NORTHWEST NATURAL GAS CO
Form 10-Q
November 06, 2018

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, 2018
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 1-15973		Commission file number 1-38681	
NORTHWEST NATURAL GAS COMPANY		NORTHWEST NATURAL HOLDING COMPANY	
(Exact name of registrant as specified in its charter)		(Exact name of registrant as specified in its charter)	
Oregon	93-0256722	Oregon	82-4710680
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)	(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
220 N.W. Second Avenue, Portland, Oregon 97209		220 N.W. Second Avenue, Portland, Oregon 97209	
(Address of principal executive offices) (Zip Code)		(Address of principal executive offices) (Zip Code)	
Registrant’s telephone number: (503) 226-4211		Registrant’s telephone number: (503) 226-4211	

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.

NORTHWEST NATURAL GAS COMPANY Yes[X] No[ ]	NORTHWEST NATURAL HOLDING COMPANY Yes[X] No[ ]

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files).

NORTHWEST NATURAL GAS COMPANY Yes[X] No[ ]	NORTHWEST NATURAL HOLDING COMPANY Yes[X] 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", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

NORTHWEST NATURAL GAS COMPANY	NORTHWEST NATURAL HOLDING COMPANY
Large Accelerated Filer [ ]	Large Accelerated Filer [X]
Accelerated Filer [ ]	Accelerated Filer [ ]
Non-accelerated Filer [X]	Non-accelerated Filer [ ]
Smaller Reporting Company [ ]	Smaller Reporting Company [ ]
Emerging Growth Company [ ]	Emerging Growth Company [ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

NORTHWEST NATURAL GAS COMPANY	NORTHWEST NATURAL HOLDING
Yes[ ] No[X]	COMPANY Yes[ ] No[X]

At October 26, 2018, 28,844,682 shares of Northwest Natural Holding Company's Common Stock (the only class of Common Stock) were outstanding, and 28,844,190 shares of Northwest Natural Gas Company's Common Stock (the only class of Common Stock) were outstanding, all of which were held by Northwest Natural Holding Company.

This combined Form 10-Q is separately filed by Northwest Natural Holding Company and Northwest Natural Gas Company. Information contained in this document relating to Northwest Natural Gas Company is filed by Northwest Natural Holding Company and separately by Northwest Natural Gas Company. Northwest Natural Gas Company makes no representation as to information relating to Northwest Natural Holding Company or its subsidiaries, except as it may relate to Northwest Natural Gas Company and its subsidiaries.

NORTHWEST NATURAL GAS COMPANY
NORTHWEST NATURAL HOLDING COMPANY
For the Quarterly Period Ended September 30, 2018

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PART I. FINANCIAL INFORMATION
FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995, which are subject to the safe harbors created by such Act. Forward-looking statements can be identified by words such as anticipates, assumes, intends, plans, seeks, believes, estimates, expects, and similar references to future periods. Examples of forward-looking statements include, but are not limited to, statements regarding the following:

- plans, projections and predictions;
- objectives, goals or strategies;
- assumptions, generalizations and estimates;
- ongoing continuation of past practices or patterns;
- future events or performance;
- trends;
- risks;
- timing and cyclicality;
- earnings and dividends;
- capital expenditures and allocation;
- capital or organizational structure, including restructuring as a holding company;
- climate change and our role in a low-carbon future;
- growth;
- customer rates;
- labor relations and workforce succession;
- commodity costs;
- gas reserves;
- operational and financial performance and costs;
- energy policy, infrastructure and preferences;
- public policy approach and involvement;
- efficacy of derivatives and hedges;
- liquidity, financial positions, and planned securities issuances;
- valuations;
- project and program development, expansion, or investment;
- business development efforts, including acquisitions and integration thereof;
- asset dispositions and outcomes thereof;
- pipeline capacity, demand, location, and reliability;
- adequacy of property rights and headquarter development;
- technology implementation and cybersecurity practices;
- competition;
- procurement and development of gas supplies;
- estimated expenditures;
- costs of compliance;
- credit exposures;
- seasonality of gas utility earnings;
- rate or regulatory outcomes, recovery or refunds;
- impacts or changes of laws, rules and regulations;
- tax liabilities or refunds, including effects of tax reform and related timing variances;
- levels and pricing of gas storage contracts and gas storage markets;
- outcomes, timing and effects of potential claims, litigation, regulatory actions, and other administrative matters;
- projected obligations, expectations and treatment with respect to retirement plans;
- availability, adequacy, and shift in mix, of gas supplies;

- effects of new or anticipated changes in critical accounting policies or estimates;
- approval and adequacy of regulatory deferrals;
- effects and efficacy of regulatory mechanisms; and
- environmental, regulatory, litigation and insurance costs and recoveries, and timing thereof.

Forward-looking statements are based on our current expectations and assumptions regarding our business, the economy and other future conditions. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. Our actual results may differ materially from those contemplated by the forward-looking statements. We therefore caution you against relying on any of these forward-looking statements. They are neither statements of historical fact nor guarantees or assurances of future operational or financial performance. Important factors that could cause actual results to differ materially from those in the forward-looking statements are discussed in NW Natural's 2017 Annual Report on Form 10-K, Part I, Item 1A “Risk Factors” and Part II, Item 7 and Item 7A, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Quantitative and Qualitative Disclosures about Market Risk,” and in Part I, Items 2 and 3, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Quantitative and Qualitative Disclosures About Market Risk”, respectively of Part II of this report.

