SOUTHWEST GAS CORP
Form 10-Q
November 08, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2005

Commission File Number 1-7850

SOUTHWEST GAS CORPORATION

(Exact name of registrant as specified in its charter)

California	88-0085720
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

5241 Spring Mountain Road Post Office Box 98510 Las Vegas, Nevada	89193-8510
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: (702) 876-7237

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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes X No _

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.

Common Stock, $1 Par Value, 39,124,126 shares as of November 1, 2005.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SOUTHWEST GAS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(Thousands of dollars, except par value)
(Unaudited)

	SEPTEMBER 30, 2005	DECEMBER 31, 2004
ASSETS		
Utility plant:		
Gas plant	$ 3,451,372	$ 3,287,591
Less: accumulated depreciation	(1,073,660)	(985,919)
Acquisition adjustments, net	2,218	2,353
Construction work in progress	52,146	31,967
Net utility plant	2,432,076	2,335,992
Other property and investments	113,274	99,879
Current assets:		
Cash and cash equivalents	16,932	13,641
Accounts receivable, net of allowances	107,431	176,090
Accrued utility revenue	31,500	68,200
Deferred purchased gas costs	60,480	82,076
Prepaids and other current assets	81,687	91,986
Total current assets	298,030	431,993
Deferred charges and other assets	78,173	70,252
Total assets	$ 2,921,553	$ 2,938,116
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Common stock, $1 par (authorized - 45,000,000 shares; issued and outstanding - 39,027,923 and 36,794,343 shares)	$ 40,658	$ 38,424
Additional paid-in capital	620,231	566,646
Accumulated other comprehensive income (loss), net	(10,892)	(10,892)
Retained earnings	101,412	111,498
Total equity	751,409	705,676
Subordinated debentures due to Southwest Gas Capital II	100,000	100,000
Long-term debt, less current maturities	1,149,190	1,162,936
Total capitalization	2,000,599	1,968,612

	SEPTEMBER 30, 2005	DECEMBER 31, 2004
Current liabilities:		
Current maturities of long-term debt	81,031	29,821
Short-term debt	29,000	100,000
Accounts payable	97,571	165,872
Customer deposits	55,717	50,194
Accrued general taxes	43,023	38,189
Accrued interest	18,942	22,425
Deferred income taxes	11,285	26,676
Other current liabilities	53,739	49,854
Total current liabilities	390,308	483,031
Deferred income taxes and other credits:		
Deferred income taxes and investment tax credits	288,514	281,743
Taxes payable	14,503	3,965
Accumulated removal costs	99,000	84,000
Other deferred credits	128,629	116,765
Total deferred income taxes and other credits	530,646	486,473
Total capitalization and liabilities	$ 2,921,553	$ 2,938,116

The accompanying notes are an integral part of these statements.

SOUTHWEST GAS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share amounts)
(Unaudited)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,		TWELVE MONTHS ENDED SEPTEMBER 30,	
	2005	2004	2005	2004	2005	2004
Operating revenues:						
Gas operating revenues	$ 239,318	$ 206,459	$ 1,032,349	$ 866,999	$ 1,427,402	$ 1,168,160
Construction revenues	73,960	58,008	184,939	149,565	250,382	200,109
Total operating revenues	313,278	264,467	1,217,288	1,016,564	1,677,784	1,368,269
Operating expenses:						
Net cost of gas sold	128,745	102,978	599,697	450,690	794,773	574,285
Operations and maintenance	77,445	74,289	226,678	214,957	302,521	285,317
Depreciation and amortization	39,387	36,725	116,449	108,867	153,600	144,123
Taxes other than income taxes	9,888	9,528	30,277	29,026	38,920	37,406
Construction expenses	63,272	49,964	161,862	130,285	218,617	175,112
Total operating expenses	318,737	273,484	1,134,963	933,825	1,508,431	1,216,243
Operating income (loss)	(5,459)	(9,017)	82,325	82,739	169,353	152,026
Other income and (expenses):						
Net interest deductions	(20,602)	(20,079)	(60,880)	(57,622)	(82,040)	(76,019)
Net interest deductions on subordinated debentures	(1,931)	(1,930)	(5,792)	(5,791)	(7,725)	(7,721)
Other income (deductions)	1,038	2,076	4,694	3,252	5,193	4,922
Total other income and (expenses)	(21,495)	(19,933)	(61,978)	(60,161)	(84,572)	(78,818)
Income (loss) before income taxes	(26,954)	(28,950)	20,347	22,578	84,781	73,208
Income tax expense (benefit)	(10,510)	(12,597)	6,779	6,249	30,767	22,405
Net income (loss)	$ (16,444)	$ (16,353)	$ 13,568	$ 16,329	$ 54,014	$ 50,803
Basic earnings (loss) per share	$ (0.43)	$ (0.46)	$ 0.36	$ 0.47	$ 1.44	$ 1.47
Diluted earnings (loss) per share	$ (0.43)	$ (0.46)	$ 0.36	$ 0.47	$ 1.43	$ 1.45

