

TARRANT APPAREL GROUP
Form 10-Q
August 13, 2009

**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, 2009

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: 0-26006

TARRANT APPAREL GROUP
(Exact name of registrant as specified in its charter)

California
(State or other jurisdiction of
incorporation or organization)

95-4181026
(I.R.S. Employer
Identification Number)

801 South Figueroa Street, Suite 2500
Los Angeles, California 90017
(Address of principal executive offices) (Zip code)

Registrant's telephone number, including area code: (323) 780-8250

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (ss.232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

Number of shares of Common Stock of the Registrant outstanding as of August 10, 2009: 30,543,763.

Registrant's telephone number, including area code: (323) 780-8250

**TARRANT APPAREL GROUP
FORM 10-Q
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Cautionary Legend Regarding Forward-looking Statements

Some of the information in this Quarterly Report on Form 10-Q may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, both as amended. These forward-looking statements are subject to various risks and uncertainties. The forward-looking statements include, without limitation, statements regarding our future business plans and strategies and our future financial position or results of operations, as well as other statements that are not historical. You can find many of these statements by looking for words like "will", "may", "believes", "expects", "anticipates", "plans" and "estimates" and for similar expressions. Because forward-looking statements involve risks and uncertainties, there are many factors that could cause the actual results to differ materially from those expressed or implied. These include, but are not limited to, our ability to timely complete the pending acquisition proposal, general economic conditions, our ability to competitively and profitably manage a sourcing and distribution business, the financial strength of our major customers, the continued acceptance of our existing and new products by our existing and new customers, dependence on key customers, the risks of foreign manufacturing, competitive and economic factors in the textile and apparel markets, the availability of raw materials, the successful resolution of pending litigation, and other risks and uncertainties that may be detailed herein. This Quarterly Report on Form 10-Q contains important cautionary statements and a discussion of many of the factors that could materially affect the accuracy of Tarrant's forward-looking statements and such statements and discussions are incorporated herein by reference. Any subsequent written or oral forward-looking statements made by us or any person acting on our behalf are qualified in their entirety by the cautionary statements and factors contained or referred to in this section. We do not intend or undertake any obligation to update any forward-looking statements to reflect events or circumstances after the date of this document or the date on which any subsequent forward-looking statement is made or to reflect the occurrence of unanticipated events.

PART I-- FINANCIAL INFORMATION

Item 1. Financial Statements.

TARRANT APPAREL GROUP
CONSOLIDATED BALANCE SHEETS

	June 30, 2009 (Unaudited)	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 88,939	\$ 5,207,293
Restricted cash	105,000	105,000
Accounts receivable, net of \$1.7 million and \$0.6 million allowance for returns, discounts and bad debts at June 30, 2009 and December 31, 2008, respectively	26,445,915	19,198,746
Due from related parties	18,950,704	21,581,447
Inventory	6,555,036	7,065,805
Temporary quota rights	—	35,835
Prepaid expenses	1,481,078	1,202,461
Deferred tax assets	156,594	146,401
Total current assets	53,783,266	54,542,988
Property and equipment, net of \$6.3 million and \$7.4 million accumulated depreciation and amortization at June 30, 2009 and December 31, 2008, respectively	2,253,846	1,985,526
Due from related parties, net of \$2.6 million reserve and \$0.8 million adjustment to fair value both at June 30, 2009 and December 31, 2008	125,050	138,700
Deferred financing cost, net of \$0.4 million accumulated amortization at December 31, 2008	—	67,217
Other assets	1,691	1,691
Goodwill, net	3,282,845	3,282,845
Total assets	\$ 59,446,698	\$ 60,018,967
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Short-term bank borrowings	\$ 8,232,626	\$ 10,630,366
Accounts payable	12,444,967	11,679,398
Accrued expenses	5,830,092	5,850,393
Income taxes, current portion	4,282,864	4,222,909
Debt facility and factoring agreement	14,715,259	12,606,796
Total current liabilities	45,505,808	44,989,862
Income taxes, net of current portion	3,887,687	5,163,568
Total liabilities	49,393,495	50,153,430
Minority interest in PBG7	60,398	60,398
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, 2,000,000 shares authorized; no shares issued and outstanding at June 30, 2009 and December 31, 2008	—	—
Common stock, no par value, 100,000,000 shares authorized; 30,543,763 shares issued and outstanding at June 30, 2009 and December 31, 2008	115,757,465	115,757,465
Warrants to purchase common stock	5,471,406	5,515,506
Contributed capital	13,094,610	12,918,949
Accumulated deficit	(122,695,915)	(122,744,111)

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	June 30, 2009	December 31, 2008
Notes receivable from officer and shareholder	(1,634,761)	(1,642,670)
Total shareholders' equity	9,992,805	9,805,139
Total liabilities and shareholders' equity	\$ 59,446,698	\$ 60,018,967

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

TARRANT APPAREL GROUP

CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2009	2008	2009	2008
Net sales	\$ 37,492,772	\$ 47,423,850	\$ 72,066,954	\$ 93,745,566
Net sales to related party	3,544,178	3,873,954	6,303,521	8,051,035
Total net sales	41,036,950	51,297,804	78,370,475	101,796,601
Cost of sales	28,240,198	36,775,183	55,071,231	73,428,596
Cost of sales to related party	3,238,319	3,547,721	5,758,695	7,353,702
Total cost of sales	31,478,517	40,322,904	60,829,926	80,782,298
Gross profit	9,558,433	10,974,900	17,540,549	21,014,303
Selling and distribution expenses	2,419,314	2,770,813	4,613,011	6,200,049
General and administrative expenses	6,333,753	7,816,067	11,707,166	14,134,684
Royalty expense	299,943	478,987	562,091	813,265
Goodwill impairment charge	—	5,300,000	—	5,300,000
Income (loss) from operations	505,423	(5,390,967)	658,281	(5,433,695)
Interest expense	(221,112)	(244,697)	(387,156)	(475,359)
Interest income	31,944	152,812	65,171	192,734
Interest in income of equity method investee	—	130,448	—	107,054
Other income	90,627	325,614	122,935	506,870
Other expense	—	(2,293)	(49,764)	(66,045)
Income (loss) before provision for income taxes and minority interest	406,882	(5,029,083)	409,467	(5,168,441)
Provision for income taxes	187,779	245,097	361,271	359,140
Minority interest	—	5	—	123
Net income (loss)	\$ 219,103	\$ (5,274,175)	\$ 48,196	\$ (5,527,458)
Net income (loss) per share:				
Basic	\$ 0.01	\$ (0.16)	\$ 0.00	\$ (0.17)
Diluted	\$ 0.01	\$ (0.16)	\$ 0.00	\$ (0.17)
Weighted average common and common equivalent shares:				
Basic	30,543,763	32,043,763	30,543,763	32,043,763
Diluted	30,543,763	32,043,763	30,543,763	32,043,763

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

TARRANT APPAREL GROUP

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30	
	2009	2008
Cash flows from operating activities:		
Net income (loss)	\$ 48,196	\$ (5,527,458)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization of property and equipment.	208,041	165,787
Amortization of deferred financing cost	67,217	73,329
Goodwill impairment charge	—	5,300,000
Change in the provision for returns and discounts	116,711	(454,919)
Change in the provision for bad debts	1,003,407	1,983,890
Inventory reserve	—	82,000
Loss on sale of fixed assets	49,764	66,045
Income from equity method investment	—	(107,054)
Gain on sale of marketable securities	—	(345,567)
Unrealized gain on marketable securities	—	(8,756)
Minority interest	—	(123)
Stock-based compensation	131,561	152,690
Changes in operating assets and liabilities:		
Accounts receivable	(8,367,287)	1,003,530
Due from related parties	2,644,394	(3,308,688)
Inventory	510,769	5,263,944
Temporary quota rights	35,835	(31,941)
Prepaid expenses	(278,616)	252,106
Other assets	—	100,000
Deferred taxes	(10,194)	(111,881)
Accounts payable	765,569	226,394
Accrued expenses	(20,300)	(3,415,113)
Income taxes payable	(1,215,926)	(4,930,035)
Net cash used in operating activities	(4,310,859)	(3,571,820)
Cash flows from investing activities:		
Purchase of marketable securities	—	(586,469)
Proceeds from sale of marketable securities	—	758,588
Notes receivable	—	(1,500,000)
Purchase of property and equipment	(535,590)	(188,078)
Proceeds from sale of property and equipment	9,464	56,864
Distribution from equity method investee	—	135,000
Collection of notes receivable from shareholder and officer	7,908	132,653
Net cash used in investing activities	(518,218)	(1,191,442)
Cash flows from financing activities:		
Short-term bank borrowings, net	(2,397,739)	2,679,764
Proceeds from debt facility and factoring agreement	65,357,550	95,286,648
Payment of debt facility and factoring agreement	(63,249,088)	(89,348,624)
Net cash provided by (used in) financing activities	(289,277)	8,617,788
Increase (decrease) in cash and cash equivalents	(5,118,354)	3,854,526
Cash and cash equivalents at beginning of period	5,207,293	491,416
Cash and cash equivalents at end of period	\$ 88,939	\$ 4,345,942

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

TARRANT APPAREL GROUP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

1. Organization and Basis of Consolidation

The accompanying financial statements consist of the consolidation of Tarrant Apparel Group, a California corporation, and its majority owned subsidiaries located primarily in the U.S. and Asia. At June 30, 2009, we own 75% of PBG7, LLC ("PBG7"). We consolidate these entities and reflect the minority interests in earnings (losses) of the ventures in the accompanying financial statements. All inter-company amounts are eliminated in consolidation. The 25% minority interest in PBG7 is owned by BH7, LLC, an unrelated party.

