

VECTREN UTILITY HOLDINGS INC  
Form 10-Q  
August 11, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended June 30, 2006**

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: **1-16739**

**VECTREN UTILITY  
HOLDINGS, INC.**  
(Exact name of registrant as specified in its charter)

**INDIANA**  
(State or other jurisdiction of incorporation or  
organization)

**35-2104850**  
(IRS Employer Identification No.)

**One Vectren  
Square,  
Evansville,  
Indiana, 47708**  
(Address of principal executive offices)  
(Zip Code)

**812-491-4000**  
(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  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):

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Large accelerated filer   Accelerated filer   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

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

<u>Common Stock- Without Par</u>	<u>10</u>	<u>July 31, 2006</u>
<u>Value</u>		
Class	Number of Shares	Date

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**Table of Contents**

Item Number		Page Number
<b>PART I. FINANCIAL INFORMATION</b>		
1	Financial Statements (Unaudited) Vectren Utility Holdings, Inc and Subsidiary Companies	
	Consolidated Condensed Balance Sheets	4-5
	Consolidated Condensed Statements of Income	6
	Consolidated Condensed Statements of Cash Flows	7
	Notes to Unaudited Consolidated Condensed Financial Statements	8
2	Management’s Discussion and Analysis of Results of Operations and Financial Condition	19
3	Quantitative and Qualitative Disclosures About Market Risk	28
4	Controls and Procedures	28
<b>PART II. OTHER INFORMATION</b>		
1	Legal Proceedings	28
1A	Risk Factors	28
6	Exhibits	28
	Signatures	29

**Access to Information**

Vectren Corporation makes available all SEC filings and recent annual reports free of charge, including those of its wholly owned subsidiary, Vectren Utility Holdings, Inc., through its website at [www.vectren.com](http://www.vectren.com), or by request, directed to Investor Relations at the mailing address, phone number, or email address that follows:

Mailing Address:  
One Vectren Square  
Evansville, Indiana 47708

Phone Number:  
(812) 491-4000

Investor Relations Contact:  
Steven M. Schein  
Vice President, Investor Relations  
[sschein@vectren.com](mailto:sschein@vectren.com)

**Definitions**

AFUDC: allowance for funds used during construction	MMBTU: millions of British thermal units
APB: Accounting Principles Board	MW: megawatts
EITF: Emerging Issues Task Force	MWh / GWh: megawatt hours / thousands of megawatt hours (gigawatt hours)
FASB: Financial Accounting Standards Board	NOx: nitrogen oxide
FERC: Federal Energy Regulatory Commission	OCC: Ohio Office of the Consumer Counselor
IDEM: Indiana Department of Environmental Management	OUCC: Indiana Office of the Utility Consumer Counselor
IURC: Indiana Utility Regulatory Commission	PUCO: Public Utilities Commission of Ohio
MCF / MMCF / BCF: thousands / millions / billions of cubic feet	SFAS: Statement of Financial Accounting Standards
MDth / MMDth: thousands / millions of dekatherms	USEPA: United States Environmental Protection Agency
MISO: Midwest Independent Transmission System Operator	Throughput: combined gas sales and gas transportation volumes

**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS**

**VECTREN UTILITY HOLDINGS, INC. AND SUBSIDIARY COMPANIES**  
**CONSOLIDATED CONDENSED BALANCE SHEETS**  
*(Unaudited - In millions)*

	June 30, 2006	December 31, 2005
<b><u>ASSETS</u></b>		
Current Assets		
Cash & cash equivalents	\$ 4.6	\$ 11.7
Accounts receivable - less reserves of \$3.7 & \$2.6, respectively	88.6	170.7
Receivables due from other Vectren companies	1.5	2.2
Accrued unbilled revenues	36.3	212.5
Inventories	112.1	126.2
Recoverable fuel & natural gas costs	-	15.4
Prepayments & other current assets	104.3	117.2
<b>Total current assets</b>	<b>347.4</b>	<b>655.9</b>
Utility Plant		
Original cost	3,726.2	3,632.0
Less: accumulated depreciation & amortization	1,420.7	1,380.1
<b>Net utility plant</b>	<b>2,305.5</b>	<b>2,251.9</b>
Investments in unconsolidated affiliates	0.2	0.2
Other investments	20.7	21.0
Non-utility property - net	159.1	160.0
Goodwill	205.0	205.0
Regulatory assets	102.7	89.9
Other assets	7.6	7.3
<b>TOTAL ASSETS</b>	<b>\$ 3,148.2</b>	<b>\$ 3,391.2</b>

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

**VECTREN UTILITY HOLDINGS, INC. AND SUBSIDIARY COMPANIES**  
**CONSOLIDATED CONDENSED BALANCE SHEETS**  
*(Unaudited - In millions)*

	June 30, 2006	December 31, 2005
<b><u>LIABILITIES &amp; SHAREHOLDER'S EQUITY</u></b>		
Current Liabilities		
Accounts payable	\$ 59.6	\$ 131.9
Accounts payable to affiliated companies	38.0	140.6
Payables to other Vectren companies	13.4	29.2
Refundable fuel & natural gas costs	34.9	7.6
Accrued liabilities	117.7	130.4
Short-term borrowings	130.4	226.9
Long-term debt subject to tender	-	53.7
<b>Total current liabilities</b>	<b>394.0</b>	<b>720.3</b>
Long-Term Debt - Net of Current Maturities & Debt Subject to Tender	1,051.6	997.8
Deferred Income Taxes & Other Liabilities		
Deferred income taxes	277.0	275.5
Regulatory liabilities	289.8	272.9
Deferred credits & other liabilities	101.8	100.9
<b>Total deferred credits &amp; other liabilities</b>	<b>668.6</b>	<b>649.3</b>
Commitments & Contingencies (Notes 6 - 8)		
Common Shareholder's Equity		
Common stock (no par value)	612.9	612.9
Retained earnings	420.1	406.9
Accumulated other comprehensive income	1.0	4.0
<b>Total common shareholder's equity</b>	<b>1,034.0</b>	<b>1,023.8</b>
<b>TOTAL LIABILITIES &amp; SHAREHOLDER'S EQUITY</b>	<b>\$ 3,148.2</b>	<b>\$ 3,391.2</b>

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





**VECTREN UTILITY HOLDINGS, INC. AND SUBSIDIARY COMPANIES**  
**CONSOLIDATED CONDENSED STATEMENTS OF INCOME**  
*(Unaudited - In millions)*

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
<b>OPERATING REVENUES</b>				
Gas utility	\$ 159.1	\$ 186.0	\$ 731.8	\$ 702.7
Electric utility	96.0	96.9	201.2	191.6
Other	0.5	0.1	0.9	0.3
<b>Total operating revenues</b>	<b>255.6</b>	<b>283.0</b>	<b>933.9</b>	<b>894.6</b>
<b>OPERATING EXPENSES</b>				
Cost of gas sold	88.5	116.3	517.5	487.2
Cost of fuel & purchased power	30.9	33.0	69.0	62.2
Other operating	59.6	59.2	121.2	120.8
Depreciation & amortization	37.7	34.5	74.8	67.9
Taxes other than income taxes	11.6	11.7	34.4	33.5
Total operating expenses	228.3	254.7	816.9	771.6
<b>OPERATING INCOME</b>	<b>27.3</b>	<b>28.3</b>	<b>117.0</b>	<b>123.0</b>
OTHER INCOME - NET	1.9	1.1	2.8	3.3
INTEREST EXPENSE	18.2	16.4	38.2	33.3
<b>INCOME BEFORE INCOME TAXES</b>	<b>11.0</b>	<b>13.0</b>	<b>81.6</b>	<b>93.0</b>
<b>TAXES</b>	<b>11.0</b>	<b>13.0</b>	<b>81.6</b>	<b>93.0</b>
INCOME TAXES	3.9	5.2	31.1	37.1
<b>NET INCOME</b>	<b>\$ 7.1</b>	<b>\$ 7.8</b>	<b>\$ 50.5</b>	<b>\$ 55.9</b>

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

**VECTREN UTILITY HOLDINGS, INC. AND SUBSIDIARY COMPANIES**  
**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS**  
*(Unaudited - In millions)*

	Six Months Ended June 30,	
	2006	2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 50.5	\$ 55.9
Adjustments to reconcile net income to cash from operating activities:		
Depreciation & amortization	74.8	67.9
Deferred income taxes & investment tax credits	(0.5)	4.0
Expense portion of pension & postretirement periodic benefit cost	2.1	2.2
Provision for uncollectible accounts	5.4	4.9
Other non-cash charges - net	3.2	(1.8)
Changes in working capital accounts:		
Accounts receivable, including to Vectren companies & accrued unbilled revenue	253.6	182.0
Inventories	14.1	1.2
Recoverable fuel & natural gas costs	42.7	30.8
Prepayments & other current assets	6.2	47.3
Accounts payable, including to Vectren companies & affiliated companies	(195.7)	(103.6)
Accrued liabilities	(23.0)	8.6
Changes in noncurrent assets	(12.6)	(3.7)
Changes in noncurrent liabilities	2.4	(7.2)
<b>Net cash flows from operating activities</b>	<b>223.2</b>	<b>288.5</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Requirements for:		
Dividends to parent	(37.3)	(40.0)
Redemption of preferred stock of subsidiary	-	(0.1)
Net change in short-term borrowings	(96.5)	(167.3)
<b>Net cash flows from financing activities</b>	<b>(133.8)</b>	<b>(207.4)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Requirements for:		
Capital expenditures, excluding AFUDC - equity	(96.5)	(81.7)
<b>Net cash flows from investing activities</b>	<b>(96.5)</b>	<b>(81.7)</b>
Net decrease in cash & cash equivalents	(7.1)	(0.6)
Cash & cash equivalents at beginning of period	11.7	5.7
Cash & cash equivalents at end of period	\$ 4.6	\$ 5.1

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

**VECTREN UTILITY HOLDINGS, INC. AND SUBSIDIARY COMPANIES  
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
(UNAUDITED)**

**1. Organization and Nature of Operations**

Vectren Utility Holdings, Inc. (Utility Holdings or the Company), an Indiana corporation, serves as the intermediate holding company for Vectren Corporation's (Vectren) three operating public utilities: Indiana Gas Company, Inc. (Indiana Gas or Vectren North), Southern Indiana Gas and Electric Company (SIGECO or Vectren South), and the Ohio operations. Utility Holdings also has other assets that provide information technology and other services to the three utilities. Vectren is an energy holding company headquartered in Evansville, Indiana. Vectren and Utility Holdings are holding companies as defined by the Energy Policy Act of 2005.

