UNITIL CORP
Form 10-Q
April 21, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For Quarter Ended March 31, 2016

Commission File Number 1-8858

UNITIL CORPORATION

(Exact name of registrant as specified in its charter)

New Hampshire	**02-0381573**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
6 Liberty Lane West, Hampton, New Hampshire	**03842-1720**
(Address of principal executive office)	**(Zip Code)**

Registrant s telephone number, including area code: (603) 772-0775

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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 and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at April 18, 2016
Common Stock, no par value	**14,043,758 Shares**

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UNITIL CORPORATION AND SUBSIDIARY COMPANIES

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CAUTIONARY STATEMENT

This report and the documents incorporated by reference into this report contain statements that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, included or incorporated by reference into this report, including, without limitation, statements regarding the financial position, business strategy and other plans and objectives for the Company s future operations, are forward-looking statements.

These statements include declarations regarding the Company s beliefs and current expectations. In some cases, forward-looking statements can be identified by terminology such as may, will, should, expects, plans, anticipates, believes, estimates, predicts, potential or negative of such terms or other comparable terminology. These forward-looking statements are subject to inherent risks and uncertainties in predicting future results and conditions that could cause the actual results to differ materially from those projected in these forward-looking statements. Some, but not all, of the risks and uncertainties include those described in Item 1A (Risk Factors) and the following:

- the Company s regulatory environment (including regulations relating to climate change, greenhouse gas emissions and other environmental matters), which could affect the rates the Company is able to charge, the Company s authorized rate of return and the Company s ability to recover costs in its rates;
- fluctuations in the supply of, demand for, and the prices of energy commodities and transmission capacity and the Company s ability to recover energy commodity costs in its rates;
- customers preferred energy sources;
- severe storms and the Company s ability to recover storm costs in its rates;
- the Company s stranded electric generation and generation-related supply costs and the Company s ability to recover stranded costs in its rates;
- declines in the valuation of capital markets, which could require the Company to make substantial cash contributions to cover its pension obligations, and the Company s ability to recover pension obligation costs in its rates;
- general economic conditions, which could adversely affect (i) the Company s customers and, consequently, the demand for the Company s distribution services, (ii) the availability of credit and liquidity resources and (iii) certain of the Company s counterparties obligations (including those of its insurers and lenders);
- the Company s ability to obtain debt or equity financing on acceptable terms;
- increases in interest rates, which could increase the Company s interest expense;
- restrictive covenants contained in the terms of the Company s and its subsidiaries indebtedness, which restrict certain aspects of the Company s business operations;

variations in weather, which could decrease demand for the Company s distribution services;

long-term global climate change, which could adversely affect customer demand or cause extreme weather events that could disrupt the Company s electric and natural gas distribution services;

numerous hazards and operating risks relating to the Company s electric and natural gas distribution activities, which could result in accidents and other operating risks and costs;

catastrophic events;

the Company s ability to retain its existing customers and attract new customers;

the Company s energy brokering customers performance under multi-year energy brokering contracts; and

increased competition.

Many of these risks are beyond the Company s control. Any forward-looking statements speak only as of the date of this report, and the Company undertakes no obligation to update any forward-looking statements to reflect events or circumstances after the date on which such statements are made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for the Company to predict all of these factors, nor can the Company assess the impact of any such factor on its business or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statements.

PART I. FINANCIAL INFORMATION

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A)

OVERVIEW

Unitil Corporation (Unitil or the Company) is a public utility holding company headquartered in Hampton, New Hampshire. Unitil is subject to regulation as a holding company system by the Federal Energy Regulatory Commission (FERC) under the Energy Policy Act of 2005.