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,		TWELVE MONTHS ENDED SEPTEMBER 30,	
Dividends paid per share	$ 0.205	$ 0.205	$ 0.615	$ 0.615	$ 0.82	$ 0.82
Average number of common shares outstanding	38,528	35,412	37,780	34,857	37,392	34,661
Average shares outstanding (assuming dilution)	--	--	38,101	35,116	37,722	34,942

The accompanying notes are an integral part of these statements.

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SOUTHWEST GAS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Thousands of dollars)
(Unaudited)

	NINE MONTHS ENDED SEPTEMBER 30,		TWELVE MONTHS ENDED SEPTEMBER 30,	
	2005	2004	2005	2004
CASH FLOW FROM OPERATING ACTIVITIES:				
Net income	$ 13,568	$ 16,329	$ 54,014	$ 50,803
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	116,449	108,867	153,600	144,123
Deferred income taxes	(8,620)	8,263	21,118	36,102
Changes in current assets and liabilities:				
Accounts receivable, net of allowances	70,434	39,477	(18,350)	(14,052)
Accrued utility revenue	37,882	37,000	(618)	(1,700)
Deferred purchased gas costs	23,070	(45,273)	(4,582)	(76,966)
Accounts payable	(69,884)	(42,734)	28,608	13,044
Accrued taxes	15,165	3,074	15,118	13,670
Other current assets and liabilities	15,533	(3,749)	(6,124)	(2,142)
Other	(4,609)	(4,880)	1,321	(6,154)
Net cash provided by operating activities	208,988	116,374	244,105	156,728
CASH FLOW FROM INVESTING ACTIVITIES:				
Construction expenditures and property additions	(200,260)	(195,360)	(307,588)	(272,132)
Other	(3,185)	3,336	(415)	(18,564)
Net cash used in investing activities	(203,445)	(192,024)	(308,003)	(290,696)
CASH FLOW FROM FINANCING ACTIVITIES:				
Issuance of common stock, net	55,819	36,633	77,873	44,248
Dividends paid	(23,196)	(21,420)	(30,612)	(28,407)
Issuance of subordinated debentures, net	--	--	--	(81)
Issuance of long-term debt, net	65,803	72,759	140,179	71,548
Retirement of long-term debt, net	(29,678)	(5,326)	(107,789)	(7,763)
Temporary changes in long-term debt	--	--	--	19,814
Change in short-term debt	(71,000)	(14,000)	(9,000)	38,000
Net cash provided by (used in) financing activities	(2,252)	68,646	70,651	137,359
Change in cash and cash equivalents	3,291	(7,004)	6,753	3,391
Cash at beginning of period	13,641	17,183	10,179	6,788
Cash at end of period	$ 16,932	$ 10,179	$ 16,932	$ 10,179

Supplemental information:

	NINE MONTHS ENDED SEPTEMBER 30,		TWELVE MONTHS ENDED SEPTEMBER 30,	
Interest paid, net of amounts capitalized	$ 67,340	$ 60,497	$ 87,276	$ 79,598
Income taxes paid (received), net	3,491	179	(9,328)	(25,598)

The accompanying notes are an integral part of these statements.

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Note 1 - Summary of Significant Accounting Policies

Nature of Operations. Southwest Gas Corporation (the "Company") is composed of two segments: natural gas operations ("Southwest" or the "natural gas operations" segment) and construction services. Southwest purchases, transports, and distributes natural gas to customers in portions of Arizona, Nevada, and California. The public utility rates, practices, facilities, and service territories of Southwest are subject to regulatory oversight. The timing and amount of rate relief can materially impact results of operations. Natural gas sales are seasonal, peaking during the winter months. Variability in weather from normal temperatures can materially impact results of operations. Natural gas purchases and the timing of related recoveries can materially impact liquidity. Northern Pipeline Construction Co. ("NPL" or the "construction services" segment), a wholly owned subsidiary, is a full-service underground piping contractor that provides utility companies with trenching and installation, replacement, and maintenance services for energy distribution systems.

