CHESAPEAKE UTILITIES CORP
Form 10-Q
November 09, 2006

United States
Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: September 30, 2006

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: 001-11590

Chesapeake Utilities Corporation
(Exact name of registrant as specified in its charter)

Delaware	**51-0064146**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

909 Silver Lake Boulevard, Dover, Delaware 19904
(Address of principal executive offices, including Zip Code)

(302) 734-6799
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ]   Accelerated filer [X]   Non-accelerated filer [ ]

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

Common Stock, par value $0.4867 — 5,990,582 shares outstanding as of October 31, 2006.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Statements of Income (Unaudited)

For the Three Months Ended September 30,	2006	2005
Operating Revenues	**$ 35,141,530**	$ 35,155,121
Operating Expenses		
Cost of sales, excluding costs below	**21,758,558**	21,957,971
Operations	**9,446,616**	9,815,819
Maintenance	**513,356**	461,586
Depreciation and amortization	**2,044,179**	1,889,266
Other taxes	**1,216,684**	1,129,628
Total operating expenses	**34,979,393**	35,254,270
Operating Income (Loss)	**162,137**	(99,149)
Other income (loss) net of other expenses	**(12,091)**	19,493
Interest charges	**1,340,879**	1,272,196
Loss Before Income Taxes	**(1,190,833)**	(1,351,852)
Income taxes	**(534,254)**	(658,078)
Net Loss	**($656,579)**	($693,774)
Earnings Per Share of Common Stock:		
Basic	**($0.11)**	($0.12)
Diluted	**($0.11)**	($0.12)
Basic weighted average shares outstanding	**5,973,149**	5,851,926
Diluted weighted average shares outstanding	**5,973,149**	5,851,926
Cash Dividends Declared Per Share of Common Stock:	**$ 0.290**	$ 0.285

The accompanying notes are an integral part of these financial statements.

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Statements of Income (Unaudited)

For the Nine Months Ended September 30,		**2006**		**2005**
Operating Revenues	**$**	**170,395,955**	$	155,220,745
Operating Expenses				
Cost of sales, excluding costs below		**116,188,846**		101,453,132
Operations		**27,899,729**		29,325,623
Maintenance		**1,540,963**		1,279,820
Depreciation and amortization		**6,058,529**		5,701,357
Other taxes		**3,903,155**		3,730,674
Total operating expenses		**155,591,222**		141,490,606
Operating Income		**14,804,733**		13,730,139
Other income net of other expenses		**130,208**		330,354
Interest charges		**4,335,568**		3,823,140
Income Before Income Taxes		**10,599,373**		10,237,353
Income taxes		**4,027,027**		3,902,407
Net Income	**$**	**6,572,346**	$	6,334,946
Earnings Per Share of Common Stock:				
Basic	**$**	**1.11**	$	1.09
Diluted	**$**	**1.10**	$	1.07
Basic weighted average shares outstanding		**5,945,119**		5,823,144
Diluted weighted average shares outstanding		**6,069,893**		5,982,303
Cash Dividends Declared Per Share of Common Stock:	**$**	**0.865**	$	0.850

The accompanying notes are an integral part of these financial statements.

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Unaudited)

For the Nine Months Ended September 30,	**2006**	**2005**
Operating Activities		
Net Income	**$ 6,572,346**	$ 6,334,946
Adjustments to reconcile net income to net operating cash:		
Depreciation and amortization	**6,058,529**	5,701,357
Depreciation and accretion included in other costs	**2,288,509**	2,006,726
Deferred income taxes, net	**(2,304,070)**	(922,437)
Unrealized loss on commodity contracts	**(708,915)**	(630,560)
Unrealized loss on investments	**(65,810)**	(18,866)
Employee benefits and compensation	**1,344,924**	1,333,363
Other, net	**(3,085)**	(2,508)
Changes in assets and liabilities:		
Purchase of investments	**(120,476)**	(1,183,889)
Accounts receivable and accrued revenue	**17,284,220**	4,828,374
Propane inventory, storage gas and other inventory	**(1,477,854)**	(5,432,158)
Regulatory assets	**3,729,326**	686,281
Prepaid expenses and other current assets	**(770,470)**	(478,960)
Other deferred charges	**35,101**	(40,790)
Long-term receivables	**108,608**	141,221
Accounts payable and other accrued liabilities	**(19,769,594)**	3,077,798
Income taxes receivable	**3,123,440**	92,961
Accrued interest	**1,024,865**	897,341
Customer deposits and refunds	**767,474**	305,828
Accrued compensation	**(842,766)**	108,798
Regulatory liabilities	**2,785,999**	1,999,921
Other liabilities	**(85,854)**	148,823
Net cash provided by operating activities	**18,974,447**	18,953,570
Investing Activities		
Property, plant and equipment expenditures	**(28,335,269)**	(19,940,043)
Environmental recoveries (expenditures)	**(9,625)**	205,689
Net cash used by investing activities	**(28,344,894)**	(19,734,354)

Financing Activities				
Common stock dividends		**(4,462,307)**		(4,334,573)
Issuance of stock for Dividend Reinvestment Plan		**228,352**		282,453
Cash settlement of warrants		**(434,782)**		-
Change in cash overdrafts due to outstanding checks		**1,042,051**		842,674
Net borrowing under line of credit agreements		**14,790,072**		4,779,169
Repayment of long-term debt		**(1,929,619)**		(1,794,596)
Net cash provided (used) by financing activities		**9,233,767**		(224,873)
Net Decrease in Cash and Cash Equivalents		**(136,680)**		(1,005,657)
Cash and Cash Equivalents — Beginning of Period		**2,487,658**		1,611,761
Cash and Cash Equivalents — End of Period	**$**	**2,350,978**	$	606,104
Supplemental Disclosures of Non-Cash Investing Activities:				
Capital property and equipment acquired on account, but not paid as of September 30	**$**	**4,291,387**	**$**	**68,504**

The accompanying notes are an integral part of these financial statements.

