55,425	43,549
Net Income Available for Common Stock	82,252	67,944

EARNINGS REINVESTED IN THE BUSINESS

Balance at Beginning of Period	1,442,617	1,306,284
	1,524,869	1,374,228
Dividends on Common Stock	(31,403)	(30,463)
Balance at December 31	\$ 1,493,466	\$ 1,343,765
Earnings Per Common Share:		
Basic:		
Net Income Available for Common Stock	\$ 0.98	\$ 0.81
Diluted:		
Net Income Available for Common Stock	\$ 0.97	\$ 0.81
Weighted Average Common Shares Outstanding:		
Used in Basic Calculation	83,707,687	83,390,278
Used in Diluted Calculation	84,659,001	84,006,050
Dividends Per Common Share:		
Dividends Declared	\$ 0.375	\$ 0.365

See Notes to Condensed Consolidated Financial Statements

Table of Contents

National Fuel Gas Company

Consolidated Statements of Comprehensive Income

(Unaudited)

(Thousands of Dollars)	Three Months Ended December 31,	
	2013	2012
Net Income Available for Common Stock	\$ 82,252	\$ 67,944
Other Comprehensive Income (Loss), Before Tax:		
Unrealized Gain on Securities Available for Sale Arising During the Period	2,498	789
Unrealized Gain on Derivative Financial Instruments Arising During the Period	2,778	35,350
Reclassification Adjustment for Realized Gains on Derivative Financial Instruments in Net Income	(10,183)	(11,584)
Other Comprehensive Income (Loss), Before Tax	(4,907)	24,555
Income Tax Expense Related to Unrealized Gain on Securities Available for Sale Arising During the Period	925	295
Income Tax Expense Related to Unrealized Gain on Derivative Financial Instruments Arising During the Period	1,271	14,738
Reclassification Adjustment for Income Tax Expense on Realized Gains from Derivative Financial Instruments in Net Income	(4,299)	(4,854)
Income Taxes – Net	(2,103)	10,179
Other Comprehensive Income (Loss)	(2,804)	14,376
Comprehensive Income	\$ 79,448	\$ 82,320

See Notes to Condensed Consolidated Financial Statements

7

Table of Contents

National Fuel Gas Company

Consolidated Balance Sheets

(Unaudited)

	December 31, 2013	September 30, 2013
(Thousands of Dollars)		
ASSETS		
Property, Plant and Equipment	\$ 7,468,200	\$ 7,313,203
Less - Accumulated Depreciation, Depletion and Amortization	2,242,521	2,161,477
	5,225,679	5,151,726
Current Assets		
Cash and Temporary Cash Investments	23,880	64,858
Hedging Collateral Deposits	-	1,094
Receivables – Net of Allowance for Uncollectible Accounts of \$31,445 and \$27,144 Respectively	164,074	133,182
Unbilled Revenue	80,828	19,483
Gas Stored Underground	36,047	51,484
Materials and Supplies - at average cost	27,364	29,904
Unrecovered Purchased Gas Costs	9,001	12,408
Other Current Assets	45,197	56,905
Deferred Income Taxes	23,127	79,359
	409,518	448,677
Other Assets		
Recoverable Future Taxes	162,296	163,355
Unamortized Debt Expense	16,065	16,645
Other Regulatory Assets	257,697	252,568
Deferred Charges	9,818	9,382
Other Investments	99,433	96,308

Edgar Filing: NATIONAL FUEL GAS CO - Form 10-Q

Goodwill	5,476	5,476
Prepaid Post-Retirement Benefit Costs	24,865	22,774
Fair Value of Derivative Financial Instruments	53,678	48,989
Other	459	2,447
	629,787	617,944
Total Assets	\$ 6,264,984	\$ 6,218,347

See Notes to Condensed Consolidated Financial Statements

8

Table of Contents

National Fuel Gas Company

Consolidated Balance Sheets

(Unaudited)

	December 31, 2013	September 30, 2013
(Thousands of Dollars)		
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Comprehensive Shareholders' Equity		
Common Stock, \$1 Par Value		
Authorized - 200,000,000 Shares; Issued And Outstanding - 83,741,402 Shares and 83,661,969 Shares, Respectively		
	\$ 83,741	\$ 83,662
Paid in Capital	695,571	687,684
Earnings Reinvested in the Business	1,493,466	1,442,617
Accumulated Other Comprehensive Loss	(22,038)	(19,234)
Total Comprehensive Shareholders' Equity	2,250,740	2,194,729
Long-Term Debt, Net of Current Portion	1,649,000	1,649,000
Total Capitalization	3,899,740	3,843,729
Current and Accrued Liabilities		
Notes Payable to Banks and Commercial Paper	-	-
Current Portion of Long-Term Debt	-	-
Accounts Payable	121,615	105,283
Amounts Payable to Customers	8,884	12,828
Dividends Payable	31,403	31,373
Interest Payable on Long-Term Debt	18,195	29,960
Customer Advances	18,678	21,959
Customer Security Deposits	15,690	16,183
Other Accruals and Current Liabilities	102,709	83,946
Fair Value of Derivative Financial Instruments	7,161	639
	324,335	302,171
Deferred Credits		
Deferred Income Taxes	1,318,577	1,347,007
Taxes Refundable to Customers	84,781	85,655
Unamortized Investment Tax Credit	1,470	1,579

Edgar Filing: NATIONAL FUEL GAS CO - Form 10-Q

Cost of Removal Regulatory Liability	163,238	157,622
Other Regulatory Liabilities	69,897	61,549
Pension and Other Post-Retirement Liabilities	139,664	158,014
Asset Retirement Obligations	120,122	119,511
Other Deferred Credits	143,160	141,510
	2,040,909	2,072,447
Commitments and Contingencies	-	-
Total Capitalization and Liabilities	\$ 6,264,984	\$ 6,218,347

See Notes to Condensed Consolidated Financial Statements

9

Table of Contents

National Fuel Gas Company

Consolidated Statements of Cash Flows

(Unaudited)

(Thousands of Dollars)	Three Months Ended December 31,	
	2013	2012
OPERATING ACTIVITIES		
Net Income Available for Common Stock	\$ 82,252	\$ 67,944
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation, Depletion and Amortization	93,114	72,331
Deferred Income Taxes	30,093	41,000
Excess Tax Benefits Associated with Stock-Based Compensation Awards	(3,149)	-
Stock-Based Compensation	2,960	3,302
Other	(2,095)	4,621
Change in:		
Hedging Collateral Deposits	1,094	364
Receivables and Unbilled Revenue	(92,261)	(55,261)
Gas Stored Underground and Materials and Supplies	17,977	3,941
Unrecovered Purchased Gas Costs	3,407	-
Other Current Assets	12,764	7,013
Accounts Payable	39,382	6,163
Amounts Payable to Customers	(3,944)	(4,686)
Customer Advances	(3,281)	(1,987)
Customer Security Deposits	(493)	984
Other Accruals and Current Liabilities	12,347	(5,667)
Other Assets	(6,268)	(597)
Other Liabilities	(7,205)	6,495
Net Cash Provided by Operating Activities	176,694	145,960
INVESTING ACTIVITIES		
Capital Expenditures	(194,920)	(162,981)
Other	3,615	(3,533)
Net Cash Used in Investing Activities	(191,305)	(166,514)

FINANCING ACTIVITIES

Changes in Notes Payable to Banks and Commercial Paper	-	67,000
Excess Tax Benefits Associated with Stock-Based Compensation Awards	3,149	-
Dividends Paid on Common Stock	(31,373)	(60,879)
Net Proceeds from Issuance of Common Stock	1,857	956
Net Cash Provided by (Used in) Financing Activities	(26,367)	7,077
Net Decrease in Cash and Temporary Cash Investments	(40,978)	(13,477)
Cash and Temporary Cash Investments at October 1	64,858	74,494
Cash and Temporary Cash Investments at December 31	\$ 23,880	\$ 61,017
Supplemental Disclosure of Cash Flow Information		
Non-Cash Investing Activities:		
Non-Cash Capital Expenditures	\$ 52,738	\$ 86,144

See Notes to Condensed Consolidated Financial Statements

Table of Contents

National Fuel Gas Company

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 1 - Summary of Significant Accounting Policies

Principles of Consolidation. The Company consolidates all entities in which it has a controlling financial interest. All significant intercompany balances and transactions are eliminated.

The preparation of the consolidated financial statements in conformity with GAAP 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.

Reclassifications. Certain prior year amounts have been reclassified to conform with current year presentation.

Earnings for Interim Periods. The Company, in its opinion, has included all adjustments (which consist of only normally recurring adjustments, unless otherwise disclosed in this Form 10-Q) that are necessary for a fair statement of the results of operations for the reported periods. The consolidated financial statements and notes thereto, included herein, should be read in conjunction with the financial statements and notes for the years ended September 30, 2013, 2012 and 2011 that are included in the Company's 2013 Form 10-K. The consolidated financial statements for the year ended September 30, 2014 will be audited by the Company's independent registered public accounting firm after the end of the fiscal year.

The earnings for the three months ended December 31, 2013 should not be taken as a prediction of earnings for the entire fiscal year ending September 30, 2014. Most of the business of the Utility and Energy Marketing segments is seasonal in nature and is influenced by weather conditions. Due to the seasonal nature of the heating business in the Utility and Energy Marketing segments, earnings during the winter months normally represent a substantial part of the earnings that those segments are expected to achieve for the entire fiscal year. The Company's business segments are discussed more fully in Note 7 – Business Segment Information.

Consolidated Statement of Cash Flows. For purposes of the Consolidated Statement of Cash Flows, the Company considers all highly liquid debt instruments purchased with a maturity of generally three months or less to be cash

equivalents.

Hedging Collateral Deposits. This is an account title for cash held in margin accounts funded by the Company to serve as collateral for hedging positions. At December 31, 2013, the Company did not have any hedging collateral deposits. At September 30, 2013, the Company had hedging collateral deposits of \$1.1 million related to its exchange-traded futures contracts. In accordance with its accounting policy, the Company does not offset hedging collateral deposits paid or received against related derivative financial instruments liability or asset balances.

Gas Stored Underground - Current. In the Utility segment, gas stored underground – current is carried at lower of cost or market, on a LIFO method. Gas stored underground – current normally declines during the first and second quarters of the year and is replenished during the third and fourth quarters. In the Utility segment, the current cost of replacing gas withdrawn from storage is recorded in the Consolidated Statements of Income and a reserve for gas replacement is recorded in the Consolidated Balance Sheets under the caption “Other Accruals and Current Liabilities.” Such reserve, which amounted to \$7.0 million at December 31, 2013, is reduced to zero by September 30 of each year as the inventory is replenished.