Basis of Presentation. The condensed consolidated financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The preparation of the condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. In the opinion of management, all adjustments, consisting of normal recurring items and estimates necessary for a fair presentation of the results for the interim periods, have been made. It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the 2004 Annual Report to Shareholders, which is incorporated by reference into the 2004 Form 10-K, and the first and second quarter 2005 Form 10-Qs.

Intercompany Transactions. NPL recognizes revenues generated from contracts with Southwest (see **Note 2** below). Accounts receivable for these services were $10.3 million at September 30, 2005 and $8.3 million at December 31, 2004. The accounts receivable balance, revenues, and associated profits are included in the condensed consolidated financial statements of the Company and were not eliminated during consolidation in accordance with Statement of Financial Accounting Standards ("SFAS") No. 71, Accounting for the Effects of Certain Types of Regulation.

Recently Issued Accounting Pronouncements. In November 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 151, Inventory Costs. SFAS No. 151 is an amendment of Accounting Research Bulletin (ARB) No. 43, Restatement and Revision of Accounting Research Bulletins. SFAS No. 151 addresses the accounting for abnormal amounts of idle facility expense, freight handling costs and spoilage and will no longer allow companies to capitalize such inventory costs on their balance sheets when the production defect rate varies significantly from the expected rate. The provisions of SFAS No. 151 are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of the standard is not expected to have a material impact on the financial position or results of operations of the Company.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets. SFAS No. 153 is an amendment of Accounting Principles Board Opinion (APB) No. 29, Accounting for Nonmonetary Transactions. SFAS No. 153 addresses the accounting for exchanges of similar productive assets and eliminates the exception to the fair-value principle for such exchanges, which previously had been accounted for based on the book value of the asset surrendered with no gain recognition. Under SFAS No. 153, using certain criteria, the gain would be recognized currently and not deferred. The provisions of SFAS No. 153 are effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company adopted this standard on July 1, 2005. The adoption did not have a material impact on the financial position or results of operations of the Company.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections. SFAS No. 154 is a replacement of APB Opinion No. 20, Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements. SFAS No. 154 changes the requirements for the accounting for and reporting of a change in accounting principle, and requires retrospective application for voluntary changes in accounting principle unless it is impracticable to do so. The provisions of SFAS No. 154 are effective for accounting changes made in fiscal years beginning after December 15, 2005. The adoption of the standard is not expected to have a material impact on the financial position or results of operations of the Company.

In March 2005, the FASB issued Interpretation No. 47 (FIN 47), Accounting for Conditional Asset Retirement Obligations. FIN 47 is an interpretation of SFAS No. 143, Accounting for Asset Retirement Obligations. FIN 47 clarifies that the term *conditional asset retirement obligation* as used in SFAS No. 143, refers to a legal obligation to perform an asset retirement activity in which the timing or method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing or method of settlement. An entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. FIN 47 is designed to clarify when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation.

Upon adoption of SFAS No. 143 in January 2003, Southwest concluded it could not reasonably estimate its conditional asset retirement obligation. At the time of adoption, Southwest determined that it had limited legal obligations related to retirement costs for portions of its system that are subject to limited-duration easements and rights-of-way agreements. However, Southwest has traditionally been able to renew its easements and rights-of-way without having to retire, abandon, or remove facilities, and anticipates no serious difficulties in obtaining future renewals. In addition, certain franchises and provisions of federal and state statutes for abandonment of facilities impose removal obligations under certain circumstances. Southwest has the intent and the ability to operate such facilities indefinitely. As a result, the probability and the length of time until settlement of the asset retirement obligation is unknown. The Company will adopt the provisions of FIN 47 on December 31, 2005. Management is evaluating the criteria under FIN 47 to determine what, if any, impact the new standard may have on the financial position or results of operations of the Company.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment. SFAS No. 123 (revised 2004) is a revision of SFAS No. 123, Accounting for Stock-Based Compensation and supersedes APB No. 25, Accounting for Stock Issued to Employees. SFAS No. 123 (revised 2004) establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity s equity instruments or that may be settled by the issuance of those equity instruments. This statement eliminates the alternative to use APB No. 25 and the intrinsic value method of accounting. SFAS No. 123 (revised 2004) requires entities to recognize the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards (with limited exceptions). The provisions of the statement (as amended by the SEC) are effective for the Company beginning January 2006. In 2006, compensation expense will increase due to the adoption of SFAS No. 123 (revised 2004) since no compensation expense is currently recorded for the Company's Stock Incentive Plan. The table below illustrates the effect SFAS No. 123 would have had on historical net income and earnings per share.