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Balance Sheets (Unaudited)

Assets	**September 30, 2006**	**December 31, 2005**
Property, Plant and Equipment		
Natural gas distribution and transmission	**$ 238,607,537**	$ 220,685,461
Propane	**43,174,349**	41,563,810
Advanced information services	**951,500**	1,221,177
Other plant	**9,110,426**	9,275,729
Total property, plant and equipment	**291,843,812**	272,746,177
Less: Accumulated depreciation and amortization	**(83,605,340)**	(78,840,413)
Plus: Construction work in progress	**17,711,608**	7,598,531
Net property, plant and equipment	**225,950,080**	201,504,295
Investments	**1,871,921**	1,685,635
Current Assets		
Cash and cash equivalents	**2,350,978**	2,487,658
Accounts receivable (less allowance for uncollectible accounts of $849,292 and $861,378, respectively)	**39,638,501**	54,284,011
Accrued revenue	**2,077,674**	4,716,383
Propane inventory, at average cost	**7,462,209**	6,332,956
Other inventory, at average cost	**1,580,509**	1,538,936
Regulatory assets	**633,663**	4,434,828
Storage gas prepayments	**8,935,207**	8,628,179
Income taxes receivable	**-**	2,725,840
Deferred income taxes	**1,643,394**	-
Prepaid expenses	**2,780,135**	2,021,164
Other current assets	**3,189,770**	1,596,797
Total current assets	**70,292,040**	88,766,752
Deferred Charges and Other Assets		
Goodwill	**674,451**	674,451
Other intangible assets, net	**195,329**	205,683
Long-term receivables	**852,826**	961,434
Other regulatory assets	**1,194,483**	1,178,232
Other deferred charges	**930,265**	1,003,393
Total deferred charges and other assets	**3,847,354**	4,023,193
Total Assets	**$ 301,961,395**	$ 295,979,875

The accompanying notes are an integral part of these financial statements.

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Balance Sheets (Unaudited)

Capitalization and Liabilities	**September 30, 2006**	**December 31, 2005**
Capitalization		
Stockholders' equity		
Common Stock, par value $0.4867 per share (authorized 12,000,000 shares) (1)	**$ 2,910,261**	$ 2,863,212
Additional paid-in capital	**41,927,856**	39,619,849
Retained earnings	**44,276,164**	42,854,894
Accumulated other comprehensive income	**(578,151)**	(578,151)
Deferred compensation obligation	**1,104,670**	794,535
Treasury stock	**(1,104,670)**	(797,156)
Total stockholders' equity	**88,536,130**	84,757,183
Long-term debt, net of current maturities	**56,792,273**	58,990,363
Total capitalization	**145,328,403**	143,747,546
Current Liabilities		
Current portion of long-term debt	**4,929,091**	4,929,091
Short-term borrowing	**51,314,364**	35,482,241
Accounts payable	**27,994,213**	45,645,228
Customer deposits and refunds	**5,908,474**	5,140,999
Accrued interest	**1,583,586**	558,719
Dividends payable	**1,733,280**	1,676,398
Income taxes payable	**397,600**	-
Deferred income taxes	**-**	1,150,828
Accrued compensation	**2,652,758**	3,793,244
Regulatory liabilities	**3,801,066**	550,546
Other accrued liabilities	**5,431,341**	3,560,055
Total current liabilities	**105,745,773**	102,487,349
Deferred Credits and Other Liabilities		
Deferred income taxes	**24,738,777**	24,248,624
Deferred investment tax credits	**325,973**	367,085
Other regulatory liabilities	**1,590,010**	2,008,779
Environmental liabilities	**241,538**	352,504
Accrued pension costs	**3,126,275**	3,099,882
Accrued asset removal cost	**18,057,163**	16,727,268
Other liabilities	**2,807,483**	2,940,838
Total deferred credits and other liabilities	**50,887,219**	49,744,980

Commitments and Contingencies ***(Note 4)***				
Total Capitalization and Liabilities	**$**	**301,961,395**	$	295,979,875

(1) Shares issued were 5,979,769 and 5,883,099 for 2006 and 2005, respectively. Shares outstanding were 5,979,769 and 5,883,002 for 2006 and 2005, respectively.

The accompanying notes are an integral part of these financial statements.

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Statements of Stockholders' Equity (Unaudited)

	For the Nine Months Ended September 30, 2006	For the Twelve Months Ended December 31, 2005
Common Stock		
Balance — beginning of period	**$ 2,863,212**	$ 2,812,538
Dividend Reinvestment Plan	**13,664**	20,038
Retirement Savings Plan	**11,161**	10,255
Conversion of debentures	**7,688**	11,004
Performance shares and options exercised	**14,536**	9,377
Balance — end of period	**$ 2,910,261**	$ 2,863,212
Additional Paid-in Capital		
Balance — beginning of period	**$ 39,619,849**	$ 36,854,717
Dividend Reinvestment Plan	**846,573**	1,224,874
Retirement Savings Plan	**700,506**	682,829
Conversion of debentures	**260,784**	373,259
Performance shares and options exercised	**887,426**	484,170
Exercise of warrants	**(387,282)**	-
Balance — end of period	**$ 41,927,856**	$ 39,619,849
Retained Earnings		
Balance — beginning of period	**$ 42,854,894**	$ 39,015,087
Net income	**6,572,346**	10,467,614
Cash dividends declared	**(5,151,076)**	(6,627,807)
Balance — end of period	**$ 44,276,164**	$ 42,854,894
Accumulated Other Comprehensive Income		
Balance — beginning of period	**($578,151)**	(527,246)
Minimum pension liability adjustment, net of tax	**-**	(50,905)
Balance — end of period	**($578,151)**	($578,151)
Deferred Compensation Obligation		
Balance — beginning of period	**$ 794,535**	$ 816,044
New deferrals	**310,135**	130,426
Payout of deferred compensation	**-**	(151,935)
Balance — end of period	**$ 1,104,670**	$ 794,535
Treasury Stock		
Balance — beginning of period	**($797,156)**	($1,008,696)
	(310,135)	(130,426)

New deferrals related to compensation obligation				
Purchase of treasury stock [1]		**(37,719)**		(182,292)
Sale and distribution of treasury stock [2]		**40,340**		524,258
Balance — end of period		**($1,104,670)**		($797,156)
Total Stockholders' Equity	**$**	**88,536,130**	$	84,757,183

(1) Amount includes shares purchased in the open market for the Company's Rabbi Trust to secure it's obligations under the Company's Supplemental Executive Retirement Savings Plan ("SERP plan").

(2) Amount includes shares issued to the Company's Rabbi Trust as obligation under the SERP plan.

