CHESAPEAKE UTILITIES CORP
Form 10-Q
August 09, 2007

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: June 30, 2007

OR

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

For the transition period from ______ to ______

Commission File Number: 001-11590

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

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

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

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

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

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

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

Common Stock, par value $0.4867 — 6,751,983 shares outstanding as of July 31, 2007.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Statements of Income (Unaudited)

For the Three Months Ended June 30,		**2007**		**2006**
Operating Revenues	**$**	**52,501,920**	$	44,303,752
Operating Expenses				
Cost of sales, excluding costs below		**34,232,939**		28,505,528
Operations		**10,316,296**		8,851,831
Maintenance		**564,854**		583,638
Depreciation and amortization		**2,367,523**		2,037,003
Other taxes		**1,332,249**		1,120,384
Total operating expenses		**48,813,861**		41,098,384
Operating Income		**3,688,059**		3,205,368
Other income net of other expenses		**234,195**		63,715
Interest charges		**1,594,701**		1,501,352
Income Before Income Taxes		**2,327,553**		1,767,731
Income taxes		**845,762**		635,222
Net Income	**$**	**1,481,791**	$	1,132,509
Earnings Per Share of Common Stock:				
Basic	**$**	**0.22**	$	0.19
Diluted	**$**	**0.22**	$	0.19
Basic weighted average shares outstanding		**6,737,384**		5,952,074
Diluted weighted average shares outstanding		**6,849,890**		5,963,596
Cash Dividends Declared Per Share of Common Stock:	**$**	**0.295**	$	0.290

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

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Statements of Income (Unaudited)

For the Six Months Ended June 30,		**2007**		**2006**
Operating Revenues	**$**	**146,028,811**	$	135,254,425
Operating Expenses				
Cost of sales, excluding costs below		**98,168,806**		94,430,289
Operations		**20,875,996**		18,453,112
Maintenance		**1,145,019**		1,027,607
Depreciation and amortization		**4,683,318**		4,014,350
Other taxes		**2,885,561**		2,686,471
Total operating expenses		**127,758,700**		120,611,829
Operating Income		**18,270,111**		14,642,596
Other income net of other expenses		**287,567**		142,299
Interest charges		**3,193,951**		2,994,689
Income Before Income Taxes		**15,363,727**		11,790,206
Income taxes		**5,890,848**		4,561,281
Net Income	**$**	**9,472,879**	$	7,228,925
Earnings Per Share of Common Stock:				
Basic	**$**	**1.41**	$	1.22
Diluted	**$**	**1.39**	$	1.20
Basic weighted average shares outstanding		**6,721,694**		5,930,872
Diluted weighted average shares outstanding		**6,835,257**		6,070,191
Cash Dividends Declared Per Share of Common Stock:	**$**	**0.585**	$	0.575

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

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Unaudited)

For the Six Months Ended June 30,	**2007**	**2006**
Operating Activities		
Net Income	**$ 9,472,879**	$ 7,228,925
Adjustments to reconcile net income to net operating cash:		
Depreciation and amortization	**4,683,318**	4,014,350
Depreciation and accretion included in other costs	**1,682,980**	1,503,982
Deferred income taxes, net	**1,590,955**	(2,594,606)
Gain on sale of assets	**(204,882)**	-
Unrealized gain on commodity contracts	**(296,892)**	(99,715)
Unrealized gain on investments	**(188,203)**	(56,628)
Employee benefits and compensation	**920,460**	876,543
Other, net	**(1,839)**	(1,806)
Changes in assets and liabilities:		
Sale (purchase) of investments	**71,432**	(66,146)
Accounts receivable and accrued revenue	**6,961,621**	20,855,446
Propane inventory, storage gas and other inventory	**2,781,638**	2,947,555
Regulatory assets	**597,354**	3,826,484
Prepaid expenses and other current assets	**(686,387)**	(145,410)
Other deferred charges	**(1,405,003)**	27,409
Long-term receivables	**51,557**	87,643
Accounts payable and other accrued liabilities	**(7,026,333)**	(20,874,990)
Income taxes receivable (payable)	**(139,486)**	5,346,331
Accrued interest	**(20,910)**	54,094
Customer deposits and refunds	**361,078**	(468,019)
Accrued compensation	**(400,959)**	(1,532,150)
Regulatory liabilities	**1,798,097**	2,110,251
Other liabilities	**15,582**	(68,757)
Net cash provided by operating activities	**20,618,057**	22,970,786
Investing Activities		
Property, plant and equipment expenditures	**(15,969,557)**	(16,825,679)
Proceeds from sale of assets	**204,882**	-
Environmental recoveries (expenditures)	**(135,953)**	1,620
Net cash used in investing activities	**(15,900,628)**	(16,824,059)
Financing Activities		
Common stock dividends	**(3,465,987)**	(2,945,899)
Issuance of stock for Dividend Reinvestment Plan	**174,315**	177,077
Change in cash overdrafts due to outstanding checks	**843,845**	1,268,914
Net repayment under line of credit agreements	**(4,829,053)**	(3,747,750)
Repayment of long-term debt	**(1,020,132)**	(1,020,454)

Net cash used in financing activities		**(8,297,012)**		(6,268,112)
Net Decrease in Cash and Cash Equivalents		**(3,579,583)**		(121,385)
Cash and Cash Equivalents — Beginning of Period		**4,488,367**		2,487,658
Cash and Cash Equivalents — End of Period	**$**	**908,784**	$	2,366,273
Supplemental Disclosures of Non-Cash Investing Activities:				
Capital property and equipment acquired on account, but not paid as of June 30	**$**	**1,216,749**	$	788,758

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

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Balance Sheets (Unaudited)

Assets	**June 30, 2007**	**December 31, 2006**
Property, Plant and Equipment		
Natural gas	**$ 277,239,562**	$ 269,012,516
Propane	**46,361,641**	44,791,552
Advanced information services	**1,098,355**	1,054,368
Other plant	**9,140,526**	9,147,500
Total property, plant and equipment	**333,840,084**	324,005,936
Less: Accumulated depreciation and amortization	**(89,484,746)**	(85,010,472)
Plus: Construction work in progress	**6,739,641**	1,829,948
Net property, plant and equipment	**251,094,979**	240,825,412
Investments	**2,132,348**	2,015,577
Current Assets		
Cash and cash equivalents	**908,784**	4,488,366
Accounts receivable (less allowance for uncollectible accounts of $720,353 and $661,597, respectively)	**40,938,891**	44,969,182
Accrued revenue	**1,394,021**	4,325,351
Propane inventory, at average cost	**6,874,869**	7,187,035
Other inventory, at average cost	**1,368,907**	1,564,937
Regulatory assets	**650,139**	1,275,653
Storage gas prepayments	**5,119,893**	7,393,335
Income taxes receivable	**1,218,368**	1,078,882
Deferred income taxes	**412,493**	1,365,316
Prepaid expenses	**2,995,506**	2,280,900
Other current assets	**3,641,451**	1,553,284
Total current assets	**65,523,322**	77,482,241
Deferred Charges and Other Assets		
Goodwill	**674,451**	674,451
Other intangible assets, net	**184,976**	191,878
Pension	**630,082**	590,562
Long-term receivables	**772,776**	824,333
Other regulatory assets	**1,757,691**	1,765,088
Other deferred charges	**2,593,474**	1,215,004
Total deferred charges and other assets	**6,613,450**	5,261,316
Total Assets	**$ 325,364,099**	$ 325,584,546