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Any forward-looking statement made by us in this report speaks only as of the date on which it is made. Factors or events that could cause our actual results to differ may emerge from time to time, and it is not possible for us to predict all of them. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law.

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ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

NORTHWEST NATURAL GAS COMPANY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
In thousands, except per share data	2018	2017	2018	2017
Operating revenues	$91,239	$86,213	$479,441	$516,413
Operating expenses:				
Cost of gas	25,538	27,239	175,697	223,855
Operations and maintenance	37,569	34,267	115,120	106,710
Environmental remediation	1,022	1,355	7,528	10,920
General taxes	7,589	7,540	24,792	23,423
Revenue taxes	3,522	—	20,731	—
Depreciation and amortization	21,485	20,352	63,507	60,529
Other operating expenses	625	—	2,157	—
Total operating expenses	97,350	90,753	409,532	425,437
Income (loss) from operations	(6,111)	(4,540)	69,909	90,976
Other income (expense), net	(312)	139	(1,139)	(624)
Interest expense, net	9,006	9,208	27,051	28,311
Income (loss) before income taxes	(15,429)	(13,609)	41,719	62,041
Income tax (benefit) expense	(4,285)	(5,722)	11,191	24,456
Net income (loss) from continuing operations	(11,144)	(7,887)	30,528	37,585
Loss from discontinued operations, net of tax	(650)	(608)	(1,783)	(3,041)
Net income (loss)	(11,794)	(8,495)	28,745	34,544
Other comprehensive income:				
Amortization of non-qualified employee benefit plan liability, net of taxes of $55 and $98 for the three months ended and $166 and $275 for the nine months ended September 30, 2018 and 2017, respectively	154	150	461	423
Comprehensive income (loss)	$(11,640)	$(8,345)	$29,206	$34,967
Average common shares outstanding:				
Basic	28,815	28,678	28,787	28,653
Diluted	28,815	28,678	28,846	28,734
Earnings (loss) from continuing operations per share of common stock:				
Basic	$(0.39)	$(0.28)	$1.06	$1.32
Diluted	(0.39)	(0.28)	1.06	1.31
Loss from discontinued operations per share of common stock:				
Basic	$(0.02)	$(0.02)	$(0.06)	$(0.11)
Diluted	(0.02)	(0.02)	(0.06)	(0.11)
Earnings (loss) per share of common stock:				
Basic	$(0.41)	$(0.30)	$1.00	$1.21
Diluted	(0.41)	(0.30)	1.00	1.20

See Notes to Unaudited Consolidated Financial Statements

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NORTHWEST NATURAL GAS COMPANY
CONSOLIDATED BALANCE SHEETS (UNAUDITED)

In thousands	September 30, 2018	September 30, 2017	December 31, 2017
Assets:			
Current assets:			
Cash and cash equivalents	$29,965	$15,780	$3,472
Accounts receivable	25,125	21,930	66,236
Accrued unbilled revenue	16,351	15,974	62,381
Allowance for uncollectible accounts	(394)	(459)	(956)
Regulatory assets	41,241	49,504	45,781
Derivative instruments	2,871	2,073	1,735
Inventories	53,064	59,135	47,577
Gas reserves	16,916	16,218	15,704
Other current assets	20,376	17,285	24,949
Discontinued operations current assets (Note 16)	12,644	2,106	3,057
Total current assets	218,159	199,546	269,936
Non-current assets:			
Property, plant, and equipment	3,370,388	3,148,545	3,204,635
Less: Accumulated depreciation	996,994	954,782	960,477
Total property, plant, and equipment, net	2,373,394	2,193,763	2,244,158
Gas reserves	70,556	87,876	84,053
Regulatory assets	333,917	345,352	356,608
Derivative instruments	861	1,555	1,306
Other investments	65,113	69,245	66,363
Goodwill	6,563	—	—
Other non-current assets	12,844	4,192	6,505
Discontinued operations non-current assets (Note 16)	—	204,078	10,817
Total non-current assets	2,863,248	2,906,061	2,769,810
Total assets	$3,081,407	$3,105,607	$3,039,746

See Notes to Unaudited Consolidated Financial Statements

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NORTHWEST NATURAL GAS COMPANY
CONSOLIDATED BALANCE SHEETS (UNAUDITED)