Unitil s principal business is the local distribution of electricity and natural gas throughout its service territory in the states of New Hampshire, Massachusetts and Maine. Unitil is the parent company of three wholly-owned distribution utilities:

i) Unitil Energy Systems, Inc. (Unitil Energy), which provides electric service in the southeastern seacoast and state capital regions of New Hampshire, including the capital city of Concord;

ii) Fitchburg Gas and Electric Light Company (Fitchburg), which provides both electric and natural gas service in the greater Fitchburg area of north central Massachusetts; and

iii) Northern Utilities, Inc. (Northern Utilities), which provides natural gas service in southeastern New Hampshire and portions of southern and central Maine, including the city of Portland, which is the largest city in northern New England.

Unitil Energy, Fitchburg and Northern Utilities are collectively referred to as the distribution utilities. Together, the distribution utilities serve approximately 103,300 electric customers and 78,700 natural gas customers in their service territory.

In addition, Unitil is the parent company of Granite State Gas Transmission, Inc. (Granite State) an interstate natural gas transmission pipeline company, operating 86 miles of underground gas transmission pipeline primarily located in Maine and New Hampshire. Granite State provides Northern Utilities with interconnection to major natural gas pipelines and access to domestic natural gas supplies in the south and Canadian natural gas supplies in the north.

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Unitil had an investment in Net Utility Plant of $813.1 million at March 31, 2016. Unitil s total operating revenue includes revenue to recover the approved cost of purchased electricity and natural gas in rates on a fully reconciling basis. As a result of this reconciling rate structure, the Company s earnings are not directly affected by changes in the cost of purchased electricity and natural gas. Earnings from Unitil s utility operations are primarily derived from the return on investment in the utility assets of the three distribution utilities and Granite State.

Unitil also conducts non-regulated operations principally through Usource Inc. and Usource L.L.C. (collectively, Usource), which is wholly-owned by Unitil Resources Inc., a wholly-owned subsidiary of Unitil. Usource provides energy brokering and advisory services to large commercial and industrial customers primarily in the northeastern United States. The Company s other subsidiaries include Unitil Service Corp., which provides, at cost, a variety of administrative and professional services to Unitil s affiliated companies, Unitil Realty Corp. (Unitil Realty), which owns and manages Unitil s corporate office building and property located in Hampton, New Hampshire and Unitil Power Corp., which formerly functioned as the full requirements wholesale power supply provider for Unitil Energy. Unitil s consolidated net income includes the earnings of the holding company and these subsidiaries.

RATES AND REGULATION

Regulation

Unitil is subject to comprehensive regulation by federal and state regulatory authorities. Unitil and its subsidiaries are subject to regulation as a holding company system by the Federal Energy Regulatory Commission (FERC) under the Energy Policy Act of 2005 with regard to certain bookkeeping, accounting and reporting requirements. Unitil s utility operations related to wholesale and interstate energy business activities are also regulated by the FERC. Unitil s distribution utilities are subject to regulation by the applicable state public utility commissions, with regard to their rates, issuance of securities and other accounting and operational matters: Unitil Energy is subject to regulation by the New Hampshire Public Utilities Commission (NHPUC); Fitchburg is subject to regulation by the Massachusetts Department of Public Utilities (MDPU); and Northern Utilities is regulated by the NHPUC and the Maine Public Utilities Commission (MPUC). Granite State, Unitil s interstate natural gas transmission pipeline, is subject to regulation by the FERC with regard to its rates and operations. Because Unitil s primary operations are subject to rate regulation, the regulatory treatment of various matters could significantly affect the Company s operations and financial position.

Unitil s distribution utilities deliver electricity and/or natural gas to all customers in their service territory, at rates established under traditional cost of service regulation. Under this regulatory structure, Unitil s distribution utilities recover the cost of providing distribution service to their customers based on a historical test year, in addition to earning a return on their capital investment in utility assets. As a result of a restructuring of the utility industry in New Hampshire, Massachusetts and Maine, Unitil s customers, with the exception of Northern Utilities residential customers, have the opportunity to purchase their electricity or natural gas supplies from third-party energy supply vendors. Most customers, however, continue to purchase such supplies through the distribution utilities under regulated energy rates and tariffs. Unitil s distribution utilities purchase electricity or natural gas from unaffiliated wholesale suppliers and recover the actual approved costs of these supplies on a pass-through basis, as well as certain costs associated with industry restructuring, through reconciling rate mechanisms that are periodically adjusted.