Indiana Gas provides energy delivery services to approximately 562,000 natural gas customers located in central and southern Indiana. SIGECO provides energy delivery services to approximately 140,000 electric customers and approximately 112,000 gas customers located near Evansville in southwestern Indiana. SIGECO also owns and operates electric generation to serve its electric customers and optimizes those assets in the wholesale power market. Indiana Gas and SIGECO generally do business as Vectren Energy Delivery of Indiana. The Ohio operations provide energy delivery services to approximately 318,000 natural gas customers located near Dayton in west central Ohio. The Ohio operations are owned as a tenancy in common by Vectren Energy Delivery of Ohio, Inc. (VEDO), a wholly owned subsidiary, (53% ownership) and Indiana Gas (47% ownership). The Ohio operations generally do business as Vectren Energy Delivery of Ohio.

**2. Basis of Presentation**

The interim consolidated condensed financial statements included in this report have been prepared by the Company, without audit, as provided in the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted as provided in such rules and regulations. The Company believes that the information in this report reflects all adjustments necessary to fairly state the results of the interim periods reported. These consolidated condensed financial statements and related notes should be read in conjunction with the Company's audited annual consolidated financial statements for the year ended December 31, 2005, filed March 2, 2006 on Form 10-K. Certain 2005 amounts have been reclassified to conform to the 2006 presentation. These reclassifications had no impact on reported net income. Because of the seasonal nature of the Company's utility operations, the results shown on a quarterly basis are not necessarily indicative of annual results.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

**3. Subsidiary Guarantor and Consolidating Information**

The Company's three operating utility companies, SIGECO, Indiana Gas, and VEDO are guarantors of Utility Holdings' \$515.0 million in short-term credit facilities, of which \$130.4 million is outstanding at June 30, 2006, and Utility Holdings' \$700.0 million unsecured senior notes outstanding at June 30, 2006. The guarantees are full and unconditional and joint and several, and Utility Holdings has no subsidiaries other than the subsidiary guarantors. However, Utility Holdings does have operations other than those of the subsidiary guarantors. Pursuant to Article 3-10 of Regulation S-X, disclosure of the results of operations and balance sheets of the subsidiary guarantors separate from the parent company's operations is required. Following are consolidating financial statements including

information on the combined operations of the subsidiary guarantors separate from the other operations of the parent company.

8

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Consolidating Statement of Income for the three months ended June 30, 2006 (in millions):

	Subsidiary Guarantors	Parent Company	Eliminations	Consolidated
<b>OPERATING REVENUES</b>				
Gas utility	\$ 159.1	\$ -	\$ -	\$ 159.1
Electric utility	96.0	-	-	96.0
Other	-	9.2	(8.7)	0.5
<b>Total operating revenues</b>	<b>255.1</b>	<b>9.2</b>	<b>(8.7)</b>	<b>255.6</b>
<b>OPERATING EXPENSES</b>				
Cost of gas sold	88.5	-	-	88.5
Cost of fuel & purchased power	30.9	-	-	30.9
Other operating	67.9	-	(8.3)	59.6
Depreciation & amortization	32.3	5.4	-	37.7
Taxes other than income taxes	11.3	0.3	-	11.6
Total operating expenses	230.9	5.7	(8.3)	228.3
<b>OPERATING INCOME</b>	<b>24.2</b>	<b>3.5</b>	<b>(0.4)</b>	<b>27.3</b>
<b>OTHER INCOME (EXPENSE) - NET</b>				
Equity in earnings of consolidated companies	-	6.1	(6.1)	-
Other income (expense) – net	1.1	10.4	(9.6)	1.9
Total other income (expense) - net	1.1	16.5	(15.7)	1.9
Interest expense	15.8	12.4	(10.0)	18.2
<b>INCOME BEFORE INCOME TAXES</b>	<b>9.5</b>	<b>7.6</b>	<b>(6.1)</b>	<b>11.0</b>
Income taxes	3.4	0.5	-	3.9
<b>NET INCOME</b>	<b>\$ 6.1</b>	<b>\$ 7.1</b>	<b>\$ (6.1)</b>	<b>\$ 7.1</b>

Consolidating Statement of Income for the three months ended June 30, 2005 (in millions):

	Subsidiary Guarantors	Parent Company	Eliminations	Consolidated
<b>OPERATING REVENUES</b>				
Gas utility	\$ 186.0	\$ -	\$ -	\$ 186.0
Electric utility	96.9	-	-	96.9
Other	-	9.1	(9.0)	0.1
<b>Total operating revenues</b>	<b>282.9</b>	<b>9.1</b>	<b>(9.0)</b>	<b>283.0</b>
<b>OPERATING EXPENSES</b>				
Cost of gas sold	116.3	-	-	116.3
Cost of fuel & purchased power	33.0	-	-	33.0
Other operating	68.1	-	(8.9)	59.2
Depreciation & amortization	29.9	4.6	-	34.5
Taxes other than income taxes	11.5	0.2	-	11.7
Total operating expenses	258.8	4.8	(8.9)	254.7
<b>OPERATING INCOME</b>	<b>24.1</b>	<b>4.3</b>	<b>(0.1)</b>	<b>28.3</b>
<b>OTHER INCOME (EXPENSE) - NET</b>				
Equity in earnings of consolidated companies	-	5.3	(5.3)	-
Other income (expense) – net	0.7	9.3	(8.9)	1.1
Total other income (expense) - net	0.7	14.6	(14.2)	1.1
Interest expense	15.6	9.8	(9.0)	16.4
<b>INCOME BEFORE INCOME TAXES</b>	<b>9.2</b>	<b>9.1</b>	<b>(5.3)</b>	<b>13.0</b>

Income taxes		3.9		1.3		-		5.2
<b>NET INCOME</b>	<b>\$</b>	<b>5.3</b>	<b>\$</b>	<b>7.8</b>	<b>\$</b>	<b>(5.3)</b>	<b>\$</b>	<b>7.8</b>

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Consolidating Statement of Income for the six months ended June 30, 2006 (in millions):

	Subsidiary Guarantors	Parent Company	Eliminations	Consolidated
<b>OPERATING REVENUES</b>				
Gas utility	\$ 731.8	\$ -	\$ -	\$ 731.8
Electric utility	201.2	-	-	201.2
Other	-	18.4	(17.5)	0.9
<b>Total operating revenues</b>	<b>933.0</b>	<b>18.4</b>	<b>(17.5)</b>	<b>933.9</b>
<b>OPERATING EXPENSES</b>				
Cost of gas sold	517.5	-	-	517.5
Cost of fuel & purchased power	69.0	-	-	69.0
Other operating	136.9	-	(15.7)	121.2
Depreciation & amortization	64.2	10.6	-	74.8
Taxes other than income taxes	33.8	0.6	-	34.4
Total operating expenses	821.4	11.2	(15.7)	816.9
<b>OPERATING INCOME</b>	<b>111.6</b>	<b>7.2</b>	<b>(1.8)</b>	<b>117.0</b>
<b>OTHER INCOME (EXPENSE) - NET</b>				
Equity in earnings of consolidated companies	-	48.3	(48.3)	-
Other income (expense) – net	0.9	20.5	(18.6)	2.8
Total other income (expense) - net	0.9	68.8	(66.9)	2.8
Interest expense	33.0	25.6	(20.4)	38.2
<b>INCOME BEFORE INCOME TAXES</b>	<b>79.5</b>	<b>50.4</b>	<b>(48.3)</b>	<b>81.6</b>
Income taxes	31.2	(0.1)	-	31.1
<b>NET INCOME</b>	<b>\$ 48.3</b>	<b>\$ 50.5</b>	<b>\$ (48.3)</b>	<b>\$ 50.5</b>

Consolidating Statement of Income for the six months ended June 30, 2005 (in millions):

	Subsidiary Guarantors	Parent Company	Eliminations	Consolidated
<b>OPERATING REVENUES</b>				
Gas utility	\$ 702.7	\$ -	\$ -	\$ 702.7
Electric utility	191.6	-	-	191.6
Other	-	18.2	(17.9)	0.3
<b>Total operating revenues</b>	<b>894.3</b>	<b>18.2</b>	<b>(17.9)</b>	<b>894.6</b>
<b>OPERATING EXPENSES</b>				
Cost of gas sold	487.2	-	-	487.2
Cost of fuel & purchased power	62.2	-	-	62.2
Other operating	136.9	-	(16.1)	120.8
Depreciation & amortization	58.9	9.0	-	67.9
Taxes other than income taxes	33.0	0.5	-	33.5
Total operating expenses	778.2	9.5	(16.1)	771.6
<b>OPERATING INCOME</b>	<b>116.1</b>	<b>8.7</b>	<b>(1.8)</b>	<b>123.0</b>
<b>OTHER INCOME (EXPENSE) - NET</b>				
Equity in earnings of consolidated companies	-	51.7	(51.7)	-
Other income (expense) – net	0.7	18.9	(16.3)	3.3
Total other income (expense) - net	0.7	70.6	(68.0)	3.3
Interest expense	31.5	19.9	(18.1)	33.3