Stock-Based Compensation. The Company has two stock-based compensation plans, which are described more fully in **Note 9 - Employee Benefits** in the 2004 Annual Report to Shareholders. These plans are currently accounted for in accordance with APB Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provision of SFAS No. 123, "Accounting for Stock-Based Compensation" to its stock-based employee compensation (thousands of dollars, except per share amounts):

	Period Ended September 30,					
	Three Months		Nine Months		Twelve Months	
	2005	2004	2005	2004	2005	2004
Net income (loss), as reported	$ (16,444)	$ (16,353)	$ 13,568	$ 16,329	$ 54,014	$ 50,803
Add:						
Stock-based employee compensation expense included in reported net income (loss), net of related tax benefits	431	365	1,331	1,253	1,903	2,337
Deduct:						
Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax benefits	(546)	(445)	(1,632)	(1,651)	(1,939)	(2,849)
Pro forma net income (loss)	$ (16,559)	$ (16,433)	$ 13,267	$ 15,931	$ 53,978	$ 50,291
Earnings (loss) per share:						
Basic - as reported	$ (0.43)	$ (0.46)	$ 0.36	$ 0.47	$ 1.44	$ 1.47
Basic - pro forma	(0.43)	(0.46)	0.35	0.46	1.44	1.45
Diluted - as reported	(0.43)	(0.46)	0.36	0.47	1.43	1.45
Diluted - pro forma	(0.43)	(0.46)	0.35	0.45	1.43	1.44

Components of Net Periodic Benefit Cost. Southwest has a noncontributory qualified retirement plan with defined benefits covering substantially all employees. Southwest also provides postretirement benefits other than pensions ("PBOP") to its qualified retirees for health care, dental, and life insurance benefits.

Components of Net Periodic Benefit Cost

	Qualified Retirement Plan					
	Period Ended September 30,					
	Three Months		Nine Months		Twelve Months	
	2005	2004	2005	2004	2005	2004
Service cost	$ 3,947	$ 3,448	$ 11,841	$ 10,343	$ 15,288	$ 13,409
Interest cost	6,332	5,915	18,996	17,745	24,910	23,055
Expected return on plan assets	(7,388)	(7,017)	(22,164)	(21,051)	(29,180)	(27,854)
Amortization of prior service costs	(3)	13	(9)	40	5	55
Amortization of unrecognized transition obligation	--	--	--	--	--	198
Amortization of net (gain) loss	613	--	1,839	--	1,839	--
Net periodic benefit cost	$ 3,501	$ 2,359	$ 10,503	$ 7,077	$ 12,862	$ 8,863

	PBOP					
	Period Ended September 30,					
	Three Months		Nine Months		Twelve Months	
	2005	2004	2005	2004	2005	2004
Service cost	$ 209	$ 181	$ 627	$ 542	$ 807	$ 710
Interest cost	529	545	1,587	1,636	2,131	2,160
Expected return on plan assets	(419)	(357)	(1,257)	(1,071)	(1,612)	(1,372)
Amortization of prior service costs	--	--	--	--	--	--
Amortization of unrecognized transition obligation	217	217	651	651	867	867
Amortization of net (gain) loss	34	53	102	159	156	224
Net periodic benefit cost	$ 570	$ 639	$ 1,710	$ 1,917	$ 2,349	$ 2,589

Note 2 Segment Information

The following tables list revenues from external customers, intersegment revenues, and segment net income (thousands of dollars):

	Natural Gas Operations	Construction Services	Total
Three months ended September 30, 2005			
Revenues from external customers	$ 239,318	$ 53,538	$ 292,856
Intersegment revenues	--	20,422	20,422
Total	$ 239,318	$ 73,960	$ 313,278
Segment net income (loss)	$ (20,023)	$ 3,579	$ (16,444)
Three months ended September 30, 2004			
Revenues from external customers	$ 206,459	$ 43,423	$ 249,882
Intersegment revenues	--	14,585	14,585
Total	$ 206,459	$ 58,008	$ 264,467
Segment net income (loss)	$ (18,954)	$ 2,601	$ (16,353)