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Fitchburg is subject to revenue decoupling. Revenue decoupling is the term given to the elimination of the dependency of a utility s distribution revenue on the volume of electricity or natural gas sales. The difference between distribution revenue amounts billed to customers and the targeted revenue decoupling amounts is recognized as an increase or a decrease in Accrued Revenue which forms the basis for resetting rates for future cash recoveries from, or credits to, customers. These revenue decoupling targets may be adjusted as a result of rate cases and other authorized adjustments that the Company files with the MDPU. The Company estimates that revenue decoupling applies to approximately 27% and 11% of Unitil s total annual electric and natural gas sales volumes, respectively.

Rate Case Activity

Unitil Energy Base Rates On March 30, 2016 Unitil Energy filed notice of its intent to seek an increase in base rates with the NHPUC. NHPUC rules provide that such notice must be filed at least 30 days prior to the actual filing of a request for an increase in rates. The Company will be seeking an increase in base rates of approximately $6.0 million, or 4 percent of total revenue. The Company also intends to request a temporary increase in rates during the pendency of the investigation of the permanent rate relief request. The Company will also be requesting a long-term rate plan for the annual recovery in future years of the costs associated with certain plant additions.

Fitchburg Base Rates Electric On June 16, 2015, Fitchburg filed for a $3.8 million increase in its electric base revenue decoupling target, which represents a 5.6 percent increase over 2014 test year operating electric revenues. The filing included a request for approval of a capital cost recovery mechanism to recover prudently incurred additions to utility plant on an annual basis. Hearings have been completed and briefs have been filed. By statute, the MDPU is afforded ten months to act on a request for a rate increase. A decision is expected by the end of April, 2016.

Fitchburg Base Rates Gas On June 16, 2015, Fitchburg filed for a $3.0 million increase in its gas base revenue decoupling target, which represents an 8.3 percent increase over 2014 test year total gas operating revenues. Hearings have been completed and briefs have been filed. By statute, the MDPU is afforded ten months to act on a request for a rate increase. A decision is expected by the end of April, 2016.

Northern Utilities Base Rates Maine The rate case settlement in Northern Utilities Maine division s last rate case allowed the Company to implement a Targeted Infrastructure Replacement Adjustment (TIRA) rate mechanism to adjust base distribution rates annually to recover the revenue requirements associated with targeted investments in gas distribution system infrastructure replacement and upgrade projects. The TIRA has an initial term of four years and covers targeted capital expenditures in 2013 through 2016. The 2016 TIRA, for 2015 expenditures, was filed on February 29, 2016, and provides for an annual increase in base distribution revenue of $1.5 million, effective May 1, 2016, and is pending approval.

Northern Utilities Base Rates New Hampshire Northern Utilities New Hampshire division s last rate case resulted in a settlement agreement providing for an increase of $4.6 million in distribution base revenue and an additional step increase in revenue of $1.4 million for investments in gas mains extensions and infrastructure replacement projects, effective May 1, 2014, and a step adjustment that provided for an annual increase of $1.8 million in revenue effective May 1, 2015.

Northern Utilities Pipeline Refund On February 19, 2015 the FERC issued Opinion No. 524-A, the final order in Portland Natural Gas Transmission s (PNGTS) Section 4 rate case, requiring PNGTS to issue refunds to shippers. Northern Utilities received a pipeline refund of $22.0 million on April 15, 2015. As a gas supply-related refund, the entire amount refunded will be credited to Northern Utilities customers and marketers. In New Hampshire, the refund is being credited to all customers over a three year period as directed by the NHPUC. In Maine, the refund has been divided into two parts, as directed by the MPUC. Maine retail customers who purchase their gas directly from Northern Utilities are being credited their portion of the refund over a three year period. The second part of the refund was paid on October 5, 2015 as a one-time lump sum payment directly to marketers who transport gas on Northern Utilities distribution system. The Company has recorded current and noncurrent Regulatory Liabilities of $6.8 million and $3.3 million, respectively, on its Consolidated Balance Sheets as of March 31, 2016.