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

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Balance Sheets (Unaudited)

Capitalization and Liabilities	**June 30, 2007**	**December 31, 2006**
Capitalization		
Stockholders' equity		
Common Stock, par value $0.4867 per share (authorized 12,000,000 shares)	**$ 3,281,792**	$ 3,254,998
Additional paid-in capital	**64,129,089**	61,960,220
Retained earnings	**51,806,645**	46,270,884
Accumulated other comprehensive loss	**(334,550)**	(334,550)
Deferred compensation obligation	**1,370,547**	1,118,509
Treasury stock	**(1,370,547)**	(1,118,509)
Total stockholders' equity	**118,882,976**	111,151,552
Long-term debt, net of current maturities	**69,965,000**	71,050,000
Total capitalization	**188,847,976**	182,201,552
Current Liabilities		
Current portion of long-term debt	**7,656,364**	7,656,364
Short-term borrowing	**23,568,733**	27,553,941
Accounts payable	**26,645,349**	33,870,552
Customer deposits and refunds	**7,863,343**	7,502,265
Accrued interest	**811,482**	832,392
Dividends payable	**1,989,086**	1,939,482
Accrued compensation	**1,881,211**	2,901,053
Regulatory liabilities	**6,117,618**	4,199,147
Other accrued liabilities	**5,739,405**	4,005,795
Total current liabilities	**82,272,591**	90,460,991
Deferred Credits and Other Liabilities		
Deferred income taxes	**27,155,230**	26,517,098
Deferred investment tax credits	**300,869**	328,277
Other regulatory liabilities	**1,053,294**	1,236,254
Environmental liabilities	**102,656**	211,581
Other pension and benefit costs	**2,241,819**	2,198,874
Accrued asset removal cost	**19,355,153**	18,410,992
Other liabilities	**4,034,511**	4,018,927
Total deferred credits and other liabilities	**54,243,532**	52,922,003
Other Commitments and Contingencies ***(Note 4)***		
Total Capitalization and Liabilities	**$ 325,364,099**	$ 325,584,546

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

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Statements of Stockholders' Equity (Unaudited)

	For the Six Months Ended June 30, 2007		For the Twelve Months Ended December 31, 2006	
Common Stock				
Balance — beginning of period	**$**	**3,254,998**	$	2,863,212
Dividend Reinvestment Plan		**9,375**		18,685
Retirement Savings Plan		**7,616**		14,457
Conversion of debentures		**1,858**		8,117
Performance shares and options exercised		**7,945**		14,536
Stock issuance		**-**		335,991
Balance — end of period	**$**	**3,281,792**	$	3,254,998
Additional Paid-in Capital				
Balance — beginning of period	**$**	**61,960,220**	$	39,619,849
Dividend Reinvestment Plan		**585,503**		1,148,100
Retirement Savings Plan		**476,758**		900,354
Conversion of debentures		**63,010**		275,300
Stock-based compensation		**1,043,598**		887,426
Stock issuance		**-**		19,362,518
Exercise of warrants		**-**		(233,327)
Balance — end of period	**$**	**64,129,089**	$	61,960,220
Retained Earnings				
Balance — beginning of period	**$**	**46,270,884**	$	42,854,894
Net income		**9,472,879**		10,506,525
Cash dividends declared		**(3,937,118)**		(7,090,535)
Balance — end of period	**$**	**51,806,645**	$	46,270,884
Accumulated Other Comprehensive Loss				
Balance — beginning of period		**($334,550)**		(578,151)
Minimum pension liability adjustment, net of tax		**-**		74,036
Gain on funded status of Employee Benefit Plans, net of tax		**-**		169,565
Balance — end of period		**($334,550)**		($334,550)
Deferred Compensation Obligation				
Balance — beginning of period	**$**	**1,118,509**	$	794,535
New deferrals		**252,038**		323,974
Balance — end of period	**$**	**1,370,547**	$	1,118,509

Treasury Stock		
Balance — beginning of period	**($1,118,509)**	($797,156)
New deferrals related to compensation obligation	**(252,038)**	(323,974)
Purchase of treasury stock [1]	**(29,771)**	(51,572)
Sale and distribution of treasury stock [2]	**29,771**	54,193
Balance — end of period	**($1,370,547)**	($1,118,509)
Total Stockholders' Equity	**$ 118,882,976**	$ 111,151,552

[1] Amount includes shares purchased in the open market for the Company's Rabbi Trust to secure its obligations under the Company's Executive Deferred Compensation Plan.
[2] Amount includes shares issued to the Company's Rabbi Trust as obligation under the Executive Deferred Compensation Plan.

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

Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation

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

The accompanying unaudited condensed consolidated financial statements have been prepared in compliance with the rules and regulations of the Securities and Exchange Commission ("SEC") and United States of America Generally Accepted Accounting Principles ("GAAP"). In accordance with these rules and regulations, certain information and disclosures normally required for audited financial statements have been condensed or omitted. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto, included in the Company's latest Annual Report on Form 10-K filed with the SEC on March 14, 2007. In the opinion of management, these statements reflect normal recurring adjustments that are necessary for a fair presentation of the Company's results of operations, financial position and cash flows for the interim periods presented.

2. Comprehensive Income

Comprehensive income contains items that are excluded from net income and recorded directly to stockholders' equity. Chesapeake did not have any adjustments to the components of comprehensive income that are required to be reported by Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income," for the first six months of 2007 and 2006. Accumulated other comprehensive loss was $334,550 at June 30, 2007 and December 31, 2006.

3. Calculation of Earnings Per Share

	Three Months Ended		Six Months Ended	
For the Periods Ended June 30,	**2007**	**2006**	**2007**	**2006**
Calculation of Basic Earnings Per Share:				
Net Income	**$ 1,481,791**	$ 1,132,509	**$ 9,472,879**	$ 7,228,925
Weighted average shares outstanding	**6,737,384**	5,952,074	**6,721,694**	5,930,872
Basic Earnings Per Share	**$ 0.22**	$ 0.19	**$ 1.41**	$ 1.22
Calculation of Diluted Earnings Per Share:				
Reconciliation of Numerator:				
Net Income	**$ 1,481,791**	$ 1,132,509	**$ 9,472,879**	$ 7,228,925
Effect of 8.25% Convertible debentures (1)	**24,015**	-	**48,214**	54,048
Adjusted numerator — Diluted	**$ 1,505,806**	$ 1,132,509	**$ 9,521,093**	$ 7,282,973
Reconciliation of Denominator:				

Weighted shares outstanding — Basic		**6,737,384**		5,952,074		**6,721,694**		5,930,872
Effect of dilutive securities (1)								
Warrants		**-**		11,522		**-**		12,016
8.25% Convertible debentures		**112,506**		-		**113,563**		127,303
Adjusted denominator — Diluted		**6,849,890**		5,963,596		**6,835,257**		6,070,191
Diluted Earnings per Share	**$**	**0.22**	$	0.19	**$**	**1.39**	$	1.20

(1) Amounts associated with securities resulting in an anti-dilutive effect on earnings per share are not included in this calculation.