	Natural Gas Operations	Construction Services	Total
Nine months ended September 30, 2005			
Revenues from external customers	$ 1,032,349	$ 133,024	$ 1,165,373
Intersegment revenues	--	51,915	51,915
Total	$ 1,032,349	$ 184,939	$ 1,217,288
Segment net income	$ 7,001	$ 6,567	$ 13,568
Nine months ended September 30, 2004			
Revenues from external customers	$ 866,999	$ 106,445	$ 973,444
Intersegment revenues	--	43,120	43,120
Total	$ 866,999	$ 149,565	$ 1,016,564
Segment net income	$ 10,992	$ 5,337	$ 16,329

Natural Gas Operations | Construction Services | Total

	Natural Gas Operations	Construction Services	Total
Twelve months ended September 30, 2005			
Revenues from external customers	$ 1,427,402	$ 179,971	$ 1,607,373
Intersegment revenues	--	70,411	70,411
Total	$ 1,427,402	$ 250,382	$ 1,677,784
Segment net income	$ 44,363	$ 9,651	$ 54,014
Twelve months ended September 30, 2004			
Revenues from external customers	$ 1,168,160	$ 140,696	$ 1,308,856
Intersegment revenues	--	59,413	59,413
Total	$ 1,168,160	$ 200,109	$ 1,368,269
Segment net income	$ 44,212	$ 6,591	$ 50,803

Note 3 Comprehensive Income (Loss)

	Three Months Ended September 30,		Nine Months Ended September 30,		Twelve Months Ended September 30,	
	2005	**2004**	**2005**	**2004**	**2005**	**2004**
Net income (loss)	$ (16,444)	$ (16,353)	$ 13,568	$ 16,329	$ 54,014	$ 50,803
Additional minimum pension liability adjustment, net of $6.5 million tax benefit	--	--	--	--	(10,892)	--
Comprehensive income (loss)	$ (16,444)	$ (16,353)	$ 13,568	$ 16,329	$ 43,122	$ 50,803

The additional minimum pension liability adjustment noted above resulted from the measurement of pension obligations at December 31, 2004. Adjustments, if any, are only made at each annual measurement date.

Note 4 Debt Instruments

In April 2005, the Company replaced its $250 million credit facility, scheduled to expire in May 2007, with a $300 million facility that expires in April 2010. Of the $300 million, $150 million will be available for working capital purposes and $150 million will be designated long-term debt. Interest rates for the facility are calculated at either the London Interbank Offering Rate plus an applicable margin, or the greater of the prime rate or one-half of one percent plus the Federal Funds rate. The applicable margin on the new credit facility is lower than the applicable margin of the previous facility. At September 30, 2005, $150 million and $29 million were outstanding on the long-term and short-term portions of the credit facility, respectively.

In June 2005, a $50.1 million letter of credit, which supports the Clark County, Nevada $50 million Industrial Development Revenue Bonds ("IDRBs") Series 2003A, due 2038, was renewed for a five-year period expiring in June 2010.

In June 2005, a $55.3 million letter of credit, which supports the City of Big Bear $50 million tax-exempt Series A IDRBs, due 2028, was renewed for a five-year period expiring in June 2010.

In July 2005, the Company amended its Financing Agreement dated March 1, 2003 with Clark County, Nevada associated with $50 million in Series 2003B IDRBs. The Company has chosen to secure payment of the principal of the Series 2003B IDRBs using an insurance policy with Ambac Assurance Corporation. Previously, payment of the principal was secured with a letter of credit. The amendment was executed in connection with the use of insurance to secure payment in the remarketing of the Series 2003B IDRBs.

Note 5 Common Stock

During the nine months ended September 30, 2005, the Company issued approximately 2.2 million shares of common stock through its Equity Shelf Program, Dividend Reinvestment and Stock Purchase Plan ("DRSPP"), Employees Investment Plan, Management Incentive Plan, and Stock Incentive Plan. Of this activity, approximately 1 million shares were issued in at-the-market offerings through the Equity Shelf Program (at an average price of $25.53 per share). As of September 30, 2005, the $60 million Equity Shelf Program is fully issued.

In July 2005, the Company registered 750,000 additional shares of common stock with the SEC for issuance under the Employees' Investment Plan.