Granite State Base Rates Granite State has in place a FERC approved amended settlement agreement under which it is permitted each June to file for a rate adjustment to recover the revenue requirements associated with specified capital investments in gas transmission projects up to a specific cost cap. The most recent rate increase under this provision was $0.4 million, effective August 1, 2015. Granite State s next rate adjustment request will be filed with the FERC in June 2016.

RESULTS OF OPERATIONS

The following section of MD&A compares the results of operations for each of the two fiscal periods ended March 31, 2016 and March 31, 2015 and should be read in conjunction with the accompanying unaudited Consolidated Financial Statements and the accompanying Notes to unaudited Consolidated Financial Statements included in Part I, Item 1 of this report, which are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP).

The Company s results of operations reflect the seasonal nature of the natural gas business. Annual gas revenues are substantially realized during the heating season as a result of higher sales of natural gas due to cold weather. Accordingly, the results of operations are historically most favorable in the first and fourth quarters. Fluctuations in seasonal weather conditions may have a significant effect on the result of operations. Sales of electricity are generally less sensitive to weather than natural gas sales, but may also be affected by the weather conditions in both the winter and summer seasons. Also, as a result of recent rate cases, the Company s natural gas sales margins are derived from a higher percentage of fixed billing components, including customer charges. Therefore, natural gas revenues and margin will be less affected by the seasonal nature of the natural gas business. In addition, as discussed above, approximately 27% and 11% of the Company s total annual electric and natural gas sales volumes, respectively, are decoupled and changes in sales to existing customers do not affect sales margin.

Earnings Overview

The Company s Net Income was $10.9 million, or $0.78 per share, for the first quarter of 2016, a decrease of $2.7 million, or $0.20 per share, compared to the first quarter of 2015. The decrease in earnings for the first three months of 2016 was driven by lower natural gas and electric sales and margins, reflecting significantly warmer weather compared to the first quarter of 2015.

Natural gas sales margin was $35.9 million in the three months ended March 31, 2016, resulting in a decrease of $2.9 million compared to the same period in 2015. Gas sales margin was negatively affected by lower therm unit sales due to warmer weather, partially offset by the positive impacts of higher natural gas distribution rates and growth in the number of customers. The Company estimates that the warmer winter weather in the first quarter of 2016 compared to 2015 negatively impacted gas sales margin by approximately $4.9 million, or $0.22 per share.

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Therm sales of natural gas decreased 16.7% in the three months ended March 31, 2016 compared to the same period in 2015 primarily driven by warmer winter weather in the first quarter of 2016 compared to 2015. Based on weather data collected in the Company s service areas, there were 23% fewer Heating Degree Days (HDD) in the first quarter of 2016, compared to the same period in 2015. Estimated weather-normalized gas therm sales, excluding decoupled sales, were up 2.1% in the first quarter of 2016 compared to the same period in 2015. This growth was led by a year over year increase of 7.4% in gas therm sales to large industrial customers.

Electric sales margin was $20.1 million in the three months ended March 31, 2016, resulting in a decrease of $1.1 million, or $0.05 per share, compared to the same period in 2015, reflecting lower kilowatt-hour (kWh) sales in the first quarter of 2016 primarily due to warmer winter weather. Total electric kWh sales decreased 6.9% in the first quarter of 2016 compared to the first quarter of 2015.

Operation and Maintenance (O&M) expenses increased $0.5 million in the three months ended March 31, 2016 compared to the same period in 2015, reflecting higher compensation and benefit costs, partially offset by lower utility operating costs.