The accompanying notes are an integral part of these financial statements.

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income (Unaudited)

	For the Nine Months Ended September 30, 2006	For the Twelve Months Ended December 31, 2005
Net income	**$ 6,572,346**	$ 10,467,614
Minimum pension liability adjustment, net of tax benefit of $33,615	**-**	(50,905)
Comprehensive Income	**$ 6,572,346**	$ 10,416,709

The accompanying notes are an integral part of these financial statements.

Notes to the Condensed Consolidated Financial Statements

1. Basis of Presentation

References in this document to "the Company," "Chesapeake," "we," "us" and "our" are intended to mean Chesapeake Utilit Corporation and its subsidiaries.

The accompanying unaudited consolidated financial statements have been prepared in compliance with the rules and regulations of the Securities and Exchange Commission ("SEC") and United States of America Generally Accepted Accounting Principles ("GAAP"). In accordance with these rules and regulations, certain information and disclosures normally required for audited financial statements have been condensed or omitted. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto, included in the Company's latest Annual Report on Form 10-K for the year ended December 31, 2005 filed on March 7, 2006. In the opinion of management, these statements reflect normal recurring adjustments that are necessary for a fair presentation of the Company's results of operations, financial position and cash flows for the interim periods presented.

2. Comprehensive Income (Loss)

Comprehensive income contains items that are excluded from "net income (loss)" and recorded directly to stockholders' equity. Chesapeake did not have any adjustments to the components of comprehensive income that are required to be reported by Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income," for the three and nine months ended September 30 2006 and 2005. Accumulated other comprehensive income was ($578,151) at September 30, 2006 and December 31, 2005 and ($527,246) at September 30, 2005 and December 31, 2004.

3. Calculation of Earnings Per Share ("EPS")

	Three Months Ended		Nine Months Ended	
For the Periods Ended September 30,	**2006**	**2005**	**2006**	**2005**
Calculation of Basic Earnings Per Share:				
Net Income (Loss)	**($656,579)**	($693,774)	**$ 6,572,346**	$ 6,334,946
Weighted average shares outstanding	**5,973,149**	5,851,926	**5,945,119**	5,823,144
Basic Earnings Per Share	**($0.11)**	($0.12)	**$ 1.11**	$ 1.09
Calculation of Diluted Earnings Per Share:				
Reconciliation of Numerator:				
Net Income (Loss)	**($656,579)**	($693,774)	**$ 6,572,346**	$ 6,334,946
Effect of 8.25% Convertible debentures (1)	**-**	-	**79,900**	94,441
Adjusted numerator — Diluted	**($656,579)**	($693,774)	**$ 6,652,246**	$ 6,429,387

Reconciliation of Denominator:				
Weighted shares outstanding — Basic	**5,973,149**	5,851,926	**5,945,119**	5,823,144
Effect of dilutive securities [1]				
Stock options	**-**	-	**-**	371
Warrants	**-**	-	**-**	11,262
8.25% Convertible debentures	**-**	-	**124,774**	147,526
Adjusted denominator — Diluted	**5,973,149**	5,851,926	**6,069,893**	5,982,303
Diluted Earnings per Share	**($0.11)**	($0.12)	**$ 1.10**	$ 1.07

[1] The amount of interest accumulated, per common share, for the three-month periods ended September 30, 2006 and 2005, obtainable from the 8.25% Convertible Debentures exceeds Basic EPS. The inclusion of these securities would therefore have an anti-dilutive effect on EPS for the three-month periods presented and, accordingly, have been omitted from this calculation for the quarter. The Company did not have any outstanding stock options or warrants at September 30, 2006.

4. Commitments and Contingencies

Environmental Matters

Chesapeake is subject to federal, state and local laws and regulations governing environmental quality and pollution control. These laws and regulations require the Company to remove or remedy the effect on the environment of the disposal or release of specified substances at current and former operating sites.

In 2004, Chesapeake received a Certificate of Completion for the remedial work performed at a former gas manufacturing plant site located in Dover, Delaware. Chesapeake is also currently participating in the investigation, assessment or remediation of two additional former gas manufacturing plant sites located in Maryland and Florida. The Company has accrued liabilities for the three sites referred to respectively as the Dover Gas Light, Salisbury Town Gas Light and the Winter Haven Coal Gas sites. The Company has been in discussions with the Maryland Department of the Environment ("MDE") regarding a fourth former gas manufacturing plant site located in Cambridge, Maryland. The following provides details of each site.

Dover Gas Light Site

The Dover Gas Light site is a former manufactured gas plant site located in Dover, Delaware. On January 15, 2004, the Company received a Certificate of Completion of Work from the United States Environmental Protection Agency ("EPA") regarding this site. This concluded Chesapeake's remedial action obligation related to this site and relieves Chesapeake from liability for future remediation at the site, unless previously unknown conditions are discovered at the site, or information previously unknown to the EPA is received that indicates the remedial action that has been taken is not sufficiently protective. These contingencies are standard and are required by the United States in all liability settlements.

The Company has reviewed its remediation costs incurred to date for the Dover Gas Light site and has concluded that all costs incurred have been paid. The Company does not expect any future environmental expenditures for this site. Through September 30, 2006, the Company has incurred approximately $9.7 million in costs related to environmental testing and remedial action studies at the site. Approximately $10.0 million has been recovered through September 2006 from other parties or through rates. As of September 30, 2006, a regulatory liability of approximately $343,000, representing the over-recovery portion of the clean-up costs, has been recorded. The over-recovery is temporary and will be refunded by the Company to customers in future rates.

Salisbury Town Gas Light Site

In cooperation with the MDE, the Company has completed remediation of the Salisbury Town Gas Light site, located in Salisbury, Maryland, where it was determined that a former manufactured gas plant had caused localized ground-water contamination. During 1996, the Company completed construction and began Air Sparging and Soil-Vapor Extraction ("AS/SVE") remediation procedures. Chesapeake has been reporting the remediation and monitoring results to the MDE on an ongoing basis since 1996. In February 2002, the MDE granted permission to permanently decommission the AS/SVE system and to discontinue all on-site and off-site well monitoring, except for one well that is being maintained for continued product monitoring and recovery. In November 2002, Chesapeake submitted a letter to the MDE requesting a No Further Action determination. The Company has been in discussions with the MDE regarding such request and is awaiting a determination from the MDE.