4. Commitments and Contingencies

Environmental Matters

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

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

Dover Gas Light Site

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

The Company has reviewed its remediation costs incurred to date for the Dover Gas Light site and has concluded that all costs incurred have been paid. The Company does not expect any future environmental expenditure for this site. Through June 30, 2007, the Company has incurred approximately $9.67 million in costs related to environmental testing and remedial action studies at the site. Approximately $9.96 million has been recovered through June 2007 from other parties or through rates. As of June 30, 2007, a regulatory liability of approximately $294,500, representing the over-recovery portion of the clean-up costs, has been recorded. The over-recovery is temporary and will be refunded by the Company to customers in future rates.

Salisbury Town Gas Light Site

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

Through June 30, 2007, the Company has incurred approximately $2.9 million for remedial actions and environmental studies at the Salisbury Town Gas Light site. Of this amount, approximately $1.77 million has been recovered through insurance proceeds or in rates. On September 26, 2006, the Company received approval from the Maryland Public Service Commission to recover, through its rates charged to customers, the remaining $1.16 million of the incurred environmental remediation costs.

Winter Haven Coal Gas Site

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

Through June 30, 2007, the Company has incurred approximately $1.8 million of environmental costs associated with this site. At June 30, 2007, the Company had accrued a liability of $103,000 related to this site, offsetting 1.) $17,000 collected, through rates in excess of costs incurred and 2.) a regulatory asset of approximately $86,000, representing the uncollected portion of the estimated clean-up costs. The Company expects to recover the remaining clean-up costs through rates.

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

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

Other Commitments and Contingencies

Natural Gas and Propane Supply
The Company’s natural gas and propane distribution operations have entered into contractual commitments to purchase gas from various suppliers. The contracts have various expiration dates. In April 2007, the Company renewed its contract with an energy marketing and risk management company to manage a portion of the Company’s natural gas transportation and storage capacity. This new contract expires on March 31, 2008.

Corporate Guarantees
The Company has issued corporate guarantees to certain vendors of its propane wholesale marketing subsidiary, its Florida natural gas supply and management subsidiary, and its Delmarva propane distribution subsidiary. These corporate guarantees provide for the payment of propane and natural gas purchases in the event of the subsidiaries’ default. The liabilities for these purchases are recorded in the Consolidated Financial Statements. The aggregate amount guaranteed at June 30, 2007 totaled $21.7 million, with the guarantees expiring on various dates in 2007 and 2008.

In addition to the corporate guarantees, the Company has issued a letter of credit to its primary insurance company for $775,000, which expires on May 31, 2008. The letter of credit is provided as security to satisfy the deductibles for claim amounts on the Company’s policies.

Application of SFAS No. 71
Certain assets and liabilities of the Company are accounted for in accordance with SFAS No. 71 ¾“Accounting for the Effects of Certain Types of Regulation.” SFAS No. 71 provides guidance for public utilities and other regulated operations where the rates (prices) charged to customers are subject to regulatory review and approval. Regulators sometimes include allowable costs in a period other than the period in which the costs would be charged to expense by an unregulated enterprise. That procedure can create assets, reduce assets, or create liabilities for the regulated enterprise. For financial reporting, an incurred cost for which a regulator permits recovery in a future period is accounted for like an incurred cost that is reimbursable under a cost-reimbursement type contract. The Company believes that all regulatory assets as of June 30, 2007 are probable of recovery through rates. If the Company were required to terminate the application of SFAS No. 71 to its regulated operations, all such deferred amounts would be

recognized in the income statement at that time. This would result in a charge to earnings, net of applicable income taxes, which could be material.

Other

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

5. Recent Authoritative Pronouncements on Financial Reporting and Accounting

In June 2006, the FASB issued FASB Interpretation (“FIN”) No. 48, “Employers’ Accounting for Uncertainty in Income Taxes.’This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with SFAS No. 109, “Accounting for Income Taxes.This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition and classification of uncertain tax positions, reporting of interest and penalties, accounting in interim periods, disclosure, and transition. This interpretation is effective for fiscal years beginning after December 15, 2006. Chesapeake was required to adopt FIN No. 48 in the first quarter of 2007, and its adoption did not have any impact on the Company’s Consolidated Financial Statements.

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements.This statement defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this statement does not require any new fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Chesapeake will be required to adopt SFAS No. 157 in the first quarter of 2008. The Company has not yet evaluated the impact that SFAS No. 157 will have on its Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115.” SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value, with unrealized gains and losses related to these financial instruments reported in earnings at each subsequent reporting date. This Statement is effective as of the beginning of an entity’s first fiscal year that begins after November 15, 2007. The Company has not yet evaluated the impact that this statement will have on its Consolidated Financial Statements.

In April 2007, the FASB directed the FASB Staff to issue FSP No. FIN 39-1, “Amendment of FASB Interpretation No. 39” (“FSP FIN 39-1”). FSP FIN 39-1 modifies FIN No. 39, “Offsetting of Amounts Related to Certain Contracts,” and permits companies to offset cash collateral receivables or payables with net derivative positions under certain circumstances. FSP FIN 39-1 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted. The Company is evaluating the effect of adopting FSP FIN 39-1 on its Consolidated Financial Statements.