Depreciation and Amortization expense increased $0.4 million in the three months ended March 31, 2016 compared to the same period in 2015, reflecting higher depreciation of $0.6 million on normal utility plant assets in service, partially offset by lower amortization expense of $0.2 million.

Taxes Other Than Income Taxes increased $0.1 million in the three months ended March 31, 2016 compared to the same period in 2015, primarily reflecting higher local property tax expense.

Interest Expense, net decreased $0.3 million in the three months ended March 31, 2016 compared to the same period in 2015, primarily reflecting lower levels of long-term debt.

Revenues of $1.6 million in the first quarter of 2016 for Usource, the Company s non-regulated energy brokering business, were on par with results for the first quarter of 2015.

At its January 2016 and April 2016 meetings, Unitil s Board of Directors declared quarterly dividends on the Company s common stock of $0.3550 per share, resulting in an increase in the effective annual dividend rate to $1.42 per share from $1.40 per share. These dividend declarations continue an unbroken record of quarterly dividend payments since trading began in Unitil s common stock.

A more detailed discussion of the Company s results of operations for the three months ended March 31, 2016 is presented below.

Gas Sales, Revenues and Margin

Therm Sales Unitil s total therm sales of natural gas decreased 16.7% in the three months ended March 31, 2016 compared to the same period in 2015, reflecting decreases of 21.1% and 15.2% in sales to Residential and C&I customers, respectively. The decrease in gas therm sales in the Company s service areas was driven by warmer winter weather in the first quarter of 2016 compared to 2015, partially offset by growth in the number of customers. Based on weather data collected in the Company s natural gas service areas, there were 23% fewer HDD in the first quarter of 2016 compared to the same period in 2015. Estimated weather-normalized gas therm sales, excluding decoupled sales, were up 2.1% in the first quarter of 2016 compared to the same period in 2015. This growth was led by a year over year increase of 7.4% in gas therm sales to large industrial customers. As of March 31, 2016, the number of total natural gas customers served has increased by 1.2% in the last twelve months.
As discussed above, sales margin derived from decoupled unit sales (representing approximately 11% of total annual therm sales volume) is not sensitive to changes in gas therm sales.

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The following table details total firm therm sales for the three months ended March 31, 2016 and 2015, by major customer class:

Therm Sales (millions)

	Three Months Ended March 31,			
	2016	**2015**	**Change**	**% Change**
Residential	**19.8**	25.1	(5.3)	(21.1%)
Commercial / Industrial	**63.1**	74.4	(11.3)	(15.2%)
Total	**82.9**	99.5	(16.6)	(16.7%)

Gas Operating Revenues and Sales Margin The following table details total Gas Operating Revenues and Sales Margin for the three months ended March 31, 2016 and 2015:

Gas Operating Revenues and Sales Margin (millions)

	Three Months Ended March 31,			
	2016	**2015**	**$ Change**	**% Change**
Gas Operating Revenues:				
Residential	**$ 29.4**	$ 40.5	$ (11.1)	(27.4%)
Commercial / Industrial	**43.7**	59.8	(16.1)	(26.9%)
Total Gas Operating Revenues	**$ 73.1**	$ 100.3	$ (27.2)	(27.1%)
Cost of Gas Sales	**$ 37.2**	$ 61.5	$ (24.3)	(39.5%)
Gas Sales Margin	**$ 35.9**	$ 38.8	$ (2.9)	(7.5%)

The Company analyzes operating results using Gas Sales Margin, a non-GAAP measure. Gas Sales Margin is calculated as Total Gas Operating Revenue less Cost of Gas Sales. The Company believes Gas Sales Margin is a better measure to analyze profitability than Total Gas Operating Revenue because the approved cost of sales are tracked and reconciled costs that are passed through directly to the customer, resulting in an equal and offsetting amount reflected in Total Gas Operating Revenue. Sales margin can be reconciled to Operating Income, a GAAP measure, by including Operation and Maintenance, Depreciation and Amortization and Taxes Other Than Income Taxes for each segment in the analysis.