Property, Plant and Equipment. In the Company’s Exploration and Production segment, oil and gas property acquisition, exploration and development costs are capitalized under the full cost method of accounting. Under this methodology, all costs associated with property acquisition, exploration and development activities are capitalized, including internal costs directly identified with acquisition, exploration and development activities. The internal costs that are capitalized do not include any costs related to production, general corporate overhead, or similar activities. The Company does not recognize any gain or loss on the sale or other disposition of oil and gas properties unless the gain or loss would significantly alter the relationship between capitalized costs and proved reserves of oil and gas attributable to a cost center.

Capitalized costs include costs related to unproved properties, which are excluded from amortization until proved reserves are found or it is determined that the unproved properties are impaired. Such costs amounted to \$130.3 million and \$106.1 million at December 31, 2013 and September 30, 2013, respectively. All costs related to unproved properties

Table of Contents

are reviewed quarterly to determine if impairment has occurred. The amount of any impairment is transferred to the pool of capitalized costs being amortized.

Capitalized costs are subject to the SEC full cost ceiling test. The ceiling test, which is performed each quarter, determines a limit, or ceiling, on the amount of property acquisition, exploration and development costs that can be capitalized. The ceiling under this test represents (a) the present value of estimated future net cash flows, excluding future cash outflows associated with settling asset retirement obligations that have been accrued on the balance sheet, using a discount factor of 10%, which is computed by applying prices of oil and gas (as adjusted for hedging) to estimated future production of proved oil and gas reserves as of the date of the latest balance sheet, less estimated future expenditures, plus (b) the cost of unevaluated properties not being depleted, less (c) income tax effects related to the differences between the book and tax basis of the properties. The natural gas and oil prices used to calculate the full cost ceiling are based on an unweighted arithmetic average of the first day of the month oil and gas prices for each month within the twelve-month period prior to the end of the reporting period. If capitalized costs, net of accumulated depreciation, depletion and amortization and related deferred income taxes, exceed the ceiling at the end of any quarter, a permanent impairment is required to be charged to earnings in that quarter. At December 31, 2013, the ceiling exceeded the book value of the oil and gas properties by approximately \$166.9 million.

Accumulated Other Comprehensive Loss. The components of Accumulated Other Comprehensive Loss and changes for the three months ended December 31, 2013, net of related tax effect, are as follows (amounts in parentheses indicate debits) (in thousands):

Three Months Ended December 31, 2013

	Gains and Losses on Derivative Financial Instruments	Gains and Losses on Securities Available for Sale	Funded Status of the Pension and Other Post- Retirement Benefit Plans	Total
Balance at October 1, 2013	\$ 30,722	\$ 6,337	\$ (56,293)	\$ (19,234)
Other Comprehensive Gain Before Reclassifications	1,507	1,573	-	3,080

Amounts Reclassified From

Edgar Filing: NATIONAL FUEL GAS CO - Form 10-Q

Other Comprehensive Loss	(5,884)	-	-	(5,884)
Balance at December 31, 2013	\$ 26,345	\$ 7,910	\$ (56,293)	\$ (22,038)

Reclassifications Out of Accumulated Other Comprehensive Loss. The details about the reclassification adjustments out of accumulated other comprehensive loss for the three months ended December 31, 2013 are as follows (amounts in parentheses indicate debits to the income statement) (in thousands):

Three Months Ended December 31, 2013

Details About Accumulated Other Comprehensive Loss Components	Amount of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Loss	Affected Line Item in the Statement Where Net Income is Presented
Gains (Losses) on Derivative Financial Instrument Cash Flow Hedges:		
Commodity Contracts	\$ 9,787	Operating Revenues
Commodity Contracts	396	Purchased Gas
	10,183	Total Before Income Tax
	(4,299)	Income Tax Expense
	\$ 5,884	Net of Tax

Table of Contents

Other Current Assets. The components of the Company's Other Current Assets are as follows (in thousands):

	At December 31, 2013	At September 30, 2013
Prepayments	\$ 6,142	\$ 10,605
Prepaid Property and Other Taxes	16,106	13,079
Federal Income Taxes Receivable	-	1,122
State Income Taxes Receivable	-	3,275
Fair Values of Firm Commitments	-	1,829
Regulatory Assets	22,949	26,995
	\$ 45,197	\$ 56,905

Other Accruals and Current Liabilities. The components of the Company's Other Accruals and Current Liabilities are as follows (in thousands):

	At December 31, 2013	At September 30, 2013
Accrued Capital Expenditures	\$ 35,749	\$ 41,100
Regulatory Liabilities	17,597	20,013
Reserve for Gas Replacement	7,003	-
Federal Income Taxes Payable	14,563	-
State Income Taxes Payable	1,902	-
Other	25,895	22,833
	\$ 102,709	\$ 83,946

Earnings Per Common Share. Basic earnings per common share is computed by dividing net income available for common stock by the weighted average number of common shares outstanding for the period. Diluted earnings per common share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. For purposes of determining earnings per common share, the potentially dilutive securities the Company has outstanding are stock options, SARs, restricted stock units and performance shares. The diluted weighted average shares outstanding shown on the Consolidated Statements of

Income reflects the potential dilution as a result of these securities as determined using the Treasury Stock Method. Stock options, SARs, restricted stock units and performance shares that are antidilutive are excluded from the calculation of diluted earnings per common share. There were 272 and 422,681 securities excluded as being antidilutive for the quarters ended December 31, 2013 and 2012, respectively.

Stock-Based Compensation. The Company granted 116,090 performance shares during the quarter ended December 31, 2013. The weighted average fair value of such performance shares was \$67.16 per share for the quarter ended December 31, 2013. Performance shares represent an award constituting units denominated in common stock of the Company (or the equivalent value in cash, as determined by the Company), the number of which such units may be adjusted over a performance cycle based upon the extent to which performance goals have been satisfied. The performance shares do not entitle the participant to receive dividends during the vesting period.

Half of the performance shares granted during the quarter ended December 31, 2013 must meet a performance goal related to relative return on capital over the performance cycle of October 1, 2013 to September 30, 2016. The performance goal over the performance cycle is the Company's total return on capital relative to the total return on capital of other companies in a group selected by the Compensation Committee ("Report Group"). Total return on capital for a given company means the average of the Report Group companies' returns on capital for each twelve month period corresponding to each of the Company's fiscal years during the performance cycle, based on data reported for the Report Group companies in the Bloomberg database. The number of these performance shares that will vest and be paid will depend upon the Company's performance relative to the Report Group and not upon the absolute level of return achieved by the Company. The fair value of these performance shares is calculated by multiplying the expected number of shares that will be issued by the average market price of Company common stock on the date of grant reduced by the present value of forgone dividends over the vesting term of the award. The fair value is recorded as compensation expense over the vesting term of the award. The other half of the performance shares granted during the quarter ended December 31, 2013 must meet a performance goal related to total shareholder return over the performance cycle of October 1, 2013 to September 30, 2016. The performance goal over the performance cycle is the Company's three-year total shareholder return relative to the three-year total shareholder return of the other companies in the Report Group. Three-year

Table of Contents

shareholder return for a given company will be based on the data reported for that company (with the starting and ending stock prices over the performance cycle calculated as the average closing stock price for the prior calendar month and with dividends reinvested in that company's securities at each ex-dividend date) in the Bloomberg database. The number of these performance shares that will vest and be paid will depend upon the Company's performance relative to the Report Group and not upon the absolute level of return achieved by the Company. The fair value price at the date of grant for these performance shares is determined using a Monte Carlo simulation technique, which includes a reduction in value for the present value of forgone dividends over the vesting term of the award. This price is multiplied by the number of performance shares awarded, the result of which is recorded as compensation expense over the vesting term of the award.

The Company granted 80,951 non-performance based restricted stock units during the quarter ended December 31, 2013. The weighted average fair value of such non-performance based restricted stock units was \$65.23 per share for the quarter ended December 31, 2013. Restricted stock units represent the right to receive shares of common stock of the Company (or the equivalent value in cash or a combination of cash and shares of common stock of the Company, as determined by the Company) at the end of a specified time period. These non-performance based restricted stock units do not entitle the participant to receive dividends during the vesting period. The accounting for non-performance based restricted stock units is the same as the accounting for restricted share awards, except that the fair value at the date of grant of the restricted stock units must be reduced by the present value of forgone dividends over the vesting term of the award.

The Company did not grant any stock options, SARs or restricted share awards during the quarter ended December 31, 2013.

New Authoritative Accounting and Financial Reporting Guidance. In December 2011, the FASB issued authoritative guidance requiring enhanced disclosures regarding offsetting assets and liabilities. Companies are required to disclose both gross information and net information about instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. This authoritative guidance became effective for the quarter ended December 31, 2013 and there was no impact to the Company's consolidated financial statements and disclosures.

In February 2013, the FASB issued authoritative guidance requiring enhanced disclosures regarding the reporting of amounts reclassified out of accumulated other comprehensive income. The authoritative guidance requires parenthetical disclosure on the face of the financial statements or a single footnote that would provide more detail about the components of reclassification adjustments that are reclassified in their entirety to net income. If a component of a reclassification adjustment is not reclassified in its entirety to net income, a cross reference would be made to the footnote disclosure that provides a more thorough discussion of the component involved in that reclassification adjustment. This authoritative guidance became effective for the quarter ended December 31, 2013. The Company has updated its financial statements to reflect the new guidance.

Note 2 – Fair Value Measurements

The FASB authoritative guidance regarding fair value measurements establishes a fair-value hierarchy and prioritizes the inputs used in valuation techniques that measure fair value. Those inputs are prioritized into three levels. Level 1 inputs are unadjusted quoted prices in active markets for assets or liabilities that the Company can access at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly at the measurement date. Level 3 inputs are unobservable inputs for the asset or liability at the measurement date. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

The following table sets forth, by level within the fair value hierarchy, the Company's financial assets and liabilities (as applicable) that were accounted for at fair value on a recurring basis as of December 31, 2013 and September 30, 2013. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The fair value presentation for over the counter swaps has been changed to combine gas and oil swaps at both December 31, 2013 and September 30, 2013. In the September 30, 2013 Form 10-K, gas swaps were reported separately from oil swaps. This change in presentation was made because a significant number of the counterparties enter both gas and oil swap agreements with the Company.