Through September 30, 2006, the Company has incurred approximately $2.9 million for remedial actions and environmental studies at the Salisbury Town Gas Light site. Of this amount, approximately $1.8 million has been recovered through insurance proceeds or in rates. On September 26, 2006, the Company received approval from the Maryland Public Service Commission to recover through its rates charged to customers the remaining $1.1 million of the incurred environmental remediation costs.

Winter Haven Coal Gas Site

The Winter Haven Coal Gas site is located in Winter Haven, Florida. Chesapeake has been working with the Florida Department of Environmental Protection ("FDEP") in assessing this coal gas site. In May 1996, the Company filed an AS/SVE Pilot Study Work Plan (the "Work Plan") for the Winter Haven site with the FDEP. The Work Plan described the Company's proposal to undertake an AS/SVE pilot study to evaluate the site. After discussions with the FDEP, the Company filed a modified Work Plan, the description of the scope of work to complete the site assessment activities and a report describing a limited sediment investigation performed in 1997. In December 1998, the FDEP approved the modified Work Plan, which the Company completed during the third quarter of 1999. In February 2001, the Company filed a Remedial Action Plan ("RAP") with the FDEP to address the contamination of the subsurface soil and ground-water in a portion of the site. The FDEP approved the RAP on May 4, 2001. Construction of the AS/SVE system was completed in the fourth quarter of 2002 and the system remains fully operational.

The Company has accrued a liability of $242,000 as of September 30, 2006 for the Winter Haven Coal Gas site. Through September 30, 2006, the Company has incurred approximately $1.6 million of environmental costs associated with this site. At September 30, 2006, the Company had collected $102,000 through rates in excess of costs incurred. A regulatory asset of approximately $140,000, representing the uncollected portion of the estimated clean-up costs, has also been recorded. The Company expects to recover the remaining costs through rates.

The FDEP has indicated that the Company may be required to remediate sediments along the shoreline of Lake Shipp, immediately west of the Winter Haven site. Based on studies performed to date, the Company objects to the FDEP's suggestion that the sediments have been contaminated and will require remediation. The Company's early estimates indicate that some of the corrective measures discussed by the FDEP may cost as much as $1 million. Given the Company's view as to the absence of ecological effects, the Company believes that cost expenditures of this magnitude are unwarranted and plans to oppose any requirements that it undertake corrective measures in the offshore sediments. Chesapeake anticipates that it will be several years before this issue is resolved. At this time, the Company has not recorded a liability for sediment remediation. The outcome of this matter cannot be predicted at this time.

Other

The Company is in discussions with the MDE regarding a gas manufacturing plant site located in Cambridge, Maryland. The outcome of this matter cannot be determined at this time; therefore, the Company has not recorded an environmental liability for this location.

Other Commitments and Contingencies

Natural Gas and Propane Supply

The Company's natural gas and propane distribution operations have entered into contractual commitments to purchase gas from various suppliers. The contracts have various expiration dates. In November 2004, the Company renewed its contract with an energy marketing and risk management company to manage a portion of the Company's natural gas transportation and storage capacity. The contract expires March 31, 2007.

Corporate Guarantees

The Company has issued corporate guarantees to certain vendors of its propane wholesale marketing subsidiary, its Florida natural gas marketing subsidiary, and Delmarva propane distribution subsidiary. These corporate guarantees provide for the payment of propane and natural gas purchases in the event of the subsidiaries' default. The liabilities for these purchases are recorded in the Consolidated Financial Statements. The aggregate amount guaranteed at September 30, 2006, totaled $18.9 million, with the guarantees expiring on various dates in 2006 and 2007.

In addition to the corporate guarantees, the Company has issued a letter of credit to its primary insurance company for $775,000, which expires on May 31, 2007. The letter of credit is provided as security for claims amounts to satisfy the deductibles on the Company's policies. The current letter of credit was renewed during the second quarter of 2006 when the insurance policies were renewed.

Application of SFAS No. 71

Certain assets and liabilities of the Company are accounted for in accordance with SFAS No. 71 ¾"Accounting for the Effects of Certain Types of Regulation." SFAS No. 71 provides guidance for public utilities and other regulated operations where the rates (prices) charged to customers are subject to regulatory review and approval. Regulators sometimes include allowable costs in a period other than the period in which the costs would be charged to expense by an unregulated enterprise. That procedure can create assets, reduce assets, or create liabilities for the regulated enterprise. For financial reporting, an incurred cost for which a regulator permits recovery in a future period is accounted for like an incurred cost that is reimbursable under a cost-reimbursement type contract. The Company believes that all regulatory assets as of September 30, 2006 are probable of recovery through rates. If the Company were required to terminate the application of SFAS No. 71 to its regulated operations, all such deferred amounts would be recognized in the income statement at that time. This would result in a charge to earnings, net of applicable income taxes, that could be material.

Other

The Company is involved in certain legal actions and claims arising in the normal course of business. The Company is also involved in certain legal and administrative proceedings before various governmental agencies concerning rates. In the opinion of management, the ultimate disposition of these proceedings will not have a material effect on the consolidated financial position, results of operations or cash flows of the Company.

5. Recent Authoritative Pronouncements on Financial Reporting and Accounting

In December 2004, the FASB released a revision ("Share-Based Payment") to SFAS No. 123, "Accounting for Stock-Based Compensation," referred to as SFAS No. 123R. SFAS 123R establishes financial accounting and reporting standards for stock-based employee compensation plans. Those plans include all arrangements by which employees receive shares of stock or other equity instruments of the employer or the employer incurs liabilities to employees in amounts based on the price of the employer's stock. Examples are stock purchase plans, stock options, restricted stock and stock appreciation rights. The impact of the Company's adoption of this pronouncement is disclosed in Note 9 to the financial statements entitled "Share Based Compensation."

In July 2006, the FASB issued FASB Interpretation 48, “Accounting for Income Tax Uncertainties,” (“FIN 48”). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as “more-likely-than-not” to be sustained by the taxing authority. The recently issued literature also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. FIN 48 is effective for fiscal years beginning after December 15, 2006. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded in retained earnings. The Company is continuing to evaluate the impact of this new standard, if any, on the Company’s financial statements.