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<b>INCOME BEFORE INCOME TAXES</b>		<b>85.3</b>		<b>59.4</b>		<b>(51.7)</b>		<b>93.0</b>
Income taxes		33.6		3.5		-		37.1
<b>NET INCOME</b>	<b>\$</b>	<b>51.7</b>	<b>\$</b>	<b>55.9</b>	<b>\$</b>	<b>(51.7)</b>	<b>\$</b>	<b>55.9</b>

10

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Consolidating Statement of Cash Flows for the six months ended June 30, 2006 (in millions):

	Subsidiary Guarantors	Parent Company	Eliminations	Consolidated
<b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>	<b>\$ 210.2</b>	<b>\$ 13.0</b>	<b>\$ -</b>	<b>\$ 223.2</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>				
Proceeds from additional capital contribution	20.0	-	(20.0)	-
Long-term Debt - net of issuance costs & hedging proceeds	150.0	-	(150.0)	-
Requirements for:				
Dividends to parent	(37.3)	(37.3)	37.3	(37.3)
Net change in short-term borrowings	(264.6)	(80.5)	248.6	(96.5)
<b>Net cash flows from financing activities</b>	<b>(131.9)</b>	<b>(117.8)</b>	<b>115.9</b>	<b>(133.8)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>				
Proceeds from consolidated subsidiary distributions	-	37.3	(37.3)	-
Requirements for:				
Capital expenditures, excluding AFUDC equity	(86.8)	(9.7)	-	(96.5)
Consolidated subsidiary investments	-	(170.0)	170.0	-
Net change in notes receivable to other Vectren companies	-	248.6	(248.6)	-
<b>Net cash flows from investing activities</b>	<b>(86.8)</b>	<b>106.2</b>	<b>(115.9)</b>	<b>(96.5)</b>
Net decrease in cash & cash equivalents	(8.5)	1.4		(7.1)
Cash & cash equivalents at beginning of period	11.0	0.7		11.7
Cash & cash equivalents at end of period	\$ 2.5	\$ 2.1	\$ -	\$ 4.6

Consolidating Statement of Cash Flows for the six months ended June 30, 2005 (in millions):

	Subsidiary Guarantors	Parent Company	Eliminations	Consolidated
<b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>	<b>\$ 270.6</b>	<b>\$ 17.9</b>	<b>\$ -</b>	<b>\$ 288.5</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>				
Requirements for:				
Dividends to parent	(40.0)	(40.0)	40.0	(40.0)
Redemption of preferred stock of subsidiary	(0.1)	-	-	(0.1)
Net change in short-term borrowings	(138.4)	(135.9)	107.0	(167.3)

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<b>Net cash flows from financing activities</b>	<b>(178.5)</b>	<b>(175.9)</b>	<b>147.0</b>	<b>(207.4)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>				
Proceeds from consolidated subsidiary distributions	-	40.0	(40.0)	-
Requirements for:				
Capital expenditures, excluding AFUDC equity	(61.6)	(20.1)	-	(81.7)
Net change in notes receivable to other Vectren companies	(31.1)	138.1	(107.0)	-
<b>Net cash flows from investing activities</b>	<b>(92.7)</b>	<b>158.0</b>	<b>(147.0)</b>	<b>(81.7)</b>
Net decrease in cash & cash equivalents	(0.6)	-		(0.6)
Cash & cash equivalents at beginning of period	4.7	1.0		5.7
Cash & cash equivalents at end of period	\$ 4.1	\$ 1.0	\$ -	\$ 5.1

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Consolidating Balance Sheet as of June 30, 2006 (in millions):

<u>ASSETS</u>	Subsidiary Guarantors	Parent Company	Eliminations	Consolidated
Current Assets				
Cash & cash equivalents	\$ 2.5	\$ 2.1	\$ -	\$ 4.6
Accounts receivable - less reserves	88.6	-	-	88.6
Receivables due from other Vectren companies	17.4	35.2	(51.1)	1.5
Accrued unbilled revenues	36.3	-	-	36.3
Inventories	112.1	-	-	112.1
Recoverable fuel & natural gas costs	-	-	-	-
Prepayments & other current assets	90.7	15.3	(1.7)	104.3
<b>Total current assets</b>	<b>347.6</b>	<b>52.6</b>	<b>(52.8)</b>	<b>347.4</b>
Utility Plant				
Original cost	3,726.2	-	-	3,726.2
Less: accumulated depreciation & amortization	1,420.7	-	-	1,420.7
<b>Net utility plant</b>	<b>2,305.5</b>	<b>-</b>	<b>-</b>	<b>2,305.5</b>
Investments in consolidated subsidiaries	-	1,113.1	(1,113.1)	-
Notes receivable from consolidated subsidiaries	-	593.1	(593.1)	-
Investments in unconsolidated affiliates	0.2	-	-	0.2
Other investments	14.6	6.1	-	20.7
Non-utility property - net	4.6	154.5	-	159.1
Goodwill	205.0	-	-	205.0
Regulatory assets	96.1	6.6	-	102.7
Other assets	6.8	0.8	-	7.6
<b>TOTAL ASSETS</b>	<b>\$ 2,980.4</b>	<b>\$ 1,926.8</b>	<b>\$ (1,759.0)</b>	<b>\$ 3,148.2</b>
<b><u>LIABILITIES &amp; SHAREHOLDER'S EQUITY</u></b>				
Current Liabilities				
Accounts payable	\$ 56.4	\$ 3.2	\$ -	\$ 59.6
Accounts payable to affiliated companies	37.7	0.3	-	38.0
Payables to other Vectren companies	23.5	0.1	(10.2)	13.4
Refundable fuel & natural gas costs	34.9	-	-	34.9
Accrued liabilities	109.5	9.9	(1.7)	117.7
Short-term borrowings	-	130.4	-	130.4
Short-term borrowings from other Vectren companies	24.9	16.0	(40.9)	-
<b>Total current liabilities</b>	<b>286.9</b>	<b>159.9</b>	<b>(52.8)</b>	<b>394.0</b>
Long-Term Debt				
Long-term debt - net of current maturities & debt subject to tender	353.5	698.1	-	1,051.6
Long-term debt due to Utility Holdings	593.1	-	(593.1)	-
Total long-term debt - net	946.6	698.1	(593.1)	1,051.6

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Deferred Income Taxes & Other Liabilities				
Deferred income taxes	255.4	21.6	-	277.0
Regulatory liabilities	281.9	7.9	-	289.8
Deferred credits & other liabilities	96.5	5.3	-	101.8
<b>Total deferred credits &amp; other liabilities</b>	<b>633.8</b>	<b>34.8</b>	<b>-</b>	<b>668.6</b>
Common Shareholder's Equity				
Common stock (no par value)	756.3	612.9	(756.3)	612.9
Retained earnings	355.8	420.1	(355.8)	420.1
Accumulated other comprehensive income	1.0	1.0	(1.0)	1.0
<b>Total common shareholder's equity</b>	<b>1,113.1</b>	<b>1,034.0</b>	<b>(1,113.1)</b>	<b>1,034.0</b>
<b>TOTAL LIABILITIES &amp; SHAREHOLDER'S EQUITY</b>	<b>\$ 2,980.4</b>	<b>\$ 1,926.8</b>	<b>\$ (1,759.0)</b>	<b>\$ 3,148.2</b>

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Consolidating Balance Sheet as of December 31, 2005 (in millions):

<u>ASSETS</u>	Subsidiary	Parent	Eliminations	Consolidated
	Guarantors	Company		
<b>Current Assets</b>				
Cash & cash equivalents	\$ 11.0	\$ 0.7	\$ -	\$ 11.7
Accounts receivable - less reserves	170.6	0.1	-	170.7
Receivables due from other Vectren companies	0.9	294.7	(293.4)	2.2
Accrued unbilled revenues	212.5	-	-	212.5
Inventories	126.2	-	-	126.2
Recoverable fuel & natural gas costs	15.4	-	-	15.4
Prepayments & other current assets	104.1	13.7	(0.6)	117.2
<b>Total current assets</b>	<b>640.7</b>	<b>309.2</b>	<b>(294.0)</b>	<b>655.9</b>
<b>Utility Plant</b>				
Original cost	3,631.6	0.4	-	3,632.0
Less: accumulated depreciation & amortization	1,380.1	-	-	1,380.1
<b>Net utility plant</b>	<b>2,251.5</b>	<b>0.4</b>	<b>-</b>	<b>2,251.9</b>
Investments in consolidated subsidiaries	-	1,085.0	(1,085.0)	-
Notes receivable from consolidated subsidiaries	-	443.1	(443.1)	-
Investments in unconsolidated affiliates	0.2	-	-	0.2
Other investments	14.9	6.1	-	21.0
Non-utility property - net	5.1	154.9	-	160.0
Goodwill	205.0	-	-	205.0
Regulatory assets	83.1	6.8	-	89.9
Other assets	6.3	1.0	-	7.3
<b>TOTAL ASSETS</b>	<b>\$ 3,206.8</b>	<b>\$ 2,006.5</b>	<b>\$ (1,822.1)</b>	<b>\$ 3,391.2</b>
<b><u>LIABILITIES &amp; SHAREHOLDER'S EQUITY</u></b>				
	Subsidiary	Parent	Eliminations	Consolidated
	Guarantors	Company		
<b>Current Liabilities</b>				
Accounts payable	\$ 125.7	\$ 6.2	\$ -	\$ 131.9
Accounts payable to affiliated companies	140.0	0.6	-	140.6
Payables to other Vectren companies	27.8	5.2	(3.8)	29.2
Refundable fuel & natural gas costs	7.6	-	-	7.6
Accrued liabilities	120.7	10.3	(0.7)	130.4
Short-term borrowings	-	226.9	-	226.9
Short-term borrowings from other Vectren companies	289.5	-	(289.5)	0.0
Long-term debt subject to tender	53.7	-	-	53.7
<b>Total current liabilities</b>	<b>765.0</b>	<b>249.2</b>	<b>(294.0)</b>	<b>720.3</b>
<b>Long-Term Debt</b>				
Long-term debt - net of current maturities & debt subject to tender	299.9	697.9	-	997.8
Long-term debt due to Utility Holdings	443.1	-	(443.1)	-
Total long-term debt - net	743.0	697.9	(443.1)	997.8