In thousands	September 30, 2018	September 30, 2017	December 31, 2017
Liabilities and equity:			
Current liabilities:			
Short-term debt	$100,500	$—	$54,200
Current maturities of long-term debt	84,940	21,995	96,703
Accounts payable	80,143	87,123	111,021
Taxes accrued	13,074	11,933	18,883
Interest accrued	9,453	9,854	6,773
Regulatory liabilities	37,504	34,659	34,013
Derivative instruments	8,828	8,968	18,722
Other current liabilities	35,497	27,218	39,942
Discontinued operations current liabilities (Note 16)	13,003	1,201	1,593
Total current liabilities	382,942	202,951	381,850
Long-term debt	724,654	757,429	683,184
Deferred credits and other non-current liabilities:			
Deferred tax liabilities	274,315	572,293	270,526
Regulatory liabilities	606,175	363,838	586,093
Pension and other postretirement benefit liabilities	212,249	212,259	223,333
Derivative instruments	3,016	3,926	4,649
Other non-current liabilities	140,475	134,123	135,292
Discontinued operations - non-current liabilities (Note 16)	—	12,106	12,043
Total deferred credits and other non-current liabilities	1,236,230	1,298,545	1,231,936
Commitments and contingencies (Note 15)			
Equity:			
Common stock - no par value; authorized 100,000 shares; issued and outstanding 28,844, 28,713, and 28,736 at September 30, 2018 and 2017, and December 31, 2017, respectively	455,499	447,129	448,865
Retained earnings	290,059	406,081	302,349
Accumulated other comprehensive loss	(7,977)	(6,528)	(8,438)
Total equity	737,581	846,682	742,776
Total liabilities and equity	$3,081,407	$3,105,607	$3,039,746

See Notes to Unaudited Consolidated Financial Statements

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NORTHWEST NATURAL GAS COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine Months Ended September 30,	
In thousands	2018	2017
Operating activities:		
Net income	$28,745	$34,544
Adjustments to reconcile net income to cash provided by operations:		
Depreciation and amortization	63,507	60,529
Regulatory amortization of gas reserves	12,056	12,036
Deferred income taxes	3,954	17,287
Qualified defined benefit pension plan expense	4,450	3,923
Contributions to qualified defined benefit pension plans	(11,690)	(15,400)
Deferred environmental expenditures, net	(10,547)	(10,468)
Amortization of environmental remediation	7,528	10,920
Regulatory revenue deferral from the TCJA	6,983	—
Other	1,541	2,522
Changes in assets and liabilities:		
Receivables, net	83,194	90,311
Inventories	(5,134)	(5,372)
Income taxes	(5,809)	(216)
Accounts payable	(22,929)	(29,282)
Interest accrued	2,680	3,888
Deferred gas costs	2,372	13,419
Other, net	(3,588)	28
Discontinued operations	1,216	4,187
Cash provided by operating activities	158,529	192,856
Investing activities:		
Capital expenditures	(158,795)	(145,274)
Other	(1,661)	(1,131)
Discontinued operations	(619)	(167)
Cash used in investing activities	(161,075)	(146,572)
Financing activities:		
Repurchases related to stock-based compensation	—	(2,034)
Proceeds from stock options exercised	1,368	3,711
Long-term debt issued	50,000	100,000
Long-term debt retired	(22,000)	(40,000)
Change in short-term debt	46,300	(53,300)
Cash dividend payments on common stock	(38,387)	(40,390)
Stock purchases related to acquisitions	(7,951)	—
Other	(291)	(2,012)
Cash provided by (used in) financing activities	29,039	(34,025)
Increase in cash and cash equivalents	26,493	12,259
Cash and cash equivalents, beginning of period	3,472	3,521

Cash and cash equivalents, end of period	$29,965	$15,780
Supplemental disclosure of cash flow information:		
Interest paid, net of capitalization	$22,821	$22,859
Income taxes paid, net of refunds	22,047	11,581

See Notes to Unaudited Consolidated Financial Statements

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NORTHWEST NATURAL HOLDING COMPANY
CONSOLIDATED BALANCE SHEET (UNAUDITED)

In thousands, except share amounts	September 30, 2018
Assets:	
Current assets:	
Cash and cash equivalents	$ 20,000
Total current assets	20,000
Total assets	$ 20,000
Equity:	
Common stock - no par value; authorized 100,000,000 shares; 100 issued and outstanding at September 30, 2018	$ 20,000
Total equity	$ 20,000

See Notes to Unaudited Consolidated Financial Statements

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NORTHWEST NATURAL HOLDING COMPANY
CONSOLIDATED STATEMENT OF CASH
FLOWS (UNAUDITED)

In thousands	Inception through September 30, 2018
Financing activities:	
Capital contributions	$ 20,000
Cash provided by financing activities	20,000
Increase in cash and cash equivalents	20,000
Cash and cash equivalents, at inception	—
Cash and cash equivalents, end of period	$ 20,000

See Notes to Unaudited Consolidated Financial Statements

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. ORGANIZATION AND PRINCIPLES OF CONSOLIDATION

On October 1, 2018, Northwest Natural Gas Company (NW Natural) and Northwest Natural Holding Company (NW Holdings) completed the reorganization into a holding company structure. NW Holdings is now the parent holding company of NW Natural, NW Natural Water Company, LLC (NWN Water) and other subsidiaries previously held by NW Natural. For further discussion, see Note 17. These financial statements and accompanying notes are for the period ending September 30, 2018 and reflect the organizational structure prior to the reorganization.

The accompanying consolidated financial statements represent the consolidated results of NW Natural and all companies NW Natural directly or indirectly controlled, either through majority ownership or otherwise as of September 30, 2018. NW Natural's regulated local gas distribution business, referred to as the utility segment, is NW Natural's core operating business and serves residential, commercial, and industrial customers in Oregon and southwest Washington. The other category primarily includes the non-utility portion of the Mist gas storage facility that provides storage services for utilities, gas marketers, electric generators, and large industrial users from facilities located in Oregon. In addition, prior to the reorganization NW Natural held regulated water services, other investments, and other non-utility activities reported as other.