Natural gas sales margin was $35.9 million in the three months ended March 31, 2016, resulting in a decrease of $2.9 million compared to the same period in 2015. The warmer weather in the first quarter of 2016 compared to 2015 had a negative impact on gas sales margin of approximately $4.9 million, which was partially offset by the positive impacts of $1.1 million in higher natural gas rates and $0.9 million from customer usage and growth.

The decrease in Total Gas Operating Revenues of $27.2 million in the first quarter of 2016 reflects lower gas sales volumes and lower cost of gas sales, which are tracked and reconciled costs that are passed through directly to customers.

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Electric Sales, Revenues and Margin

Kilowatt-hour Sales In the first quarter of 2016, Unitil s total electric kWh sales decreased 6.9% compared to the first quarter of 2015. Sales to Residential and C&I customers decreased 11.7% and 3.2%, respectively, in the first quarter of 2016 compared to the same period in 2015, reflecting warmer winter weather in 2016 compared to 2015. Based on weather data collected in the Company s electric service areas, there were 23% fewer HDD in the first quarter of 2016 compared to the same period in 2015. As discussed above, sales margin derived from decoupled unit sales (representing approximately 27% of total annual kWh sales volume) is not sensitive to changes in electric kWh sales.

The following table details total kWh sales for the three months ended March 31, 2016 and 2015 by major customer class:

kWh Sales (millions)	**Three Months Ended March 31,**			
	2016	**2015**	**Change**	**% Change**
Residential	**175.4**	198.6	(23.2)	(11.7%)
Commercial / Industrial	**241.9**	249.8	(7.9)	(3.2%)
Total	**417.3**	448.4	(31.1)	(6.9%)

Electric Operating Revenues and Sales Margin The following table details total Electric Operating Revenues and Sales Margin for the three months ended March 31, 2016 and 2015:

Electric Operating Revenues and Sales Margin (millions)	**Three Months Ended March 31,**			
	2016	**2015**	**$ Change**	**% Change**
Electric Operating Revenues:				
Residential	**$ 30.1**	$ 42.7	$ (12.6)	(29.5%)
Commercial / Industrial	**21.0**	27.6	(6.6)	(23.9%)
Total Electric Operating Revenues	**$ 51.1**	$ 70.3	$ (19.2)	(27.3%)
Total Cost of Electric Sales	**$ 31.0**	$ 49.1	$ (18.1)	(36.9%)
Electric Sales Margin	**$ 20.1**	$ 21.2	$ (1.1)	(5.2%)

The Company analyzes operating results using Electric Sales Margin, a non-GAAP measure. Electric Sales Margin is calculated as Total Electric Operating Revenues less Cost of Electric Sales. The Company believes Electric Sales Margin is a better measure to analyze profitability than Total Electric Operating Revenues because the approved cost of sales are tracked and reconciled costs that are passed through directly to the customer resulting in an equal and offsetting amount reflected in Total Electric Operating Revenues. Sales margin can be reconciled to Operating Income, a GAAP measure, by including Operation and Maintenance, Depreciation and Amortization and Taxes Other Than Income Taxes for each segment in the analysis.

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Electric sales margin was $20.1 million in the three months ended March 31, 2016, resulting in a decrease of $1.1 million compared to the same period in 2015 reflecting lower kWh sales in the first quarter of 2016 primarily due to warmer weather in the first quarter of 2016 compared to 2015.

The decrease in Total Electric Operating Revenues of $19.2 million in the first quarter of 2016 reflects lower electric sales volumes and lower cost of electric sales, which are tracked and reconciled costs that are passed through directly to customers.