Table of Contents

Recurring Fair Value Measures (Thousands of Dollars)	At fair value as of December 31, 2013				
	Level 1	Level 2	Level 3	Netting Adjustments(1)	Total(1)
Assets:					
Cash Equivalents – Money Market Mutual Funds	\$ 16,798	\$ -	\$ -	\$ -	\$ 16,798
Derivative Financial Instruments:					
Commodity Futures Contracts – Gas	2,928	-	-	(979)	1,949
Over the Counter Swaps – Gas and Oil	-	76,581	-	(24,852)	51,729
Other Investments:					
Balanced Equity Mutual Fund	33,674	-	-	-	33,674
Common Stock – Financial Services Industry	7,797	-	-	-	7,797
Other Common Stock	327	-	-	-	327
Hedging Collateral Deposits	-	-	-	-	-
Total	\$ 61,524	\$ 76,581	\$ -	\$ (25,831)	\$ 112,274
Liabilities:					
Derivative Financial Instruments:					
Commodity Futures Contracts – Gas	\$ 979	\$ -	\$ -	\$ (979)	\$ -
Over the Counter Swaps – Gas and Oil	-	30,171	1,842	(24,852)	7,161
Total	\$ 979	\$ 30,171	\$ 1,842	\$ (25,831)	\$ 7,161
Total Net Assets/(Liabilities)	\$ 60,545	\$ 46,410	\$ (1,842)	\$ -	\$ 105,113

Recurring Fair Value Measures (Thousands of Dollars)	At fair value as of September 30, 2013				
	Level 1	Level 2	Level 3	Netting Adjustments(1)	Total(1)
Assets:					
Cash Equivalents – Money Market Mutual Funds	\$ 51,332	\$ -	\$ -	\$ -	\$ 51,332
Derivative Financial Instruments:					
Commodity Futures Contracts – Gas	2,552	-	-	(1,641)	911
Over the Counter Swaps – Gas and Oil	-	57,070	-	(9,003)	48,067
Other Investments:					
Balanced Equity Mutual Fund	31,813	-	-	-	31,813
Common Stock – Financial Services Industry	6,544	-	-	-	6,544
Other Common Stock	330	-	-	-	330
Hedging Collateral Deposits	1,094	-	-	-	1,094

Edgar Filing: NATIONAL FUEL GAS CO - Form 10-Q

Total	\$ 93,665	\$ 57,070	\$ -	\$ (10,644)	\$ 140,091
Liabilities:					
Derivative Financial Instruments:					
Commodity Futures Contracts – Gas	\$ 1,641	\$ -	\$ -	\$ (1,641)	\$ -
Over the Counter Swaps – Gas and Oil	-	4,452	5,190	(9,003)	639
Total	\$ 1,641	\$ 4,452	\$ 5,190	\$ (10,644)	\$ 639
Total Net Assets/(Liabilities)	\$ 92,024	\$ 52,618	\$ (5,190)	\$ -	\$ 139,452

(1) Netting Adjustments represent the impact of legally-enforceable master netting arrangements that allow the Company to net gain and loss positions held with the same counterparties. The net asset or net liability for each counterparty is recorded as an asset or liability on the Company's balance sheet.

Derivative Financial Instruments

At December 31, 2013 and September 30, 2013, the derivative financial instruments reported in Level 1 consist of natural gas NYMEX and ICE futures contracts used in the Company's Energy Marketing segment. Hedging collateral deposits of \$1.1 million at September 30, 2013, which are associated with these futures contracts, have been reported in Level 1 as well. The derivative financial instruments reported in Level 2 at December 31, 2013 and September 30, 2013 consist of natural gas price swap agreements used in the Company's Exploration and Production and Energy Marketing

Table of Contents

segments and a portion of the crude oil price swap agreements used in the Company's Exploration and Production segment. The fair value of the Level 2 price swap agreements is based on an internal, discounted cash flow model that uses observable inputs (i.e. LIBOR based discount rates and basis differential information, if applicable, at active natural gas and crude oil trading markets). The derivative financial instruments reported in Level 3 consist of a portion of the crude oil price swap agreements used in the Company's Exploration and Production segment at December 31, 2013 and September 30, 2013. The fair value of the Level 3 crude oil price swap agreements is based on an internal, discounted cash flow model that uses both observable (i.e. LIBOR based discount rates) and unobservable inputs (i.e. basis differential information of crude oil trading markets with low trading volume).

The significant unobservable input used in the fair value measurement of a portion of the Company's over-the-counter crude oil swaps is the basis differential between Midway Sunset oil and NYMEX contracts. Significant changes in the assumed basis differential could result in a significant change in value of the derivative financial instruments. At December 31, 2013, it was assumed that Midway Sunset oil was 103.1% of NYMEX. This is based on a historical twelve month average of Midway Sunset oil sales versus NYMEX settlements. During this twelve-month period, the price of Midway Sunset oil ranged from 96.2% to 111.0% of NYMEX. If the basis differential between Midway Sunset oil and NYMEX contracts used in the fair value measurement calculation at December 31, 2013 had been 10 percentage points higher, the fair value of the Level 3 crude oil price swap agreements liability would have been approximately \$4.5 million higher. If the basis differential between Midway Sunset oil and NYMEX contracts used in the fair value measurement at December 31, 2013 had been 10 percentage points lower, the fair value measurement of the Level 3 crude oil price swap agreements liability would have changed from a net liability of \$1.8 million to a net asset of \$2.7 million. These calculated amounts are based solely on basis differential changes and do not take into account any other changes to the fair value measurement calculation.

The accounting rules for fair value measurements and disclosures require consideration of the impact of nonperformance risk (including credit risk) from a market participant perspective in the measurement of the fair value of assets and liabilities. At December 31, 2013, the Company determined that nonperformance risk would have no material impact on its financial position or results of operation. To assess nonperformance risk, the Company considered information such as any applicable collateral posted, master netting arrangements, and applied a market-based method by using the counterparty (for an asset) or the Company's (for a liability) credit default swaps rates.

The tables listed below provide reconciliations of the beginning and ending net balances for assets and liabilities measured at fair value and classified as Level 3 for the quarters ended December 31, 2013 and 2012, respectively. For the quarters ended December 31, 2013 and December 31, 2012, no transfers in or out of Level 1 or Level 2 occurred. There were no purchases or sales of derivative financial instruments during the periods presented in the tables below. All settlements of the derivative financial instruments are reflected in the Gains/Losses Realized and Included in Earnings column of the tables below.

Fair Value Measurements Using Unobservable Inputs (Level 3)

(Thousands of Dollars)

	Total Gains/Losses			
	(Gains)/	Gains/(Losses)		
	Losses	Unrealized and	Transfer	
	Realized	Included	In/Out of	December
	and	in Other	Level 3	31,
	Included	Comprehensive		2013
	in	Income (Loss)		
	Earnings			
October	1,	2013		
Derivative				
Financial Instruments(2)	\$ (5,190)	\$ 281 (1)	\$ 3,067	\$ -
				\$ (1,842)

(1) Amounts are reported in Operating Revenues in the Consolidated Statement of Income for the three months ended December 31, 2013.

(2) Derivative Financial Instruments are shown on a net basis.

Table of Contents

Fair Value Measurements Using Unobservable Inputs (Level 3)

(Thousands of Dollars)	Total Gains/Losses		Transfer	December	
	(Gains)/ Losses Realized and Included in Earnings	Gains/(Losses) Unrealized and Included In Other Comprehensive Income (Loss)			In/Out of Level 3
Derivative Financial Instruments(2)	\$ (19,664)	\$ 2,261 (1)	\$ 3,314	\$ -	\$ (14,089)

(1) Amounts are reported in Operating Revenues in the Consolidated Statement of Income for the three months ended December 31, 2012.

(2) Derivative Financial Instruments are shown on a net basis.

Note 3 – Financial Instruments

Long-Term Debt. The fair market value of the Company's debt, as presented in the table below, was determined using a discounted cash flow model, which incorporates the Company's credit ratings and current market conditions in determining the yield, and subsequently, the fair market value of the debt. Based on these criteria, the fair market value of long-term debt, including current portion, was as follows (in thousands):

	December 31, 2013		September 30, 2013	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-Term Debt	\$ 1,649,000	\$ 1,749,091	\$ 1,649,000	\$ 1,767,519

The fair value amounts are not intended to reflect principal amounts that the Company will ultimately be required to pay. Carrying amounts for other financial instruments recorded on the Company's Consolidated Balance Sheets

approximate fair value. The fair value of long-term debt was calculated using observable inputs (U.S. Treasuries/LIBOR for the risk free component and company specific credit spread information – generally obtained from recent trade activity in the debt). As such, the Company considers the debt to be Level 2.

Any temporary cash investments, notes payable to banks and commercial paper are stated at cost. Temporary cash investments are considered Level 1, while notes payable to banks and commercial paper are considered to be Level 2. Given the short-term nature of the notes payable to banks and commercial paper, the Company believes cost is a reasonable approximation of fair value.

Other Investments. Investments in life insurance are stated at their cash surrender values or net present value as discussed below. Investments in an equity mutual fund and the stock of an insurance company (marketable equity securities), as discussed below, are stated at fair value based on quoted market prices.

Other investments include cash surrender values of insurance contracts (net present value in the case of split-dollar collateral assignment arrangements) and marketable equity securities. The values of the insurance contracts amounted to \$57.6 million at both December 31, 2013 and September 30, 2013. The fair value of the equity mutual fund was \$33.7 million at December 31, 2013 and \$31.8 million at September 30, 2013. The gross unrealized gain on this equity mutual fund was \$7.0 million at December 31, 2013 and \$5.7 million at September 30, 2013. The fair value of the stock of an insurance company was \$7.8 million at December 31, 2013 and \$6.5 million at September 30, 2013. The gross unrealized gain on this stock was \$5.4 million at December 31, 2013 and \$4.1 million at September 30, 2013. The insurance contracts and marketable equity securities are primarily informal funding mechanisms for various benefit obligations the Company has to certain employees.

Derivative Financial Instruments. The Company uses derivative instruments to manage commodity price risk in the Exploration and Production and Energy Marketing segments. During 2012, the Pipeline and Storage segment discontinued its use of derivative instruments as a means of managing commodity price risk. The Company enters into futures contracts and over-the-counter swap agreements for natural gas and crude oil to manage the price risk associated with forecasted sales of gas and oil. The Company also enters into futures contracts and swaps to manage the risk associated with forecasted gas purchases, forecasted gas sales, storage of gas, withdrawal of gas from storage to meet customer demand and the potential decline in the value of gas held in storage. The duration of the Company's hedges does not typically exceed 5 years.