In September 2006, the FASB issued Statement No. 157, “Fair Value Measurements ” (“SFAS No. 157”), which clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure and gives the highest priority to quoted prices in active markets in determining fair value. SFAS No. 157 requires disclosures about (1) the extent to which companies measure assets and liabilities at fair value, (2) the methods and assumptions used to measure fair value, and (3) the effect of fair value measures on earnings. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is continuing to evaluate the impact of this new standard, if any, on the Company’s financial statements.

In September 2006, the FASB issued SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106 and 132(R).” This statement would require a company to (a) recognize in its statement of financial position an asset for a plan’s overfunded status or a liability for a plan’s underfunded status, (b) measure a plan’s assets and its obligations that determine its funded status as of the end of the employer’s fiscal year, and (c) recognize changes in the funded status of a defined postretirement plan in the year in which the changes occur and to report the changes as adjustments to comprehensive income. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006. The requirement to measure the plan assets and benefit obligations as of the date of the employer’s fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2006. The Company does not anticipate that the adoption of SFAS No. 158 will have a material impact on the Company’s financial position, and anticipates no impact to the statements of income or cash flows.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements” (“SAB 108”), which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 is effective as of the end of our 2006 fiscal year, allowing a one-time transitional cumulative effect adjustment to beginning retained earnings as of January 1, 2006, for errors that were not previously deemed material, but are material under the guidance in SAB 108. The Company does not anticipate that the adoption of SAB 108 will have a material impact on our Consolidated Financial Statements.

6. Segment Information

Chesapeake uses the management approach to identify operating segments. Chesapeake organizes its business around differences in products or services and the operating results of each segment are regularly reviewed by the Company's chief operating decision maker in order to make decisions about resources and to assess performance. The following table presents information about the Company's reportable segments.

For the Periods Ended September 30,	Three Months Ended 2006	Three Months Ended 2005	Nine Months Ended 2006	Nine Months Ended 2005
Operating Revenues, Unaffiliated Customers				
Natural gas	**$ 25,949,067**	$ 26,085,513	**$ 126,855,572**	$ 112,336,037
Propane	**5,850,616**	5,913,760	**34,338,931**	33,399,579
Advanced information services	**3,341,847**	3,151,372	**9,200,427**	9,341,258
Other	**-**	4,476	**1,025**	143,871
Total operating revenues, unaffiliated customers	**$ 35,141,530**	$ 35,155,121	**$ 170,395,955**	$ 155,220,745
Intersegment Revenues (1)				
Natural gas	**$ 66,214**	$ 57,466	**$ 183,930**	$ 141,483
Propane	**-**	-	**-**	668
Advanced information services	**12,475**	2,624	**33,988**	13,433
Other	**154,623**	154,623	**463,869**	463,869
Total intersegment revenues	**$ 233,312**	$ 214,713	**$ 681,787**	$ 619,453
Operating Income				
Natural gas	**$ 1,760,552**	$ 1,130,620	**$ 13,256,385**	$ 12,116,857
Propane	**(1,826,353)**	(1,425,028)	**1,165,748**	1,814,135
Advanced information services	**321,528**	186,425	**509,898**	(77,165)
Other and eliminations	**(93,590)**	8,834	**(127,298)**	(123,688)
Total operating income	**$ 162,137**	($99,149)	**$ 14,804,733**	$ 13,730,139

(1) All significant intersegment revenues are billed at market rates and have been eliminated from consolidated revenues.

	September 30, 2006	December 31, 2005
Identifiable Assets		
Natural gas	**$ 224,192,686**	$ 225,667,049
Propane	**64,449,789**	57,344,859
Advanced information services	**2,701,590**	2,062,902
Other	**10,617,330**	10,905,065
Total identifiable assets	**$ 301,961,395**	$ 295,979,875

The Company's operations are all domestic. The advanced information services segment, headquartered in Norcross, Georgia, provides domestic and international clients with information technology related business services and solutions. These transactions with foreign companies are denominated and paid in U.S. dollars. These transactions are immaterial to the consolidated revenues.

7. Employee Benefit Plans

Net periodic benefit costs for the defined benefit pension plan, the executive excess retirement benefit plan and other post-retirement benefits are shown below:

For the Three Months Ended September 30,	Defined Benefit Pension Plan 2006	Defined Benefit Pension Plan 2005	Executive Excess Retirement Benefit Plan 2006	Executive Excess Retirement Benefit Plan 2005	Other Post-Retirement Benefits 2006	Other Post-Retirement Benefits 2005
Service Cost	$ 0	$ 0	$ 0	$ 0	$ 1,564	$ 1,564
Interest Cost	161,212	161,435	29,897	29,915	19,468	19,468
Expected return on plan assets	(174,191)	(175,821)	-	-	-	-
Amortization of transition amount	-	-	-	-	6,964	6,964
Amortization of prior service cost	(1,174)	(1,174)	-	-	-	-
Amortization of net loss (gain)	-	-	14,259	12,329	22,072	22,072
Net periodic (benefit) cost	($14,153)	($15,560)	$ 44,156	$ 42,244	$ 50,068	$ 50,068

For the Nine Months Ended September 30,	Defined Benefit Pension Plan 2006	Defined Benefit Pension Plan 2005	Executive Excess Retirement Benefit Plan 2006	Executive Excess Retirement Benefit Plan 2005	Other Post-Retirement Benefits 2006	Other Post-Retirement Benefits 2005
Service Cost	$ 0	$ 0	$ 0	$ 0	$ 4,693	$ 4,693
Interest Cost	474,664	484,305	89,691	89,744	58,404	58,404
Expected return on plan assets	(516,343)	(527,464)	-	-	-	-
Amortization of transition amount	-	-	-	-	20,894	20,894
Amortization of prior service cost	(3,524)	(3,524)	-	-	-	-
Amortization of net loss (gain)	-	-	42,779	36,989	66,218	66,218
Net periodic (benefit) cost	($45,203)	($46,683)	$ 132,470	$ 126,733	$ 150,209	$ 150,209

As disclosed in the December 31, 2005 financial statements, no contributions are expected to be required in 2006 for the defined benefit pension plan. The Company maintains a Rabbi Trust to cover the costs of the executive excess retirement benefit plan (Note 8); however, the other post-retirement benefit plans are unfunded. Cash benefits paid under the executive excess retirement benefit plan for the first nine months of 2006 were $73,000, and for the year 2006, benefits paid are expected to be $100,000. Net benefits paid for other post-retirement benefits are primarily for medical claims and were $121,000 for the first nine months of 2006. For the year 2006, the Company has estimated that the benefits to be paid are $215,000.