We serve mass merchandisers, department stores, branded wholesalers and specialty chains by designing, merchandising, contracting for the manufacture of, and selling casual apparel for women, men and children under private label and private brands.

Historically, our operating results have been subject to seasonal trends when measured on a quarterly basis. This trend is dependent on numerous factors, including the markets in which we operate, holiday seasons, consumer demand, climate, economic conditions and numerous other factors beyond our control. Generally, the second and third quarters are stronger than the first and fourth quarters. There can be no assurance that the historic operating patterns will continue in future periods.

2. Summary of Significant Accounting Policies

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America ("US GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by US GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the results of operations for the periods presented have been included.

The consolidated financial data at December 31, 2008 is derived from audited financial statements which are included in our Annual Report on Form 10-K for the year ended December 31, 2008, and should be read in conjunction with the audited financial statements and notes thereto. Interim results are not necessarily indicative of results for the full year.

The accompanying unaudited consolidated financial statements include all majority-owned subsidiaries in which we exercise control. All significant inter-company transactions and balances have been eliminated from the consolidated financial statements.

The preparation of financial statements in conformity with US GAAP requires us to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant estimates used by us in preparation of the consolidated financial statements include allowance for returns, discounts and bad debts, inventory, due from related parties reserve, valuation of long-lived and intangible assets and goodwill, accrued expenses, income taxes, stock options valuation, contingencies and litigation. Actual results could differ from those estimates.

Marketable Securities

In January 2008, we invested \$586,000 in marketable securities which were classified as trading marketable securities. During the six months ended June 30, 2008, we sold some of the investments in marketable securities; proceeds from the sale were \$759,000 and the gain of \$346,000 was reported in other income in the consolidated statements of operations. As of June 30, 2008, the unrealized gain on investment in marketable securities of \$9,000 was recorded in other income based on the closing price of the marketable securities at June 30, 2008 in the consolidated statements of operations. We sold all of the investment in marketable securities before December 31, 2008.

TARRANT APPAREL GROUP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

License Agreements and Royalty Expense

We enter into license agreements from time to time that allow us to use certain trademarks and trade names on certain of our products. These agreements require us to pay royalties, generally based on the sales of such products, and may require guaranteed minimum royalties, a portion of which may be paid in advance. Our accounting policy is to match royalty expense with revenue by recording royalties at the time of sale at the greater of the contractual rate or an effective rate calculated based on the guaranteed minimum royalty and our estimate of sales during the contract period. If a portion of the guaranteed minimum royalty is determined not to be recoverable, the unrecoverable portion is charged to expense at that time. See Note 13 of the "Notes to Consolidated Financial Statements" regarding agreements we have entered into.

Royalty expense in the six months ended June 30, 2009 and 2008 was \$562,000 and \$813,000, respectively.

Deferred Rent Provision

When a lease requires fixed escalation of the minimum lease payments, rental expense is recognized on a straight line basis over the initial term of the lease, and the difference between the average rental amount charged to expense and amounts payable under the lease is included in deferred amount. Furthermore, this amount also includes \$579,000 of tenant improvement allowance, which is also recognized on a straight-line basis from the date the asset was put into place up to the end of the lease term and/or the end of the asset's useful life, whichever comes first.

As of June 30, 2009 and December 31, 2008, deferred rent of \$767,000 and \$661,000, respectively, was recorded under accrued expense in our consolidated financial statements.

Reclassification on Financial Statements

Certain 2008 amounts have been reclassified to conform to the 2009 presentation.

3. Stock-Based Compensation

Our Employee Incentive Plan, formerly the 1995 Stock Option Plan (the "1995 Plan"), authorized the grant to our officers, employees, directors and consultants of both incentive and non-qualified stock options for shares of our common stock. As of June 30, 2009, there were outstanding options to purchase a total of 737,000 shares of common stock granted under the 1995 Plan. No further grants may be made under the 1995 Plan. On May 25, 2006, we adopted the Tarrant Apparel Group 2006 Stock Incentive Plan (the "2006 Plan"), which authorizes the issuance of up to 5,100,000 shares of our common stock pursuant to options or awards granted under the 2006 Plan. As of June 30, 2009, there were outstanding options to purchase a total of 743,000 shares of common stock, and 2,857,000 shares remained available for issuance pursuant to awards granted under the 2006 Plan. The exercise price of options under the plan must be equal to at least 100% of fair market value of common stock on the date of grant. The 2006 Plan also permits other types of awards, including stock appreciation rights, restricted stock and other performance-based benefits.

On January 1, 2006, we adopted SFAS No. 123 (revised 2004), "Share-Based Payment," ("SFAS No. 123(R)") which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values. SFAS No. 123(R) supersedes our previous accounting under Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees" for periods beginning in fiscal 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 107 relating to SFAS No. 123(R). We have applied the provisions of SAB No. 107 in our adoption of SFAS No. 123(R).

We adopted SFAS No. 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of our fiscal year 2006. Our financial statements as of and for the three months and six months ended June 30, 2009 and 2008 reflect the impact of SFAS No. 123(R). SFAS No. 123(R) requires companies to estimate the fair value of share-based payment awards to employees and directors on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in our consolidated statements of operations.

TARRANT APPAREL GROUP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

A summary of our stock option activity and related information for the year ended December 31, 2008 and the six months ended June 30, 2009 is as follows:

	Employees	
	Number of Shares	Exercise Price
Options outstanding at December 31, 2007	8,214,209	\$ 1.39-\$45.50
Granted	—	—
Exercised	—	—
Forfeited	(1,309,550)	\$ 1.84-\$39.97
Expired	(1,022,750)	\$ 15.50-\$33.13
Options outstanding at December 31, 2008	5,881,909	\$ 1.39-\$45.50
Granted	—	—
Exercised	—	—
Forfeited	—	—
Expired	(2,000)	\$ 45.50
Options outstanding at June 30, 2009	5,879,909	\$ 1.39-\$9.94

We had no stock options outstanding to non-employees as of December 31, 2008 and June 30, 2009.

The following table summarizes information about stock options outstanding, expected to vest and exercisable as of December 31, 2008 and June 30, 2009:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Intrinsic Value
As of December 31, 2008				
Employees - Outstanding	5,881,909	\$ 4.16	4.5	\$ 0
Employees - Expected to vest	5,824,678	\$ 4.18	4.4	\$ 0
Employees - Exercisable	5,497,780	\$ 4.32	4.2	\$ 0
As of June 30, 2009:				
Employees - Outstanding	5,879,909	\$ 4.14	4.0	\$ 0
Employees - Expected to vest	5,822,678	\$ 4.17	3.9	\$ 0
Employees - Exercisable	5,639,095	\$ 4.24	3.8	\$ 0

The following table summarizes our non-vested options as of December 31, 2008 and changes during the six months ended June 30, 2009:

Non-vested Options	Number of Shares	Weighted Average Grant-Date Fair Value
Non-vested at December 31, 2008	384,129	\$ 1.24
Granted	—	—
Vested	(143,315)	\$ 1.22
Forfeited	—	—
Non-vested at June 30, 2009	240,814	\$ 1.26

TARRANT APPAREL GROUP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in the consolidated statements of operations for the three months and six months ended June 30, 2009 and 2008 consisted of compensation expense for the share-based payment awards granted subsequent to January 1, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R). For stock-based payment awards issued to employees and directors, stock-based compensation is attributed to expense using the straight-line single option method. As stock-based compensation expense recognized in the consolidated statements of operations for the six months ended June 30, 2009 and 2008 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures, which we estimate to be 11.0% and 13.1%, respectively. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Our determination of fair value of share-based payment awards to employees and directors on the date of grant using the Black-Scholes model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to our expected stock price volatility over the term of the awards. When valuing awards, we estimate the expected terms using the "safe harbor" provisions provided in SAB No. 110 and the volatility using historical data. We did not grant any options to purchase shares of common stock during the six months ended June 30, 2009 and 2008. The stock-based compensation expense related to employees or director stock options recognized for the six months ended June 30, 2009 was \$132,000, of which \$110,000 was recorded under general and administrative expenses and \$22,000 was recorded under selling and distribution expenses in our consolidated statements of operation. The stock-based compensation expense related to employees or director stock options recognized for the six months ended June 30, 2008 was \$153,000, of which \$109,000 was recorded under general and administrative expenses and \$44,000 was recorded under selling and distribution expenses in our consolidated statements of operation. Basic and dilutive income per share for the three months and six months ended June 30, 2008 was not materially affected by the additional stock-based compensation recognized. Basic and dilutive income per share for the three months ended June 30, 2009 was not materially affected by the additional stock-based compensation recognized. Basic and dilutive income per share for the six months ended June 30, 2009 was decreased by \$0.01 from \$0.01 to \$0.00 by the additional stock-based compensation recognized.

There were no options exercised in the six months ended June 30, 2009 or 2008. The total fair value of shares vested for the six months ended June 30, 2009 and 2008 were approximately \$175,000 and \$497,000, respectively.

As of June 30, 2009, there was \$227,000 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the plans. That cost is expected to be recognized over the weighted-average period of 1.0 years.