Table of Contents

The Company has presented its net derivative assets and liabilities as “Fair Value of Derivative Financial Instruments” on its Consolidated Balance Sheets at December 31, 2013 and September 30, 2013. All of the derivative financial instruments reported on those line items relate to commodity contracts.

Cash Flow Hedges

For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income (loss) and reclassified into earnings in the period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

As of December 31, 2013, the Company’s Exploration and Production segment had the following commodity derivative contracts (swaps) outstanding to hedge forecasted sales (where the Company uses short positions (i.e. positions that pay-off in the event of commodity price decline) to mitigate the risk of decreasing revenues and earnings):

Commodity Units
Natural Gas 261.5 Bcf (all short positions)
Crude Oil 3,771,000 Bbls (all short positions)

As of December 31, 2013, the Company’s Energy Marketing segment had the following commodity derivative contracts (futures contracts and swaps) outstanding to hedge forecasted sales (where the Company uses short positions to mitigate the risk associated with natural gas price decreases and its impact on decreasing revenues and earnings) and, when applicable, purchases (where the Company uses long positions (i.e. positions that pay-off in the event of commodity price increases) to mitigate the risk of increasing natural gas prices, which would lead to increased purchased gas expense and decreased earnings):

Commodity Units
Natural Gas

5.1 Bcf (4.0 Bcf short positions (mostly forecasted storage withdrawals) and 1.1 Bcf long positions (mostly forecasted storage injections))

As of December 31, 2013, the Company's Exploration and Production segment had \$46.4 million (\$26.7 million after tax) of net hedging gains included in the accumulated other comprehensive income (loss) balance. It is expected that \$0.1 million (less than \$0.1 million after tax) of unrealized losses will be reclassified into the Consolidated Statement of Income within the next 12 months as the expected sales of the underlying commodities occur. It is expected that \$46.5 million (\$26.8 million after tax) of unrealized gains will be reclassified into the Consolidated Statement of Income after 12 months as the expected sales of the underlying commodities occur.

As of December 31, 2013, the Company's Energy Marketing segment had \$0.7 million (\$0.4 million after tax) of net hedging losses included in the accumulated other comprehensive income (loss) balance. It is expected that the full amount will be reclassified into the Consolidated Statement of Income (Loss) within the next 12 months as the expected sales of the underlying commodity occurs.

Refer to Note 1, under Accumulated Other Comprehensive Income (Loss), for the after-tax gain (loss) pertaining to derivative financial instruments for the Exploration and Production and Energy Marketing segments.

Table of Contents

The Effect of Derivative Financial Instruments on the Statement of Financial Performance for the Three Months Ended December 31, 2013 and 2012 (Thousands of Dollars)

	Amount of Derivative Gain or (Loss) Recognized in Other Comprehensive Income (Loss) on the Consolidated Statement of Comprehensive Income (Loss) for the Three Months Ended December 31, 2013		Location of Derivative Gain or (Loss) Reclassified from Accumulated Other Comprehensive Income (Loss) on the Consolidated Balance Sheet into the Consolidated Statement of Comprehensive Income (Effective Portion)		Amount of Derivative Gain or (Loss) Reclassified from Accumulated Other Comprehensive Income (Loss) on the Consolidated Balance Sheet into the Consolidated Statement of Comprehensive Income (Effective Portion) for the Three Months Ended December 31, 2012		Location of Derivative Gain or (Loss) Recognized in the Consolidated Statement of Comprehensive Income (Ineffective Portion and Amount Excluded from Effectiveness Testing) for the Three Months Ended December 31, 2013		Amount of Derivative Gain or (Loss) Recognized in the Consolidated Statement of Comprehensive Income (Ineffective Portion and Amount Excluded from Effectiveness Testing) for the Three Months Ended December 31, 2012	
	2013	2012	Operating Revenue	Operating Revenue	2013	2012	Testing)	Testing)	2013	2012
Derivatives in Cash Flow Hedging Relationships										
Commodity Contracts – Exploration & Production segment	\$ 5,118	\$ 33,615	Operating Revenue	Operating Revenue	\$ 9,787	\$ 12,304	Operating Revenue	\$ 1,434	\$ -	
Commodity Contracts – Energy Marketing segment	\$ (2,340)	\$ 1,735	Purchased Gas	Not Applicable	\$ 396	\$ (48)	Not Applicable	\$ -	\$ -	
Commodity Contracts – Pipeline & Storage segment(1)	\$ -	\$ -	Operating Revenue	Not Applicable	\$ -	\$ (672)	Not Applicable	\$ -	\$ -	
Total	\$ 2,778	\$ 35,350			\$ 10,183	\$ 11,584		\$ 1,434	\$ -	

(1) There were no open hedging positions at December 31, 2013 or 2012.

Fair Value Hedges

The Company's Energy Marketing segment utilizes fair value hedges to mitigate risk associated with fixed price sales commitments, fixed price purchase commitments, and the decline in the value of certain natural gas held in storage. With respect to fixed price sales commitments, the Company enters into long positions to mitigate the risk of price increases for natural gas supplies that could occur after the Company enters into fixed price sales agreements with its customers. With respect to fixed price purchase commitments, the Company enters into short positions to mitigate the risk of price decreases that could occur after the Company locks into fixed price purchase deals with its suppliers. With respect to storage hedges, the Company enters into short positions to mitigate the risk of price decreases that could result in a lower of cost or market writedown of the value of natural gas in storage that is recorded in the Company's financial statements. As of December 31, 2013, the Company's Energy Marketing segment had fair value hedges covering approximately 9.7 Bcf (9.1 Bcf of fixed price sales commitments (mostly long positions) and 0.6 Bcf of fixed price purchase commitments (mostly short positions)). For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative as well as the offsetting gain or loss on the hedged item attributable to the hedged risk completely offset each other in current earnings, as shown below.

19

Table of Contents

		Amount of Gain or (Loss) on Derivative Recognized in the Consolidated Statement of Income for the Three Months Ended December 31, 2013 (In Thousands)	Amount of Gain or (Loss) on the Hedged Item Recognized in the Consolidated Statement of Income for the Three Months Ended December 31, 2013 (In Thousands)
Derivatives in Fair Value Hedging Relationships –	Location of Gain or (Loss) on Derivative and Hedged Item Recognized in the Consolidated Statement of Income		
Energy Marketing segment			
Commodity Contracts – Hedge of fixed price sales commitments of natural gas	Operating Revenues	\$ 3,450	\$ (3,450)
Commodity Contracts – Hedge of fixed price purchase commitments of natural gas	Purchased Gas	\$ (305)	\$ 305
Commodity Contracts – Hedge of natural gas held in storage	Purchased Gas	\$ (36) \$ 3,109	\$ 36 \$ (3,109)

Economic Hedges

For derivative instruments that do not qualify as either a cash flow hedge or fair value hedge, all gains and losses are recognized in the Consolidated Statement of Income. As of December 31, 2013, the Company's Exploration and Production segment had derivative contracts (swaps) outstanding to hedge forecasted sales of 696,000 Bbls of crude oil (where the Company uses short positions (i.e. positions that pay-off in the event of commodity price decline) to mitigate the risk of decreasing revenues and earnings). The aggregate derivative gain associated with such contracts for the quarter ended December 31, 2013 was \$0.4 million. This gain was reported as a component of Operating

Revenues in the Consolidated Statement of Income.

Credit Risk

The Company may be exposed to credit risk on any of the derivative financial instruments that are in a gain position. Credit risk relates to the risk of loss that the Company would incur as a result of nonperformance by counterparties pursuant to the terms of their contractual obligations. To mitigate such credit risk, management performs a credit check, and then on a quarterly basis monitors counterparty credit exposure. The majority of the Company's counterparties are financial institutions and energy traders. The Company has over-the-counter swap positions with fifteen counterparties of which eight are in a net gain position. On average, the Company had \$6.5 million of credit exposure per counterparty in a gain position at December 31, 2013. The maximum credit exposure per counterparty in a gain position at December 31, 2013 was \$17.5 million. As of December 31, 2013, the Company had not received any collateral from the counterparties. The Company's gain position on such derivative financial instruments had not exceeded the established thresholds at which the counterparties would be required to post collateral, nor had the counterparties' credit ratings declined to levels at which the counterparties were required to post collateral.

As of December 31, 2013, twelve of the fifteen counterparties to the Company's outstanding derivative instrument contracts (specifically the over-the-counter swaps) had a common credit-risk related contingency feature. In the event the Company's credit rating increases or falls below a certain threshold (applicable debt ratings), the available credit extended to the Company would either increase or decrease. A decline in the Company's credit rating, in and of itself, would not cause the Company to be required to increase the level of its hedging collateral deposits (in the form of cash deposits, letters of credit or treasury debt instruments). If the Company's outstanding derivative instrument contracts were in a liability position (or if the current liability were larger) and/or the Company's credit rating declined, then additional hedging collateral deposits may be required. At December 31, 2013, the fair market value of the derivative financial instrument assets with a credit-risk related contingency feature was \$47.5 million according to the Company's internal model

Table of Contents

(discussed in Note 2 — Fair Value Measurements). At December 31, 2013, the fair market value of the derivative financial instrument liabilities with a credit-risk related contingency feature was \$5.9 million according to the Company's internal model (discussed in Note 2 — Fair Value Measurements). For its over-the-counter swap agreements, the Company was not required to post any hedging collateral deposits at December 31, 2013.

For its exchange traded futures contracts, which are in an asset position, the Company was not required to post any hedging collateral deposits as of December 31, 2013. As these are exchange traded futures contracts, there are no specific credit-risk related contingency features. The Company posts hedging collateral based on open positions and margin requirements it has with its counterparties.

The Company's requirement to post hedging collateral deposits is based on the fair value determined by the Company's counterparties, which may differ from the Company's assessment of fair value. Hedging collateral deposits may also include closed derivative positions in which the broker has not cleared the cash from the account to offset the derivative liability. The Company records liabilities related to closed derivative positions in Other Accruals and Current Liabilities on the Consolidated Balance Sheet. These liabilities are relieved when the broker clears the cash from the hedging collateral deposit account. This is discussed in Note 1 under Hedging Collateral Deposits.