8. Investments

The Company maintains investments in a Rabbi Trust to cover the cost of the Company's Supplemental Executive Retirement Savings Plan. In accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and based on the Company's intentions regarding these instruments, the Company classifies all investments in equity securities as trading securities. As a result of classifying them as trading securities, the Company is required to report the securities at their fair value, with any unrealized gains and losses included in earnings. At the end of September 2006, total investments had a fair value of $1.9 million.

9. Share-Based Compensation

Effective January 1, 2006, the Company adopted SFAS No. 123R, "Share-Based Payment," which establishes accounting for equity instruments exchanged for employee services. Prior to January 1, 2006, the Company accounted for share-based compensation to employees in accordance with Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees," and related interpretations. The Company also followed the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure." Commencing January 1, 2006, the Company elected to adopt the modified prospective method as provided by SFAS No. 123R and, accordingly, financial statement amounts for the prior periods presented in this Form 10-Q have not been restated to reflect the fair value of expensing stock-based compensation.

For the three months ended September 30, 2006 and 2005, included in net income are expense amounts of $173,000 and $206,000, after-tax, respectively, related to stock-based compensation expense from restricted stock awards issued under the Company's Director's Stock Compensation and Performance Incentive Plans. For the first nine months of 2006 and 2005, included in net income are expense amounts of $437,000 and $465,000, after-tax, respectively, related to stock-based compensation expense from restricted stock awards issued under the Company's Director's Stock Compensation and Performance Incentive Plans.

Stock Options

The Company did not have any stock options outstanding at September 30, 2006 or December 31, 2005, nor were any stock options issued during the nine months ended September 30, 2006.

Director's Stock Compensation Plan ("DSCP")

Under the Company's DSCP, each non-employee director receives an annual retainer of 600 shares of common stock and an additional 150 shares of common stock for services as a committee chairman, subject to adjustment in future years consistent with the terms of the DSCP. Shares issued under the DSCP are fully vested as of the date of the grant. At the date of grant, the Company records a prepaid expense equal to the fair value of the shares issued and amortizes the expense equally over the service period of one year. Compensation expense recorded by the Company relating to the DSCP awards was $44,000 and $36,000 for the three-month periods ended September 30, 2006 and 2005, respectively, and $121,000 and $104,000 for the first nine months of 2006 and 2005, respectively.

A summary of restricted stock activity for the DSCP as of September 30, 2006, and changes during the nine months then ended, is presented below:

	Number of Restricted Shares	Weighted Average Grant Date Fair Value
Outstanding — December 31, 2005	-	
Issued — May 2, 2006	5,850	$ 30.02
Vested	5,850	
Outstanding — September 30, 2006	-	

Performance Incentive Plans ("PIP")

The Company's Compensation Committee of the Board of Directors is authorized to grant to key employees of the Company the rights to receive awards of shares of the Company's common stock, contingent upon the achievement of established performance goals. These awards are made pursuant to the Company's Performance Incentive Plan, subject to certain post-vesting transfer restrictions, and are granted in the first quarter of each year based upon the performance achieved in the previous fiscal year. In the first quarters of 2006 and 2005, the Company granted 23,666 and 10,130 shares, respectively, to key employees as PIP stock awards for each of the preceding fiscal years.

The Company accrues an expense each month of the fiscal year, preceding the date of grant, representing an estimate of the value of the stock awards to be granted for the current fiscal year. This accrual process matches the compensation expense with the employees' service period rather than recognizing the expense on the grant date, which occurs in the first quarter of the subsequent year. The shares granted under the PIP are fully vested and the fair value of each share is equal to the market price of the Company's stock on the date of grant. Compensation expense recorded by the Company relating to the PIP was $239,000 and $302,000 for the three-month periods ended September 30, 2006 and 2005, respectively, and $596,000 and $659,000 for the first nine months of 2006 and 2005, respectively.

A summary of restricted stock activity for the PIP as of September 30, 2006, and changes during the nine months then ended, is presented below:

	Number of Restricted Shares	Weighted Average Grant Date Fair Value
Outstanding — December 31, 2005	-	
Issued — February 23, 2006	23,666	$ 30.3999
Vested	23,666	
Outstanding — September 30, 2006	-	

10. Stockholders' Equity

The changes in common stock shares issued and outstanding are shown below:

	For the Nine Months Ended September 30, 2006	For the Twelve Months Ended December 31, 2005
Common Stock shares issued and outstanding [1]		
Shares issued — beginning of period balance	**5,883,099**	5,778,976
Dividend Reinvestment Plan [2]	**28,075**	41,175
Retirement Savings Plan	**22,932**	21,071
Conversion of debentures	**15,797**	22,609
Employee award plan	**350**	-
Performance shares and options exercised [3]	**29,516**	19,268
Shares issued — end of period balance [4]	**5,979,769**	5,883,099
Treasury shares — beginning of period balance	**(97)**	(9,418)
Purchases	**-**	(4,852)
Dividend Reinvestment Plan	**-**	2,142
Retirement Savings Plan	**-**	12,031
Other issuances	**97**	-
Treasury Shares — end of period balance	**-**	(97)
Total Shares Outstanding	**5,979,769**	**5,883,002**

[1] 12,000,000 shares are authorized at a par value of $0.4867 per share.

[2] Includes shares purchased with reinvested dividends and optional cash payments.

[3] Includes shares issued for Directors' compensation.

[4] Includes 47,721 and 37,528 shares at September 30, 2006 and December 31, 2005, respectively, held in a Rabbi Trust established by the Company relating to the Supplemental Executive Retirement Savings Plan.

In 2000 and 2001, the Company entered into agreements with an investment banker to assist in identifying acquisition candidates. Under the agreements, the Company issued warrants to the investment banker to purchase 15,000 share of Chesapeake stock in 2000 at an exercise price of $18.00 per share and 15,000 shares in 2001 at an exercise price of $18.25 per share.