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Deferred Income Taxes & Other				
Liabilities				
Deferred income taxes	251.6	23.9	-	275.5
Regulatory liabilities	266.2	6.8	-	272.9
Deferred credits & other liabilities	96.0	4.9	-	100.9
Total deferred credits & other liabilities	613.8	35.6	-	649.3
Common Shareholder's Equity				
Common stock (no par value)	736.3	612.9	(736.3)	612.9
Retained earnings	344.7	406.9	(344.7)	406.9
Accumulated other comprehensive income	4.0	4.0	(4.0)	4.0
<b>Total common shareholder's equity</b>	<b>1,085.0</b>	<b>1,023.8</b>	<b>(1,085.0)</b>	<b>1,023.8</b>
<b>TOTAL LIABILITIES &amp; SHAREHOLDER'S EQUITY</b>	<b>3,206.8</b>	<b>2,006.5</b>	<b>(1,822.1)</b>	<b>3,391.2</b>

13

#### 4. Transactions with Other Vectren Companies

##### Support Services and Purchases

Vectren provides corporate and general and administrative services to the Company including legal, finance, tax, risk management and human resources, which includes charges for share-based compensation and for pension and other postretirement benefits not directly charged to subsidiaries. These costs have been allocated using various allocators, primarily number of employees, number of customers and/or revenues. Allocations are based on cost. Utility Holdings received corporate allocations totaling \$20.5 million and \$21.1 million for the three months ended June 30, 2006 and 2005, respectively. Utility Holdings received corporate allocations totaling \$40.6 million and \$43.0 million for the six months ended June 30, 2006 and 2005, respectively.

Vectren Fuels, Inc., a wholly owned subsidiary of Vectren, owns and operates coal mines from which SIGECO purchases fuel used for electric generation. The Company has a letter agreement from the IURC regarding the price of coal that is charged by Fuels to SIGECO. Amounts paid for such purchases for the three months ended June 30, 2006 and 2005, totaled \$31.2 million and \$24.7 million, respectively. Amounts paid for such purchases for the six months ended June 30, 2006 and 2005, totaled \$62.5 million and \$48.1 million, respectively.

##### Share-Based Incentive Plans

On January 1, 2006, the Company adopted SFAS 123R "Share Based Compensation" (SFAS 123R) using the modified prospective method. Prior to the adoption of SFAS 123R, the Company accounted for these programs using APB Opinion 25, "Accounting for Stock Issued to Employees" (APB 25), and its related interpretations. The effect of the adoption of SFAS 123R was not material to the Company's operating results or financial condition.

Utility Holdings does not have share-based compensation plans separate from Vectren. An insignificant number of Utility Holdings' employees participate in Vectren's share-based compensation plans.

#### 5. Transactions with ProLiance Energy, LLC

ProLiance Energy, LLC (ProLiance), a nonutility energy marketing affiliate of Vectren and Citizens Gas and Coke Utility (Citizens Gas), provides services to a broad range of municipalities, utilities, industrial operations, schools, and healthcare institutions located throughout the Midwest and Southeast United States. ProLiance's customers include Vectren's utilities and nonutility gas supply operations as well as Citizens Gas. ProLiance's primary businesses include gas marketing, gas portfolio optimization, and other portfolio and energy management services.

##### Transactions with ProLiance

The Company contracted for approximately 72% of its natural gas purchases through ProLiance during the six months ended June 30, 2006. In the period ended June 30, 2005, the Company contracted for all of its natural gas purchases through ProLiance. Purchases from ProLiance for resale and for injections into storage for the three months ended June 30, 2006 and 2005, totaled \$117.3 million and \$192.8 million, respectively, and for the six months ended June 30, 2006 and 2005, totaled \$344.0 million and \$410.2 million, respectively. Amounts owed to ProLiance at June 30, 2006, and December 31, 2005, for those purchases were \$34.9 million and \$137.4 million, respectively, and are included in *Accounts payable to affiliated companies*. Amounts charged by ProLiance for gas supply services are established by supply agreements with each utility.

The Company received regulatory approval on April 25, 2006, from the IURC for ProLiance to provide natural gas supply services to the Indiana utilities through March 2011.

As required by a June 2005, PUCO order, VEDO solicited bids for its gas supply/portfolio administration services and selected a third party provider under a one year contract. ProLiance's obligation to supply these services to VEDO

ended October 31, 2005.

## **6. Commitments & Contingencies**

The Company is party to various legal proceedings arising in the normal course of business. In the opinion of management, there are no legal proceedings, except those discussed herein, pending against the Company that are likely to have a material adverse effect on its financial position, results of operations or cash flows.

14

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## 7. Environmental Matters

### Clean Air Interstate Rule & Clean Air Mercury Rule

In March of 2005 USEPA finalized two new air emission reduction regulations. The Clean Air Interstate Rule (CAIR) is an allowance cap and trade program requiring further reductions in Nitrogen Oxides (NO<sub>x</sub>) and Sulfur Dioxide (SO<sub>2</sub>) emissions from coal-burning power plants. The Clean Air Mercury Rule (CAMR) is an allowance cap and trade program requiring further reductions in mercury emissions from coal-burning power plants. Both sets of regulations require emission reductions in two phases. The first phase deadline for both rules is 2010 (2009 for NO<sub>x</sub> under CAIR), and the second phase deadline for compliance with the emission reductions required under CAIR is 2015, while the second phase deadline for compliance with the emission reduction requirements of CAMR is 2018. The Company is evaluating compliance options and fully expects to be in compliance by the required deadlines.

In February 2006, the IURC approved a multi-emission compliance plan filed by the Company's utility subsidiary, SIGECO. Once the plan is implemented, SIGECO's coal-fired plants will be 100% scrubbed for SO<sub>2</sub>, 90% scrubbed for NO<sub>x</sub>, and mercury emissions will be reduced to meet the new mercury reduction standards. The order, as previously agreed to by the OUCC and Citizens Action Coalition, allows SIGECO to recover an approximate 8% return on up to \$110 million in capital investments through a rider mechanism which is updated every six months for actual costs incurred. The Company will also recover through a rider its operating expenses, including depreciation, once the equipment is placed into service. The order also stipulates that SIGECO study renewable energy alternatives and include a carbon forecast in future filings with regard to new generation and further environmental compliance plans, among other initiatives. As of June 30, 2006, the Company has made capital investments of approximately \$15.3 million related to this initiative.

### Manufactured Gas Plants

In the past, Indiana Gas, SIGECO, and others operated facilities for the manufacture of gas. Given the availability of natural gas transported by pipelines, these facilities have not been operated for many years. Under currently applicable environmental laws and regulations, Indiana Gas, SIGECO, and others may now be required to take remedial action if certain byproducts are found above the regulatory thresholds at these sites.

Indiana Gas has identified the existence, location, and certain general characteristics of 26 gas manufacturing and storage sites for which it may have some remedial responsibility. Indiana Gas has completed a remedial investigation/feasibility study (RI/FS) at one of the sites under an agreed order between Indiana Gas and the IDEM, and a Record of Decision was issued by the IDEM in January 2000. Although Indiana Gas has not begun an RI/FS at additional sites, Indiana Gas has submitted several of the sites to the IDEM's Voluntary Remediation Program (VRP) and is currently conducting some level of remedial activities, including groundwater monitoring at certain sites, where deemed appropriate, and will continue remedial activities at the sites as appropriate and necessary.

In conjunction with data compiled by environmental consultants, Indiana Gas has accrued the estimated costs for further investigation, remediation, groundwater monitoring, and related costs for the sites. While the total costs that may be incurred in connection with addressing these sites cannot be determined at this time, Indiana Gas has recorded costs that it reasonably expects to incur totaling approximately \$20.4 million.

The estimated accrued costs are limited to Indiana Gas' proportionate share of the remediation efforts. Indiana Gas has arrangements in place for 19 of the 26 sites with other potentially responsible parties (PRP), which serve to limit Indiana Gas' share of response costs at these 19 sites to between 20% and 50%.

With respect to insurance coverage, Indiana Gas has received and recorded settlements from all known insurance carriers in an aggregate amount approximating \$20.4 million.

Environmental matters related to manufactured gas plants have had no material impact on earnings since costs recorded to date approximate PRP and insurance settlement recoveries. While Indiana Gas has recorded all costs

which it presently expects to incur in connection with activities at these sites, it is possible that future events may require some level of additional remedial activities which are not presently foreseen.

15

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In October 2002, the Company received a formal information request letter from the IDEM regarding five manufactured gas plants owned and/or operated by SIGECO and not currently enrolled in the IDEM's VRP. In response, SIGECO submitted to the IDEM the results of preliminary site investigations conducted in the mid-1990's. These site investigations confirmed that based upon the conditions known at the time, the sites posed no risk to human health or the environment. Follow up reviews have been initiated by the Company to confirm that the sites continue to pose no such risk.

On October 6, 2003, SIGECO filed applications to enter four of the manufactured gas plant sites in IDEM's VRP. The remaining site is currently being addressed in the VRP by another Indiana utility. SIGECO added those four sites into the renewal of the global Voluntary Remediation Agreement that Indiana Gas has in place with IDEM for its manufactured gas plant sites. That renewal was approved by the IDEM on February 24, 2004. On July 13, 2004, SIGECO filed a declaratory judgment action against its insurance carriers seeking a judgment finding its carriers liable under the policies for coverage of further investigation and any necessary remediation costs that SIGECO may accrue under the VRP program. Costs of remediation at the four SIGECO sites, as well as the amount of any PRP or insurance recoveries, cannot be determined at this time. The total costs accrued to date, including investigative costs, have been immaterial.