Note 4 - Income Taxes

The components of federal and state income taxes included in the Consolidated Statements of Income are as follows (in thousands):

	Three Months Ended December 31,	
	2013	2012
Current Income Taxes		
Federal	\$ 19,707	\$ -
State	5,625	2,549
Deferred Income Taxes		
Federal	23,206	34,903
State	6,887	6,097
	55,425	43,549
Deferred Investment Tax Credit	(109)	(107)

Total Income Taxes	\$ 55,316	\$ 43,442
Presented as Follows:		
Other Income	(109)	(107)
Income Tax Expense	55,425	43,549
Total Income Taxes	\$ 55,316	\$ 43,442

Table of Contents

Total income taxes as reported differ from the amounts that were computed by applying the federal income tax rate to income before income taxes. The following is a reconciliation of this difference (in thousands):

	Three Months Ended	
	December 31, 2013	2012
U.S. Income Before Income Taxes	\$ 137,568	\$ 111,386
Income Tax Expense, Computed at U.S. Federal Statutory Rate of 35%	\$ 48,149	\$ 38,985
Increase (Reduction) in Taxes Resulting from:		
State Income Taxes	8,133	5,620
Miscellaneous	(966)	(1,163)
Total Income Taxes	\$ 55,316	\$ 43,442

Significant components of the Company's deferred tax liabilities and assets were as follows (in thousands):

	At December 31, 2013	At September 30, 2013
Deferred Tax Liabilities:		
Property, Plant and Equipment	\$ 1,517,363	\$ 1,504,187
Pension and Other Post-Retirement Benefit Costs	123,294	124,021
Other	72,352	75,419
Total Deferred Tax Liabilities	1,713,009	1,703,627
Deferred Tax Assets:		
Pension and Other Post-Retirement Benefit Costs	(130,217)	(130,256)
Tax Loss Carryforwards	(197,411)	(215,262)
Other	(89,931)	(90,461)
Total Deferred Tax Assets	(417,559)	(435,979)

Edgar Filing: NATIONAL FUEL GAS CO - Form 10-Q

Total Net Deferred Income Taxes	\$ 1,295,450	\$ 1,267,648
---------------------------------	--------------	--------------

Presented as Follows:

Net Deferred Tax Liability/(Asset) – Current	(23,127)	(79,359)
Net Deferred Tax Liability – Non-Current	1,318,577	1,347,007
Total Net Deferred Income Taxes	\$ 1,295,450	\$ 1,267,648

As a result of certain realization requirements of the authoritative guidance on stock-based compensation, the table of deferred tax liabilities and assets shown above does not include certain deferred tax assets that arose directly from excess tax deductions related to stock-based compensation. Tax benefits of \$3.1 million and \$0.7 million relating to the excess stock-based compensation deductions were recorded in Paid in Capital during the quarter ended December 31, 2013 and the year ended September 30, 2013, respectively. Cumulative tax benefits of \$36.4 million remain at both December 31, 2013 and September 30, 2013 and will be recorded in Paid in Capital in future years when such tax benefits are realized.

Regulatory liabilities representing the reduction of previously recorded deferred income taxes associated with rate-regulated activities that are expected to be refundable to customers amounted to \$84.8 million and \$85.7 million at December 31, 2013 and September 30, 2013, respectively. Also, regulatory assets representing future amounts collectible from customers, corresponding to additional deferred income taxes not previously recorded because of prior

Table of Contents

ratemaking practices, amounted to \$162.3 million and \$163.4 million at December 31, 2013 and September 30, 2013, respectively.

During the quarter ended December 31, 2013, there was no change in the balance of unrecognized tax benefits. Approximately \$2.0 million of the remaining balance of unrecognized tax benefits would favorably impact the effective tax rate, if recognized. It is reasonably possible that a reduction of \$2.0 million of the balance of uncertain tax positions may occur as a result of potential settlements with taxing authorities within the next twelve months.

The Internal Revenue Service (IRS) is currently conducting examinations of the Company for fiscal 2012 and fiscal 2013 in accordance with the Compliance Assurance Process (CAP). The CAP audit employs a real time review of the Company's books and tax records by the IRS that is intended to permit issue resolution prior to the filing of the tax return. While the federal statute of limitations remains open for fiscal 2009 and later years, IRS examinations for fiscal 2008 and prior years have been completed and the Company believes such years are effectively settled. During fiscal 2009, consent was received from the IRS National Office approving the Company's application to change its tax method of accounting for certain capitalized costs relating to its utility property. During the quarter ended March 31, 2013, local IRS examiners issued no-change reports for fiscal 2009, fiscal 2010 and fiscal 2011, but have reserved the right to re-examine these years, pending the anticipated issuance of IRS guidance addressing the issue for natural gas utilities.

The Company is also subject to various routine state income tax examinations. The Company's principal subsidiaries operate mainly in four states which have statutes of limitations that generally expire between three to four years from the date of filing of the income tax return.

Note 5 - Capitalization

Common Stock. During the three months ended December 31, 2013, the Company issued 39,500 original issue shares of common stock as a result of stock option exercises and 8,732 original issue shares of common stock for restricted stock units that vested. In addition, the Company issued 24,788 original issue shares of common stock for the Direct Stock Purchase and Dividend Reinvestment Plan and 15,712 original issue shares of common stock for the Company's 401(k) plans. The Company also issued 3,850 original issue shares of common stock to the non-employee directors of the Company who receive compensation under the Company's 2009 Non-Employee Director Equity Compensation Plan, as partial consideration for the directors' services during the three months ended December 31, 2013. Holders of stock options, SARs, restricted share awards or restricted stock units will often tender shares of common stock to the Company for payment of option exercise prices and/or applicable withholding taxes. During the three months ended December 31, 2013, 13,149 shares of common stock were tendered to the Company for such purposes. The Company considers all shares tendered as cancelled shares restored to the status of authorized but unissued shares, in accordance with New Jersey law.

Current Portion of Long-Term Debt. None of the Company's long-term debt at December 31, 2013 will mature within the following twelve-month period.

Note 6 - Commitments and Contingencies

Environmental Matters. The Company is subject to various federal, state and local laws and regulations relating to the protection of the environment. The Company has established procedures for the ongoing evaluation of its operations to identify potential environmental exposures and to comply with regulatory policies and procedures. It is the Company's policy to accrue estimated environmental clean-up costs (investigation and remediation) when such amounts can reasonably be estimated and it is probable that the Company will be required to incur such costs.

The Company has agreed with the NYDEC to remediate a former manufactured gas plant site located in New York. In February 2009, the Company received approval from the NYDEC of a Remedial Design Work Plan (RDWP) for this site. In October 2010, the Company submitted a RDWP addendum to conduct additional Preliminary Design Investigation field activities necessary to design a successful remediation. As a result of this work, the Company submitted to the NYDEC a proposal to amend the NYDEC's Record of Decision remedy for the site. In April 2013, the NYDEC approved the Company's proposed amendment. Final remedial design work for the site has begun. An estimated minimum liability for remediation of this site of \$13.3 million has been recorded.

At December 31, 2013, the Company has estimated its remaining clean-up costs related to former manufactured gas plant sites and third party waste disposal sites (including the former manufactured gas plant site discussed above) will be approximately \$14.7 million. This estimated liability, which includes the \$13.3 million discussed above, has been

Table of Contents

recorded in Other Deferred Credits on the Consolidated Balance Sheet at December 31, 2013. The Company expects to recover its environmental clean-up costs through rate recovery over a period of approximately 13 years.

The Company is currently not aware of any material additional exposure to environmental liabilities. However, changes in environmental laws and regulations, new information or other factors could have an adverse financial impact on the Company.

Other. The Company is involved in other litigation and regulatory matters arising in the normal course of business. These other matters may include, for example, negligence claims and tax, regulatory or other governmental audits, inspections, investigations and other proceedings. These matters may involve state and federal taxes, safety, compliance with regulations, rate base, cost of service and purchased gas cost issues, among other things. While these other matters arising in the normal course of business could have a material effect on earnings and cash flows in the period in which they are resolved, an estimate of the possible loss or range of loss, if any, cannot be made at this time.

Note 7 – Business Segment Information

The Company reports financial results for five segments: Utility, Pipeline and Storage, Exploration and Production, Energy Marketing and Gathering. The division of the Company’s operations into reportable segments is based upon a combination of factors including differences in products and services, regulatory environment and geographic factors.

The data presented in the tables below reflect financial information for the segments and reconciliations to consolidated amounts. As stated in the 2013 Form 10-K, the Company evaluates segment performance based on income before discontinued operations, extraordinary items and cumulative effects of changes in accounting (when applicable). When these items are not applicable, the Company evaluates performance based on net income. There have not been any changes in the basis of segmentation nor in the basis of measuring segment profit or loss from those used in the Company’s 2013 Form 10-K. As for segment assets at December 31, 2013, there have been changes from the segment assets disclosed in the 2013 Form 10-K. A listing of segment assets at December 31, 2013 and September 30, 2013 is shown in the tables below. Energy Marketing segment revenue from external customers and net income for the quarter ended December 31, 2013 reflect the impact of \$25.5 million and \$1.3 million, respectively, of unbilled revenue and related margin (net of tax). In prior periods, Energy Marketing segment revenues and related purchased gas costs were recorded when billed, resulting in a one month lag. The impact of not recording unbilled revenue and related costs was immaterial in all prior periods.

Quarter Ended December 31, 2013 (Thousands)

Pipeline and	Exploration and	Energy	Total Reportable	All	Corporate and Intersegment
-----------------	--------------------	--------	---------------------	-----	----------------------------------

Edgar Filing: NATIONAL FUEL GAS CO - Form 10-Q

	Utility	Storage	Production	Marketing	Gathering	Segments	Other	Eliminations	C
Revenue from External Customers	\$ 230,453	\$ 51,212	\$ 193,046	\$ 73,159	\$ 235	\$ 548,105	\$ 1,700	\$ 267	\$
Intersegment Revenues	\$ 4,706	\$ 20,739	\$ -	\$ 255	\$ 14,350	\$ 40,050	\$ -	\$ (40,050)	\$
Segment Profit: Net Income (Loss)	\$ 24,215	\$ 19,138	\$ 31,097	\$ 1,604	\$ 6,147	\$ 82,201	\$ 675	\$ (624)	\$
(Thousands)	Utility	Pipeline and Storage	Exploration and Production	Energy Marketing	Gathering	Total Reportable Segments	All Other	Corporate and Intersegment Eliminations	T
Segment Assets:									
At December 31, 2013	\$ 1,911,689	\$ 1,244,551	\$ 2,752,386	\$ 93,735	\$ 225,191	\$ 6,227,552	\$ 95,541	\$ (58,109)	\$
At September 30, 2013	\$ 1,870,587	\$ 1,246,027	\$ 2,746,233	\$ 67,267	\$ 203,323	\$ 6,133,437	\$ 95,793	\$ (10,883)	\$

Table of Contents

Quarter Ended December 31, 2012 (Thousands)