When options are exercised, our policy is to issue previously unissued shares of common stock to satisfy share option exercises. As of June 30, 2009, we had 69.5 million authorized, unissued shares of common stock.

4. Accounts Receivable

Accounts receivable consists of the following:

	June 30, 2009	December 31, 2008
U.S. trade accounts receivable	\$ 1,844,966	\$ 1,015,340
Foreign trade accounts receivable	5,271,382	4,433,595
Factored accounts receivable	20,833,343	14,011,129
Other receivables	168,001	290,341
Allowance for returns, discounts and bad debts	(1,671,777)	(551,659)
	\$ 26,445,915	\$ 19,198,746

TARRANT APPAREL GROUP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

At June 30, 2009, substantially all trade receivables, irrespective of their debt ratings, were factored under our credit facility with GMAC and GMAC advances up to 90% of the invoice value to us immediately upon the submission of invoices. See Note 8 of "Notes to Consolidated Financial Statements."

5. Inventory

Inventory consists of the following:

	June 30, 2009	December 31, 2008
Raw materials - fabric and trim accessories	\$ 470,111	\$ 821,411
Finished goods shipments-in-transit	1,642,665	3,256,727
Finished goods	4,442,260	2,987,667
	\$ 6,555,036	\$ 7,065,805

6. Equity Method Investment – American Rag

In 2003, we acquired a 45% equity interest in the owner of the trademark "American Rag Cie" and the operator of American Rag retail stores for \$1.4 million; and our subsidiary, Private Brands, Inc., acquired an exclusive license to certain rights to this trademark. We guaranteed the payment to the licensor of minimum royalties of \$10.4 million over the initial 10-year term of the agreement. The guaranteed annual minimum royalty is payable in advance in monthly installments during the term of the agreement. The royalty owed to the licensor in excess of the guaranteed minimum, if any, is payable no later than 30 days after the end of the preceding full quarter with the amount for last quarter adjusted based on actual royalties owed for the year. If a portion of the guaranteed minimum royalty is determined not to be recoverable, the unrecoverable portion is charged to expense at that time. Private Brands also entered into a multi-year exclusive distribution agreement with Macy's Merchandising Group, LLC, the sourcing arm of Federated Department Stores, to supply Macy's Merchandising Group with American Rag Cie, a casual sportswear collection for juniors and young men. Under this arrangement, Private Brands designs and manufactures American Rag apparel, which is distributed by Macy's Merchandising Group exclusively to Federated stores across the country. Beginning in August 2003, the American Rag collection was available in select Macy's locations and is currently available in approximately 600 Macy's stores nationally. The investment in American Rag Cie, LLC was accounted for under the equity method. Income (loss) of the equity method investment was recorded in the United States geographical segment.

During 2008, we became involved in litigation with American Rag Cie, LLC and American Rag Cie II with respect to our license rights to the American Rag Cie trademark. On December 23, 2008, we entered into a Settlement Agreement with American Rag Cie, LLC and American Rag Cie II providing for a settlement and release of all claims with respect to our litigation with American Rag Cie, LLC and American Rag Cie II. Pursuant to the Settlement Agreement, the parties agreed to the following actions:

- o Dismissal of the Action by all parties and release of claims asserted in the Action;
- o Redemption by American Rag Cie, LLC of our 45% membership interest in American Rag Cie, LLC, and redemption by American Rag Compagnie of our 5,000 shares in American Rag Compagnie; and
- o Amendment of the License Agreement with respect to the "American Rag Cie" trademark.

As a result of the Settlement Agreement, we no longer own an equity interest in American Rag Cie, LLC or American Rag Compagnie, and continue to license rights to the American Rag Cie trademark. As a result of disposition of our membership interest in American Rag Cie, LLC and shares in American Rag Compagnie, we recorded an impairment of goodwill of \$1.4 million in the fourth quarter of 2008.

TARRANT APPAREL GROUP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

In connection with the Settlement Agreement, on December 23, 2008, Private Brands, Inc. and American Rag Cie, LLC entered into an Amended License Agreement. The Amended License Agreement amends and restates our prior license agreement for the “American Rag Cie” trademark effective October 1, 2008 to, among other things:

- o Extend the initial term of the agreement to September 30, 2018, with six consecutive ten-year automatic renewal terms;
- o Amend the territory to consist of the United States, Canada, Mexico and Bermuda;
- o Reduce the annual guaranteed minimum royalties and revise the royalty rates;
- o Clarify the provisions with respect to calculation of royalties and reporting; and
- o Amend the termination provisions.

We have accounted for the transfers and exchanges within the Settlement Agreement in accordance to APB 29 “Accounting for Nonmonetary Transactions”, which fair-valued the non-monetary exchange as we deemed the transaction to have commercial substance. We performed a calculation to determine the present value of the future cash flows under the prior license agreement and amended license agreement and determined that the cash flows did not differ significantly. Therefore, the incremental fair value of the economic benefit from the original to the amended license agreement was insignificant.

The guaranteed annual minimum royalty under the License Agreement, as amended, for year 2009 is \$553,000. At June 30, 2009, the total commitment on royalties remaining on the term under the Amended License Agreement was \$8.0 million. Royalty expense payable to American Rag in the first six months of 2009 and 2008 was \$562,000 and \$813,000, respectively.

7. Impairment of Assets

We have adopted SFAS No. 142, “Goodwill and Other Intangible Assets.” We assess the need for impairment of identifiable intangibles, long-lived assets and goodwill with a fair-value-based test on an annual basis or more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Factors considered important that could trigger an impairment review include, but are not limited to, the following:

- o a significant underperformance relative to expected historical or projected future operating results;
- o a significant change in the manner of the use of the acquired asset or the strategy for the overall business; or
- o a significant negative industry or economic trend.

We utilized the discounted cash flow methodology to estimate fair value. As of June 30, 2009, we had a goodwill balance of \$3.3 million.

Impairment of Goodwill

Goodwill in the accompanying consolidated balance sheets represents the “excess of costs over fair value of net assets acquired in previous business combination”. SFAS No. 142, “Goodwill and Other Intangible Assets,” requires that goodwill and other intangibles be tested for impairment using a two-step process. The first step is to determine the fair value of the reporting unit, which may be calculated using a discounted cash flow methodology, and compare this value to its carrying value. If the fair value exceeds the carrying value, no further work is required and no impairment loss would be recognized. The second step is an allocation of the fair value of the reporting unit to all of the reporting unit’s assets and liabilities under a hypothetical purchase price allocation.

TARRANT APPAREL GROUP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

On July 29, 2008, Mervyn's LLC filed for bankruptcy protection. We expected sales to Mervyn's to decrease significantly. Mervyn's was the most important customer of our FR TCL-Chazzz/MGI division. It represented approximately 22% and 37% of sales of this division in the first six months of 2008 and in the twelve months of 2007, respectively; we immediately performed an assessment of the goodwill relating to this division pursuant to SFAS 142. Having taken the two step analysis outlined above, we concluded that due to the Mervyn's bankruptcy filing and the significant reduction of business from another retail customer serviced by the FR TCL-Chazzz/MGI division, the fair value of the reporting unit was less than the carrying value and we therefore recorded an impairment charge to goodwill of \$5.3 million in the second quarter of 2008. There was no impairment charge to goodwill at June 30, 2009.

8. Debt

Short-term bank borrowings consist of the following:

	June 30, 2009	December 31, 2008
Import trade bills payable - DBS Bank and Aurora Capital	\$ 2,876,791	\$ 4,000,602
Bank direct acceptances - DBS Bank	2,867,986	3,591,801
Other Hong Kong credit facilities - DBS Bank	2,487,849	3,037,963
	\$ 8,232,626	\$ 10,630,366

Debt facility and factoring agreement - GMAC CF:

	June 30, 2009	December 31, 2008
Debt facility and factoring agreement - GMAC CF	\$ 14,715,259	\$ 12,606,796

Import Trade Bills Payable, Bank Direct Acceptances and Other Hong Kong Credit Facilities

In June 2006, our subsidiaries in Hong Kong, Tarrant Company Limited, Marble Limited and Trade Link Holdings Limited, entered into a credit facility with DBS Bank (Hong Kong) Limited ("DBS"), which replaced our prior letter of credit facility with DBS. Under this facility, we may arrange for letters of credit and acceptances. The maximum amount our Hong Kong subsidiaries were permitted to borrow under this facility at any time was US \$25 million. In November 2008, the maximum amount was temporarily decreased to \$22 million, and in March 2009 the maximum amount was further reduced to \$20 million as a result of the bank's policy of reducing credit limits provided to corporate clients. The interest rate under the letter of credit facility is equal to the Hong Kong Dollar Standard Bills Rate quoted by DBS minus 0.5% if paid in Hong Kong Dollars (which rate was 5.75% per annum at June 30, 2009) or the U.S. Dollar Standard Bills Rate quoted by DBS plus 0.5% if paid in any other currency (which rate was 3.57% per annum at June 30, 2009). This is a demand facility and is secured by a security interest in all the assets of the Hong Kong subsidiaries, by a pledge of our office property where our Hong Kong office is located, which is owned by Gerard Guez and Todd Kay, and by our guarantee. The DBS facility includes customary default provisions. In addition, we are subject to certain restrictive covenants, including annual covenants that we maintain a specified tangible net worth and a minimum level of EBITDA at December 31, 2009. We are also required to maintain specified interest coverage and leverage ratios and are limited in engaging in mergers and acquisitions in excess of a specified amount. As of June 30, 2009 we were in compliance with the covenants. As of June 30, 2009, \$6.2 million was outstanding under this facility. In addition, \$7.4 million of open letters of credit were outstanding and \$6.4 million was available for future borrowings as of June 30, 2009.