Operating Revenue Other

The following table details total Other Operating Revenue for the three months ended March 31, 2016 and 2015:

Other Operating Revenue (Millions)

	Three Months Ended March 31,			
	2016	**2015**	**$ Change**	**% Change**
Other	**$ 1.6**	$ 1.6	$	
Total Other Operating Revenue	**$ 1.6**	$ 1.6	$	

Total Other Operating Revenue in the first quarter of 2016, which is comprised of revenues from the Company s non-regulated energy brokering business, Usource, was on par with results for the first quarter of 2015. Usource s revenues are primarily derived from fees and charges billed to suppliers as customers take delivery of energy from these suppliers under term contracts brokered by Usource.

Operating Expenses

Cost of Gas Sales Cost of Gas Sales includes the cost of natural gas purchased and manufactured to supply the Company s total gas supply requirements and spending on energy efficiency programs. Cost of Gas Sales decreased $24.3 million, or 39.5%, in the three months ended March 31, 2016 compared to the same period in 2015. This decrease reflects lower sales of natural gas, a decrease in the amount of natural gas purchased by customers directly from third-party suppliers and lower wholesale natural gas prices. The Company reconciles and recovers the approved Cost of Gas Sales in its rates at cost on a pass through basis and therefore changes in approved expenses do not affect earnings.

Cost of Electric Sales Cost of Electric Sales includes the cost of electric supply as well as other energy supply related restructuring costs, including power supply buyout costs, and spending on energy efficiency programs. Cost of Electric Sales decreased $18.1 million, or 36.9%, in the three months ended March 31, 2016 compared to the same period in 2015. This decrease reflects lower sales of electricity and lower wholesale electricity prices, partially offset by an increase in the amount of electricity purchased by customers directly from third-party suppliers. The Company reconciles and recovers the approved Cost of Electric Sales in its rates at cost and therefore changes in approved expenses do not affect earnings.

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Operation and Maintenance O&M expense includes electric and gas utility operating costs, and the operating costs of the Company s other business activities. O&M expenses increased $0.5 million, or 3.0%, in the three months ended March 31, 2016 compared to the same period in 2015. The change in O&M expenses reflects higher compensation, health care and other benefit costs of $0.8 million, partially offset by lower utility operating costs.

Depreciation and Amortization Depreciation and Amortization expense increased $0.4 million, or 3.5%, in the three months ended March 31, 2016 compared to the same period in 2015, reflecting higher depreciation of $0.6 million on normal utility plant assets in service, partially offset by lower amortization expense of $0.2 million.

Taxes Other Than Income Taxes Taxes Other Than Income Taxes increased $0.1 million, or 2.0%, in the three months ended March 31, 2016 compared to the same period in 2015, primarily reflecting higher local property tax expense.

Other Expense, net Other Expense, net in the three month period ended March 31, 2016 decreased $0.1 million compared to the same period in 2015.

Income Taxes Federal and State Income Taxes decreased by $1.9 million for the three months ended March 31, 2016 compared to the same period in 2015, reflecting lower pre-tax earnings in the current period.

Interest Expense, net

Interest expense is presented in the financial statements net of interest income. Interest expense is mainly comprised of interest on long-term debt and short-term borrowings. In addition, certain reconciling rate mechanisms used by the Company s distribution operating utilities give rise to regulatory assets and regulatory liabilities on which interest is accrued.

Unitil s utility subsidiaries operate a number of reconciling rate mechanisms to recover specifically identified costs on a pass-through basis. These reconciling rate mechanisms track costs and revenue on a monthly basis. In any given month, this monthly tracking and reconciling process will produce either an under-collected or an over-collected balance of costs. In accordance with the distribution utilities rate tariffs, interest is accrued on these balances and will produce either interest income or interest expense. Consistent with regulatory precedent, interest income is recorded on an under-collection of costs which creates a regulatory asset to be recovered in future periods when rates are reset. Interest expense is recorded on an over-collection of costs, which creates a regulatory liability to be refunded in future periods when rates are reset.