	Utility	Pipeline and Storage	Exploration and Production	Energy Marketing	Gathering	Total Reportable Segments	All Other	Corporate and Intersegment Eliminations	Total Consolidated
Revenue from External Customers	\$ 208,563	\$ 43,459	\$ 155,450	\$ 44,166	\$ 202	\$ 451,840	\$ 813	\$ 201	\$ 452,854
Intersegment Revenues	\$ 4,311	\$ 22,797	\$ -	\$ 426	\$ 5,480	\$ 33,014	\$ -	\$ (33,014)	\$ -
Segment Profit: Net Income (Loss)	\$ 22,878	\$ 16,933	\$ 26,680	\$ 495	\$ 1,942	\$ 68,928	\$ (57)	\$ (927)	\$ 67,944

Note 8 – Retirement Plan and Other Post-Retirement Benefits

Components of Net Periodic Benefit Cost (in thousands):

Three Months Ended December 31,

	Retirement Plan		Other Post-Retirement Benefits	
	2013	2012	2013	2012
Service Cost	\$ 2,997	\$ 3,961	\$ 735	\$ 1,176

Edgar Filing: NATIONAL FUEL GAS CO - Form 10-Q

Interest Cost	10,893	9,124	5,327	4,803
Expected Return on Plan Assets	(14,993)	(14,336)	(9,356)	(8,218)
Amortization of Prior Service Cost (Credit)	52	60	(534)	(534)
Amortization of Transition Amount	-	-	-	2
Amortization of Losses	9,002	13,194	661	5,223
Net Amortization and Deferral for Regulatory Purposes (Including Volumetric Adjustments) (1)	1,578	(3,682)	6,060	2,703
Net Periodic Benefit Cost	\$ 9,529	\$ 8,321	\$ 2,893	\$ 5,155

(1) The Company's policy is to record retirement plan and other post-retirement benefit costs in the Utility segment on a volumetric basis to reflect the fact that the Utility segment experiences higher throughput of natural gas in the winter months and lower throughput of natural gas in the summer months.

Employer Contributions. During the three months ended December 31, 2013, the Company contributed \$23.9 million to its tax-qualified, noncontributory defined-benefit retirement plan (Retirement Plan) and \$1.8 million to its VEBA trusts and 401(h) accounts for its other post-retirement benefits. In the remainder of 2014, the Company expects to contribute between \$5.0 million and \$15.0 million to the Retirement Plan. Changes in the discount rate, other actuarial assumptions, and asset performance could ultimately cause the Company to fund larger amounts to the Retirement Plan in fiscal 2014 in order to be in compliance with the Pension Protection Act of 2006 (as impacted by the Moving Ahead for Progress in the 21st Century Act). In July 2012, the Surface Transportation Extension Act, which is also referred to as the Moving Ahead for Progress in the 21st Century Act (the Act), was passed by Congress and signed by the President. The Act included pension funding stabilization provisions. The Company is continually evaluating its future contributions in light of the provisions of the Act. In the remainder of 2014, the Company expects its contributions to its VEBA trusts and 401(h) accounts to be in the range of zero to \$10.0 million.

Table of Contents

Note 9 – Regulatory Matters

Following discussions with regulatory staff with respect to earnings levels, on March 27, 2013, Distribution Corporation filed a plan (“Plan”) with the NYPSC proposing to adopt an “earnings stabilization and sharing mechanism” that would allocate earnings above a rate of return on equity of 9.96% evenly between shareholders and an accounting reserve (“Reserve”). The Reserve would be utilized to stabilize Distribution Corporation’s earnings and to fund customer benefit programs. The Plan also proposed to increase capital spending and to aid new customer system expansion efforts. Discussions were held with NYPSC staff and others with respect to the Plan.

In a related development, on April 19, 2013, the NYPSC issued an order directing Distribution Corporation to either agree to make its rates and charges temporary subject to refund effective June 1, 2013, or show cause why its gas rates and charges should not be set on a temporary basis subject to refund (“Order”). The Order recognized Distribution Corporation’s Plan and, while acknowledging the Company’s cost-cutting and efficiency achievements, determined nonetheless that the Plan did not propose to adjust “existing rates . . . enough to compensate for the imbalance between ratepayer and shareholder interests that has developed since . . . 2007 . . .” Pursuant to the Order, the NYPSC commenced a “temporary rate” proceeding and, following hearings, on June 14, 2013, the NYPSC issued an order (“Temporary Rates Order”) making Distribution Corporation’s rates and charges temporary and subject to refund pending the determination of permanent gas rates through further rate proceedings. Discussions for settlement of Distribution Corporation’s rates and charges were commenced while the formal case to establish permanent rates proceeded along a parallel path. The Consolidated Balance Sheets at December 31, 2013 and September 30, 2013 reflect a \$7.5 million refund provision in anticipation of a potential settlement.

In addition to authorizing a “temporary rate” proceeding, the Order also suggested an examination of the applicability of a provision of New York public utility law, PSL §66(20), that provides the NYPSC with stated authority to direct a refund of revenues received by a utility “in excess of its authorized rate of return for a period of twelve months.” On May 17, 2013, Distribution Corporation commenced an action in New York Supreme Court, Erie County, seeking the court’s declaration that PSL §66(20) is unconstitutional. On October 25, 2013, the court dismissed Distribution Corporation’s complaint without prejudice to recommence the action after a decision is rendered in the rate proceeding before the NYPSC. In addition, on September 25, 2013, Distribution Corporation commenced an appeal in New York Supreme Court, Albany County, seeking to annul the Temporary Rates Order on various grounds.

On December 6, 2013, Distribution Corporation filed an agreement, executed by five of the six active parties in the rate proceeding, for settlement of the temporary rate proceeding and all issues relating to rates. The settlement agreement proposes to fix customer rates at existing levels for a minimum two-year term retroactive to October 1, 2013. Although customer rates are fixed, the parties agreed that the allowed rate of return on equity would be set, for ratemaking purposes, at 9.1%. Earnings in excess of the allowed rate of return would be allocated primarily to pay down existing deferred pension liabilities. Following conventional practice in New York, the agreement also proposes an “earnings sharing mechanism” (“ESM”). The ESM distributes earnings above the allowed rate of return as follows: from 9.5% to 10.5%, 50% would be allocated to shareholders, and 50% will be deferred for the benefit of customers; above 10.5%, 20% to shareholders and 80% will be deferred for the benefit of customers. The agreement further authorizes, and rates reflect, an increase in Distribution Corporation’s pipeline replacement spending by \$8.2

million per year. The agreement contains other terms and conditions of service that are customary for settlement agreements recently approved by the NYPSC.

Signatory parties also filed statements with the NYPSC requesting approval of the settlement agreement without modification. One special-interest consumer advocate is opposing the settlement agreement. Following further proceedings, the NYPSC is expected to address the settlement agreement at a regular session scheduled to be held in March 2014.

26

Table of Contents

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

OVERVIEW

Please note that this overview is a high-level summary of items that are discussed in greater detail in subsequent sections of this report.

The Company is a diversified energy company that owns a number of subsidiary operating companies, and reports financial results in five reportable business segments. For the quarter ended December 31, 2013 compared to the quarter ended December 31, 2012, the Company experienced an increase in earnings of \$14.3 million. The earnings increase for the quarter reflects increases in all of the Company's segments as well as the All Other category. For further discussion of the Company's earnings, refer to the Results of Operations section below.

The Company's natural gas reserve base has grown substantially in recent years due to its development of reserves in the Marcellus Shale, a Middle Devonian-age geological shale formation that is present nearly a mile or more below the surface in the Appalachian region of the United States, including much of Pennsylvania and southern New York. The Company controls the natural gas interests associated with approximately 780,000 net acres within the Marcellus Shale area, with a majority of the interests held in fee, carrying no royalty and no lease expirations. Natural gas proved developed and undeveloped reserves in the Appalachian region increased from 925 Bcf at September 30, 2012 to 1,239 Bcf at September 30, 2013. The Company has spent significant amounts of capital in this region related to the development of such reserves. For the three months ended December 31, 2013, the Company's Exploration and Production segment had capital expenditures of \$105.0 million in the Appalachian region, of which \$99.1 million was spent towards the development of the Marcellus Shale. The amount spent towards the development of the Marcellus Shale represented approximately 60% of the Company's capital expenditures for the quarter ended December 31, 2013.

From a capital resources perspective, the Company has largely been able to meet its capital expenditure needs by using cash from operations as well as both short and long-term debt. It is expected that the Company will use short-term debt as necessary during fiscal 2014 to help meet its capital expenditure needs.

The well completion technology referred to as hydraulic fracturing used in conjunction with horizontal drilling continues to be debated. In Pennsylvania, where the Company is focusing its Marcellus Shale development efforts, the permitting and regulatory processes seem to strike a balance between the environmental concerns associated with hydraulic fracturing and the benefits of increased natural gas production. Hydraulic fracturing is a well stimulation technique that has been used for many years, and in the Company's experience, one that the Company believes has little negative impact to the environment. Nonetheless, the potential for increased state or federal regulation of hydraulic fracturing could impact future costs of drilling in the Marcellus Shale and lead to operational delays or restrictions. There is also the risk that drilling could be prohibited on certain acreage that is prospective for the

Marcellus Shale. Please refer to the Risk Factors section of the Company's 2013 Form 10-K for further discussion.

CRITICAL ACCOUNTING ESTIMATES

For a complete discussion of critical accounting estimates, refer to "Critical Accounting Estimates" in Item 7 of the Company's 2013 Form 10-K. There have been no material changes to that disclosure other than as set forth below. The information presented below updates and should be read in conjunction with the critical accounting estimates in that Form 10-K.