NW Natural's direct and indirect wholly-owned subsidiaries as of September 30, 2018 include:

- NW Natural Energy, LLC (NWN Energy);
  NW Natural Gas Storage, LLC (NWN Gas Storage);
  Gill Ranch Storage, LLC (Gill Ranch), which is presented as a discontinued operation;
- Northwest Energy Corporation (Energy Corp);
  NWN Gas Reserves LLC (NWN Gas Reserves);
- NNG Financial Corporation (NNG Financial);

- NW Natural Water Company, LLC (NWN Water);
  Falls Water Co., Inc. (Falls Water);
  Cascadia Water, LLC (Cascadia);
- Northwest Natural Holding Company (NW Holdings); and
  NWN Merger Sub, Inc. (NWN Holdco Sub).

NW Holdings' direct and indirect wholly-owned subsidiaries as of the filing date of this report include:

- Northwest Natural Gas Company (NW Natural);
  Northwest Energy Corporation (Energy Corp);
- NWN Gas Reserves LLC (NWN Gas Reserves);
- NW Natural Energy, LLC (NWN Energy);
  NW Natural Gas Storage, LLC (NWN Gas Storage);
  Gill Ranch Storage, LLC (Gill Ranch), which is presented as a discontinued operation;
- NNG Financial Corporation (NNG Financial);

- NW Natural Water Company, LLC (NWN Water);

Falls Water Co., Inc. (Falls Water);
Salmon Valley Water Company;
Cascadia Water, LLC (Cascadia);
NW Natural Water of Oregon, LLC (NWN Water of Oregon);
NW Natural Water of Washington, LLC; and
NW Natural Water of Idaho, LLC.

Investments in corporate joint ventures and partnerships that the registrant does not directly or indirectly control, and for which it is not the primary beneficiary, include NWN Energy's investment in Trail West Holdings, LLC (TWH), which is accounted for under the equity method, and NNG Financial's investment in Kelso-Beaver Pipeline. The consolidated financial statements are presented after elimination of all intercompany balances and transactions. In this report, the term “utility” is used to describe NW Natural's regulated gas distribution business, and the term “non-utility” is used to describe the non-utility portion of the Mist gas storage facility and other non-utility investments and business activities.

Information presented in these interim consolidated financial statements is unaudited, but includes all material adjustments management considers necessary for a fair statement of the results for each period reported including normal recurring accruals. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in NW Natural's 2017 Annual Report on Form 10-K (2017 Form 10-K), taking into consideration the changes mentioned below in this Note 1 and in Notes 4 and 15, as reflected in Exhibit 99.1 to the Current Report on Form 8-K (Form 8-K) filed on September 24, 2018. A significant part of NW Natural's business is of a seasonal nature; therefore, results of operations for interim periods are not necessarily indicative of full year results.

During the second quarter of 2018, we moved forward with NW Natural's long-term strategic plans, which include a shift away from the California gas storage business. In June 2018, NWN Gas Storage, a wholly-owned subsidiary, entered into a Purchase and Sale Agreement that provides for the sale of all of the membership interests in its wholly-owned subsidiary, Gill Ranch, subject to various regulatory approvals and closing conditions. We have concluded that the pending sale of Gill Ranch qualifies as assets and liabilities held for sale and discontinued operations. As such, for all periods presented, the results of Gill Ranch have been presented as a discontinued operation on the consolidated statements of comprehensive income and cash flows, and the assets and liabilities associated with Gill Ranch have been classified as discontinued operations assets and liabilities on the consolidated balance sheets. See Note 16 for additional information. Additionally, we reevaluated reportable segments and concluded that the remaining gas storage activities no longer meet the requirements to be separately reported as a segment. The non-utility portion of the Mist gas storage facility is now reported as other, and all prior periods reflect this change. See Note 4, which provides segment information. These reclassifications had no effect on the prior year's consolidated results of operations, financial condition, or cash flows.

NW Holdings was formed on March 7, 2018. The accompanying financial statements for NW Holdings are provided in accordance with Exchange Act Rules 13a-13 and 15d-13. There was no income statement activity for NW Holdings during the period ended September 30, 2018 and thus no income statement is provided for NW Holdings. Prior to completing the reorganization, NW Holdings received a $20.0 million capital contribution.

Notes to the consolidated financial statements reflect the activity of continuing operations for all periods presented, unless otherwise noted. Note 16 provides information regarding discontinued operations.

2. SIGNIFICANT ACCOUNTING POLICIES

Significant accounting policies are described in Note 2 of the 2017 Form 10-K. There were no material changes to those accounting policies during the nine months ended September 30, 2018 other than those incorporated in Note 5, Note 13, and Note 16 relating to revenue, business combinations and goodwill, and discontinued operations, respectively. The following are current updates to certain critical accounting policy estimates and new accounting standards.

Industry Regulation

In applying regulatory accounting principles, NW Natural capitalizes or defers certain costs and revenues as regulatory assets and liabilities pursuant to orders of the Oregon Public Utilities Commission (OPUC), Washington Utilities and Transportation Commission (WUTC) or Idaho Public Utilities Commission (IPUC), which provide for the recovery of revenues or expenses from, or refunds to, utility customers in future periods, including a return or a carrying charge in certain cases.