From time to time, we open letters of credit under an uncommitted line of credit from Aurora Capital Associates which issues these letters of credits out of Israeli Discount Bank. As of June 30, 2009, \$2.0 million was outstanding under this facility and \$0.3 million of letters of credit was open under this arrangement. We pay a commission fee of 2.25% on all letters of credits issued under this arrangement.

TARRANT APPAREL GROUP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)*Debt Facility and Factoring Agreement - GMAC Commercial Finance*

On June 16, 2006, we expanded our previously existing credit facility with GMAC Commercial Finance, LLC ("GMAC CF") by entering into a new Loan and Security Agreement and amending and restating our previously existing Factoring Agreement with GMAC CF. This is a revolving credit facility and had a term of 3 years. In February 2009, we entered into a consent and amendment pursuant to which GMAC CF approved the proposed acquisition of our publicly held shares by an entity owned and controlled by Gerard Guez and Todd Kay, the maximum amount of the credit facility was reduced to \$40 million, and the credit facility was extended for an additional year. The extension is subject to an opt-out provision which allows GMAC CF to terminate the credit facility with a notice of 60 business days after the proposed acquisition is closed. The amount we may borrow under this credit facility is determined by a percentage of eligible accounts receivable and inventory, up to a maximum of \$40 million, and includes a letter of credit facility of up to \$2 million. Interest on outstanding amounts under this credit facility is payable monthly and accrues at the rate of the "prime rate" plus 0.5%. Our obligations under the GMAC CF credit facility are secured by a lien on substantially all our domestic assets, including a first priority lien on our accounts receivable and inventory. This credit facility contains customary financial covenants, including covenants that we maintain minimum levels of EBITDA and interest coverage ratio and limitations on additional indebtedness. This facility includes customary default provisions, and all outstanding obligations may become immediately due and payable in the event of a default. The facility bore interest at 3.75% per annum at June 30, 2009. As of June 30, 2009, we were not in compliance with the EBITDA covenant and a waiver of the default and amendment to the existing agreements were obtained on August 6, 2009. A total of \$14.7 million was outstanding with respect to receivables factored under the GMAC CF facility at June 30, 2009.

The credit facility with GMAC CF prohibits us from paying dividends or making other distributions on our common stock. In addition, the credit facility with GMAC CF prohibits our subsidiaries that are borrowers under the facility from paying dividends or making other distributions to us. The credit facility with DBS prohibits our Hong Kong subsidiaries from paying any dividends or making other distributions or advances to us.

9. Recently Issued Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations". The objective of SFAS No. 141(R) is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. The new standard requires the acquiring entity in a business new roman">.75

Earnings per common share -- diluted

Earnings before discontinued operations				
\$.63	\$.45	\$ 1.01	\$.67	
Discontinued operations, net of tax				
---	.04	---	.07	
Earnings per common share -- diluted				
\$.63	\$.49	\$ 1.01	\$.74	
Dividends per common share				
\$.1450	\$.1350	\$.2900	\$.2700	
Weighted average common shares outstanding -- basic				
182,972	181,847	182,785	181,595	
Weighted average common shares outstanding -- diluted				
183,727	182,746	183,513	182,469	

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

MDU RESOURCES GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2008	June 30, 2007	December 31, 2007
(In thousands, except shares and per share amounts)			
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 82,039	\$ 68,134	\$ 105,820
Receivables, net	769,379	642,559	715,484
Inventories	267,125	221,179	229,255
Deferred income taxes	47,442	---	7,046
Short-term investments	13,768	16,700	91,550
Prepayments and other current assets	175,293	78,535	64,998
Current assets held for sale and related to discontinued operations	---	69,662	179
	1,355,046	1,096,769	1,214,332
Investments	121,279	136,585	118,602
Property, plant and equipment	6,507,164	4,953,171	5,930,246
Less accumulated depreciation, depletion and amortization	2,408,093	1,851,825	2,270,691
	4,099,071	3,101,346	3,659,555
Deferred charges and other assets:			
Goodwill	437,832	227,029	425,698
Other intangible assets, net	32,485	17,150	27,792
Other	166,019	113,193	146,455
Noncurrent assets held for sale and related to discontinued operations	---	410,662	---
	636,336	768,034	599,945
	\$ 6,211,732	\$ 5,102,734	\$ 5,592,434

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:			
Short-term borrowings	\$ 79,960	\$ ---	\$ 1,700
Long-term debt due within one year	87,366	131,661	161,682
Accounts payable	396,715	284,208	369,235
Taxes payable	46,200	38,769	60,407
Deferred income taxes	---	1,396	---
Dividends payable	26,723	24,725	26,619
Accrued compensation	55,631	47,440	66,255
Other accrued liabilities	295,153	108,450	163,990
Current liabilities held for sale and related to discontinued operations	---	14,156	---
	987,748	650,805	849,888
Long-term debt	1,474,908	1,224,286	1,146,781
Deferred credits and other liabilities:			
Deferred income taxes	685,480	570,590	668,016

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Other liabilities	472,989	349,895	396,430
Noncurrent liabilities held for sale and related to discontinued operations	---	35,488	---
	1,158,469	955,973	1,064,446
Commitments and contingencies			
Stockholders' equity:			
Preferred stocks	15,000	15,000	15,000
Common stockholders' equity:			
Common stock			
Shares issued -- \$1.00 par value, 183,706,236 at June 30, 2008, 182,416,029 at June 30, 2007 and 182,946,528 at December 31, 2007	183,706	182,416	182,947
Other paid-in capital	925,784	895,838	912,806
Retained earnings	1,567,035	1,190,935	1,433,585
Accumulated other comprehensive loss	(97,292)	(8,893)	(9,393)
Treasury stock at cost – 538,921 shares	(3,626)	(3,626)	(3,626)
Total common stockholders' equity	2,575,607	2,256,670	2,516,319
Total stockholders' equity	2,590,607	2,271,670	2,531,319
	\$ 6,211,732	\$ 5,102,734	\$ 5,592,434

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

MDU RESOURCES GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30,	
	2008	2007
	(In thousands)	
Operating activities:		
Net income	\$ 186,558	\$ 136,137
Income from discontinued operations, net of tax	---	12,694
Income from continuing operations	186,558	123,443
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	176,909	139,846
Earnings, net of distributions, from equity method investments	(1,844)	(722)
Deferred income taxes	34,870	24,756
Changes in current assets and liabilities, net of acquisitions:		
Receivables	(46,550)	(14,083)
Inventories	(36,482)	(16,690)
Other current assets	(111,199)	(25,259)
Accounts payable	18,953	(11,644)
Other current liabilities	11,209	(38,040)
Other noncurrent changes	6,381	(1,107)
Net cash provided by continuing operations	238,805	180,500
Net cash used in discontinued operations	---	(41,884)
Net cash provided by operating activities	238,805	138,616
Investing activities:		
Capital expenditures	(386,014)	(242,729)
Acquisitions, net of cash acquired	(271,191)	(329)
Net proceeds from sale or disposition of property	26,379	10,848
Investments	80,389	17,309
Net cash used in continuing operations	(550,437)	(214,901)
Net cash used in discontinued operations	---	(1,379)
Net cash used in investing activities	(550,437)	(216,280)
Financing activities:		
Issuance of short-term borrowings	79,960	---
Repayment of short-term borrowings	(1,700)	---
Issuance of long-term debt	379,644	186,578
Repayment of long-term debt	(125,637)	(85,028)
Proceeds from issuance of common stock	4,945	15,775
Dividends paid	(53,296)	(49,300)
Tax benefit on stock-based compensation	3,737	4,505
Net cash provided by continuing operations	287,653	72,530
Net cash provided by discontinued operations	---	---

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Net cash provided by financing activities	287,653	72,530
Effect of exchange rate changes on cash and cash equivalents	198	190
Decrease in cash and cash equivalents	(23,781)	(4,944)
Cash and cash equivalents -- beginning of year	105,820	73,078
Cash and cash equivalents -- end of period	\$ 82,039	\$ 68,134

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

MDU RESOURCES GROUP, INC.
NOTES TO CONSOLIDATED
FINANCIAL STATEMENTS

June 30, 2008 and 2007
(Unaudited)

1. Basis of presentation

The accompanying consolidated interim financial statements were prepared in conformity with the basis of presentation reflected in the consolidated financial statements included in the Company's 2007 Annual Report, and the standards of accounting measurement set forth in APB Opinion No. 28 and any amendments thereto adopted by the FASB. Interim financial statements do not include all disclosures provided in annual financial statements and, accordingly, these financial statements should be read in conjunction with those appearing in the 2007 Annual Report. The information is unaudited but includes all adjustments that are, in the opinion of management, necessary for a fair presentation of the accompanying consolidated interim financial statements and are of a normal recurring nature.

2. Seasonality of operations

Some of the Company's operations are highly seasonal and revenues from, and certain expenses for, such operations may fluctuate significantly among quarterly periods. Accordingly, the interim results for particular businesses, and for the Company as a whole, may not be indicative of results for the full fiscal year.