Oil and Gas Exploration and Development Costs. The Company, in its Exploration and Production segment, follows the full cost method of accounting for determining the book value of its oil and natural gas properties. In accordance with this methodology, the Company is required to perform a quarterly ceiling test. Under the ceiling test, the present value of future revenues from the Company's oil and gas reserves based on an unweighted arithmetic average of the first day of the month oil and gas prices for each month within the twelve-month period prior to the end of the reporting period (the "ceiling") is compared with the book value of the Company's oil and gas properties at the balance sheet date. If the book value of the oil and gas properties exceeds the ceiling, a non-cash impairment charge must be recorded to reduce the book value of the oil and gas properties to the calculated ceiling. At December 31, 2013, the ceiling exceeded the book value of the oil and gas properties by approximately \$166.9 million. The 12-month average of the first day of the month price for crude oil for each month during the twelve months ended December 31, 2013, based on posted Midway Sunset prices, was \$100.18 per Bbl. The 12-month average of the first day of the month price for natural gas for each month during the twelve months ended December 31, 2013, based on the quoted Henry Hub spot price for natural gas, was \$3.67 per MMBtu. (Note – Because actual pricing of the Company's various producing properties varies depending on their location and hedging, the actual various prices received for such production is utilized to calculate the ceiling, rather than the Midway Sunset and Henry Hub prices, which are only indicative of 12-month average prices for the twelve

Table of Contents

months ended December 31, 2013.) If natural gas average prices used in the ceiling test calculation at December 31, 2013 had been \$1 per MMBtu lower, the book value of the Company's oil and gas properties would have exceeded the ceiling by approximately \$134.4 million, which would have resulted in an impairment charge. If crude oil average prices used in the ceiling test calculation at December 31, 2013 had been \$5 per Bbl lower, the ceiling would have exceeded the book value of the Company's oil and gas properties by approximately \$127.4 million. If both natural gas and crude oil average prices used in the ceiling test calculation at December 31, 2013 were lower by \$1 per MMBtu and \$5 per Bbl, respectively, the book value of the Company's oil and gas properties would have exceeded the ceiling by approximately \$173.8 million, which would have resulted in an impairment charge. These calculated amounts are based solely on price changes and do not take into account any other changes to the ceiling test calculation. For a more complete discussion of the full cost method of accounting, refer to "Oil and Gas Exploration and Development Costs" under "Critical Accounting Estimates" in Item 7 of the Company's 2013 Form 10-K.

RESULTS OF OPERATIONS

Earnings

The Company's earnings were \$82.3 million for the quarter ended December 31, 2013 compared with earnings of \$67.9 million for the quarter ended December 31, 2012. The increase in earnings is primarily a result of higher earnings in all of the Company's segments as well as in the All Other category.

Additional discussion of earnings in each of the business segments can be found in the business segment information that follows. Note that all amounts used in the earnings discussions are after-tax amounts, unless otherwise noted.

Earnings (Loss) by Segment

	Three Months Ended December 31,		
(Thousands)	2013	2012	Increase
Utility	\$ 24,215	\$ 22,878	\$ 1,337
Pipeline and Storage	19,138	16,933	2,205
Exploration and Production	31,097	26,680	4,417
Energy Marketing	1,604	495	1,109
Gathering	6,147	1,942	4,205
Total Reportable Segments	82,201	68,928	13,273

Edgar Filing: NATIONAL FUEL GAS CO - Form 10-Q

All Other	675	(57)	732
Corporate	(624)	(927)	303
Total Consolidated	\$ 82,252	\$ 67,944	\$ 14,308

Table of Contents

Utility

Utility Operating Revenues

(Thousands)	Three Months Ended December 31,		Increase (Decrease)
	2013	2012	
Retail Sales Revenues:			
Residential	\$ 162,075	\$ 145,805	\$ 16,270
Commercial	20,548	17,592	2,956
Industrial	864	1,773	(909)
	183,487	165,170	18,317
Transportation	40,356	37,253	3,103
Off-System Sales	7,921	8,720	(799)
Other	3,395	1,731	1,664
	\$ 235,159	\$ 212,874	\$ 22,285

Utility Throughput

(MMcf)	Three Months Ended December 31,		Increase (Decrease)
	2013	2012	
Retail Sales:			
Residential	17,008	15,153	1,855
Commercial	2,360	1,967	393
Industrial	91	301	(210)
	19,459	17,421	2,038
Transportation	21,190	18,637	2,553
Off-System Sales	1,978	2,429	(451)
	42,627	38,487	4,140

Degree Days

Three Months Ended December 31	Percent Colder (Warmer) Than			
	Normal	2013	2012	Normal(1) Prior Year(1)
Buffalo	2,253	2,290	2,036	1.6 12.5
Erie	2,044	2,110	1,898	3.2 11.2

(1) Percents compare actual 2013 degree days to normal degree days and actual 2013 degree days to actual 2012 degree days.

2013 Compared with 2012

Operating revenues for the Utility segment increased \$22.3 million for the quarter ended December 31, 2013 as compared with the quarter ended December 31, 2012. This increase resulted from an \$18.3 million increase in retail gas sales revenues, a \$3.1 million increase in transportation revenues, and a \$1.7 million increase in other revenues. The increase in retail gas sales revenues was primarily due to the impact of a 2.0 Bcf increase in retail throughput. The increase in retail throughput was largely the result of colder weather compared to the prior period. The increase in transportation revenues was primarily due to a 2.6 Bcf increase in transportation throughput, largely the result of colder

Table of Contents

weather compared to the prior period and the migration of customers from retail sales to transportation services. The increase in other revenues was largely driven by a true-up of regulatory asset balances associated with a NYPSC settlement concerning insurance proceeds on site remediation claims, which was partially offset by a reduction to revenue associated with an earnings sharing refund provision established by the terms of a recent NYPSC settlement. This was partially offset by the lower off-system gas sales revenue of \$0.8 million (due to lower volumes). Due to profit sharing with retail customers, the margins resulting from off-system sales are minimal.

The Utility segment's earnings for the quarter ended December 31, 2013 were \$24.2 million, an increase of \$1.3 million when compared with earnings of \$22.9 million for the quarter ended December 31, 2012. The increase in earnings is largely attributable to colder weather (\$1.9 million). In addition, regulatory true-up adjustments, partially offset by a refund provision, contributed \$1.1 million to earnings. Lower interest expense of \$0.9 million further increased earnings. The decrease in interest expense was attributable to a decrease in the weighted average amount of debt outstanding due to the Utility segment's share of the Company's \$250 million of notes that matured in March 2013. These earnings increases were partially offset by the earnings impact of higher operating expenses of \$2.4 million. The increase in operating expenses was largely attributable to increased costs associated with defined benefit and defined contribution retirement plans as a result of a recent settlement with the NYPSC.

The impact of weather variations on earnings in the Utility segment's New York rate jurisdiction is mitigated by that jurisdiction's weather normalization clause (WNC). The WNC in New York, which covers the eight-month period from October through May, has had a stabilizing effect on earnings for the New York rate jurisdiction. In addition, in periods of colder than normal weather, the WNC benefits the Utility segment's New York customers. For the quarter ended December 31, 2013, the WNC reduced earnings by approximately \$0.2 million, as the weather was colder than normal. For the quarter ended December 31, 2012, the WNC preserved earnings of approximately \$0.6 million, as the weather was warmer than normal.

Pipeline and Storage

Pipeline and Storage Operating Revenues

	Three Months Ended December 31,		
(Thousands)	2013	2012	Increase
Firm Transportation	\$ 52,146	\$ 46,597	\$ 5,549
Interruptible Transportation	586	501	85
	52,732	47,098	5,634
Firm Storage Service	17,465	17,436	29

Interruptible Storage Service	1	-	1
Other	1,753	1,722	31
	\$ 71,951	\$ 66,256	\$ 5,695

Pipeline and Storage Throughput

Three Months Ended
December 31,

(MMcf)	2013	2012	Increase
Firm Transportation	191,656	123,413	68,243
Interruptible Transportation	1,322	1,252	70
	192,978	124,665	68,313

2013 Compared with 2012

Operating revenues for the Pipeline and Storage segment increased \$5.7 million for the quarter ended December 31, 2013 as compared with the quarter ended December 31, 2012. The increase was primarily due to an increase in transportation revenues of \$5.6 million. The increase in transportation revenues was largely due to demand and

Table of Contents

commodity charges on new contracts for transportation service on Supply Corporation's Northern Access expansion project, which was placed fully in service in January 2013 and Supply Corporation's Line N 2012 Expansion Project, which was placed fully in service in November 2012. These projects provide pipeline capacity for Marcellus Shale production. Also contributing to the increase in transportation revenues was additional non-expansion revenue as a result of new short-term contracts and new contracts for transportation service from an Open Season Supply Corporation held near the end of fiscal 2013.

Transportation volume for the quarter ended December 31, 2013 increased by 68.3 Bcf from the prior year's quarter. The large increase in transportation volume for the quarter primarily reflects the impact of the above mentioned expansion projects being placed in service and new contracts for transportation service. This increase was enhanced by weather that was significantly colder than the prior year and colder than normal.

The Pipeline and Storage segment's earnings for the quarter ended December 31, 2013 were \$19.1 million, an increase of \$2.2 million when compared with earnings of \$16.9 million for the quarter ended December 31, 2012. The increase in earnings is primarily due to the earnings impact of higher transportation revenues of \$3.7 million, as discussed above, combined with a decrease in operating expenses (\$1.7 million). The decrease in operating expenses primarily reflects lower pension and other post-retirement benefit costs and lower stock-based compensation expense. These earnings increases were partially offset by a decrease in the allowance for funds used during construction (equity component) of \$1.5 million and higher income taxes (\$0.9 million). The decrease in the allowance for funds used during construction is mainly due to Supply Corporation's Line N 2012 Expansion Project and Supply Corporation's Northern Access expansion project, which were under construction in the prior year and have since been placed in service. The increase in income taxes is a result of higher state taxes combined with a reduced benefit associated with the allowance for funds used during construction.

Exploration and Production

Exploration and Production Operating Revenues

	Three Months Ended December 31,		Increase (Decrease)
(Thousands)	2013	2012	
Gas (after Hedging)	\$ 121,616	\$ 84,838	\$ 36,778

Edgar Filing: NATIONAL FUEL GAS CO - Form 10-Q

Oil (after Hedging)	67,254	69,034	(1,780)
Gas Processing Plant	1,316	979	337
Other	2,860	599	2,261
	\$ 193,046	\$ 155,450	\$ 37,596

Production Volumes

	Three Months Ended		
	December 31,		
	2013	2012	Increase (Decrease)
Gas Production (MMcf)			
Appalachia	32,052	19,496	12,556
West Coast	786	745	41
Total Production	32,838	20,241	12,597

Oil Production (Mbbbl)			
Appalachia	9	6	3
West Coast	706	708	(2)
Total Production	715	714	1

31

Table of Contents

Average Prices

	Three Months Ended December 31,		Increase (Decrease)
	2013	2012	
Average Gas Price/Mcf			
Appalachia	\$ 3.28	\$ 3.35	\$ (0.07)
West Coast (1)	\$ 5.93	\$ 6.53	\$ (0.60)
Weighted Average	\$ 3.35	\$ 3.47	\$ (0.12)
Weighted Average After Hedging	\$ 3.70	\$ 4.19	\$ (0.49)
Average Oil Price/Bbl			
Appalachia	\$ 96.03	\$ 87.83	\$ 8.20
West Coast	\$ 97.45	\$ 100.10	\$ (2.65)
Weighted Average	\$ 97.43	\$ 100.01	\$ (2.58)
Weighted Average After Hedging	\$ 94.00	\$ 96.69	\$ (2.69)

(1) Prices for all periods presented reflect revenues from gas produced on the West Coast, including natural gas liquids. In previous quarters, natural gas liquids were reported as gas processing plant revenues as opposed to natural gas revenues.