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Amounts deferred as regulatory assets and liabilities were as follows:

	Regulatory Assets		
	September 30,		December 31,
In thousands	2018	2017	2017
Current:			
Unrealized loss on derivatives[1]	$8,828	$8,887	$18,712
Gas costs	461	1,851	154
Environmental costs[2]	5,633	6,362	6,198
Decoupling[3]	11,990	15,663	11,227
Income taxes	2,217	4,378	2,218
Other[4]	12,112	12,363	7,272
Total current	$41,241	$49,504	$45,781
Non-current:			
Unrealized loss on derivatives[1]	$3,016	$3,926	$4,649
Pension balancing[5]	72,291	57,599	60,383
Income taxes	19,267	36,591	19,991
Pension and other postretirement benefit liabilities	165,741	172,687	179,824
Environmental costs[2]	63,464	63,339	72,128
Gas costs	14	48	84
Decoupling[3]	829	1,025	3,970
Other[4]	9,295	10,137	15,579
Total non-current	$333,917	$345,352	$356,608

	Regulatory Liabilities		
	September 30,		December 31,
In thousands	2018	2017	2017
Current:			
Gas costs	$20,716	$16,459	$14,886
Unrealized gain on derivatives[1]	2,862	2,020	1,674
Decoupling[3]	1,697	314	322
Other[4]	12,229	15,866	17,131
Total current	$37,504	$34,659	$34,013
Non-current:			
Gas costs	$1,409	$1,015	$4,630
Unrealized gain on derivatives[1]	861	1,555	1,306
Decoupling[3]	119	—	957
Income taxes[6]	223,841	—	213,306
Accrued asset removal costs[7]	375,257	356,106	360,929
Other[4]	4,688	5,162	4,965
Total non-current	$606,175	$363,838	$586,093

(1) Unrealized gains or losses on derivatives are non-cash items and therefore, do not earn a rate of return or a carrying charge. These amounts are recoverable through utility rates as part of the annual Purchased Gas Adjustment (PGA) mechanism when realized at settlement.

(2) Refer to footnote (3) per the Deferred Regulatory Asset table in Note 15 for a description of environmental costs.

(3) This deferral represents the margin adjustment resulting from differences between actual and expected volumes.

(4) Balances consist of deferrals and amortizations under approved regulatory mechanisms and typically earn a rate of return or carrying charge.
(5) Refer to footnote (1) of the Net Periodic Benefit Cost table in Note 8 for information regarding the deferral of pension expenses.
(6) This balance represents estimated amounts associated with the Tax Cuts and Jobs Act. See Note 9.
(7) Estimated costs of removal on certain regulated properties are collected through rates.

We believe all costs incurred and deferred at September 30, 2018 are prudent. All regulatory assets and liabilities are reviewed annually for recoverability, or more often if circumstances warrant. If we should determine that all or a portion of these regulatory assets or liabilities no longer meet the criteria for continued application of regulatory accounting, then NW Natural would be required to write-off the net unrecoverable balances in the period such determination is made.

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New Accounting Standards
We consider the applicability and impact of all accounting standards updates (ASUs) issued by the Financial Accounting Standards Board (FASB). ASUs not listed below were assessed and determined to be either not applicable or are expected to have minimal impact on NW Natural's consolidated financial position or results of operations.

Recently Adopted Accounting Pronouncements
STOCK COMPENSATION. On May 10, 2017, the FASB issued ASU 2017-09, "Stock Compensation - Scope of Modification Accounting." The purpose of the amendment is to provide clarity, reduce diversity in practice, and reduce the cost and complexity when applying the guidance in Topic 718, related to a change to the terms or conditions of a share-based payment award. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. The amendments in this update were effective for NW Natural beginning January 1, 2018, and will be applied prospectively to any award modified on or after the adoption date. The adoption did not have a material impact to financial statements or disclosures.

RETIREMENT BENEFITS. On March 10, 2017, the FASB issued ASU 2017-07, "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Post Retirement Benefit Cost." The ASU requires entities to disaggregate current service cost from the other components of net periodic benefit cost and present it with other current compensation costs for related employees in the income statement. Additionally, the other components of net periodic benefit costs are to be presented elsewhere in the income statement and outside of income from operations, if that subtotal is presented. Only the service cost component of the net periodic benefit cost is eligible for capitalization. The amendments in this update were effective for us beginning January 1, 2018.

Upon adoption, the ASU required that changes to the income statement presentation of net periodic benefit cost be applied retrospectively, while changes to amounts capitalized must be applied prospectively. As such, the interest cost, expected return on assets, amortization of prior service costs, and other costs have been reclassified from operations and maintenance expense to other income (expense), net on the consolidated statement of comprehensive income for the three and nine months ended September 30, 2017. NW Natural did not elect the practical expedient which would have allowed us to reclassify amounts disclosed previously in the pension and other postretirement benefits footnote disclosure as the basis for applying retrospective presentation. As mentioned above, on a prospective basis, the other components of net periodic benefit cost will not be eligible for capitalization, however, they will continue to be included in the pension regulatory balancing mechanism.