## **8. Rate & Regulatory Matters**

### Indiana and Ohio Lost Margin Recovery/Conservation Filings

On October 25, 2005, Vectren Energy Delivery of Indiana filed with the IURC for approval of a conservation program and a conservation adjustment rider in its two Indiana service territories. If approved, the plan outlined in the petition will better align the interests of the Company with its customers through the promotion of natural gas conservation. The petition requests the use of a tracker mechanism to recover certain costs of funding the design and implementation of conservation efforts, such as consumer education programs and rebates for high efficiency equipment. The conservation tracker works in tandem with a lost margin recovery mechanism. This mechanism would allow the Company to recover the distribution portion of its rates from residential and commercial customers based on the level of customer usage established in each utility's last general rate case.

On May 5, 2006, the Company and the OUCC filed a settlement with the IURC that provides for a 5 year energy efficiency program to be implemented at both Indiana Gas and SIGECO. Further, as part of the settlement, Indiana Gas will recover 85% of all lost margin since its last rate case. Recovery of lost margin at SIGECO will not commence until approval of new base rates in its next general rate case. A hearing before the IURC on the settlement occurred on July 18, 2006, post-hearing filings will be completed in August 2006 and an order is anticipated during the fourth quarter.

Similarly, on November 28, 2005, Vectren Energy Delivery of Ohio filed with the PUCO for approval of a conservation program and a conservation adjustment rider that would accomplish the same objectives, including lost margin recovery. On April 10, 2006, Vectren Energy Delivery of Ohio filed with the PUCO, a settlement agreement between the OCC, the Ohio Partners for Affordable Energy, and the Company that provides for at least two years of comprehensive energy efficiency programs for Ohio customers. A hearing has been conducted and an order by the PUCO is expected in the third quarter.

If the agreements are approved, these efficiency programs should be available to customers before the 2006 winter heating season.

### Gas Cost Recovery (GCR) Audit Proceedings

On June 14, 2005, the PUCO issued an order disallowing the recovery of approximately \$9.6 million of gas costs relating to the two year audit period ended November 2002. That audit period provided the PUCO staff its initial review of the portfolio administration arrangement between VEDO and ProLiance. The disallowance includes approximately \$1.3 million relating to pipeline refunds and penalties and approximately \$4.5 million of costs for

winter delivery services purchased by VEDO to ensure reliability over the two year period. The PUCO also held that ProLiance should have credited to VEDO an additional \$3.8 million more than credits actually received for the right to use VEDO's gas transportation capacity periodically during the periods when it was not required for serving VEDO's customers. The PUCO also directed VEDO to either submit its receipt of portfolio administration services to a request for proposal process or to in-source those functions. During 2003, the Company recorded a reserve of \$1.1 million for this matter. An additional pretax charge of \$4.2 million was recorded in *Cost of Gas Sold* in 2005, of which \$3.0 million was recorded in June 2005. The reserve reflects management's assessment of the impact of the PUCO decisions, an estimate of any current impact that decision may have on subsequent audit periods, and an estimate of a sharing in any final disallowance by Vectren's partner in ProLiance.

VEDO filed its request for rehearing on July 14, 2005, and on August 10, 2005, the PUCO granted rehearing to further consider the \$3.8 million portfolio administration issue and all interest on the findings, but denied rehearing on all other aspects of the case. On October 7, 2005, the Company filed an appeal with the Ohio Supreme Court requesting that the \$4.5 million disallowance related to the winter delivery service issue be reversed. On December 21, 2005, the PUCO granted in part VEDO's rehearing request, and reduced the \$3.8 million disallowance related to portfolio administration to \$1.98 million. The Company has filed an appeal on that decision as well. However, as part of the Ohio lost margin/conservation settlement agreement awaiting a PUCO decision, the Company has proposed to use the \$1.98 million disallowance as a funding source for Ohio conservation programs. If the settlement is approved, the appeal of the \$1.98 million disallowance amount would be withdrawn. Briefings of all matters were completed by July 31, 2006.

In addition, the Company solicited and received bids for VEDO's gas supply and portfolio administration services and has selected a third party provider, who began providing services to VEDO on November 1, 2005, under a one year contract.

#### Commodity Prices

Commodity prices for natural gas purchases have remained above historic levels and have become more volatile. Subject to compliance with applicable state laws, the Company's utility subsidiaries are allowed recovery of such changes in purchased gas costs from their retail customers through commission-approved gas cost adjustment mechanisms, and margin on gas sales are not expected to be impacted. Nevertheless, it is possible regulators may disallow recovery of a portion of gas costs for a variety of reasons, including, but not limited to, a finding by the regulator that natural gas was not prudently procured. In addition, as a result of this near term change in the natural gas commodity price, the Company's utility subsidiaries have been experiencing, and may continue to experience, increased interest expense due to higher working capital requirements; increased uncollectible accounts expense and unaccounted for gas; and some level of price sensitive reduction in volumes sold or delivered. In response to higher gas prices, the Company increased its utility-related credit facilities in November 2005.

### **9. Impact of Recently Issued Accounting Guidance**

#### FIN 48

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN 48) "Accounting for Uncertainty in Income Taxes" an interpretation of SFAS 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of tax positions taken or expected to be taken in an income tax return. FIN 48 also provides guidance related to reversal of tax positions, balance sheet classification, interest and penalties, interim period accounting, disclosure and transition. The interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently assessing the impact this interpretation will have on its financial statements.

### **10. Segment Reporting**

The Company's operations consist of regulated operations and other operations that provide information technology and other support services to those regulated operations. The Company segregates its regulated operations into a Gas Utility Services operating segment and an Electric Utility Services operating segment. The Gas Utility Services segment provides natural gas distribution and transportation services to nearly two-thirds of Indiana and to west central Ohio. The Electric Utility Services segment provides electric distribution services primarily to southwestern Indiana, and includes the Company's power generating and marketing operations. The Company cross manages its regulated operations as separated between Energy Delivery, which includes the gas and electric transmission and distribution functions, and Power Supply, which includes the power generating and marketing operations. In total, regulated operations supply natural gas and /or electricity to over one million customers. For these regulated operations the Company uses after tax operating income as a measure of profitability, consistent with regulatory reporting requirements. For Utility Holdings' other operations, net income is used as the measure of profitability. In

total, there are three operating segments as defined by SFAS 131 “Disclosure About Segments of an Enterprise and Related Information” (SFAS 131).

17

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Information related to the Company's business segments is summarized below:

<i>(In millions)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
<b>Revenues</b>				
Gas Utility Services	\$ 159.1	\$ 186.0	\$ 731.8	\$ 702.7
Electric Utility Services	96.0	96.9	201.2	191.6
Other Operations	9.2	9.1	18.4	18.2
Eliminations	(8.7)	(9.0)	(17.5)	(17.9)
Consolidated Revenues	\$ 255.6	\$ 283.0	\$ 933.9	\$ 894.6
<b>Profitability Measure</b>				
Regulated Operating Income (Operating Income Less Applicable Income Taxes)				
Gas Utility Services	\$ 6.5	\$ 5.7	\$ 49.9	\$ 50.8
Electric Utility Services	14.4	14.5	30.5	31.8
Total Regulated Operating Income	20.9	20.2	80.4	82.6
Regulated other income - net	1.0	0.3	0.9	0.2
Regulated interest expense & preferred dividends	(15.8)	(15.2)	(33.0)	(31.1)
Regulated Net Income	6.1	5.3	48.3	51.7
Other Operations Net Income	1.0	2.5	2.2	4.2
Consolidated Net Income	\$ 7.1	\$ 7.8	\$ 50.5	\$ 55.9

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

### **Description of the Business**

Vectren Utility Holdings, Inc. (Utility Holdings or the Company), an Indiana corporation, serves as the intermediate holding company for Vectren Corporation's (Vectren) three operating public utilities: Indiana Gas Company, Inc. (Indiana Gas or Vectren North), Southern Indiana Gas and Electric Company (SIGECO or Vectren South), and the Ohio operations. Utility Holdings also has other assets that provide information technology and other services to the three utilities. Vectren is an energy holding company headquartered in Evansville, Indiana. Vectren and Utility Holdings are holding companies as defined by the Energy Policy Act of 2005.

Indiana Gas provides energy delivery services to approximately 562,000 natural gas customers located in central and southern Indiana. SIGECO provides energy delivery services to approximately 140,000 electric customers and approximately 112,000 gas customers located near Evansville in southwestern Indiana. SIGECO also owns and operates electric generation to serve its electric customers and optimizes those assets in the wholesale power market. Indiana Gas and SIGECO generally do business as Vectren Energy Delivery of Indiana. The Ohio operations provide energy delivery services to approximately 318,000 natural gas customers located near Dayton in west central Ohio. The Ohio operations are owned as a tenancy in common by Vectren Energy Delivery of Ohio, Inc. (VEDO), a wholly owned subsidiary, (53% ownership) and Indiana Gas (47% ownership). The Ohio operations generally do business as Vectren Energy Delivery of Ohio.

### **Executive Summary of Consolidated Results of Operations**

The following discussion and analysis should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto.

Earnings were \$7.1 million for the three months ended June 30, 2006, compared to \$7.8 million in the prior year quarter and \$50.5 million for the six months ended June 30, 2006, compared to \$55.9 million in 2005. The \$0.7 million quarter over quarter decrease, as well as the year over year \$5.4 million decrease, is primarily a result of a decline in customer usage, due largely to price sensitivity. Higher depreciation and interest costs largely offset margin increases associated with higher gas base rate revenues, a 2005 second quarter Ohio gas cost disallowance, and higher electric revenues associated with recovery of pollution control investments. Both quarterly and year to date results also reflect lower wholesale power marketing margins compared to the prior year period due largely to mark-to-market gains recognized in 2005. Warmer than normal weather, net of the normal temperature adjustment (NTA) mechanism implemented in the Company's Indiana natural gas service territories in the fourth quarter of 2005, had a minimal impact compared to the prior year periods. Year to date, management estimates the effect of weather on all utilities, net of the NTA's impact, was unfavorable \$3.0 million after tax in 2006 and unfavorable \$3.6 million after tax in 2005.