Note 6 Asset Purchase

In April 2005, the Company purchased the natural gas distribution properties of Avista Corporation (Avista) in South Lake Tahoe, California, which included approximately 19,000 customers. The cash purchase price for the properties was $15.2 million, net of post-closing adjustments. The assets acquired and the liabilities assumed at the acquisition date were as follows (thousands of dollars):

Gas plant	$ 20,951
Less: accumulated depreciation	(13,158)
Net utility plant	7,793
Accounts receivable, net of allowances	1,775
Accrued utility revenue	1,182
Deferred purchased gas costs	1,474
Prepaids and other current assets	276
Deferred charges and other assets	4,670
Total assets acquired	17,170
Accounts payable	1,583
Customer deposits	169
Accrued general taxes	207
Accrued interest	2
Total liabilities assumed	1,961
Cash acquisition price	$ 15,209

Note 7 Contingency

The Company maintains liability insurance for various risks associated with the operation of its natural gas pipelines and facilities. In connection with these liability insurance policies, the Company has been responsible for an initial deductible or self-insured retention amount per incident, after which the insurance carriers would be responsible for amounts up to the policy limits. For the policy year August 2004 to July 2005, the self-insured retention amount associated with general liability claims increased from $1 million per incident to $1 million per incident plus payment of the first $10 million in aggregate claims above $1 million in the policy year. In May 2005, a leaking natural gas line was involved in a fire that injured an individual. The injuries are severe and life threatening. The cause of the leak is under investigation. Claims are expected to be filed against the Company. If the Company was deemed fully or partially responsible, the Company estimates its exposure could be from $1 million to $11 million (the maximum noted above) depending on a number of factors currently under investigation. Accordingly, the Company has recorded a $1 million liability related to this incident. Future results of operations would be impacted to the extent that the Company was deemed responsible for amounts in excess of $1 million. However, the Company believes that the range of possible losses would not materially affect the financial position of the Company.

Note 8 Subsequent Event

In October 2005, the Company issued $100 million in Clark County, Nevada, 4.85% Series 2005A IDRBs. The IDRBs were issued at a discount of 0.75% and are due October 2035. The proceeds from the IDRBs will be used by Southwest to expand and upgrade facilities in Clark County, Nevada.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Executive Summary

The following discussion of Southwest Gas Corporation and subsidiaries (the Company) includes information related to regulated natural gas transmission and distribution activities and non-regulated activities.

The Company is composed of two business segments: natural gas operations (Southwest or the natural gas operations segment) and construction services. Southwest is engaged in the business of purchasing, transporting, and distributing natural gas in portions of Arizona, Nevada, and California. Southwest is the largest distributor in Arizona, selling and transporting natural gas in most of central and southern Arizona, including the Phoenix and Tucson metropolitan areas. Southwest is also the largest distributor and transporter of natural gas in Nevada, serving the Las Vegas metropolitan area and northern Nevada. In addition, Southwest distributes and transports natural gas in portions of California, including the Lake Tahoe area and the high desert and mountain areas in San Bernardino County.

Southwest purchases, transports, and distributes natural gas to approximately 1,677,000 residential, commercial, industrial, and other customers, of which 54 percent are located in Arizona, 36 percent are in Nevada, and 10 percent are in California. During the twelve months ended September 30, 2005, Southwest earned 53 percent of operating margin in Arizona, 37 percent in Nevada, and 10 percent in California. During this same period, Southwest earned 86 percent of operating margin from residential and small commercial customers, 5 percent from other sales customers, and 9 percent from transportation customers. These general patterns are expected to continue.

Northern Pipeline Construction Co. (NPL or the "construction services" segment), a wholly owned subsidiary, is a full-service underground piping contractor that provides utility companies with trenching and installation, replacement, and maintenance services for energy distribution systems.

Results of Consolidated Operations

	Period Ended September 30,					
	Three Months		Nine Months		Twelve Months	
	2005	2004	2005	2004	2005	2004
Contribution to net income (loss)						
(Thousands of dollars)						
Natural gas operations	$ (20,023)	$ (18,954)	$ 7,001	$ 10,992	$ 44,363	$ 44,212
Construction services	3,579	2,601	6,567	5,337	9,651	6,591

	Period Ended September 30,					
Net income (loss)	$ (16,444)	$ (16,353)	$ 13,568	$ 16,329	$ 54,014	$ 50,803
Basic earnings (loss) per share						
Natural gas operations	$ (0.52)	$ (0.53)	$ 0.19	$ 0.32	$ 1.18	$ 1.28
Construction services	0.09	0.07	0.17	0.15	0.26	0.19
Consolidated	$ (0.43)	$ (0.46)	$ 0.36	$ 0.47	$ 1.44	$ 1.47

See separate discussions at **Results of Natural Gas Operations** and **Results of Construction Services.** Average shares outstanding increased by 3.1 million between the third quarter of 2005 and 2004, 2.9 million between the year-to-date periods, and 2.7 million in the current twelve-month period compared to the same period a year ago, primarily resulting from at-the-market offerings through the Equity Shelf Program and continuing issuances under the Company's various stock plans. The Equity Shelf Program was fully issued as of September 30, 2005.