In August 2006, the investment banker exercised the 30,000 warrants pursuant to the terms of the agreement at $33.3657 per share. At the request of the investment banker, Chesapeake settled the warrants with a cash payment of $434,782, in lieu of issuing shares of the Company’s common stock. Chesapeake does not have any other stock warrants outstanding at September 30, 2006.

11. Other Event

In March 2006, the Company's propane distribution subsidiary, Sharp Energy, Inc. ("Sharp"), identified that approximately 75,000 gallons of propane that it purchased contained above-normal levels of petroleum byproducts. The supplier's testing identified above-normal concentration levels of the petroleum byproduct benzene. Benzene, which may be found in trace amounts in propane, is used to make plastics, resins, nylon, synthetic fibers, detergents, lubricants, drugs, dyes and pesticides. It is also routinely found in crude oil and gasoline. The supplier has conducted modeling and testing of the propane in combustion situations and has stated that they have found no health or safety concerns.

Sharp replaced the propane for each of the approximately 600 customers impacted by this event at no cost to the customers. Sharp also replaced any remaining propane contained at its storage facilities. The propane that the Company retrieved from customers and Sharp's storage facilities was returned to the supplier.

The supplier indicated that it would reimburse Sharp for all damages, costs and expenses incurred by Sharp or the Company in connection with this matter. As a result of the supplier's commitment, Sharp invoiced the supplier $734,000 for costs relating to this incident through September 2006. The supplier has paid the entire amount and no amounts remain outstanding at September 30, 2006. The Company does not anticipate any additional costs in relation to the incident and does not believe that the event will ultimately have a material adverse effect on the Company or its business, results of operations or long-term financial condition.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is designed to provide a reader of the financial statements with a narrative on the Company's financial condition, results of operations and liquidity. The Company's MD&A is presented in nine sections: Overview, Results of Operations, Liquidity and Capital Resources, Off-Balance Sheet Arrangements, Contractual Obligations, Environmental Matters, Other Matters, Competition, and Recent Accounting Pronouncements. This discussion and analysis should be read in conjunction with the attached unaudited consolidated financial statements and notes thereto and Chesapeake's 2005 Annual Report on Form 10-K, including the audited consolidated financial statements and notes contained in the 2005 Annual Report on Form 10-K.

Overview

Chesapeake Utilities Corporation (the "Company" or "Chesapeake") is a diversified utility company engaged in natural gas distribution, transmission and marketing, propane distribution and wholesale marketing, advanced information services and other related businesses. For additional information regarding segments, refer to Note 6, "Segment Information," of the Notes to the Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

The Company's strategy is to grow earnings from a stable utility foundation by investing in related businesses and services that provide opportunities for higher, unregulated returns. This growth strategy includes acquisitions and investments in unregulated businesses, as well as the continued investment and expansion of the Company's utility operations that provide the stable base of earnings. The Company continually reevaluates its investments to ensure that they are consistent with its strategy and the goal of enhancing shareholder value. The Company's unregulated businesses and services currently include natural gas marketing, propane distribution and wholesale marketing, advanced information services and other related businesses.

Due to the seasonality of the Company's business, results for interim periods are not necessarily indicative of results for the entire fiscal year. Revenue and earnings are typically greater during the Company's first and fourth quarters, when natural gas and propane consumption is highest due to colder temperatures.

The principal business, economic and other factors that affect the operations and/or financial performance of the Company include:

- weather conditions and weather patterns;
- regulatory environment and regulatory decisions;
- availability of natural gas and propane supplies;
- natural gas and propane production levels;
- interstate pipeline transportation and storage capacity;
- natural gas and propane prices and the prices of competing fuels, such as oil and electricity;
- changes in natural gas and propane usage resulting from customer conservation, including improved appliance efficiencies;
- the level of capital expenditures for adding new customers and replacing facilities worn beyond economic repair;
- use of derivative instruments;
- changes in credit risk;
- competitive environment;
- environmental matters;
- economic conditions and interest rates;
- inflation / deflation;
- changes in technology; and
- changes in accounting principles.

Results of Operations for the Three Months Ended September 30, 2006

Consolidated Overview
The Company's operating income increased by $261,000 for the quarter ended September 30, 2006 compared to the same period in 2005. The Company's seasonal net loss for the quarter ended September 30, 2006 decreased $37,000, or 5 percent, compared to the same period in 2005. The Company experienced a net loss of $657,000, or $0.11 per share (diluted) — a decrease of $0.01 in the loss per share when compared to 2005. The Company's Delmarva natural gas distribution and propane distribution operations typically experience seasonal losses during the third quarter, because heating customers do not require gas in the summer months.

For the Three Months Ended September 30,	**2006**	**2005**	**Change**
Operating Income			
Natural Gas	**$ 1,760,552**	$ 1,130,620	$ 629,932
Propane	**(1,826,353)**	(1,425,028)	(401,325)
Advanced Information Services	**321,528**	186,425	135,103
Other & eliminations	**(93,590)**	8,834	(102,424)
Operating Income	**162,137**	(99,149)	261,286
Other Income (Loss)	**(12,091)**	19,493	(31,584)
Interest Charges	**1,340,879**	1,272,196	68,683
Income Taxes	**(534,254)**	(658,078)	123,824
Net Loss	**($656,579)**	($693,774)	$ 37,195
Diluted Earnings Per Share	**($0.11)**	($0.12)	$ 0.01

The following discussions for the three months ended September 30, 2006 of segment results include use of the term "gross margin". Gross margin is determined by deducting the cost of sales from operating revenue. Cost of sales includes the purchased gas cost for the natural gas and propane segments and the cost of labor spent on direct revenue-producing activities. Gross margin should not be considered an alternative to operating income or net income, which are determined in accordance with Generally Accepted Accounting Principles ("GAAP"). Chesapeake believes that gross margin, although a non-GAAP measure, is useful and meaningful to investors as a basis for making investment decisions. It provides investors with information that demonstrates the profitability achieved by the Company under its allowed rates for regulated operations and under its competitive pricing structure for unregulated segments. Chesapeake's management uses gross margin in measuring its business units' performance and has historically analyzed and reported gross margin information publicly. Other companies may calculate gross margin in a different manner.

Natural Gas

The natural gas segment earned operating income of $1.8 million for the third quarter of 2006 compared to $1.1 million for the corresponding period last year, an increase of $630,000 or 56 percent. Gross margin increased by $706,000, or 8 percent, while other operating expenses increased $76,000, or 1 percent.