3. Discontinued operations

As described in Note 3 in the Company's Notes to Consolidated Financial Statements in the 2007 Annual Report, the Company's consolidated financial statements and accompanying notes for prior periods present the results of operations of Innovatum and the domestic independent power production assets as discontinued operations. In addition, the assets and liabilities of these operations were treated as held for sale from the time each of the assets was classified as held for sale.

During the fourth quarter of 2006, the stock and a portion of the assets of Innovatum were sold and the Company sold the remaining assets of Innovatum on January 23, 2008. The loss on disposal of Innovatum was not material.

In July 2007, Centennial Resources sold its domestic independent power production business consisting of Centennial Power and CEM. The gain on the sale of the assets, excluding the gain on the sale of Hartwell as discussed in Note 11, was approximately \$85.4 million (after tax).

Operating results related to Innovatum were as follows:

	Three Months Ended June 30, 2007 (In thousands)	Six Months Ended June 30, 2007
Operating revenues	\$ 439	\$ 689
Income from discontinued operations before income tax expense (benefit)	104	28
Income tax expense (benefit)	15	(29)
Income from discontinued operations, net of tax	\$ 89	\$ 57

Operating results related to the domestic independent power production assets were as follows:

	Three Months Ended June 30, 2007 (In thousands)	Six Months Ended June 30, 2007
Operating revenues	\$ 64,291	\$ 98,887
Income from discontinued operations before income tax expense	9,532	16,923
Income tax expense	2,182	4,286
Income from discontinued operations, net of tax	\$ 7,350	\$ 12,637

The carrying amounts of the major assets and liabilities related to the domestic independent power production assets held for sale, as well as the major assets and liabilities related to Innovatum, were as follows:

	June 30, 2007	December 31, 2007
	(In thousands)	
Cash and cash equivalents	\$ 1,575	\$ ---
Receivables, net	7,878	---
Inventories	555	179
Prepayments and other current assets	59,654	---
Total current assets held for sale and related to discontinued operations	\$ 69,662	\$ 179
Net property, plant and equipment	\$ 391,708	\$ ---
Goodwill	11,167	---
Other intangible assets, net	7,241	---
Other	546	---
Total noncurrent assets held for sale and related to discontinued operations	\$ 410,662	\$ ---
Accounts payable	\$ 7,264	\$ ---
Other accrued liabilities	6,892	---
Total current liabilities held for sale and related to discontinued operations	\$ 14,156	\$ ---
Deferred income taxes	\$ 32,888	\$ ---
Other liabilities	2,600	---
Total noncurrent liabilities held for sale and related to discontinued operations	\$ 35,488	\$ ---

4. Allowance for doubtful accounts

The Company's allowance for doubtful accounts as of June 30, 2008 and 2007, and December 31, 2007, was \$14.3 million, \$7.7 million and \$14.6 million, respectively.

5. Natural gas in storage

Natural gas in storage for the Company's regulated operations is generally carried at cost using the last-in, first-out method. The portion of the cost of natural gas in storage expected to be used within one year was included in inventories and was \$11.4 million, \$9.7 million and \$28.8 million at June 30, 2008 and 2007, and December 31, 2007, respectively. The remainder of natural gas in storage, which largely represents the cost of gas required to maintain pressure levels for normal operating purposes, was included in other assets and was \$43.0 million, \$44.2 million, and \$43.0 million at June 30, 2008 and 2007, and December 31, 2007, respectively.

6. Inventories

Inventories, other than natural gas in storage for the Company's regulated operations, consisted primarily of aggregates held for resale of \$110.2 million, \$100.6 million and \$102.2 million; materials and supplies of \$101.7 million, \$75.0 million and \$56.0 million; and other inventories of \$43.8 million, \$35.9 million and \$42.3 million, as of June 30, 2008 and 2007, and December 31, 2007, respectively. These inventories were stated at the lower of average cost or market value.

7. Earnings per common share

Basic earnings per common share were computed by dividing earnings on common stock by the weighted average number of shares of common stock outstanding during the applicable period. Diluted earnings per common share were computed by dividing earnings on common stock by the total of the weighted average number of shares of common stock outstanding during the applicable period, plus the effect of outstanding stock options, restricted stock grants and performance share awards. Common stock outstanding includes issued shares less shares held in treasury.

8. Cash flow information

Cash expenditures for interest and income taxes were as follows:

	Six Months Ended June 30,	
	2008	2007
	(In thousands)	
Interest, net of amount capitalized	\$ 37,504	\$ 35,028
Income taxes	\$ 91,398	\$ 113,919

Income taxes paid for the six months ended June 30, 2008, decreased from the amount paid for the six months ended June 30, 2007, primarily due to estimated quarterly income tax payments paid in 2007 on the estimated gain on the sale of the domestic independent power production assets as discussed in Note 3.

9. New accounting standards

SFAS No. 157 In September 2006, the FASB issued SFAS No. 157. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The standard applies under other accounting pronouncements that require or permit fair value measurements with certain exceptions. SFAS No. 157 was effective for the Company on January 1, 2008. FSP FAS 157-2 delays the effective date of SFAS No. 157 for certain nonfinancial assets and nonfinancial liabilities to January 1, 2009. The types of assets and liabilities that are recognized at fair value for which the Company has not applied the provisions of SFAS No. 157, due to the delayed effective date, include nonfinancial assets and nonfinancial liabilities initially measured at fair value in a business combination or new basis event, certain fair value measurements associated with goodwill impairment testing, indefinite-lived intangible assets and nonfinancial long-lived assets measured at fair value for impairment assessment, and asset retirement obligations initially measured at fair value. The adoption of SFAS No. 157, excluding the application to certain nonfinancial assets and nonfinancial liabilities with a delayed effective date of January 1, 2009, did not have a material effect on the Company's financial position or results of

operations. The Company is evaluating the effects of the adoption of the delayed provisions of SFAS No. 157.

SFAS No. 159 In February 2007, the FASB issued SFAS No. 159. 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. The standard also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 was effective for the Company on January 1, 2008, and at adoption, the Company elected to measure its investments in certain fixed-income and equity securities at fair value in accordance with SFAS No. 159. These investments prior to January 1, 2008, were accounted for as available-for-sale investments and recorded at fair value with any unrealized gains or losses, net of income taxes, recorded in accumulated other comprehensive income (loss) on the Consolidated Balance Sheets until realized. Upon the adoption of SFAS No. 159, the unrealized gain on the available-for-sale investments of \$405,000 (after tax) was recorded as an increase to the January 1, 2008, balance of retained earnings. The adoption of SFAS No. 159 did not have a material effect on the Company's financial position or results of operations.

SFAS No. 141 (revised) In December 2007, the FASB issued SFAS No. 141 (revised). SFAS No. 141 (revised) requires an acquirer to recognize and measure the assets acquired, liabilities assumed and any noncontrolling interests in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exception. In addition, SFAS No. 141 (revised) requires that acquisition-related costs will be generally expensed as incurred. SFAS No. 141 (revised) also expands the disclosure requirements for business combinations. SFAS No. 141 (revised) will be effective for the Company on January 1, 2009. The Company is evaluating the effects of the adoption of SFAS No. 141 (revised).

SFAS No. 160 In December 2007, the FASB issued SFAS No. 160. SFAS No. 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 will be effective for the Company on January 1, 2009. The Company is evaluating the effects of the adoption of SFAS No. 160.

SFAS No. 161 In March 2008, the FASB issued SFAS No. 161. SFAS No. 161 requires enhanced disclosures about an entity's derivative and hedging activities including how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for, and how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. This Statement will be effective for the Company on January 1, 2009. The Company is evaluating the effects of the adoption of SFAS No. 161.

10. Comprehensive income

Comprehensive income is the sum of net income as reported and other comprehensive income (loss). The Company's other comprehensive income (loss) resulted from gains (losses) on derivative instruments qualifying as hedges and foreign currency translation adjustments. For more information on derivative instruments, see Note 13.

Comprehensive income, and the components of other comprehensive income (loss) and related tax effects, were as follows:

	Three Months Ended June 30,	
	2008	2007
(In thousands)		
Net income	\$ 115,507	\$ 89,475
Other comprehensive income (loss):		
Net unrealized gain (loss) on derivative instruments qualifying as hedges:		
Net unrealized gain (loss) on derivative instruments arising during the period, net of tax of \$(37,169) and \$6,096 in 2008 and 2007, respectively	(60,644)	9,739
Less: Reclassification adjustment for gain (loss) on derivative instruments included in net income, net of tax of \$(5,045) and \$1,509 in 2008 and 2007, respectively	(8,230)	2,411
Net unrealized gain (loss) on derivative instruments qualifying as hedges	(52,414)	7,328
Foreign currency translation adjustment, net of tax of \$2,570 in 2008	3,977	3,576
	(48,437)	10,904
Comprehensive income	\$ 67,070	\$ 100,379

	Six Months Ended June 30,	
	2008	2007
(In thousands)		
Net income	\$ 186,558	\$ 136,137
Other comprehensive loss:		
Net unrealized loss on derivative instruments qualifying as hedges:		
Net unrealized gain (loss) on derivative instruments arising during the period, net of tax of \$(53,537) and \$1,204 in 2008 and 2007, respectively	(87,433)	1,923
Less: Reclassification adjustment for gain on derivative instruments included in net income, net of tax of \$2,786 and \$6,272 in 2008 and 2007, respectively	4,522	10,018
Net unrealized loss on derivative instruments qualifying as hedges	(91,955)	(8,095)
Foreign currency translation adjustment, net of tax of \$2,876 in 2008	4,461	5,684
	(87,494)	(2,411)
Comprehensive income	\$ 99,064	\$ 133,726

11. Equity method investments

Investments in companies in which the Company has the ability to exercise significant influence over operating and financial policies are accounted for using the equity method. The Company's equity method investments at June 30, 2008, include the Brazilian Transmission Lines.