As reflected in the table above, the natural gas operations segment accounted for an average of 85 percent of twelve-month-to-date consolidated net income over the past two years. Accordingly, management s main focus of discussion in this document is on that segment.

Southwest s operating revenues are recognized from the distribution and transportation of natural gas (and related services) billed to customers. An estimate of the amount of natural gas distributed, but not yet billed, to residential and commercial customers from the latest meter reading date to the end of the reporting period is also recognized in revenues.

Operating margin is the measure of utility revenues less the net cost of gas sold. Management uses operating margin as a main benchmark in comparing operating results from period to period. The principal factors affecting operating margin are general rate relief, weather/conservation, and customer growth. Weather is primarily a factor during the first and fourth quarters of the year.

Rates are intended to provide for recovery of all prudently incurred costs and provide a reasonable return on investment. The mix of fixed and variable components in rates assigned to various customer classes (rate design) can significantly impact the operating margin actually realized by Southwest. The Company currently has a rate case on file in Arizona seeking $70.8 million to cover increased costs and provide a reasonable return on plant investment. The filing also proposes a revised rate structure to reduce the amount of rate recovery subject to volumetric fluctuations. Hearings were held in October 2005. See the section on **Rates and Regulatory Proceedings** for additional information.

Rates charged to customers vary according to customer class and rate jurisdiction and are set by the individual state and federal regulatory commissions that govern Southwest s service territories. Southwest makes periodic filings for rate adjustments as the costs of providing service (including the cost of natural gas purchased) change and as additional investments in new or replacement pipeline and related facilities are made. General rate relief in California and Nevada provided $15 million in incremental operating margin during the twelve months ended September 30, 2005. Of equal importance, improvements in rate design have mitigated the impacts of weather and conservation on margin volatility for nearly half of Southwest's business. See the section on **Rates and Regulatory Proceedings** for additional information.

Customer growth, excluding acquisitions, has averaged five percent in recent years. Southwest served 98,000 more customers (including approximately 19,000 customers associated with the purchase of the South Lake Tahoe natural gas distribution properties of Avista Corporation (Avista) described below) in the third quarter of 2005 than in the third quarter of 2004. Incremental margin has accompanied this customer growth, but the costs associated with creating and maintaining the infrastructure needed to accommodate these customers also are increasing. The timing of including these costs in rates is often delayed (regulatory lag) and results in a reduction of current-period earnings. Management has attempted to mitigate the regulatory lag by being judicious in its staffing levels through the effective use of technology. However, growth, coupled with external factors, is causing operating expenses to increase. See **Results of Natural Gas Operations** for additional information.

The results of the natural gas operations segment and the overall results of the Company are heavily dependent upon the components noted previously (general rate relief, weather/conservation, and customer growth). Significant changes in these components (primarily weather) have contributed to somewhat volatile earnings. Management continues to work with its regulatory commissions in designing rate structures that strive to provide affordable and reliable service to its customers while mitigating the volatility in prices to customers and stabilizing returns to investors.

In April 2005, the Company purchased the natural gas distribution properties of Avista in South Lake Tahoe, California, which included approximately 19,000 customers. The cash purchase price for the properties was $15.2 million, net of post-closing adjustments. See **Capital**

Resources and Liquidity for further discussion.

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Results of Natural Gas Operations

Quarterly Analysis

	Three Months Ended September 30,	
	2005	2004
	(Thousands of dollars)	
Gas operating revenues	$ 239,318	$ 206,459
Net cost of gas sold	128,745	102,978
Operating margin	110,573	103,481
Operations and maintenance expense	77,445	74,289
Depreciation and amortization	34,611	32,844
Taxes other than income taxes	9,888	9,528
Operating income (loss)	(11,371)	(13,180)
Other income (expense)	767	1,566
Net interest deductions	20,323	19,814
Net interest deductions on subordinated debentures	1,931	1,930
Income (loss) before income taxes	(32,858)	(33,358)
Income tax expense (benefit)	(12,835)	(14,404)
Contribution to consolidated net income (loss)	$ (20,023)	$ (18,954)

Contribution from natural gas operations decreased $1.1 million in the third quarter of 2005 compared to the same period a year ago. A $1.6 million nonrecurring income tax benefit recognized in the third quarter of 2004 was the primary reason for the change between quarters.