6. Segment Information

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

	Three Months Ended		Six Months Ended	
For the Periods Ended June 30,	**2007**	**2006**	**2007**	**2006**
Operating Revenues, Unaffiliated Customers				
Natural gas	**$ 39,287,667**	$ 33,327,846	**$ 104,719,271**	$ 100,906,504
Propane	**9,494,170**	7,937,378	**34,416,570**	28,488,315
Advanced information services	**3,720,083**	3,038,015	**6,892,970**	5,858,581
Other	**-**	513	**-**	1,025
Total operating revenues, unaffiliated customers	**$ 52,501,920**	$ 44,303,752	**$ 146,028,811**	$ 135,254,425
Intersegment Revenues [(1)]				
Natural gas	**$ 78,087**	$ 58,769	**$ 156,150**	$ 117,717
Propane	**-**	-	**406**	-
Advanced information services	**95,991**	16,875	**228,227**	21,513
Other	**154,623**	154,623	**309,246**	309,246
Total intersegment revenues	**$ 328,701**	$ 230,267	**$ 694,029**	$ 448,476
Operating Income				
Natural gas	**$ 3,992,282**	$ 3,500,628	**$ 13,608,264**	$ 11,495,833
Propane	**(545,898)**	(441,632)	**4,327,658**	2,992,101
Advanced information services	**178,706**	172,061	**227,528**	188,371
Other and eliminations	**62,969**	(25,689)	**106,661**	(33,709)
Total operating income	**$ 3,688,059**	$ 3,205,368	**$ 18,270,111**	$ 14,642,596

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

	June 30, 2007	December 31, 2006
Identifiable Assets		
Natural gas	**$ 249,358,307**	$ 252,292,600
Propane	**62,151,633**	60,170,200
Advanced information services	**2,877,021**	2,573,810
Other	**10,977,138**	10,547,936
Total identifiable assets	**$ 325,364,099**	$ 325,584,546

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

7. Employee Benefit Plans

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

For the Three Months Ended June 30,	Defined Benefit Pension Plan 2007	Defined Benefit Pension Plan 2006	Executive Excess Retirement Benefit Plan 2007	Executive Excess Retirement Benefit Plan 2006	Other Post-Retirement Benefits 2007	Other Post-Retirement Benefits 2006
Service Cost	$ 0	$ 0	$ 0	$ 0	$ 2,529	$ 1,565
Interest Cost	155,514	156,726	30,841	29,897	23,233	19,468
Expected return on plan assets	(174,100)	(171,076)	-	-	-	-
Amortization of transition amount	-	-	-	-	-	6,965
Amortization of prior service cost	(1,175)	(1,175)	-	-	-	-
Amortization of net loss	-	-	12,933	14,260	41,640	22,074
Net periodic (benefit) cost	($19,761)	($15,525)	$ 43,774	$ 44,157	$ 67,402	$ 50,072

For the Six Months Ended June 30,	Defined Benefit Pension Plan 2007	Defined Benefit Pension Plan 2006	Executive Excess Retirement Benefit Plan 2007	Executive Excess Retirement Benefit Plan 2006	Other Post-Retirement Benefits 2007	Other Post-Retirement Benefits 2006
Service Cost	$ 0	$ 0	$ 0	$ 0	$ 5,057	$ 3,129
Interest Cost	311,029	313,452	61,681	59,794	46,467	38,936
Expected return on plan assets	(348,199)	(342,152)	-	-	-	-
Amortization of transition amount	-	-	-	-	-	13,930
Amortization of prior service cost	(2,350)	(2,350)	-	-	-	-
Amortization of net loss	-	-	25,867	28,520	83,280	44,147
Net periodic (benefit) cost	($39,520)	($31,050)	$ 87,548	$ 88,314	$ 134,804	$ 100,142

As disclosed in the December 31, 2006 financial statements, no contributions are expected to be required in 2007 for the defined benefit pension plan. The cost of the executive excess defined benefit pension plan and the other post-retirement benefit plans are unfunded, and are expected to be paid out of the general funds of the Company. Cash benefits paid under the executive excess defined benefit pension plan for the three months and six months ended June 30, 2007 were $23,000 and $45,000, respectively; for the year 2007, such benefits paid are expected to be $89,000. Cash benefits paid for other post-retirement benefits, primarily for medical claims, for the three months and six months ended June 30, 2007 totaled $117,000 and $161,000, respectively; for the year 2007, the Company's actuary has estimated that such benefits to be paid are $180,000.

8. Investments

The investment balance at June 30, 2007 represents a Rabbi Trust ("the Trust") associated with the Company's Supplemental Executive Retirement Savings Plan. In accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," the Company classifies these investments as trading securities. As a result of classifying them as trading securities, the Company is required to report the securities at their fair value, with any unrealized gains and losses included in other income. The Company also has an associated liability that is recorded and adjusted each month for the gains and losses incurred by the Trust. At June 30, 2007, total investments had a fair value of $2.1 million.

9. Share-Based Compensation

The Company accounts for its share-based compensation arrangements under the revised SFAS No. 123, "Share Based Payments" ("SFAS 123R"), which requires the recognition of compensation cost over the respective service period for employee services received in exchange for an award of equity or equity-based compensation based on the fair value of the grant on the date it was awarded. The Company currently has two share-based compensation plans, Director's Stock Compensation ("DSCP") and the Performance Incentive Plan ("PIP"), that require accounting under SFAS 123R.

The table below presents the amounts included in net income, after tax, related to share-based compensation expense, in respect of restricted stock awards issued under the DSCP and the PIP.

	Three Months Ended		Six Months Ended	
For the periods ended June 30,	**2007**	2006	**2007**	2006
Director's Stock Compensation Plan	**$ 27,600**	$ 25,100	**$ 54,400**	$ 47,100
Performance Incentive Plans	**130,800**	134,900	**253,900**	217,300
Amounts included in net income, after tax	**$ 158,400**	$ 160,000	**$ 308,300**	$ 264,400

Stock Options

The Company did not have any stock options outstanding at June 30, 2007 or December 31, 2006, nor were any stock options issued during the six months ended June 30, 2007 and June 30, 2006.

Director's Stock Compensation Plan

Under the DSCP, each non-employee director of the Company received in 2007 an annual retainer of 600 shares of common stock and an additional 150 shares of common stock for services as a committee chairman. Shares issued under the DSCP are fully vested as of the date of the grant. The Company records a prepaid expense as of the date of the grant equal to the fair value of the shares issued and amortizes the expense equally over the service period of one year.

Compensation expense related to DSCP awards recorded by the Company for the three months and six months ended June 30, 2007 and 2006 is presented in the following table:

	Three Months Ended		Six Months Ended	
For the periods ended June 30,	**2007**	2006	**2007**	2006
Compensation expense for DSCP	**$ 45,200**	$ 41,200	**$ 89,100**	$ 77,200

A summary of restricted stock activity under the DSCP as of June 30, 2007, and changes during the six months then ended, is presented below:

	Number of Restricted Shares	**Weighted Average Grant Date Fair Value**
Outstanding — December 31, 2006	-	
Issued — May 2, 2007	5,850	$ 31.38
Vested	5,850	
Outstanding — June 30, 2007	-	

Performance Incentive Plan ("PIP")

The Company's Compensation Committee of the Board of Directors is authorized to grant key employees of the Company the rights to receive awards of shares of the Company's common stock, contingent upon the achievement of established performance goals. These awards are subject to certain post-vesting transfer restrictions. The Company issued 10,124 and 23,666 restricted stock awards during the three months of March 2007 and 2006, respectively, to key employees under the Company's PIP. The shares granted under the PIP are fully vested, and the fair value of each share is equal to the market price of the Company's common stock on the date of grant. The fair value of these restricted stock awards, based on the fair value of the Company's stock on the issue date, was $30.89 and $30.40, for the shares issued in March 2007 and 2006, respectively.