In August 2006, MDU Brasil acquired ownership interests in companies owning the Brazilian Transmission Lines. The interests involve the ENTE (13.3-percent ownership interest), ERTE (13.3-percent ownership interest) and ECTE (25-percent ownership interest) electric transmission lines, which are primarily in northeastern and southern Brazil.

In September 2004, Centennial Resources, through indirect wholly owned subsidiaries, acquired a 50-percent ownership interest in Hartwell, which owns a 310-MW natural gas-fired electric generating facility near Hartwell, Georgia. In July 2007, the Company sold its ownership interest in Hartwell, and realized a gain of \$10.1 million (\$6.1 million after tax) from the sale.

At June 30, 2008 and 2007, and December 31, 2007, the Company's equity method investments had total assets of \$431.1 million, \$469.2 million and \$398.4 million, respectively, and long-term debt of \$218.8 million, \$277.2 million and \$211.2 million, respectively. The Company's investment in its equity method investments was approximately \$63.0 million, \$80.6 million and \$59.0 million, including undistributed earnings of \$8.7 million, \$7.6 million and \$6.9 million, at June 30, 2008 and 2007, and December 31, 2007, respectively.

12. Goodwill and other intangible assets

The changes in the carrying amount of goodwill were as follows:

Six Months Ended June 30, 2008	Balance as of January 1, 2008	Goodwill Acquired During the Year*	Balance as of June 30, 2008
		(In thousands)	
Electric	\$ ---	\$ ---	\$ ---
Natural gas distribution	171,129	(11)	171,118
Construction services	91,385	3,937	95,322
Pipeline and energy services	1,159	---	1,159
Natural gas and oil production	---	---	---
Construction materials and contracting	162,025	8,208	170,233
Other	---	---	---
Total	\$ 425,698	\$ 12,134	\$ 437,832

*Includes purchase price adjustments that were not material related to acquisitions in a prior period.

Six Months Ended June 30, 2007	Balance as of January 1, 2007	Goodwill Acquired During the Year*	Balance as of June 30, 2007
		(In thousands)	
Electric	\$ ---	\$ ---	\$ ---
Natural gas distribution	---	---	---
Construction services	86,942	3,596	90,538
Pipeline and energy services	1,159	---	1,159
Natural gas and oil production	---	---	---
Construction materials and contracting	136,197	(865)	135,332
Other	---	---	---
Total	\$ 224,298	\$ 2,731	\$ 227,029

*Includes purchase price adjustments that were not material related to acquisitions in a prior period.

Year Ended December 31, 2007	Balance as of January 1, 2007	Goodwill Acquired During the Year*	Balance as of December 31, 2007
		(In thousands)	
Electric	\$ ---	\$ ---	\$ ---
Natural gas distribution	---	171,129	171,129
Construction services	86,942	4,443	91,385
Pipeline and energy services	1,159	---	1,159
Natural gas and oil production	---	---	---
Construction materials and contracting	136,197	25,828	162,025
Other	---	---	---
Total	\$ 224,298	\$ 201,400	\$ 425,698

*Includes purchase price adjustments that were not material related to acquisitions in a prior period.

Other amortizable intangible assets were as follows:

	June 30, 2008	June 30, 2007	December 31, 2007
	(In thousands)		
Customer relationships	\$ 25,262	\$ 13,959	\$ 21,834
Accumulated amortization	(5,979)	(3,234)	(4,444)
	19,283	10,725	17,390
Noncompete agreements	10,823	7,434	10,655
Accumulated amortization	(4,493)	(2,926)	(3,654)
	6,330	4,508	7,001
Other	8,370	3,745	5,943
Accumulated amortization	(1,498)	(1,828)	(2,542)
	6,872	1,917	3,401
Total	\$ 32,485	\$ 17,150	\$ 27,792

Amortization expense for intangible assets for the three and six months ended June 30, 2008, was \$1.2 million and \$2.6 million, respectively. Amortization expense for the three and six months ended June 30, 2007, and for the year ended December 31, 2007, was \$900,000, \$1.9 million and \$4.4 million, respectively. Estimated amortization expense for amortizable intangible assets is \$5.4 million in 2008, \$4.8 million in 2009, \$4.0 million in 2010, \$3.5 million in 2011, \$3.3 million in 2012, and \$14.1 million thereafter.

13. Derivative instruments

From time to time, the Company utilizes derivative instruments as part of an overall energy price, foreign currency and interest rate risk management program to efficiently manage and minimize commodity price, foreign currency and interest rate risk. As of June 30, 2008, the Company had no outstanding foreign currency or interest rate hedges. The following information should be read in conjunction with Notes 1 and 7 in the Company's Notes to Consolidated Financial Statements in the 2007 Annual Report.

Cascade

At June 30, 2008, Cascade held natural gas swap agreements which were not designated as hedges. Cascade utilizes natural gas swap agreements to manage a portion of the market risk associated with fluctuations in the price of natural gas on its forecasted purchases of natural gas for core customers in accordance with authority granted by the WUTC and OPUC. Core customers consist of residential, commercial and smaller industrial customers. The fair value of the derivative instrument must be estimated as of the end of each reporting period and is recorded on the Consolidated Balance Sheets as an asset or a liability. Cascade applies SFAS No. 71 and records periodic changes in the fair market value of the derivative instruments on the Consolidated Balance Sheets as a regulatory asset or a regulatory liability, and settlements of these arrangements are expected to be recovered through the purchased gas cost adjustment mechanism. Under the terms of these arrangements, Cascade will either pay or receive settlement payments based on the difference between the fixed strike price and the monthly index price applicable to each contract.

Fidelity

At June 30, 2008, Fidelity held natural gas and oil swap and collar agreements as well as a natural gas basis swap derivative instrument designated as cash flow hedging instruments. Fidelity utilizes these derivative instruments to manage a portion of the market risk associated with fluctuations in the price of natural gas and oil on its forecasted sales of natural gas and oil production. These derivative instruments were designated as cash flow hedges of the forecasted sales of the related production.

The fair value of the hedging instruments must be estimated as of the end of each reporting period and is recorded on the Consolidated Balance Sheets as an asset or a liability. Changes in the fair value attributable to the effective portion of hedging instruments, net of tax, are recorded in stockholders' equity as a component of accumulated other comprehensive income (loss). At the date the natural gas or oil quantities are settled, the amounts accumulated in other comprehensive income (loss) are reported in the Consolidated Statements of Income. To the extent that the hedges are not effective, the ineffective portion of the changes in fair market value is recorded directly in earnings. The proceeds received for natural gas and oil production are generally based on market prices.

For the three and six months ended June 30, 2008 and 2007, the amount of hedge ineffectiveness was immaterial. For the three and six months ended June 30, 2008 and 2007, there were no components of the derivative instruments' gain or loss excluded from the assessment of hedge effectiveness. Gains and losses must be reclassified into earnings as a result of the discontinuance of cash flow hedges if it is probable that the original forecasted transactions will not occur. There were no such reclassifications into earnings as a result of the discontinuance of hedges.

Gains and losses on derivative instruments that are reclassified from accumulated other comprehensive income (loss) to current-period earnings are included in the line item in which the hedged item is recorded. As of June 30, 2008, the maximum term of the swap and collar agreements, in which the exposure to the variability in future cash flows for forecasted transactions is being hedged, is 42 months. The Company estimates that over the next 12 months net losses of approximately \$61.2 million (after tax) will be reclassified from accumulated other comprehensive loss into earnings, subject to changes in natural gas and oil market prices, as the hedged transactions affect earnings.

14.

Fair value measurements

On January 1, 2008, the Company adopted SFAS No. 157 and SFAS No. 159, as discussed in Note 9.

Upon the adoption of SFAS No. 159, the Company elected to measure its investments in certain fixed-income and equity securities at fair value. These investments had previously been accounted for as available-for-sale investments in accordance with SFAS No. 115. The Company anticipates using these investments to satisfy its obligations under its unfunded, nonqualified benefit plans for executive officers and certain key management employees, and invests in these fixed-income and equity securities for the purpose of earning investment returns and capital appreciation. These investments totaled \$34.0 million as of June 30, 2008. The decrease in the fair value of these investments for the three and six months ended June 30, 2008, was \$184,000 (before tax) and \$2.3 million (before tax), respectively, which is considered part of the cost of the plan, and is classified in operation and maintenance

expense on the Consolidated Statements of Income. The Company did not elect the fair value option for its remaining available-for-sale securities, which are auction rate securities, as they are not intended for long-term investment. The Company's auction rate securities, which totaled \$11.4 million at June 30, 2008, are accounted for as available-for-sale in accordance with SFAS No. 115 and are recorded at fair value. The fair value of the auction rate securities approximate cost and, as a result, there are no accumulated unrealized gains or losses recorded in accumulated other comprehensive income on the Consolidated Balance Sheets related to these investments.