2013 Compared with 2012

Operating revenues for the Exploration and Production segment increased \$37.6 million for the quarter ended December 31, 2013 as compared with the quarter ended December 31, 2012. Gas production revenue after hedging increased \$36.8 million due to an increase in production, which was partially offset by a \$0.49 per Mcf decrease in the weighted average price of natural gas after hedging. The increase in Appalachian production was primarily due to increased development within the Marcellus Shale formation, mainly in Lycoming County, Pennsylvania. Other revenue increased \$2.3 million largely due to a \$1.9 million mark-to-market adjustment related to hedging ineffectiveness associated with certain crude oil hedges. Oil production revenue after hedging decreased \$1.8 million due to a \$2.69 per Bbl decrease in the weighted average price of crude oil after hedging. Oil production was flat quarter over quarter.

The Exploration and Production segment's earnings for the quarter ended December 31, 2013 were \$31.1 million, an increase of \$4.4 million when compared with earnings of \$26.7 million for the quarter ended December 31, 2012. Higher natural gas and crude oil production increased earnings by \$34.3 million and \$0.1 million, respectively. In addition, the impact of lower general, administrative and other operating expenses and the aforementioned mark-to-market adjustments increased earnings by \$1.3 million and \$1.2 million, respectively. The decrease in general, administrative and other operating expenses was largely due to the non-recurrence of a drilling rig lease termination fee that occurred during the quarter ended December 31, 2012. The aforementioned items, which contributed positively to earnings, were partially offset by higher depletion expense (\$12.5 million), lower natural gas prices (\$10.4 million), higher production costs (\$6.2 million), higher income taxes (\$0.8 million), higher property and other taxes (\$0.7 million), higher interest expense (\$1.3 million), and lower crude oil prices (\$1.2 million). The increase in depletion expense is primarily due to an increase in the depletable base (due to increased capital spending in the Appalachian region within the last few years) and higher production. The increase in production costs is largely attributable to higher transportation costs, which is due to an increase in Appalachian production. The increase in income taxes was largely attributable to higher state income taxes. The increase in property and other taxes was due to an increase in the "natural gas impact fee" (due to an increase in well activity in Pennsylvania), an increase in franchise taxes in Pennsylvania (as a result of a decrease in the Pennsylvania Research and Development tax credit, and an increase in ad valorem and property taxes due to acquisition of properties in the East Coalinga Field in Fresno County, California in the second quarter of 2013 and an overall increase in property tax rates in Kern County, California). The increase in interest expense was attributable to an increase in the weighted average amount of debt due to the Exploration and Production segment's share of the Company's \$500 million long-term debt issuance in February 2013.

Table of Contents

Energy Marketing

Energy Marketing Operating Revenues

(Thousands)	Three Months Ended December 31,		
	2013	2012	Increase
Natural Gas (after Hedging)	\$ 73,373	\$ 44,572	\$ 28,801
Other	41	20	21
	\$ 73,414	\$ 44,592	\$ 28,822

Energy Marketing Volume

	Three Months Ended December 31,		
	2013	2012	Increase
Natural Gas – (MMcf)	16,008	10,365	5,643

2013 Compared with 2012

Operating revenues for the Energy Marketing segment increased \$28.8 million for the quarter ended December 31, 2013 as compared with the quarter ended December 31, 2012. The increase reflects an increase in gas sales revenue due to recording a \$25.5 million accrual for unbilled revenue, as discussed below. A higher average price of natural gas and an increase in volume sold as a result of colder weather also contributed slightly to the increase in gas sales revenue.

The Energy Marketing segment's earnings for the quarter ended December 31, 2013 were \$1.6 million, an increase of \$1.1 million when compared with earnings of \$0.5 million for the quarter ended December 31, 2012. The increase in earnings was largely attributable to higher margin of \$1.2 million, which largely reflects the impact of unbilled revenues at December 31, 2013. In prior periods, Energy Marketing segment revenues and related purchased gas costs were recorded when billed, resulting in a one month lag. The impact of the change was to increase operating revenues and margin by \$25.5 million and \$1.3 million, respectively, in the quarter ended December 31, 2013. Management has determined that the impact of not recording unbilled revenue and related costs was immaterial in all prior periods.

Gathering

Gathering Operating Revenues

(Thousands)	Three Months Ended December 31,		
	2013	2012	Increase
Gathering	\$ 14,377	\$ 5,480	\$ 8,897
Processing Revenues	208	202	6
	\$ 14,585	\$ 5,682	\$ 8,903

Table of Contents

Gathering Volume

Three Months Ended
December 31,

2013 2012 Increase

Gathered Volume - (MMcf) 31,014 16,811 14,203

2013 Compared with 2012

Operating revenues for the Gathering segment increased \$8.9 million for the quarter ended December 31, 2013 as compared with the quarter ended December 31, 2012 largely due to an increase in gathering revenues driven by a 14.2 Bcf increase in gathered volume combined with a higher gathering rate on Midstream Corporation's Trout Run Gathering System (Trout Run). The volume increase was primarily due to a 13,177 MMcf increase in gathered volume on Trout Run. Trout Run transports Seneca's production in Lycoming County, Pennsylvania. In addition, there was an increase in gathering revenue for Midstream Corporation's Covington Gathering System (Covington), Midstream Corporation's Mt. Jewett Gathering System (Mt. Jewett) and Midstream Corporation's Tionesta Gathering System (Tionesta). Covington, Mt. Jewett, and Tionesta also provide gathering services for Seneca's production. Mt. Jewett and Tionesta were placed in service in September 2013 and April 2013, respectively.

The Gathering segment's earnings for the quarter ended December 31, 2013 were \$6.1 million, an increase of \$4.2 million when compared with earnings of \$1.9 million for the quarter ended December 31, 2012. The increase in earnings is due to the earnings impact of higher gathering and processing revenues (\$5.8 million). This was partially offset by higher depreciation expense (\$0.8 million) and higher income tax expense (\$0.7 million). The significant growth of Trout Run is primarily responsible for the revenue and depreciation expense variations. The increase in income tax expense was largely due to higher state taxes.

Corporate and All Other

2013 Compared with 2012

Corporate and All Other operations recorded earnings of \$0.1 million for the quarter ended December 31, 2013, an increase of \$1.1 million when compared with a loss of \$1.0 million for the quarter ended December 31, 2012. Earnings increased as a result of the earnings impact of a \$0.9 million increase in revenues (largely due to the receipt of insurance proceeds and gains on the sale of certain timber stumpage tracts by Seneca's land and timber division in November 2013). These increases were partially offset by the earnings impact of a \$0.4 million increase in operating expenses (largely due to higher personnel costs).

Interest Expense on Long-Term Debt (amounts below are pre-tax amounts)

Interest on long-term debt increased \$1.4 million for the quarter ended December 31, 2013 as compared with the quarter ended December 31, 2012. This increase is due to a higher average amount of long-term debt outstanding partially offset by a decrease in the weighted average interest rate on such debt. The Company issued \$500 million of 3.75% notes in February 2013 and repaid \$250 million of 5.25% notes that matured in March 2013.

CAPITAL RESOURCES AND LIQUIDITY

The Company's primary source of cash during the three-month period ended December 31, 2013 consisted of cash provided by operating activities. The Company's primary sources of cash during the three-month period ended December 31, 2012 consisted of cash provided by operating activities and net proceeds from short-term borrowings. These sources of cash were supplemented by net proceeds from the issuance of common stock for both the three months ended December 31, 2013 and December 31, 2012, including the issuance of original issue shares for the Direct Stock Purchase and Dividend Reinvestment Plan. For the three months ended December 31, 2013, net proceeds from the issuance of common stock also includes the issuance of original issue shares for the Company's 401(k) plans. During the three months ended December 31, 2012, the common stock used to fulfill the requirements of the Company's 401(k) plans was obtained via open market purchases.

Table of Contents

Operating Cash Flow

Internally generated cash from operating activities consists of net income available for common stock, adjusted for non-cash expenses, non-cash income and changes in operating assets and liabilities. Non-cash items include depreciation, depletion and amortization and deferred income taxes.

Cash provided by operating activities in the Utility and Pipeline and Storage segments may vary substantially from period to period because of the impact of rate cases. In the Utility segment, supplier refunds, over- or under-recovered purchased gas costs and weather may also significantly impact cash flow. The impact of weather on cash flow is tempered in the Utility segment's New York rate jurisdiction by its WNC and in the Pipeline and Storage segment by the straight fixed-variable rate design used by Supply Corporation and Empire.

Because of the seasonal nature of the heating business in the Utility and Energy Marketing segments, revenues in these segments are relatively high during the heating season, primarily the first and second quarters of the fiscal year, and receivable balances historically increase during these periods from the receivable balances at September 30.

The storage gas inventory normally declines during the first and second quarters of the fiscal year and is replenished during the third and fourth quarters. For storage gas inventory accounted for under the LIFO method, the current cost of replacing gas withdrawn from storage is recorded in the Consolidated Statements of Income and a reserve for gas replacement is recorded in the Consolidated Balance Sheets under the caption "Other Accruals and Current Liabilities." Such reserve is reduced as the inventory is replenished.

Cash provided by operating activities in the Exploration and Production segment may vary from period to period as a result of changes in the commodity prices of natural gas and crude oil as well as changes in production. The Company uses various derivative financial instruments, including price swap agreements and futures contracts in an attempt to manage this energy commodity price risk.

Net cash provided by operating activities totaled \$176.7 million for the three months ended December 31, 2013, an increase of \$30.7 million compared with \$146.0 million provided by operating activities for the three months ended December 31, 2012. The increase in cash provided by operating activities reflects higher cash provided by operating activities in the Exploration and Production segment primarily due to higher cash receipts from natural gas production in the Appalachian region.

Investing Cash Flow

Expenditures for Long-Lived Assets

The Company's expenditures for long-lived assets totaled \$166.5 million during the three months ended December 31, 2013 and \$181.6 million for the three months ended December 31, 2012. These amounts include accounts payable and accrued liabilities related to capital expenditures and will differ from capital expenditures shown on the Consolidated Statement of Cash Flows. They are included in subsequent Consolidated Statement of Cash Flows when they are paid. The table below presents these expenditures:

Table of Contents