The retrospective presentation requirement related to the other components of net periodic benefit cost affected the operations and maintenance expense and other income (expense), net lines on the consolidated statement of comprehensive income. For the three and nine months ended September 30, 2017, $1.4 million and $4.0 million of expense was reclassified from operations and maintenance expense and included in other income (expense), net, respectively.

GOODWILL. On January 26, 2017, the FASB issued ASU 2017-04, "Simplifying the Test for Goodwill Impairment." The ASU removes Step 2 from the goodwill impairment test and under the amended guidance an entity should perform its annual goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognize an impairment charge for the amount in which the carrying amounts exceeds the fair value of the reporting unit. The amendments in this standard are effective for us beginning January 1, 2020 and early adoption is permitted for interim or annual goodwill impairment tests performed after January 1, 2017. NW Natural early adopted ASU 2017-04 in the third quarter ended September 30, 2018. The adoption of this ASU did not materially affect the financial statements and disclosures.

STATEMENT OF CASH FLOWS. On August 26, 2016, the FASB issued ASU 2016-15, "Classification of Certain Cash Receipts and Cash Payments." The ASU adds guidance pertaining to the classification of certain cash receipts and payments on the statement of cash flows. The purpose of the amendment is to clarify issues that have been creating diversity in practice. The amendments in this standard were effective for us beginning January 1, 2018, and the adoption did not have a material impact to financial statements or disclosures as NW Natural's historical practices and presentation were consistent with the directives of this ASU.

FINANCIAL INSTRUMENTS. On January 5, 2016, the FASB issued ASU 2016-01, "Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities." The ASU enhances the reporting model for financial instruments, which includes amendments to address aspects of recognition, measurement, presentation, and disclosure. The new standard was effective for us beginning January 1, 2018, and the adoption did not materially impact financial statements or disclosures.

REVENUE RECOGNITION. On May 28, 2014, the FASB issued ASU 2014-09 "Revenue From Contracts with Customers." The underlying principle of the guidance requires entities to recognize revenue depicting the transfer of goods or services to customers at amounts the entity is expected to be entitled to in exchange for those goods or services. The ASU also prescribes a five-step approach to revenue recognition: (1) identify the contract(s) with the customer; (2) identify the separate performance obligations in the contract(s); (3) determine the transaction price; (4) allocate the transaction price to separate performance obligations; and (5) recognize revenue when, or as, each performance obligation is satisfied. The guidance also requires additional disclosures, both qualitative and quantitative, regarding the nature, amount, timing and uncertainty of revenue and cash flows.

The new accounting standard and all related amendments were effective for us beginning January 1, 2018. NW Natural applied the accounting standard to all contracts using the modified retrospective method. The new standard is primarily reflected in the consolidated statement of comprehensive income and Note 5. The implementation of the new revenue standard did not result in changes to how NW Natural currently recognizes revenue, and therefore, no cumulative effect or adjustment to the opening balance of retained earnings was required. The implementation did result in changes to the disclosures and presentation of revenue and expenses. The comparative information for prior years has not been restated. There is no material impact to financial results and no significant changes to NW Natural's control environment due to the adoption of the new revenue standard on an ongoing basis.

As previously discussed, the adoption of the new revenue standard did not impact the consolidated balance sheet or statement of cash flows but did result in changes to the presentation of the consolidated statements of comprehensive income. Had the adoption of the new revenue standard not occurred, operating revenues for the three and nine months ended September 30, 2018 would have been $87.7 million and $458.7 million, compared to the reported amounts of $91.2 million and $479.4 million under the new revenue standard, respectively. Similarly, absent the impact of the new revenue standard, operating expenses would have been $93.9 million and $388.8 million, compared to the reported amounts of $97.4 million and $409.5 million under the new revenue standard for the three and nine months ended September 30, 2018, respectively. The effect of the change was an increase in both operating revenues and operating expenses of $3.5 million and $20.7 million for the three and nine months ended September 30, 2018, respectively, due to the change in presentation of revenue taxes. As part of the adoption of the new revenue standard, we evaluated the presentation of revenue taxes under the new guidance and across NW Natural's peer group and concluded that the gross presentation of revenue taxes provides the greatest level of consistency and transparency. Prior to the adoption of the new revenue standard, a portion of revenue taxes was presented net in operating revenues and a portion was recorded directly on the balance sheet. During the three and nine months ended September 30, 2018, NW Natural recognized $3.5 million and $20.7 million in revenue taxes in operating revenues and operating expenses, respectively. In comparison, for the three and nine months ended September 30, 2017, NW Natural recognized $3.7 million and $23.0 million in revenue taxes, of which $2.3 million and $13.3 million were recorded in operating revenues and $1.4 million and $9.7 million were recorded on the balance sheet, respectively. The change in presentation of revenue taxes had no impact on utility margin, net income or earnings per share.

Recently Issued Accounting Pronouncements

CLOUD COMPUTING. On August 29, 2018, the FASB issued ASU 2018-15, "Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract." The purpose of the amendment is to align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The amendments in this update are effective for us beginning January 1, 2020. Early adoption is permitted. The amended guidance can be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. We are currently assessing the effect of this standard on financial statements and disclosures.