For the Three Months Ended September 30,	2006	2005	Change
Revenue	**$ 26,015,281**	$ 26,142,979	($127,698)
Cost of gas	**15,982,581**	16,816,684	(834,103)
Gross margin	**10,032,700**	9,326,295	706,405
Operations & maintenance	**5,800,783**	5,946,564	(145,781)
Depreciation & amortization	**1,562,522**	1,416,664	145,858
Other taxes	**908,843**	832,447	76,396
Other operating expenses	**8,272,148**	8,195,675	76,473
Total Operating Income	**$ 1,760,552**	$ 1,130,620	$ 629,932
Statistical Data — Delmarva Peninsula			
Heating degree-days (“HDD”)			
Actual	**45**	31	14
10-year average (normal)	**60**	60	-
Estimated gross margin per HDD	**$ 2,234**	$ 2,234	$ 0
Per residential customer added:			
Estimated gross margin	**$ 372**	$ 372	$ 0
Estimated other operating expenses	**$ 111**	$ 106	$ 5
Residential Customer Information			
Average number of customers			
Delmarva	**40,086**	36,803	3,283
Florida	**12,695**	11,599	1,096
Total	**52,781**	48,402	4,379

Gross margin for the Company’s natural gas segment increased $706,000 in the third quarter of 2006 compared to the same period in 2005.

- The Delmarva distribution operations experienced an increase of $121,000 in gross margin. The Company added an average of 3,283 residential customers in Delmarva, an increase of 9 percent, over 2005. The Company estimates that these additional customers added $165,000 to gross margin, which was partially offset by lower volumes sold to existing customers and lower off-system sales.

- The natural gas transmission operation achieved gross margin growth of $486,000, or 14 percent. The increase was attributed to new transportation services implemented in November 2005 and an increase in interruptible revenues. The Company estimates that its annual gross margin for its natural gas transmission operation will be $1.7 million higher in 2006 than in 2005.

- Gross margin for the Florida natural gas distribution and the unregulated natural gas marketing operations increased $85,000 and $14,000, respectively. The increases were attained primarily from continued growth, including a 9 percent increase in the average number of residential customers.

Other operating expenses for the natural gas operations increased $76,000, or 1 percent, in the third quarter of 2006 compared to the same period in 2005. Items contributing to the increase include:

- Due to the additional capital investments by the Company, depreciation and amortization expense, asset removal cost, and property taxes increased $146,000, $60,000, and $82,000, respectively.

- Payroll costs decreased $137,000 primarily due to a decrease of $69,000 in amounts recognized in respect of incentive compensation reflecting the lower than expected earnings as a result of warmer weather. Also contributing to the reduction in payroll costs are other factors such as vacant positions and lower sales commissions.

- Health care costs decreased by $101,000 for the natural gas segment during the third quarter of 2006. The Company changed health care service providers in November 2005 and has subsequently experienced lower cost of claims.

Propane

The seasonal operating loss for the propane segment increased $401,000, or 28 percent in the third quarter of 2006 compared to the same period in 2005. This segment typically experiences a loss during the third quarter, as heating customers do not require propane during the summer months. The operating loss for the third quarter of 2006 was $1.8 million compared to an operating loss of $1.4 million for the same period in 2005.

For the Three Months Ended September 30,	2006	2005	Change
Revenue	**$ 5,850,616**	$ 5,913,760	($63,144)
Cost of sales	**3,967,428**	3,427,896	539,532
Gross margin	**1,883,188**	2,485,864	(602,676)
Operations & maintenance	**3,123,666**	3,349,367	(225,701)
Depreciation & amortization	**415,982**	394,317	21,665
Other taxes	**169,893**	167,208	2,685
Other operating expenses	**3,709,541**	3,910,892	(201,351)
Total Operating Loss	**($1,826,353)**	($1,425,028)	($401,325)
Statistical Data — Delmarva Peninsula			
Heating degree-days (“HDD”)			
Actual	**45**	31	14
10-year average (normal)	**60**	60	-
Estimated gross margin per HDD	**$ 1,743**	$ 1,743	$ 0

The Company’s propane segment experienced a decrease of $603,000 in gross margin in the third quarter of 2006 compared to the same period in 2005, primarily from a decrease of $357,000 for the Delmarva propane distribution operation, a decrease of $206,000 for the propane wholesale and marketing operation and a decrease of $39,000 for the Florida propane distribution operation.

- During the third quarter of 2006, the Delmarva propane distribution operation experienced a decrease in gross margin of $357,000. The reduction in gross margin is primarily attributed to a reduction in the average gross margin per retail gallon and lower service sales. The average gross margin per retail gallon decreased $0.13 in the third quarter of 2006 compared to the same period in 2005, which negatively affected gross margin by $244,000. The decrease in gross margin per retail gallon was principally the result of a $175,000 write-down of propane inventory to reflect the lower of cost or market. The remaining $113,000 decrease of gross margin is from a combination of miscellaneous items, including lower service sales, partially offset by an increase in fuel surcharges and other various fees.

- Gross margin for the Company’s propane wholesale marketing operation decreased by $206,000 in the third quarter of 2006 compared to the same period in 2005. The decrease is primarily due to the decrease of wholesale propane prices experienced in the third quarter of 2006, in contrast to the rising prices experienced in the third quarter of 2005 in response to the hurricanes in the Gulf of Mexico area.

- The Florida propane distribution operation experienced a decrease of $39,000 in gross margin for the third quarter of 2006 compared to the same period in 2005. The lower gross margin reflects a decrease of $70,000 in house-piping sales as the operation is exiting the house-piping service. This was partially offset by an increase in propane margins of $34,000.

Other operating expenses decreased for the three months ended September 30, 2006 by $201,000, compared to the same period in 2005. Items contributing to the decrease include payroll and health care costs:

- Payroll costs decreased $94,000 primarily due to a decrease of $116,000 in amounts recognized with respect to incentive compensation reflecting the lower than expected earnings.

- Health care costs decreased by $104,000 for the third quarter of 2006. The Company changed health care service providers in November 2005 and has subsequently experienced lower cost of claims.

Advanced Information Services

Operating income for the Company’s advanced information services business increased $135,000 for th