The Company's assets and liabilities measured at fair value on a recurring basis are as follows:

	Balance at June 30, 2008	Fair Value Measurements at June 30, 2008, Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(In thousands)				
Assets:				
Available-for-sale securities	\$ 45,390	\$ 33,990	\$ 11,400	\$ ---
Commodity derivative agreements	89,136	---	89,136	---
Total assets measured at fair value	\$ 134,526	\$ 33,990	\$ 100,536	\$ ---
Liabilities:				
Commodity derivative agreements	\$ 138,615	\$ ---	\$ 138,615	\$ ---
Total liabilities measured at fair value	\$ 138,615	\$ ---	\$ 138,615	\$ ---

The estimated fair value of the Company's Level 1 available-for-sale securities is based on quoted market prices in active markets for identical equity and fixed-income securities. The estimated fair value of the Company's Level 2 available-for-sale securities is based on comparable market transactions. The estimated fair value of the Company's commodity derivative instruments reflects the estimated amounts the Company would receive or pay to terminate the contracts at the reporting date based upon quoted market prices of comparable contracts.

15. Business segment data

The Company's reportable segments are those that are based on the Company's method of internal reporting, which generally segregates the strategic business units due to differences in products, services and regulation. The vast majority of the Company's operations are located within the United States. The Company also has investments in foreign countries, which largely consist of Centennial Resources' equity method investment in the Brazilian Transmission Lines.

The electric segment generates, transmits and distributes electricity in Montana, North Dakota, South Dakota and Wyoming. The natural gas distribution segment distributes natural gas in those states as well as in Minnesota, Oregon and Washington. These operations also supply related value-added products and services.

The construction services segment specializes in electric line construction, pipeline construction, utility excavation, inside electrical wiring, cabling and mechanical work, fire protection and the manufacture and distribution of specialty equipment.

The pipeline and energy services segment provides natural gas transportation, underground storage and gathering services through regulated and nonregulated pipeline systems primarily in the Rocky Mountain and northern Great Plains regions of the United States. This segment also provides energy-related management services.

The natural gas and oil production segment is engaged in natural gas and oil acquisition, exploration, development and production activities in the Rocky Mountain and Mid-Continent regions of the United States and in and around the Gulf of Mexico.

The construction materials and contracting segment mines aggregates and markets crushed stone, sand, gravel and related construction materials, including ready-mixed concrete, cement, asphalt, liquid asphalt and other value-added products. It also performs integrated construction services. The construction materials and contracting segment operates in the central, southern and western United States and Alaska and Hawaii.

The Other category includes the activities of Centennial Capital, which insures various types of risks as a captive insurer for certain of the Company's subsidiaries. The function of the captive insurer is to fund the deductible layers of the insured companies' general liability and automobile liability coverages. Centennial Capital also owns certain real and personal property. The Other category also includes Centennial Resources' equity method investment in the Brazilian Transmission Lines.

The information below follows the same accounting policies as described in Note 1 of the Company's Notes to Consolidated Financial Statements in the 2007 Annual Report. Information on the Company's businesses was as follows:

Three Months Ended June 30, 2008	External	Inter- segment	Earnings on Common Stock
	Operating Revenues	Operating Revenues	
	(In thousands)		
Electric	\$ 45,873	\$ ---	\$ 2,787
Natural gas distribution	196,956	---	5,443
Pipeline and energy services	133,495	21,621	6,842
	376,324	21,621	15,072
Construction services	324,632	38	14,089
Natural gas and oil production	123,370	91,824	71,687
Construction materials and contracting	427,446	---	12,735
Other	---	2,660	1,753
	875,448	94,522	100,264
Intersegment eliminations	---	(116,143)	---
Total	\$ 1,251,772	\$ ---	\$ 115,336

Three Months Ended June 30, 2007	External	Inter- segment	Earnings on Common Stock
	Operating Revenues	Operating Revenues	
	(In thousands)		
Electric	\$ 44,591	\$ ---	\$ 3,568
Natural gas distribution	53,403	---	(559)
Pipeline and energy services	97,494	14,660	6,228
	195,488	14,660	9,237
Construction services	263,483	349	13,026
Natural gas and oil production	67,924	59,471	35,166
Construction materials and contracting	455,470	---	25,541
Other	---	2,440	6,334
	786,877	62,260	80,067
Intersegment eliminations	---	(76,920)	---
Total	\$ 982,365	\$ ---	\$ 89,304

	External	Inter- segment	Earnings on Common Stock
Six Months Ended June 30, 2008	Operating Revenues	Operating Revenues	
(In thousands)			
Electric	\$ 98,129	\$ ---	\$ 8,267
Natural gas distribution	559,101	---	21,828
Pipeline and energy services	236,356	52,553	13,996
	893,586	52,553	44,091
Construction services	632,019	82	24,903
Natural gas and oil production	219,351	165,430	122,333
Construction materials and contracting	628,723	---	(8,362)
Other	---	5,296	3,250
	1,480,093	170,808	142,124
Intersegment eliminations	---	(223,361)	---
Total	\$ 2,373,679	\$ ---	\$ 186,215

	External	Inter- segment	Earnings on Common Stock
Six Months Ended June 30, 2007	Operating Revenues	Operating Revenues	
(In thousands)			
Electric	\$ 91,695	\$ ---	\$ 7,353
Natural gas distribution	189,465	---	5,584
Pipeline and energy services	182,340	42,952	11,938
	463,500	42,952	24,875
Construction services	500,120	474	20,260
Natural gas and oil production	123,193	122,781	65,787
Construction materials and contracting	683,043	---	15,745
Other	---	4,880	9,127
	1,306,356	128,135	110,919
Intersegment eliminations	---	(171,087)	---
Total	\$ 1,769,856	\$ ---	\$ 135,794

The pipeline and energy services segment recognized income from discontinued operations, net of tax, of \$89,000 and \$57,000 for the three and six months ended June 30, 2007. The Other category reflects income from discontinued operations, net of tax, of \$7.4 million and \$12.6 million for the three and six months ended June 30, 2007.

Excluding the income from discontinued operations at pipeline and energy services, earnings from electric, natural gas distribution and pipeline and energy services are substantially all from regulated operations. Earnings (loss) from construction services, natural gas and oil production, construction materials and contracting, and other are all from nonregulated operations.

16. Acquisitions

During the first six months of 2008, the Company acquired natural gas properties in Texas and construction materials and contracting businesses in Alaska, California and Texas, none of which were material. The total purchase consideration for these properties and purchase price adjustments with respect to certain other acquisitions made prior to 2008, consisting of the Company's common stock and cash, was \$276.3 million.

The above acquisitions were accounted for under the purchase method of accounting and, accordingly, the acquired assets and liabilities assumed have been preliminarily recorded at their respective fair values as of the date of acquisition. On certain of the above acquisitions, final fair market values are pending the completion of the review of the relevant assets, liabilities and issues identified as of the acquisition date. The results of operations of the acquired businesses and properties are included in the financial statements since the date of each acquisition. Pro forma financial amounts reflecting the effects of the above acquisitions are not presented, as such acquisitions were not material to the Company's financial position or results of operations.

17. Employee benefit plans

The Company has noncontributory defined benefit pension plans and other postretirement benefit plans for certain eligible employees. Components of net periodic benefit cost for the Company's pension and other postretirement benefit plans were as follows:

Three Months Ended June 30,	Pension Benefits		Other Postretirement Benefits	
	2008	2007	2008	2007
(In thousands)				
Components of net periodic benefit cost:				
Service cost	\$ 2,191	\$ 2,011	\$ 660	\$ 447
Interest cost	6,505	4,222	1,797	1,180
Expected return on assets	(8,458)	(5,094)	(1,691)	(1,279)
Amortization of prior service cost (credit)	198	207	(988)	14
Amortization net actuarial loss	332	426	246	164
Amortization of net transition obligation	---	---	763	635
Net periodic benefit cost, including amount capitalized	768	1,772	787	1,161
Less amount capitalized	217	217	124	90
Net periodic benefit cost	\$ 551	\$ 1,555	\$ 663	\$ 1,071
Six Months Ended June 30,	Pension Benefits		Other Postretirement Benefits	
	2008	2007	2008	2007
(In thousands)				
Components of net periodic benefit cost:				
Service cost	\$ 4,820	\$ 4,261	\$ 1,150	\$ 980
Interest cost	11,629	8,363	2,982	2,118
Expected return on assets	(14,494)	(10,164)	(3,388)	(2,372)
Amortization of prior service cost (credit)	364	416	(1,677)	25
Amortization net actuarial (gain) loss	574	500	361	(149)
Amortization of net transition obligation	---	---	1,294	1,166
Net periodic benefit cost, including amount capitalized	2,893	3,376	722	1,768
Less amount capitalized	396	368	189	141
Net periodic benefit cost	\$ 2,497	\$ 3,008	\$ 533	\$ 1,627

In addition to the qualified plan defined pension benefits reflected in the table, the Company has an unfunded, nonqualified benefit plan for executive officers and certain key management employees that generally provides for defined benefit payments at age 65 following the employee's retirement or to their beneficiaries upon death for a 15-year period. The Company's net periodic benefit cost for this plan for the three and six months ended June 30, 2008, was \$2.4 million and \$4.4 million, respectively. The Company's net periodic benefit cost for this plan for the three and six months ended June 30, 2007, was \$2.1 million and \$3.9 million, respectively.