Compensation expense related to the PIP recorded by the Company for the three months and six months ended June 30, 2007 and 2006 is presented in the following table:

	Three Months Ended		Six Months Ended	
For the periods ended June 30,	**2007**	2006	**2007**	2006
Compensation expense for PIP	**$ 214,400**	$ 221,100	**$ 416,300**	$ 356,200

A summary of restricted stock activity under the PIP as of June 30, 2007, and changes during the six months then ended, is presented below:

	Number of Restricted Shares	Weighted Average Grant Date Fair Value
Outstanding — December 31, 2006	-	
Issued — March 1, 2007	10,124	$ 30.89
Vested	10,124	
Outstanding — June 30, 2007	-	

10. Stockholders' Equity

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

	For the Six Months Ended June 30, 2007	For the Twelve Months Ended December 31, 2006
Common Stock shares issued and outstanding (1)		
Shares issued — beginning of period balance	**6,688,084**	5,883,099
Dividend Reinvestment Plan (2)	**19,262**	38,392
Retirement Savings Plan	**15,649**	29,705
Conversion of debentures	**3,817**	16,677
Employee award plan	**350**	350
Performance shares and options exercised (3)	**15,974**	29,516
Public offering	**-**	690,345
Shares issued — end of period balance (4)	**6,743,136**	6,688,084
Treasury shares — beginning of period balance	**-**	(97)
Other issuances	**-**	97
Treasury Shares — end of period balance	**-**	-
Total Shares Outstanding	**6,743,136**	**6,688,084**

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

(2) Includes shares purchased with reinvested dividends and optional cash payments.

(3) Includes shares issued for DSCP.

(4) Includes 54,978 and 48,187 shares at June 30, 2007 and December 31, 2006, respectively, held in a Rabbi Trust established by the Company relating to the Executive Deferred Compensation Plan.

11. Reclassifications

The Company reclassified some previously reported amounts to conform to current period classifications.

- Share-based compensation was recorded as a liability to Accrued Compensation at December 31, 2006. Accordingly, the Company reclassified the $123,000 remaining in the liability account, after the issuance of the 2006 performance shares, to Additional Paid in Capital. This reclassification is considered immaterial to the overall presentation of the Company’s consolidated financial statements.

    - Pension assets were netted against the liabilities for the executive excess defined benefit pension plan and the other post-retirement benefit plans at December 31, 2006 and March 31, 2007. Accordingly, the Company reclassified the pension assets of $630,000 at June 30, 2007 to the asset side of the balance sheet. For comparison, the balance of $591,000 at December 31, 2006 has also been reclassed to the asset side of the balance sheet. This reclassification is considered immaterial to the overall presentation of the Company’s consolidated financial statements.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is designed to provide a reader of the financial statements with a narrative on the Company's financial condition, results of operations and liquidity. This discussion and analysis should be read in conjunction with the attached unaudited condensed consolidated financial statements and notes thereto and Chesapeake's Annual Report on Form 10-K for the year ended December 31, 2006, including the audited consolidated financial statements and notes contained in the Form 10-K.

Safe Harbor for Forward-Looking Statements

Chesapeake Utilities Corporation has made statements in this Form 10-Q that are considered to be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are not matters of historical fact and are typically identified by words such as, but not limited to, "believes," "expects," "intends," "plans," and similar expressions, or future or conditional verbs such as "may," "will," "should," "would," and "could." T statements relate to matters such as customer growth, changes in revenues or gross margins, capital expenditures, environmental remediation costs, regulatory trends and decisions, market risks associated with our propane operations, the competitive position of the Company and other matters. It is important to understand that these forward-looking statements are not guarantees, but are subject to certain risks and uncertainties and other important factors that could cause actual results to differ materially from those in the forward-looking statements. The factors that could cause actual results to differ materially from the Company's expectations include, but are not limited to:

- the temperature sensitivity of the natural gas and propane businesses;
- the effects of spot, forward, futures market prices, and the Company's use of derivative instruments on the Company's distribution, wholesale marketing and energy trading businesses;
- amount and availability of natural gas and propane supplies;
- the access to interstate pipelines' transportation and storage capacity and the construction of new facilities to support future growth;
- the effects of natural gas and propane commodity price changes on the operating costs and competitive positions of our natural gas and propane distribution operations;
- third-party competition for the Company's unregulated and regulated businesses;
- changes in federal, state or local regulatory and tax requirements, including deregulation;
- changes in technology affecting the Company's advanced information services segment;
- changes in credit risk and credit requirements affecting the Company's energy marketing subsidiaries;
- the effects of accounting changes;
- changes in benefit plan assumptions;
- cost of compliance with environmental regulations or the remediation of environmental damage;
- the effects of general economic conditions, including interest rates, on the Company and its customers;
- the ability of the Company's new and planned facilities and acquisitions to generate expected revenues;
- the ability of the Company to construct facilities at its estimated costs;
- the Company's ability to obtain the rate relief and cost recovery requested from utility regulators and the timing of the requested regulatory actions;
- the Company's ability to obtain necessary approvals and permits from regulatory agencies on a timely basis;
- impact of inflation on the results of operations, cash flows, financial position and on the Company's planned capital expenditures;
- inability to access the financial markets that may impair future growth; and
- operating and litigation risks that may not be covered by insurance.

Overview

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

The Company's strategy is focused on growing earnings from a stable utility foundation and investing in related businesses and services that provide opportunities for returns greater than traditional utility returns. The key elements of this strategy include:

- executing a capital investment program in pursuit of organic growth opportunities that generate returns equal to or greater than our cost of capital;
- expanding the natural gas distribution and transmission business through expansion into new geographic areas in our current service territories;
- expanding the propane distribution business in existing and new markets through leveraging our community gas system services and our bulk delivery capabilities;
- utilizing the Company's expertise across our various businesses to improve overall performance;
- enhancing marketing channels to attract new customers;
- providing reliable and responsive customer service to retain existing customers;
- maintaining a capital structure that enables the Company to access capital as needed; and
- maintaining a consistent and competitive dividend for shareholders.

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

Results of Operations for the Quarter Ended June 30, 2007

The following discussions on operating income and segment results for the three months ended June 30, 2007 include use of the term "gross margin." Gross margin is determined by deducting the cost of sales from operating revenue. Cost of sales includes the purchased gas cost for natural gas and propane and the cost of labor spent on direct revenue-producing activities. Gross margin should not be considered an alternative to operating income or net income, which are determined in accordance with GAAP. Chesapeake believes that gross margin, although a non-GAAP measure, is useful and meaningful to investors as a basis for making investment decisions. It provides investors with information that demonstrates the profitability achieved by the Company under its allowed rates for regulated operations and under its competitive pricing structure for non-regulated segments. Chesapeake's management uses gross margin in measuring its business units' performance and has historically analyzed and reported gross margin information publicly. Other companies may calculate gross margin in a different manner.