The Company generates revenue primarily from the delivery of natural gas and electric service to its customers. The primary source of cash flow results from the collection of customer bills and the payment for goods and services procured for the delivery of gas and electric services. The results are impacted by weather patterns in its service territory and general economic conditions both in its service territory as well as nationally.

The Company has in place a disclosure committee that consists of senior management as well as financial management. The committee is actively involved in the preparation and review of the Company's SEC filings.

### **Significant Fluctuations**



Throughout this discussion, the terms Gas Utility margin and Electric Utility margin are used. Gas Utility margin is calculated as *Gas utility revenues* less the *Cost of gas*. Electric Utility margin is calculated as *Electric utility revenues* less *Cost of fuel & purchased power*. These measures exclude *Other operating expenses*, *Depreciation and amortization*, and *Taxes other than income taxes*, which are included in the calculation of operating income. The Company believes Gas Utility and Electric Utility margins are better indicators of relative contribution than revenues since gas prices and fuel costs can be volatile and are generally collected on a dollar-for-dollar basis from customers.

Margin generated from the sale of natural gas and electricity to residential and commercial customers is seasonal and impacted by weather patterns in the Company's service territories. The weather impact in the Company's Indiana gas utility service territories is mitigated somewhat by a normal temperature adjustment mechanism, which was implemented in the fourth quarter of 2005. Margin generated from sales to large customers (generally industrial, other contract, and firm wholesale customers) is primarily impacted by overall economic conditions. Margin is also impacted by the collection of state mandated taxes, which fluctuate with gas costs, as well as other tracked expenses and is also impacted by some level of price sensitivity in volumes sold. Electric generating asset optimization activities are primarily affected by market conditions, the level of excess generating capacity, and electric transmission availability. Following is a discussion and analysis of margin generated from regulated utility operations.

Gas Utility Margin (Gas Utility Revenues less Cost of Gas Sold)

Gas Utility margin and throughput by customer type follows:

<i>(In millions)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Gas utility revenues	\$ 159.1	\$ 186.0	\$ 731.8	\$ 702.7
Cost of gas sold	88.5	116.3	517.5	487.2
<b>Total gas utility margin</b>	<b>\$ 70.6</b>	<b>\$ 69.7</b>	<b>\$ 214.3</b>	<b>\$ 215.5</b>
Margin attributed to:				
Residential & Commercial	\$ 57.0	\$ 57.9	\$ 181.7	\$ 185.6
Industrial	9.8	9.7	24.7	25.3
Other	3.8	2.1	7.9	4.6
Sold & transported volumes in MMDth attributed to:				
To residential & commercial customers	11.4	13.5	56.7	68.5
To industrial customers	18.0	19.2	43.5	46.0
<b>Total sold &amp; transported volumes</b>	<b>29.4</b>	<b>32.7</b>	<b>100.2</b>	<b>114.5</b>

Even though warm weather and price sensitivity negatively impacted usage and tracked expenses recovered dollar for dollar in margin have decreased, gas utility margins are generally flat compared to the prior year periods. During the three and six months ended June 30, 2006, margin decreases were offset by base rate increases implemented in the Company's Ohio service territory, a \$3.0 million disallowance of Ohio gas costs reflected in the second quarter of 2005, and the effects of the NTA. With the current outlook for continued high gas commodity prices, management expects continued usage decline throughout 2006. If the conservation-oriented rate mechanisms discussed below are approved in Indiana and Ohio, the impact on margin of additional usage decline will be mitigated. The average cost per dekatherm of gas purchased for the six months ended June 30, 2006, was \$9.35 compared to \$7.41 in 2005, an increase of 26 percent.

For the three and six months ended June 30, 2006 compared to 2005, incremental revenues associated with gas base rate increases increased margin approximately \$0.7 million and \$4.2 million, respectively. For the six months ended June 30, 2006, it is estimated that weather 17 percent warmer than normal and 10 percent warmer than prior year would have decreased margins \$8.2 million compared to the prior year, had the NTA not been in effect. Weather, net of the NTA, increased margins \$1.2 million quarter over quarter and increased margins \$1.6 million year over year. Further, for the three and six months ended June 30, 2006, margin associated with tracked expenses and revenue taxes decreased \$0.9 million and \$1.9 million, respectively.

Electric Utility Margin (Electric Utility Revenues less Cost of Fuel & Purchased Power)

Electric Utility margin by revenue type follows:

<i>(In millions)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Electric utility revenues	\$ 96.0	\$ 96.9	\$ 201.2	\$ 191.6
Cost of fuel & purchased power	30.9	33.0	69.0	62.2
<b>Total electric utility margin</b>	<b>\$ 65.1</b>	<b>\$ 63.9</b>	<b>\$ 132.2</b>	<b>\$ 129.4</b>
Residential & commercial	\$ 38.4	\$ 39.7	\$ 76.3	\$ 76.8
Industrial	17.9	16.3	34.5	31.6
Municipalities & other	6.8	5.1	12.3	9.2
<b>Subtotal: retail &amp; firm wholesale</b>	<b>\$ 63.1</b>	<b>\$ 61.1</b>	<b>\$ 123.1</b>	<b>\$ 117.6</b>
Asset optimization	\$ 2.0	\$ 2.8	\$ 9.1	\$ 11.8

Electric volumes sold in GWh  
attributed to:

Residential & commercial customers	648.4	665.5	1,305.4	1,331.4
Industrial customers	671.3	651.1	1,309.2	1,270.0
Municipalities & other	161.3	173.7	311.8	328.1
<b>Total retail &amp; firm wholesale volumes sold</b>	<b>1,481.0</b>	<b>1,490.3</b>	<b>2,926.4</b>	<b>2,929.5</b>

*Retail & Firm Wholesale Margin*

Electric retail and firm wholesale utility margins were \$63.1 million and \$123.1 million for the three and six months ended June 30, 2006. This represents an increase over the prior year periods of \$2.0 million and \$5.5 million, respectively. The recovery of pollution control related investments and associated operating expenses and related depreciation increased margins \$1.4 million quarter over quarter and \$4.0 million year over year. Large customer margin, driven primarily by higher volumes, increased an additional \$1.4 million in the quarter and \$1.9 million year to date compared to the prior year periods. These increases were partially offset by mild weather and other factors. The estimated decrease in margin due to weather was \$0.3 million and \$0.5 million for the three and six month periods, respectively, compared to the prior year.

*Margin from Asset Optimization Activities*

Periodically, generation capacity is in excess of that needed to serve native load and firm wholesale customers. The Company markets and sells this unutilized generating and transmission capacity to optimize the return on its owned assets. On an annual basis, a majority of the margin generated from these activities is associated with wholesale off-system sales, and beginning in April 2005, substantially all off-system sales occur into the MISO day-ahead market. Following is a reconciliation of asset optimization activity.

<i>(In millions)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Beginning of Period Net Balance Sheet Position	\$ 1.2	\$ 2.4	\$ 1.3	\$ (0.6)
Statement of Income Activity				
Net mark-to-market gains/(losses)	(0.6)	0.3	(1.2)	2.8
Other unrealized losses	(0.5)	-	(0.1)	-
Net realized gains	3.1	2.5	10.4	9.0
<b>Net activity in electric utility margin</b>	<b>2.0</b>	<b>2.8</b>	<b>9.1</b>	<b>11.8</b>

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Net cash received & other adjustments	(1.1)	(2.0)	(8.3)	(8.0)
End of Period Net Balance Sheet				
Position	\$ 2.1	\$ 3.2	\$ 2.1	\$ 3.2

21

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For the three and six month periods ended June 30 2006, net asset optimization margins were \$2.0 million and \$9.1 million, which represents a decrease of \$0.8 million and \$2.7 million, as compared to 2005. The decrease was due primarily to prior year mark-to-market gains which were partially offset by increased margin from non-firm wholesale volumes sold off-system. Year to date off-system sales totaled 648.3 GWh in 2006, compared to 548.0 GWh in 2005.

### Operating Expenses

Other operating expenses for both the three and six months ended June 30, 2006, increased only \$0.4 million compared to 2005. Though largely offset by other cost decreases, for the three and six months ended June 30, 2006, bad debt expense in the Company's Indiana service territories increased \$1.5 million and \$2.4 million, respectively, due in part to higher gas costs.

### Depreciation & Amortization

Depreciation expense increased \$3.2 million and \$6.9 million for the three and six month periods ended June 30, 2006, as compared to 2005. In addition to depreciation on additions to plant in service, incremental depreciation expense associated with environmental compliance equipment placed into service in 2005 of \$1.0 million for the quarter and \$2.4 million for the year to date period also contributed to the increase.

### Interest Expense

For the three and six months ended June 30, 2006, interest expense increased \$1.8 million and \$4.9 million, respectively, compared to the prior year periods. The increases are primarily driven by rising interest rates and also include the impact of permanent financing transactions completed in the fourth quarter of 2005 in which \$150 million in debt-related proceeds were received and used to retire short-term borrowings and other long-term debt.

### Income Taxes

For the three and six months ended June 30, 2006, federal and state income taxes decreased \$1.3 million and \$6.0 million, respectively, compared to the prior year periods. The decreases are primarily due to lower pre-tax income as compared to the prior year. Year to date results also reflect the impact of an Indiana tax law change that resulted in the recalculation of certain state deferred income tax liabilities.