RETIREMENT BENEFITS. On August 28, 2018, the FASB issued ASU 2018-14, "Changes to the Disclosure Requirements for Defined Benefit Plans." The purpose of the amendment is to modify the disclosure requirements for defined benefit pension and other postretirement plans. The amendments in this update are effective for us beginning January 1, 2020. Early adoption is permitted. The amended presentation and disclosure guidance should be applied retrospectively. We are currently assessing the effect of this standard on disclosures.

FAIR VALUE MEASUREMENT. On August 28, 2018, the FASB issued ASU 2018-13, "Changes to the Disclosure Requirements for Fair Value Measurement." The purpose of the amendment is to modify the disclosure requirements for fair value measurements. The amendments in this update are effective for us beginning January 1, 2020. Early adoption is permitted. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty should be applied prospectively. All other amendments should be applied retrospectively. We are currently assessing the effect of this standard on disclosures.

ACCUMULATED OTHER COMPREHENSIVE INCOME. On February 14, 2018, the FASB issued ASU 2018-02, "Income Statement—Reporting Comprehensive Income: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." This update was issued in response to concerns from certain stakeholders regarding the current requirements under U.S. GAAP that deferred tax assets and liabilities are adjusted for a change in tax laws or rates, and the effect is to be included in income from continuing operations in the period of the enactment date. This requirement is also applicable to items in accumulated other comprehensive income where the related tax effects were originally recognized in other comprehensive income. The adjustment of deferred taxes due to the new corporate income tax rate enacted through the Tax Cuts and Jobs Act (TCJA) on December 22, 2017 recognized in income from continuing operations causes the tax effects of items within accumulated other comprehensive income (referred to as stranded tax effects) to not reflect the appropriate tax rate. The amendments in this update allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the TCJA and require certain disclosures about stranded tax effects. The amendments in this update are effective for us beginning January 1, 2019, and should be applied either in the period of adoption or retrospectively to each period in which the effect of the change in the federal corporate income tax rate in the TCJA is recognized. The

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reclassification allowed in this update is elective, and we are currently assessing whether NW Natural will make the reclassification. This update is not expected to have a material impact on financial condition.

DERIVATIVES AND HEDGING. On August 28, 2017, the FASB issued ASU 2017-12, "Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities." The purpose of the amendment is to more closely align hedge accounting with companies' risk management strategies. The ASU amends the accounting for risk component hedging, the hedged item in fair value hedges of interest rate risk, and amounts excluded from the assessment of hedge effectiveness. The guidance also amends the recognition and presentation of the effect of hedging instruments and includes other simplifications of hedge accounting. The amendments in this update are effective for us beginning January 1, 2019. Early adoption is permitted. The amended presentation and disclosure guidance is required prospectively. We are currently assessing the effect of this standard on financial statements and disclosures.

LEASES. On February 25, 2016, the FASB issued ASU 2016-02, "Leases," which revises the existing lease accounting guidance. Pursuant to the new standard, lessees will be required to recognize all leases, including operating leases that are greater than 12 months at lease commencement, on the balance sheet and record corresponding right-of-use assets and lease liabilities. Lessor accounting will remain substantially the same under the new standard. Quantitative and qualitative disclosures are also required for users of the financial statements to have a clear understanding of the nature of NW Natural's leasing activities. On November 29, 2017, the FASB proposed an additional practical expedient that would allow entities to apply the transition requirements on the effective date of the standard. Additionally, on January 25, 2018, the FASB issued ASU 2018-01, "Land Easement Practical Expedient for Transition to Topic 842", to address the costs and complexity of applying the transition provisions of the new lease standard to land easements. This ASU provides an optional practical expedient to not evaluate existing or expired land easements that were not previously accounted for as leases under the current lease guidance. The standard and associated ASUs are effective for us beginning January 1, 2019. We are currently assessing NW Natural's lease population and material contracts to determine the effect of this standard on financial statements and disclosures. Refer to Note 14 of the 2017 Form 10-K for NW Natural's current lease commitments.

3. EARNINGS PER SHARE

Basic earnings per share are computed using net income and the weighted average number of common shares outstanding for each period presented. Diluted earnings per share are computed in the same manner, except using the weighted average number of common shares outstanding plus the effects of the assumed exercise of stock options and the payment of estimated stock awards from other stock-based compensation plans that are outstanding at the end of each period presented. Antidilutive stock awards are excluded from the calculation of diluted earnings per common share.

Diluted earnings (loss) from continuing operations per share are calculated as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
In thousands, except per share data	2018	2017	2018	2017
Net income (loss) from continuing operations	$(11,144)	$(7,887)	$30,528	$37,585
Average common shares outstanding - basic	28,815	28,678	28,787	28,653
Additional shares for stock-based compensation plans (See Note 6)	—	—	59	81
Average common shares outstanding - diluted	28,815	28,678	28,846	28,734
Earnings (loss) from continuing operations per share of common stock - basic	$(0.39)	$(0.28)	$1.06	$1.32

Earnings (loss) from continuing operations per share of common stock - diluted	$(0.39)	$(0.28)	$1.06	$1.31
Additional information:				
Antidilutive shares	73	96	4	15

4. SEGMENT INFORMATION

We primarily operate in one reportable business segment, which is NW Natural's local gas distribution business and is referred to as the utility segment. During the second quarter of 2018, we moved forward with long-term strategic plans, which include a shift away from the California gas storage business, by entering into a Purchase and Sale Agreement that provides for the sale of all of the membership interests in Gill Ranch, subject to various regulatory approvals and closing conditions. As such, we reevaluated reportable segments and concluded that the gas storage activities no longer meet the requirements of a reportable segment. Ongoing, non-utility gas storage activities, which include interstate storage and asset management activities at the Mist gas storage facility, are now reported as other. NW Natural also has regulated water operations, other investments, and

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business activities not specifically related to the utility segment, which are aggregated and reported as other. We refer to NW Natural's local gas distribution business as the utility and all other activities as non-utility.