Consolidated Overview

The Company's net income for the quarter ended June 30, 2007 increased $349,000, or 31 percent, compared to the same period in 2006. Net income was $1.5 million, or $0.22 per share (diluted), an increase of $0.03 per share compared to 2006. The period-over-period period increase in quarterly earnings reflects an increase in the operating income of the Company's natural gas and other segments, partially offset by a decrease in the propane segment. The period-over-period increase in the quarterly operating income resulted primarily from the Company's continued growth, colder weather on the Delmarva Peninsula, and increased rates for our natural gas customers. The Company estimates that the growth, colder weather, and rate increases contributed $1.4 million, $425,000, and $295,000, respectively, to gross margin during the second quarter of 2007.

For the Three Months Ended June 30,	**2007**	**2006**	**Change**
Operating Income			
Natural Gas	**$ 3,992,282**	$ 3,500,628	$ 491,654
Propane	**(545,898)**	(441,632)	(104,266)
Advanced Information Services	**178,706**	172,061	6,645
Other & Eliminations	**62,969**	(25,689)	88,658
Operating Income	**3,688,059**	3,205,368	482,691
Other Income	**234,195**	63,715	170,480
Interest Charges	**1,594,701**	1,501,352	93,349
Income Taxes	**845,762**	635,222	210,540
Net Income	**$ 1,481,791**	$ 1,132,509	$ 349,282
Diluted Earnings Per Share	**$ 0.22**	$ 0.19	$ 0.03

Natural Gas

The natural gas segment earned operating income of approximately $4.0 million for the second quarter ended June 30, 2007 compared to $3.5 million for the corresponding period in 2006, an increase of approximately $492,000, or 14 percent.

For the Three Months Ended June 30,	**2007**	**2006**	**Change**
Revenue	**$ 39,365,754**	$ 33,386,615	$ 5,979,139
Cost of sales	**26,130,962**	21,941,405	4,189,557
Gross margin	**13,234,792**	11,445,210	1,789,582
Operations & maintenance	**6,440,171**	5,563,477	876,694
Depreciation & amortization	**1,834,712**	1,565,995	268,717
Other taxes	**967,627**	815,110	152,517
Other operating expenses	**9,242,510**	7,944,582	1,297,928
Total Operating Income	**$ 3,992,282**	$ 3,500,628	$ 491,654
Statistical Data — Delmarva Peninsula			
Heating degree-days ("HDD"):			
Actual	**527**	388	139
10-year average (normal)	**496**	512	(16)

Estimated gross margin per HDD	**$**	**2,283**	$	2,234	$	49
Per residential customer added:						
Estimated gross margin	**$**	**372**	$	372	$	0
Estimated other operating expenses	**$**	**106**	$	106	$	0
Residential Customer Information						
Average number of customers:						
Delmarva		**43,331**		40,037		3,294
Florida		**13,361**		12,511		850
Total		**56,692**		52,548		4,144

Gross margin for the Company's natural gas segment increased by $1.8 million, or 16 percent, and other operating expenses increased $1.3 million, or 16 percent, in the quarter ended June 30, 2007, compared to the same period in 2006. The gross margin increases of $1.1 million for the natural gas transmission operation, $790,000 for the Delmarva natural gas distribution operations, and $7,000 for the Florida natural gas distribution operation were partially offset by lower gross margin of $70,000 for the natural gas marketing operation, as further explained below.

Natural Gas Transmission

The natural gas transmission operation achieved gross margin growth of $1.1 million, or 26 percent. This increase was primarily attributed to new transportation capacity contracts implemented in November 2006 and the implementation of temporary rates, subject to refund, based on the status of the Company's rate proceeding discussed below in the "Regulatory Matters" section. In total for 2007, these new transportation capacity contracts are expected to generate a gross margin of $3.3 million above the 2006 gross margin. An increase of $845,000 in other operating expenses partially offset the increased gross margin. The factors contributing to the increase in other operating expenses are as follow:

- The increase in operating expenses for the second quarter of 2007 relative to the second quarter of 2006 is magnified by the approval from the Federal Energy Regulatory Commission ("FERC") in July 2006 to defer pre-service costs of the Company's Energylink Expansion Project as a regulatory asset. The deferral of these costs resulted in the reduction of $310,000 in other operating expenses in the second quarter of 2006. Please refer to the "Regulatory Matters" section below for further information regarding this expansion project.
- Payroll and benefit costs increased by $76,000 and $34,000, respectively, to comply with federal pipeline integrity maintenance regulations and to serve the additional growth experienced by the operation.
- Incentive compensation increased by $71,000 as a result of the improved operating results in 2007 compared to 2006.
- Regulatory expenses increased by $55,000 in the second quarter of 2007 as the Company incurred costs associated with its rate filing with the FERC.
- The increased level of capital investment caused higher depreciation and asset removal costs of $194,000 and increased property taxes of $31,000.
  - Other operating expenses relating to various items increased collectively by approximately $74,000.

Natural Gas Distribution

The Delmarva distribution operations experienced an increase of $790,000, or 20 percent, in gross margin. The significant factors contributing to the increase in gross margin include:

- Continued residential customer growth contributed to the increase in gross margin. The average number of residential customers on the Delmarva Peninsula increased by 3,294, or eight percent, for the second quarter 2007 compared to the same period in 2006, and the Company estimates that these additional residential customers contributed approximately $243,000 to gross margin.
- The Company estimates that colder weather contributed $224,000 to gross margin in the second quarter of 2007 compared to the same period in 2006, as temperatures on the Delmarva Peninsula were 36 percent colder in 2007. The colder temperatures did not have a significant impact on the Maryland distribution operation's gross margin in the second quarter of 2007 because the operation's approved rate structure now includes a weather normalization adjustment ("WNA") mechanism. The WNA mechanism was implemented in October 2006 and is designed to protect a portion of the Company's revenues against warmer-than-normal weather, as deviations from normal weather can affect our financial performance and liquidity. The WNA also serves to offset the impact of colder-than-normal weather by reducing the amounts the Company can charge its customers during such periods.
- In October 2006, the Maryland PSC granted the Company a base rate increase, which resulted in an $183,000 period-over-period increase to gross margin in the second quarter of 2007.
-

The remaining $140,000 increase in gross margin can be attributed to various factors, including increases in the number of commercial and industrial customers.

Gross margin for the Florida distribution operation increased by $7,000 in the second quarter of 2007 compared to the second quarter of 2006. The impact of a seven percent growth in residential customers and a three percent growth in commercial customers was offset by lower volumes sold to industrial customers.