Operating margin increased approximately $7 million, or seven percent, in the third quarter of 2005 compared to the third quarter of 2004. During the last twelve months, the Company added 79,000 customers (excluding 19,000 customers associated with the acquisition of the South Lake Tahoe service territory of Avista Corporation), an increase of five percent. Customer growth contributed an incremental $4 million in operating margin during the quarter. Incremental rate relief in Nevada and California added $3 million in margin compared to the prior year.

Operations and maintenance expense increased $3.2 million, or four percent, primarily due to the impact of general cost increases and incremental costs associated with providing service to a growing customer base.

Depreciation expense and general taxes increased $2.1 million, or five percent, as a result of construction activities. Average gas plant in service increased $253 million, or eight percent, as compared to the third quarter of 2004. The increase reflects ongoing capital expenditures for the upgrade of existing operating facilities, the expansion of the system to accommodate continued customer growth, and the purchase of the South Lake Tahoe properties.

Income taxes in the prior-year quarter included a $1.6 million benefit which resulted from completion of general rate cases and the closure of federal tax year 2000.

Nine-Month Analysis

	Nine Months Ended September 30,	
	2005	2004
	(Thousands of dollars)	
Gas operating revenues	$ 1,032,349	$ 866,999
Net cost of gas sold	599,697	450,690
Operating margin	432,652	416,309
Operations and maintenance expense	226,678	214,957
Depreciation and amortization	103,068	97,396
Taxes other than income taxes	30,277	29,026
Operating income	72,629	74,930
Other income (expense)	2,853	1,627
Net interest deductions	60,244	57,122
Net interest deductions on subordinated debentures	5,792	5,791
Income before income taxes	9,446	13,644
Income tax expense	2,445	2,652
Contribution to consolidated net income	$ 7,001	$ 10,992

Contribution to consolidated net income from natural gas operations decreased $4 million in the first nine months of 2005 compared to the same period a year ago. The decrease was principally attributed to higher operating expenses and financing costs, partially offset by improved, but lower than expected, operating margin.

Operating margin increased approximately $16 million, or four percent, in the first nine months of 2005 compared to the first nine months of 2004. During the current period, customer growth contributed an incremental $14 million in operating margin. Rate relief in Nevada and California added $8 million in margin. Differences in heating demand primarily caused by weather variations between periods resulted in a $6 million margin decrease as warmer-than-normal temperatures were experienced during both periods. During the current period, operating margin was negatively impacted by $12 million, while the negative impact in the prior-year period was $6 million.

Operations and maintenance expense increased $11.7 million, or five percent, principally due to the impact of general cost increases and incremental costs associated with providing service to a growing customer base. Additional factors include higher insurance premiums, uncollectible expenses, employee-related expenses, and compliance costs.

Other income rose $1.2 million between periods. The current period includes a $636,000 increase in interest income primarily associated with the unrecovered balance of deferred purchased gas costs.

Depreciation expense and general taxes increased $6.9 million, or five percent, as a result of construction activities. Average gas plant in service increased $250 million, or eight percent, as compared to the first nine months of 2004. The increase reflects ongoing capital expenditures for the upgrade of existing operating facilities, the expansion of the system to accommodate continued customer growth, and the purchase of the South Lake Tahoe properties.

Net financing costs increased $3.1 million, or five percent, between periods primarily due to an increase in average debt outstanding and higher rates on variable-rate debt.

Income tax expense in the prior period included a $1.6 million benefit which resulted from completion of general rate cases and the closure of federal tax year 2000.

Twelve-Month Analysis

	Twelve Months Ended September 30, 2005	Twelve Months Ended September 30, 2004
	(Thousands of dollars)	
Gas operating revenues	$ 1,427,402	$ 1,168,160
Net cost of gas sold	794,773	574,285
Operating margin	632,629	593,875
Operations and maintenance expense	302,521	285,317
Depreciation and amortization	136,187	128,815
Taxes other than income taxes	38,920	37,406
Operating income	155,001	142,337
Other income (expense)	2,837	3,073
Net interest deductions	81,259	75,382
Net interest deductions on subordinated debentures	7,725	7,721
Income before income taxes	68,854	62,307
Income tax expense	24,491	18,095