### Environmental Matters

#### Clean Air Interstate Rule & Clean Air Mercury Rule

In March of 2005 USEPA finalized two new air emission reduction regulations. The Clean Air Interstate Rule (CAIR) is an allowance cap and trade program requiring further reductions in Nitrogen Oxides (NOx) and Sulfur Dioxide (SO<sub>2</sub>) emissions from coal-burning power plants. The Clean Air Mercury Rule (CAMR) is an allowance cap and trade program requiring further reductions in mercury emissions from coal-burning power plants. Both sets of regulations require emission reductions in two phases. The first phase deadline for both rules is 2010 (2009 for NOx under CAIR), and the second phase deadline for compliance with the emission reductions required under CAIR is 2015, while the second phase deadline for compliance with the emission reduction requirements of CAMR is 2018. The Company is evaluating compliance options and fully expects to be in compliance by the required deadlines.

In February 2006, the IURC approved a multi-emission compliance plan filed by the Company's utility subsidiary, SIGECO. Once the plan is implemented, SIGECO's coal-fired plants will be 100% scrubbed for SO<sub>2</sub>, 90% scrubbed for NOx, and mercury emissions will be reduced to meet the new mercury reduction standards. The order, as previously agreed to by the OUCC and Citizens Action Coalition, allows SIGECO to recover an approximate 8% return on up to \$110 million in capital investments through a rider mechanism which is updated every six months for

actual costs incurred. The Company will also recover through a rider its operating expenses, including depreciation, once the equipment is placed into service. The order also stipulates that SIGECO study renewable energy alternatives and include a carbon forecast in future filings with regard to new generation and further environmental compliance plans, among other initiatives. As of June 30, 2006, the Company has made capital investments of approximately \$15.3 million related to this initiative.

### Manufactured Gas Plants

In the past, Indiana Gas, SIGECO, and others operated facilities for the manufacture of gas. Given the availability of natural gas transported by pipelines, these facilities have not been operated for many years. Under currently applicable environmental laws and regulations, Indiana Gas, SIGECO, and others may now be required to take remedial action if certain byproducts are found above the regulatory thresholds at these sites.

Indiana Gas has identified the existence, location, and certain general characteristics of 26 gas manufacturing and storage sites for which it may have some remedial responsibility. Indiana Gas has completed a remedial investigation/feasibility study (RI/FS) at one of the sites under an agreed order between Indiana Gas and the IDEM, and a Record of Decision was issued by the IDEM in January 2000. Although Indiana Gas has not begun an RI/FS at additional sites, Indiana Gas has submitted several of the sites to the IDEM's Voluntary Remediation Program (VRP) and is currently conducting some level of remedial activities, including groundwater monitoring at certain sites, where deemed appropriate, and will continue remedial activities at the sites as appropriate and necessary.

In conjunction with data compiled by environmental consultants, Indiana Gas has accrued the estimated costs for further investigation, remediation, groundwater monitoring, and related costs for the sites. While the total costs that may be incurred in connection with addressing these sites cannot be determined at this time, Indiana Gas has recorded costs that it reasonably expects to incur totaling approximately \$20.4 million.

The estimated accrued costs are limited to Indiana Gas' proportionate share of the remediation efforts. Indiana Gas has arrangements in place for 19 of the 26 sites with other potentially responsible parties (PRP), which serve to limit Indiana Gas' share of response costs at these 19 sites to between 20% and 50%.

With respect to insurance coverage, Indiana Gas has received and recorded settlements from all known insurance carriers in an aggregate amount approximating \$20.4 million.

Environmental matters related to manufactured gas plants have had no material impact on earnings since costs recorded to date approximate PRP and insurance settlement recoveries. While Indiana Gas has recorded all costs which it presently expects to incur in connection with activities at these sites, it is possible that future events may require some level of additional remedial activities which are not presently foreseen.

In October 2002, the Company received a formal information request letter from the IDEM regarding five manufactured gas plants owned and/or operated by SIGECO and not currently enrolled in the IDEM's VRP. In response, SIGECO submitted to the IDEM the results of preliminary site investigations conducted in the mid-1990's. These site investigations confirmed that based upon the conditions known at the time, the sites posed no risk to human health or the environment. Follow up reviews have been initiated by the Company to confirm that the sites continue to pose no such risk.

On October 6, 2003, SIGECO filed applications to enter four of the manufactured gas plant sites in IDEM's VRP. The remaining site is currently being addressed in the VRP by another Indiana utility. SIGECO added those four sites into the renewal of the global Voluntary Remediation Agreement that Indiana Gas has in place with IDEM for its manufactured gas plant sites. That renewal was approved by the IDEM on February 24, 2004. On July 13, 2004, SIGECO filed a declaratory judgment action against its insurance carriers seeking a judgment finding its carriers liable under the policies for coverage of further investigation and any necessary remediation costs that SIGECO may accrue under the VRP program. Costs of remediation at the four SIGECO sites, as well as the amount of any PRP or insurance recoveries, cannot be determined at this time. The total costs accrued to date, including investigative costs, have been immaterial.

## **Rate & Regulatory Matters**

### **Indiana and Ohio Lost Margin Recovery/Conservation Filings**

On October 25, 2005, Vectren Energy Delivery of Indiana filed with the IURC for approval of a conservation program and a conservation adjustment rider in its two Indiana service territories. If approved, the plan outlined in the petition will better align the interests of the Company with its customers through the promotion of natural gas conservation. The petition requests the use of a tracker mechanism to recover certain costs of funding the design and implementation of conservation efforts, such as consumer education programs and rebates for high efficiency equipment. The conservation tracker works in tandem with a lost margin recovery mechanism. This mechanism would allow the Company to recover the distribution portion of its rates from residential and commercial customers based on the level of customer usage established in each utility's last general rate case.

On May 5, 2006, the Company and the OUCC filed a settlement with the IURC that provides for a 5 year energy efficiency program to be implemented at both Indiana Gas and SIGECO. Further, as part of the Settlement, Indiana Gas will recover 85% of all lost margin since its last rate case. Recovery of lost margin at SIGECO will not commence until approval of new base rates in its next general rate case. A hearing before the IURC on the settlement occurred on July 18, 2006, post-hearing filings will be completed in August 2006 and an order is anticipated during the fourth quarter.

Similarly, on November 28, 2005, Vectren Energy Delivery of Ohio filed with the PUCO for approval of a conservation program and a conservation adjustment rider that would accomplish the same objectives, including lost margin recovery. On April 10, 2006, Vectren Energy Delivery of Ohio filed with the PUCO, a settlement agreement between the OCC, the Ohio Partners for Affordable Energy, and the Company that provides for at least two years of comprehensive energy efficiency programs for Ohio customers. A hearing has been conducted and an order by the PUCO is expected in the third quarter.

If the agreements are approved, these efficiency programs should be available to customers before the 2006 winter heating season.

### **Gas Cost Recovery (GCR) Audit Proceedings**

On June 14, 2005, the PUCO issued an order disallowing the recovery of approximately \$9.6 million of gas costs relating to the two year audit period ended November 2002. That audit period provided the PUCO staff its initial review of the portfolio administration arrangement between VEDO and ProLiance. The disallowance includes approximately \$1.3 million relating to pipeline refunds and penalties and approximately \$4.5 million of costs for winter delivery services purchased by VEDO to ensure reliability over the two year period. The PUCO also held that ProLiance should have credited to VEDO an additional \$3.8 million more than credits actually received for the right to use VEDO's gas transportation capacity periodically during the periods when it was not required for serving VEDO's customers. The PUCO also directed VEDO to either submit its receipt of portfolio administration services to a request for proposal process or to in-source those functions. During 2003, the Company recorded a reserve of \$1.1 million for this matter. An additional pretax charge of \$4.2 million was recorded in *Cost of Gas Sold* in 2005. The reserve reflects management's assessment of the impact of the PUCO decisions, an estimate of any current impact that decision may have on subsequent audit periods, and an estimate of a sharing in any final disallowance by Vectren's partner in ProLiance.

VEDO filed its request for rehearing on July 14, 2005, and on August 10, 2005, the PUCO granted rehearing to further consider the \$3.8 million portfolio administration issue and all interest on the findings, but denied rehearing on all other aspects of the case. On October 7, 2005, the Company filed an appeal with the Ohio Supreme Court requesting that the \$4.5 million disallowance related to the winter delivery service issue be reversed. On December



21, 2005, the PUCO granted in part VEDO's rehearing request, and reduced the \$3.8 million disallowance related to portfolio administration to \$1.98 million. The Company has filed an appeal on that decision as well. However, as part of the Ohio lost margin/conservation settlement agreement awaiting a PUCO decision, the Company has proposed to use the \$1.98 million disallowance as a funding source for Ohio conservation programs. If the settlement is approved, the appeal of the \$1.98 million disallowance amount would be withdrawn. Briefings of all matters were completed by July 31, 2006.

In addition, the Company solicited and received bids for VEDO's gas supply and portfolio administration services and has selected a third party provider, who began providing services to VEDO on November 1, 2005, under a one year contract.

#### Commodity Prices

Commodity prices for natural gas purchases have remained above historic levels and have become more volatile. Subject to compliance with applicable state laws, the Company's utility subsidiaries are allowed recovery of such changes in purchased gas costs from their retail customers through commission-approved gas cost adjustment mechanisms, and margin on gas sales are not expected to be impacted. Nevertheless, it is possible regulators may disallow recovery of a portion of gas costs for a variety of reasons, including, but not limited to, a finding by the regulator that natural gas was not prudently procured. In addition, as a result of this near term change in the natural gas commodity price, the Company's utility subsidiaries have been experiencing, and may continue to experience, increased interest expense due to higher working capital requirements; increased uncollectible accounts expense and unaccounted for gas; and some level of price sensitive reduction in volumes sold or delivered. In response to higher gas prices, the Company increased its utility-related credit facilities in November 2005.