Local Gas Distribution
NW Natural's local gas distribution segment is a regulated utility principally engaged in the purchase, sale, and delivery of natural gas and related services to customers in Oregon and southwest Washington. As a regulated utility, NW Natural is responsible for building and maintaining a safe and reliable pipeline distribution system, purchasing sufficient gas supplies from producers and marketers, contracting for firm and interruptible transportation of gas over interstate pipelines to bring gas from the supply basins into its service territory, and re-selling the gas to customers subject to rates, terms, and conditions approved by the OPUC or WUTC. Gas distribution also includes taking customer-owned gas and transporting it from interstate pipeline connections, or city gates, to the customers' end-use facilities for a fee, which is approved by the OPUC or WUTC. As of December 31, 2017, approximately 89% of NW Natural's customers are located in Oregon and 11% in Washington. On an annual basis, residential and commercial customers typically account for around 60% of utility total volumes delivered and 90% of utility margin. Industrial customers largely account for the remaining volumes and utility margin. A small amount of utility margin is also derived from miscellaneous services, gains or losses from an incentive gas cost sharing mechanism, and other service fees.
Industrial sectors served by NW Natural include: pulp, paper, and other forest products; the manufacture of electronic, electrochemical and electrometallurgical products; the processing of farm and food products; the production of various mineral products; metal fabrication and casting; the production of machine tools, machinery, and textiles; the manufacture of asphalt, concrete, and rubber; printing and publishing; nurseries; government and educational institutions; and electric generation.
In addition to NW Natural's local gas distribution business, the utility segment also includes the utility portion of the Mist underground storage facility, the North Mist gas storage expansion in Oregon, and NWN Gas Reserves, which is a wholly-owned subsidiary of Energy Corp.

Other
Regulated water operations, non-utility investments, and other business activities are aggregated and reported as other. Other includes NWN Gas Storage, a wholly-owned subsidiary of NWN Energy, and the non-utility portion of the Mist facility in Oregon and third-party asset management services. Earnings from non-utility assets at the Mist facility are primarily related to firm storage capacity revenues. Earnings from the Mist facility also include revenue, net of amounts shared with utility customers, from management of utility assets at Mist and upstream pipeline capacity when not needed to serve utility customers. Under the Oregon sharing mechanism, NW Natural retains 80% of the pre-tax income from these services when the costs of the capacity have not been included in utility rates, or 33% of the pre-tax income when the costs have been included in utility rates. The remaining 20% and 67%, respectively, are recorded to a deferred regulatory account for crediting back to utility customers.

Other also includes NNG Financial, non-utility appliance retail center operations, NWN Water, which consolidates the regulated water operations and is pursuing other investments in the water sector itself and through its wholly-owned subsidiaries Falls Water and Cascadia, NWN Energy's equity investment in TWH, which is pursuing development of a cross-Cascades transmission pipeline project and NW Holdings, which was used in effecting the holding company reorganization of NW Natural through its wholly-owned subsidiary NWN Holdco Sub. See Note 1 for information regarding changes to NW Natural's organizational structure subsequent to September 30, 2018.

All prior period amounts have been retrospectively adjusted to reflect the change in reportable segments and the designation of Gill Ranch as a discontinued operation.

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Inter-segment transactions were immaterial for the periods presented. The following table presents summary financial information concerning the reportable segments of continuing operations. See Note 16 for information regarding the discontinued operation, Gill Ranch.

	Three Months Ended September 30,		
In thousands	Utility	Other	Total
2018			
Operating revenues	$85,077	$6,162	$91,239
Depreciation and amortization	21,127	358	21,485
Income (loss) from operations	(9,780)	3,669	(6,111)
Net income (loss) from continuing operations	(11,983)	839	(11,144)
Capital expenditures	55,914	511	56,425
2017			
Operating revenues	$81,126	$5,087	$86,213
Depreciation and amortization	20,023	329	20,352
Income (loss) from operations	(8,624)	4,084	(4,540)
Net income (loss) from continuing operations	(10,349)	2,462	(7,887)
Capital expenditures	50,009	932	50,941

	Nine Months Ended September 30,		
In thousands	Utility	Other	Total
2018			
Operating revenues	$461,525	$17,916	$479,441
Depreciation and amortization	62,436	1,071	63,507
Income from operations	59,521	10,388	69,909
Net income from continuing operations	24,930	5,598	30,528
Capital expenditures	156,609	2,186	158,795
Total assets at September 30, 2018[(1)]			