Other operating expense for the natural gas distribution operations increased by $220,000 in the second quarter of 2007 compared to the second quarter of 2006. Among the key components of the increase were the following:

- Payroll costs increased by $48,000 to serve the additional growth experienced by the operations.
- Health care costs increased by $103,000 during the second quarter of 2007 compared to the second quarter of 2006 as the Company experienced higher cost of health care claims during this period.
- Depreciation and amortization expense, asset removal cost and property taxes increased by $96,000, $51,000 and $21,000, respectively, as a result of the Company’s continued capital investments.
- The 2007 increase in revenue related taxes is magnified by the Company’s receipt of approval in the second quarter of 2006 from the Delaware Public Service Commission to defer $74,000 of previously expensed taxes associated with the Annual Gross Revenue Tax as a regulatory asset.
- In addition, other operating expenses relating to various minor items increased by approximately $36,000.
- The above increases were partially offset by a decrease of $111,000 in the allowance for uncollectible accounts, which was due primarily to increased collection efforts. In addition, merchant payment fees decreased by $98,000 as the Company’s Delmarva operation outsourced the processing of credit card payments in April of 2007 in an effort to reduce operating costs.

Natural Gas Marketing

Gross margin for the natural gas marketing operation decreased by $70,000, or 13 percent, for the second quarter of 2007 compared to the same period in 2006. The decline in gross margin was primarily the result of unfavorable imbalance resolutions with interstate pipelines, which caused an increase in the cost of gas. Other operating expenses increased by $233,000 for the marketing operation due to increased payroll and benefit costs and increased incentive compensation. The year-over-year increase in incentive compensation is due to an adjustment that occurred in second quarter 2006 to record compensation at the expected payout based on the level of earnings.

Propane

The propane segment incurred an operating loss of $546,000, representing an increased loss of $104,000, or 24 percent, for the second quarter of 2007 compared to the same period in 2006. Gross margin increased by $408,000, which was offset by an increase in other operating expenses of $512,000.

For the Three Months Ended June 30,		**2007**		**2006**		**Change**
Revenue	**$**	**9,494,170**	$	7,937,378	$	1,556,792
Cost of sales		**5,930,398**		4,781,819		1,148,579
Gross margin		**3,563,772**		3,155,559		408,213
Operations & maintenance		**3,463,047**		3,024,725		438,322
Depreciation & amortization		**458,788**		402,675		56,113
Other taxes		**187,835**		169,791		18,044
Other operating expenses		**4,109,670**		3,597,191		512,479
Total Operating Loss		**($545,898)**		($441,632)		($104,266)
Statistical Data — Delmarva Peninsula						
Heating degree-days ("HDD"):						
Actual		**527**		388		139
10-year average (normal)		**496**		512		(16)
Estimated gross margin per HDD	**$**	**1,974**	$	1,743	$	231

Gross margin for the Company’s propane segment increased by $408,000, or 13 percent, and other operating expenses increased $512,000, or 14 percent, in the three months ended June 30, 2007 compared to the same period in 2006. The gross margin increases of $216,000 for the Delmarva propane distribution operations, $39,000 for the Florida propane distribution operations, and $153,000 for the propane wholesale marketing are further explained below.

<u>Delmarva Propane Distribution</u>

The Delmarva propane distribution operation’s increase in gross margin of $216,000 resulted from the following:

- Volumes sold in the second quarter 2007 increased by 365,000 gallons, or 13 percent, primarily because temperatures on the Delmarva Peninsula were 36 percent colder during this period in 2007 when compared to the same period in 2006. The Company estimates that the colder weather increased gross margin by approximately $201,000 for the Delmarva propane distribution operation compared to the second quarter of 2006.
- Gross margin for the Delmarva Community Gas Systems (“CGS”) increased by $116,000 in the second quarter of 2007, compared to the same period in 2006, primarily because of an increase in the average number of customers and the colder weather on the Delmarva Peninsula. The average number of CGS customers increased by approximately 1,020 to a total count of approximately 4,800, or a 27 percent increase, compared to the second quarter 2006. The Company expects the growth of its CGS operation to continue, as the number of systems currently under construction or under contract is anticipated to provide an additional 7,900 CGS customers once the systems are built out.
- The remaining $90,000 increase in gross margin can be attributed to various factors, including service sales and wholesale sales.
- Partially offsetting the increases to gross margin listed above, the Delmarva propane distribution operations experienced a decrease in gross margin of $191,000 in the second quarter of 2007 compared to the same period in 2006 because of a $0.06 decrease in the average gross margin per retail gallon. This decrease occurs when the

market price of propane decreases to levels closer to the Company’s average inventory price per gallon. Propane gross margin is also impacted by the Company’s pricing with its customers.

Total other operating expenses increased by $379,000 for the Delmarva propane distribution operations in the quarter ended June 30, 2007 compared to the same period in 2006. The significant items contributing to this increase are explained below.

- The increase in operating expenses for the second quarter of 2007 is magnified by the Company's one-time recovery of previously incurred costs of $87,000 from one of its propane suppliers. This recovery reimbursed the Company for fixed costs incurred in the removal of above-normal levels of petroleum by-products contained in approximately 75,000 gallons of propane that it purchased from the supplier. The recovery of these costs reduced other operating expenses in the second quarter of 2006.
- Health care costs increased by $85,000 during the second quarter of 2007 compared to the second quarter of 2006 as the Company experienced a higher cost of health care claims during the period.
  - The operation incurred an additional $108,000 in the second quarter of 2007 compared to 2006 for propane tank recertifications and maintenance to comply with Department of Transportation standards.
- Depreciation and amortization expense increased by $40,000 as a result of the Company's continued capital investments.
- In addition, other operating expenses relating to various items increased collectively by approximately $59,000.

Florida Propane Distribution

The Florida propane distribution operation experienced an increase in gross margin of $39,000, or 15 percent, in the second quarter of 2007 compared to the same period in 2006. Gross margin from propane sales increased $32,000 as a higher average gross margin per retail gallon was partially offset by a nine percent decrease in the volumes sold in 2007. The remaining increase of $7,000 is attributed to higher in-house piping sales. Other operating expenses in the second quarter 2007 compared to the second quarter 2006 increased by $69,000 primarily due to an increase in payroll costs, insurance and higher depreciation expense, partially offset by lower incentive compensation.

Propane Wholesale and Marketing

Gross margin for the Company's propane wholesale marketing operation increased by $153,000, or 35 percent, in the second quarter of 2007 compared to the same period in 2006. This increase reflects the larger number of market opportunities that arose in the second quarter of 2007 due to price volatility in the propane wholesale market. The increase in gross margin was partially offset by higher other operating expenses of $64,000 primarily due to higher incentive compensation based on the increased earnings in 2007.

Advanced Information Services

The advanced information services segment provides domestic and international clients with information-technology-related business services and solutions for both enterprise and e-business applications. The advanced information services business experienced gross margin growth of approximately $376,000, or 30 percent, and contributed operating income of approximately $179,000 for the three months ended June 30, 2007. Increases in revenue and gross margin were almost completely offset by increases in other operating expenses, consequently, operating income increased by only $7,000 compared to the same period in 2006.