#### **Impact of Recently Issued Accounting Guidance**

##### FIN 48

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN 48) "Accounting for Uncertainty in Income Taxes" an interpretation of SFAS 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of tax positions taken or expected to be taken in an income tax return. FIN 48 also provides guidance related to reversal of tax positions, balance sheet classification, interest and penalties, interim period accounting, disclosure and transition. The interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently assessing the impact this interpretation will have on its financial statements.

#### **Financial Condition**

Within Vectren's consolidated group, Utility Holdings funds the short-term and long-term financing needs of utility operations. Vectren does not guarantee Utility Holdings debt. Utility Holdings' outstanding long-term and short-term borrowing arrangements are jointly and severally guaranteed by Indiana Gas, SIGECO, and VEDO. The guarantees are full and unconditional and joint and several, and Utility Holdings has no subsidiaries other than the subsidiary guarantors. Information about the subsidiary guarantors as a group is included in Note 3 to the condensed consolidated financial statements. Utility Holdings' long-term and short-term obligations outstanding at June 30, 2006, totaled \$700.0 million and \$130.4 million, respectively. Additionally, prior to Utility Holdings formation, Indiana Gas and SIGECO funded their operations separately, and therefore, have long-term debt outstanding funded solely by their operations. Utility Holdings operations have historically funded almost all of Vectren's common stock dividends.

Utility Holdings' and Indiana Gas' credit ratings on outstanding senior unsecured debt at June 30, 2006, are A-/Baa1 as rated by Standard and Poor's Ratings Services (Standard and Poor's) and Moody's Investors Service (Moody's), respectively. SIGECO's credit ratings on outstanding secured debt are A/A3. Utility Holdings' commercial paper has a credit rating of A-2/P-2. The current outlook of both Moody's and Standard and Poor's is stable. These ratings and outlooks have not changed since December 31, 2005. A security rating is not a recommendation to buy, sell, or hold securities. The rating is subject to revision or withdrawal at any time, and each rating should be evaluated independently of any other rating. Standard and Poor's and Moody's lowest level investment grade rating is BBB- and Baa3, respectively.

The Company's consolidated equity capitalization objective is 45-55% of long-term capitalization. This objective may have varied, and will vary, depending on particular business opportunities, capital spending requirements, execution of long-term financing plans and seasonal factors that affect the Company's operations. The Company's equity component was 50% and 49% of long-term capitalization at June 30, 2006, and December 31, 2005, respectively. Long-term capitalization includes long-term debt, including current maturities and debt subject to tender, as well as common shareholders' equity and any outstanding preferred stock.

## **Sources & Uses of Liquidity**

### Operating Cash Flow

The Company's primary historical source of liquidity to fund working capital requirements has been cash generated from operations. Cash flow from operating activities decreased \$65.3 million during the six months ended June 30, 2006, compared to 2005 primarily as a result of changes in working capital accounts, which is reflective of the impact of higher gas costs. Working capital changes generated cash of \$97.9 million in 2006 compared to \$166.3 million in 2005. The decrease resulting from working capital changes was partially offset by increased earnings before non-cash charges.

### Financing Cash Flow

Although working capital requirements are generally funded by cash flow from operations, the Company uses short-term borrowings to supplement working capital needs when accounts receivable balances are at their highest and gas storage is refilled. Additionally, short-term borrowings are required for capital projects and investments until they are permanently financed.

Cash flow required for financing activities of \$133.8 million for the six months ended June 30, 2006, includes a net decrease of short-term borrowings of \$96.5 million, \$70.8 million less than amounts repaid during the six months ended June 30, 2005. The decreased debt repayments were principally the result of increased working capital requirements.

### Investing Cash Flow

Cash flow required for investing activities was \$96.5 million for the six months ended June 30, 2006, an increase of \$14.8 million over the prior year. The increase is attributable to the timing of payments for capital expenditures.

## **Available Sources of Liquidity**

At June 30, 2006, the Company has \$520.0 million of short-term borrowing capacity, of which approximately \$389.6 million is available.

In response to higher natural gas prices, Utility Holdings increased its available consolidated short-term borrowing capacity in the fourth quarter of 2005 to \$520 million, a \$165 million increase over previous levels. In addition, Utility Holdings extended the maturity of its largest credit facility, which totals \$515 million, through November, 2010. The amendment was completed on November 10, 2005.

## **Planned Capital Expenditures & Investments**

Capital expenditures for the remainder of 2006 are estimated to be approximately \$133 million.

### **Forward-Looking Information**

A “safe harbor” for forward-looking statements is provided by the Private Securities Litigation Reform Act of 1995 (Reform Act of 1995). The Reform Act of 1995 was adopted to encourage such forward-looking statements without the threat of litigation, provided those statements are identified as forward-looking and are accompanied by meaningful cautionary statements identifying important factors that could cause the actual results to differ materially from those projected in the statement. Certain matters described in Management’s Discussion and Analysis of Results of Operations and Financial Condition are forward-looking statements. Such statements are based on management’s beliefs, as well as assumptions made by and information currently available to management. When used in this filing, the words “believe”, “anticipate”, “endeavor”, “estimate”, “expect”, “objective”, “projection”, “forecast”, “goal” and similar expressions are intended to identify forward-looking statements. In addition to any assumptions and other factors referred to specifically in connection with such forward-looking statements, factors that could cause the Company’s actual results to differ materially from those contemplated in any forward-looking statements include, among others, the following:

- Factors affecting utility operations such as unusual weather conditions; catastrophic weather-related damage; unusual maintenance or repairs; unanticipated changes to fossil fuel costs; unanticipated changes to gas supply costs, or availability due to higher demand, shortages, transportation problems or other developments; environmental or pipeline incidents; transmission or distribution incidents; unanticipated changes to electric energy supply costs, or availability due to demand, shortages, transmission problems or other developments; or electric transmission or gas pipeline system constraints.
  - Increased competition in the energy environment including effects of industry restructuring and unbundling.
- Regulatory factors such as unanticipated changes in rate-setting policies or procedures, recovery of investments and costs made under traditional regulation, and the frequency and timing of rate increases.
- Financial or regulatory accounting principles or policies imposed by the Financial Accounting Standards Board; the Securities and Exchange Commission; the Federal Energy Regulatory Commission; state public utility commissions; state entities which regulate electric and natural gas transmission and distribution, natural gas gathering and processing, electric power supply; and similar entities with regulatory oversight.
- Economic conditions including the effects of an economic downturn, inflation rates, commodity prices, and monetary fluctuations.
- Increased natural gas commodity prices and the potential impact on customer consumption, uncollectible accounts expense, unaccounted for gas, and interest expense.
- Changing market conditions and a variety of other factors associated with physical energy and financial trading activities including, but not limited to, price, basis, credit, liquidity, volatility, capacity, interest rate, and warranty risks.
- Direct or indirect effects on our business, financial condition or liquidity resulting from a change in credit ratings, changes in interest rates, and/or changes in market perceptions of the utility industry and other energy-related industries.
- Employee or contractor workforce factors including changes in key executives, collective bargaining agreements with union employees, or work stoppages.
- Legal and regulatory delays and other obstacles associated with mergers, acquisitions, and investments in joint ventures.
- Costs and other effects of legal and administrative proceedings, settlements, investigations, claims, and other matters, including, but not limited to, those described in Management’s Discussion and Analysis of Results of Operations and Financial Condition.
- Changes in federal, state or local legislature requirements, such as changes in tax laws or rates, environmental laws and regulations.

The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of changes in actual results, changes in assumptions, or other factors affecting such statements.



### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company is exposed to various business risks associated with commodity prices, interest rates, and counter-party credit. These financial exposures are monitored and managed by the Company as an integral part of its overall risk management program. The Company's risk management program includes, among other things, the use of derivatives to mitigate risk. The Company also executes derivative contracts in the normal course of operations while buying and selling commodities to be used in operations and optimizing its generation assets.

The Company has in place a risk management committee that consists of senior management as well as financial and operational management. The committee is actively involved in identifying risks as well as reviewing and authorizing risk mitigation strategies.

These risks are not significantly different from the information set forth in Item 7A Quantitative and Qualitative Disclosures About Market Risk included in the Company's 2005 Form 10-K and are therefore not presented herein.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Changes in Internal Controls over Financial Reporting**

During the quarter ended June 30, 2006, there have been no changes to the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

#### **Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

As of June 30, 2006, the Company conducted an evaluation under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer of the effectiveness and the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Company's disclosure controls and procedures, as defined by Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (Exchange Act), are effective at providing reasonable assurance that material information relating to the Company required to be disclosed by the Company in its filings under the Exchange Act is brought to their attention on a timely basis.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

The Company is party to various legal proceedings arising in the normal course of business. In the opinion of management, there are no legal proceedings pending against the Company that are likely to have a material adverse effect on its financial position, results of operations or cash flows.

### **ITEM 1A. RISK FACTORS**

These risks are not significantly different from the information set forth in Item 1A Risk Factors included in the Utility Holdings 2005 Form 10-K and are therefore not presented herein.

### **ITEM 6. EXHIBITS**

#### **Exhibits and Certifications**

**Exhibits**

12. Ratio of Earnings to Fixed Charges

**Certifications**

31.1 Certification Pursuant To Section 302 of The Sarbanes-Oxley Act Of 2002- Chief Executive Officer

31.2 Certification Pursuant To Section 302 of The Sarbanes-Oxley Act Of 2002- Chief Financial Officer

32 Certification Pursuant To Section 906 of The Sarbanes-Oxley Act Of 2002

28

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

VECTREN UTILITY HOLDINGS, INC.

Registrant

August 11, 2006

/s/ Jerome A. Benkert, Jr.  
Jerome A. Benkert, Jr.  
Executive Vice President &  
Chief Financial Officer  
(Principal Financial Officer)

/s/ M. Susan Hardwick  
M. Susan Hardwick  
Vice President & Controller  
(Principal Accounting Officer)