For the Three Months Ended June 30,	2007	2006	Change
Revenue	**$ 3,816,074**	$ 3,054,890	$ 761,184
Cost of sales	**2,166,963**	1,781,866	385,097
Gross margin	**1,649,111**	1,273,024	376,087
Operations & maintenance	**1,273,241**	958,234	315,007
Depreciation & amortization	**35,248**	28,276	6,972
Other taxes	**161,916**	114,453	47,463
Other operating expenses	**1,470,405**	1,100,963	369,442
Total Operating Income	**$ 178,706**	$ 172,061	$ 6,645

The increase of revenues in the three months ended June 30, 2007 is attributable to:

- An increase of $654,000 in consulting revenues as the number of billable hours increased by 20 percent;
- An increase of $69,000 from Managed Database Administration (“MDBA”) services, first offered in 2006, which provide clients with professional database monitoring and support solutions during business hours or around the clock; and
- An increase of $38,000 in revenue from training services and product sales.

Other operating expenses increased by $369,000 in the three months ended June 30, 2007 to $1.5 million, compared to $1.1 million for the same period in 2006. This increase in operating expenses is primarily due to an increase in accrued incentive compensation based on improved operating results and other costs incurred to support the growth.

Other Business Operations and Eliminations

Other operations consist primarily of subsidiaries that own real estate leased to other Company subsidiaries and the results of operations for OnSight Energy, LLC (“OnSight”). Other operations generated an operating income of approximately $63,000 for the three months ended June 30, 2007 compared to an operating loss of approximately $26,000 for the same period in 2006. The improved results are primarily from OnSight experiencing a reduced operating loss in the second quarter of 2007.

The Company formed OnSight in 2004 to provide distributed energy services. Distributed energy refers to a variety of small, modular power generating technologies that may be combined with heating and/or cooling systems. For the three months ended June 30, 2007, OnSight had an operating loss of $10,000 compared to an operating loss of $98,000 for the same period in 2006. The reduced operating loss in 2007 is a direct result of actions which the Company took in the third quarter of 2006 to reduce operating expenses going forward.

For the Three Months Ended June 30,	**2007**	**2006**	**Change**
Revenue	**$ 154,623**	$ 155,136	($513)
Cost of sales	**4,616**	438	4,178
Gross margin	**150,007**	154,698	(4,691)
Operations & maintenance	**33,394**	119,301	(85,907)
Depreciation & amortization	**39,545**	40,827	(1,282)
Other taxes	**14,871**	21,029	(6,158)
Other operating expenses	**87,810**	181,157	(93,347)
Operating Income (Loss) - Other	**62,197**	(26,459)	88,656
Operating Income - Eliminations (1)	**772**	770	2
Total Operating Income (Loss)	**$ 62,969**	($25,689)	$ 88,658

(1) Eliminations are entries required to eliminate activities between business segments from the consolidated results.

Interest Expense

Total interest expense for the three months ended June 30, 2007 increased approximately $93,000, or six percent, compared to the same period in 2006. The higher interest expense is a result of the following developments:

- The Company's average long-term debt balance during the three months ended June 30, 2007 was $78.0 million with a weighted average interest rate of 6.67 percent, compared to $62.8 million with a weighted average interest rate of 7.11 percent for the same period in 2006. The large period-over-period increase in the average long-term debt balance is the result of a debt placement of $20 million Senior Notes ("Notes") at 5.5 percent in October 2006 with three institutional investors (The Prudential Insurance Company of America, Prudential Retirement Insurance and Annuity Company and United Omaha Life Insurance Company).
- An increase in the Company's average short-term interest rate in the three months ended June 30, 2007 compared to 2006. The average interest rate for short-term borrowing increased from 5.46 percent to 5.73 percent.
- A decrease in the Company's average short-term debt balance during the three months ended June 30, 2007 compared to the same period in 2006. The average short-term borrowing balance decreased $9.8 million in 2007 to $14.1 million compared to $23.9 million in 2006.

Income Taxes

Income tax expense for the three months ended June 30, 2007 was $846,000 compared to $635,000 for the three months ended June 30, 2006. The increase in income tax expense primarily reflects higher earnings. The effective tax rate for the second quarter of 2007 is 36.3 percent compared to an effective tax rate of 35.9 percent for the same period in 2006.

Results of Operations for the Six Months Ended June 30, 2007

The following discussions on operating income and segment results for the six months ended June 30, 2007 include use of the term "gross margin." Gross margin is determined by deducting the cost of sales from operating revenue. Cost of sales includes the purchased gas cost for natural gas and propane and the cost of labor spent on direct revenue-producing activities. Gross margin should not be considered an alternative to operating income or net income, which are determined in accordance with GAAP. Chesapeake believes that gross margin, although a non-GAAP measure, is useful and meaningful to investors as a basis for making investment decisions. It provides investors with information that demonstrates the profitability achieved by the Company under its allowed rates for regulated operations and under its competitive pricing structure for non-regulated segments. Chesapeake's management uses gross margin in measuring its business units' performance and has historically analyzed and reported gross margin information publicly. Other companies may calculate gross margin in a different manner.

Consolidated Overview

The Company's net income for the six months ended June 30, 2007 increased $2.2 million, or 31 percent, compared to the same period in 2006. Net income was $9.4 million, or $1.39 per share (diluted), an increase of $0.19 per share compared to 2006. The period-over-period increase in earnings reflects an increase in operating income at the Company's natural gas and propane operations as a result of continued growth and colder temperatures on the Delmarva Peninsula, which increased volumes sold to customers. The Company estimates that the growth and colder weather contributed $3.4 million and $1.7 million, respectively, to gross margin during the first six months of 2007.

For the Six Months Ended June 30,	**2007**	**2006**	**Change**
Operating Income			
Natural Gas	**$ 13,608,264**	$ 11,495,833	$ 2,112,431
Propane	**4,327,658**	2,992,101	1,335,557
Advanced Information Services	**227,528**	188,371	39,157
Other & Eliminations	**106,661**	(33,709)	140,370
Operating Income	**18,270,111**	14,642,596	3,627,515
Other Income	**287,567**	142,299	145,268
Interest Charges	**3,193,951**	2,994,689	199,262
Income Taxes	**5,890,848**	4,561,281	1,329,567
Net Income	**$ 9,472,879**	$ 7,228,925	$ 2,243,954
Diluted Earnings Per Share	**$ 1.39**	$ 1.20	$ 0.19

Natural Gas

The natural gas segment earned operating income of $13.6 million for the six months ended June 30, 2007 compared to $11.5 million for the corresponding period in 2006, an increase of $2.1 million, or 18 percent.

For the Six Months Ended June 30,	2007	2006	Change
Revenue	**$ 104,875,421**	$ 101,024,221	$ 3,851,200
Cost of sales	**72,899,708**	73,166,577	(266,869)
Gross margin	**31,975,713**	27,857,644	4,118,069
Operations & maintenance	**12,703,572**	11,367,924	1,335,648
Depreciation & amortization			