18. Regulatory matters and revenues subject to refund

In November 2006, Montana-Dakota filed an application with the NDPSC requesting an advance determination of prudence of Montana-Dakota's ownership interest in Big Stone Station II. Hearings on the application were held in June 2007. In September 2007, Montana-Dakota informed the NDPSC that certain of the other participants in the project had withdrawn and it was considering the impact of these withdrawals on the project and its options. Supplemental hearings before the NDPSC were held in late April 2008 regarding possible plant configuration changes as a result of the participant withdrawals and updated supporting modeling. The NDPSC is expected to rule on the advance determination of prudence application in the third quarter of 2008.

In December 1999, Williston Basin filed a general natural gas rate change application with the FERC. Williston Basin began collecting such rates effective June 1, 2000, subject to refund. Currently, the only remaining issue outstanding related to this rate change application is in regard to certain service restrictions. In May 2004, the FERC remanded this issue to an ALJ for resolution. In November 2005, the FERC issued an Order on Initial Decision affirming the ALJ's Initial Decision regarding certain service and annual demand quantity restrictions. In April 2006, the FERC issued an Order on Rehearing denying Williston Basin's Request for Rehearing of the FERC's Order on Initial Decision. In April 2006, Williston Basin appealed to the D.C. Appeals Court certain issues addressed by the FERC's Order on Initial Decision and its Order on Rehearing. On March 18, 2008, the D.C. Appeals Court issued its opinion in this matter concerning the service restrictions. The D.C. Appeals Court found that the FERC was correct to decide the case under the "just and reasonable" standard of section 5(a) of the Natural Gas Act; however, it remanded the case back to the FERC as flaws in the FERC's reasoning render its orders arbitrary and capricious. The matter concerning the service restrictions is pending resolution by the FERC.

19. Contingencies

Litigation

Coalbed Natural Gas Operations Fidelity is a party to and/or certain of its operations are or have been the subject of approximately a dozen lawsuits in Montana and Wyoming in connection with Fidelity's CBNG development in the Powder River Basin. The lawsuits generally involve either challenges to regulatory agency decisions under the NEPA or the MEPA or to Fidelity's management of water produced in association with its operations.

Challenges to State/Federal Regulatory Agency Decision Making Under NEPA/MEPA

In 1999 and 2000, the BLM, the Montana BOGC, and the Montana DEQ announced their respective decisions to prepare an EIS analyzing CBNG development in Montana. In 2003, the agencies each signed RODs approving a final EIS and allowing CBNG development throughout the State of Montana. The approval actions by the agencies resulted in numerous lawsuits initiated by environmental groups and the Northern Cheyenne Tribe related to the validity of the final EIS and associated environmental assessments. Fidelity has intervened in several of these lawsuits to protect its interests.

In lawsuits filed in Montana Federal District Court in May 2003, the NPRC and the Northern Cheyenne Tribe asserted that the BLM violated NEPA and other federal laws when approving the 2003 EIS. Producers, including Fidelity, are operating under an order

that allows limited CBNG development of up to 500 CBNG wells to be drilled annually on private, state, and federal lands in the Montana Powder River Basin pending the BLM's preparation of a SEIS.

In December 2006, the BLM issued a draft SEIS that endorses a phased-development approach to CBNG production in the Montana Powder River Basin, whereby future projects would be reviewed against four screens or filters (relating to water quality, wildlife, Native American concerns and air quality). Fidelity filed written comments on the draft SEIS asking the BLM to reconsider its proposed phased-development approach and to make numerous other changes to the draft SEIS. The final SEIS is scheduled for release in September 2008 with a ROD expected in March 2009. Fidelity cannot predict what the final terms of the SEIS will be.

In a related action filed in Montana Federal District Court in December 2003, the NPRC asserted, among other things, that the actions of the BLM in approving Fidelity's applications for permits and the plan of development for the Badger Hills Project in Montana did not comply with applicable federal laws, including the NEPA. As a result of the litigation, Fidelity is operating under an Order, based on a stipulation between the parties, that allows production from existing wells in Fidelity's Badger Hills Project to continue pending preparation of a revised environmental analysis.

Cases Involving Fidelity's Management of Water Produced in Association with Its Operations

About half the CBNG cases Fidelity is involved in relate to administrative agency regulation of water produced in association with CBNG development in Montana and Wyoming. These cases involve legal challenges to the issuance of discharge permits, as well as challenges to the State of Wyoming's CBNG water permitting procedures.

In April 2006, the Northern Cheyenne Tribe filed a complaint in Montana State District Court against the Montana DEQ seeking to set aside Fidelity's renewed direct discharge and treatment permits. The Northern Cheyenne Tribe claimed the Montana DEQ violated the Clean Water Act and the Montana Water Quality Act by failing to include in the permits conditions requiring application of the best practicable control technology currently available and by failing to impose a nondegradation policy like the one the BER adopted soon after the permit was issued. In addition, the Northern Cheyenne Tribe claimed that the actions of the Montana DEQ violated the Montana State Constitution's guarantee of a clean and healthful environment, that the Montana DEQ's related environmental assessment was invalid, that the Montana DEQ was required, but failed, to prepare an EIS and that the Montana DEQ failed to consider other alternatives to the issuance of the permits. Fidelity, the NPRC and the TRWUA have been granted leave to intervene in this proceeding. Fidelity's discharge of water pursuant to its two permits is its primary means for managing CBNG produced water. Fidelity believes that its discharge permits should, assuming normal operating conditions, allow Fidelity to continue its existing CBNG operations through the expiration of the permits in March 2011. If its permits are set aside, Fidelity's CBNG operations in Montana could be significantly and adversely affected.

The Powder River Basin Resource Council is funding litigation, filed in Wyoming State District Court in June 2007, on behalf of two surface owners against the Wyoming State

Engineer and the Wyoming Board of Control. The plaintiffs seek a declaratory judgment that current ground water permitting practices are unlawful; that the state is required to adopt rules and procedures to ensure that coalbed groundwater is managed in accordance with the Wyoming Constitution and other laws; and that would prohibit the Wyoming State Engineer from issuing permits to produce coalbed groundwater and permits to store coalbed groundwater in reservoirs until the Wyoming State Engineer adopts such rules. The Petroleum Association of Wyoming has conditionally been granted intervention in this lawsuit and Fidelity is partly funding the intervention. On May 29, 2008, the Wyoming State District Court dismissed the case. The plaintiffs appealed to the Wyoming Supreme Court on June 27, 2008. Fidelity's CBNG operations in Wyoming could be materially adversely affected if the plaintiffs are successful in this lawsuit.

Fidelity is involved in, or certain of its operations are the subject of, other legal proceedings that concern its CBNG operations. Although the outcomes of those proceedings can not be predicted, management believes that such outcomes will not have a material adverse effect on the Company's financial position or results of its operations.

Fidelity will continue to vigorously defend its interests in all CBNG-related litigation in which it is involved, including the proceedings challenging its water permits. In those cases where damage claims have been asserted, Fidelity is unable to quantify the damages sought and will be unable to do so until after the completion of discovery. If the plaintiffs are successful in these lawsuits, the ultimate outcome of the actions could adversely impact Fidelity's existing CBNG operations and/or the future development of this resource in the affected regions.

Electric Operations Montana-Dakota joined with two electric generators in appealing a September 2003 finding by the ND Health Department that it may unilaterally revise operating permits previously issued to electric generating plants. Although it is doubtful that any revision of Montana-Dakota's operating permits by the ND Health Department would reduce the amount of electricity its plants could generate, the finding, if allowed to stand, could increase costs for sulfur dioxide removal and/or limit Montana-Dakota's ability to modify or expand operations at its North Dakota generation sites. Montana-Dakota and the other electric generators filed their appeal of the order in October 2003 in the Burleigh County District Court in Bismarck, North Dakota. Proceedings were stayed pending conclusion of the periodic review of sulfur dioxide emissions in the state.

In September 2005, the ND Health Department issued its final periodic review decision based on its August 2005 final air quality modeling report. The ND Health Department concluded there were no violations of the sulfur dioxide increment in North Dakota. In March 2006, the DRC filed a complaint in Colorado Federal District Court seeking to force the EPA to declare that the increment had been violated based on earlier modeling conducted by the EPA. The EPA defended against the DRC claim and filed a motion to dismiss the case. The Colorado Federal District Court has dismissed the case.

In June 2007, the EPA noticed for public comment a proposed rule that would, among other things, adopt PSD increment modeling refinements that, if adopted, would operate to formally ratify the modeling techniques and conclusions contained in the September 2005 ND Health Department decision and the August 2005 final report. The public comment

period on the proposed rule closed in September 2007. The dismissal of the case in Burleigh County District Court referenced above is dependant upon the outcome of the proposed rule.

On June 10, 2008, the Sierra Club filed a complaint in the South Dakota Federal District Court against Montana-Dakota and the two other co-owners of the Big Stone Station. The complaint alleges certain violations of the PSD and NSPS provisions of the Clean Air Act and certain violation of the South Dakota SIP. The action further alleges that the Big Stone Station was modified and operated without obtaining the appropriate permits, without meeting certain emissions limits and NSPS requirements and without installing appropriate emission control technology, all allegedly in violation of the Clean Air Act and the South Dakota SIP. The Sierra Club alleges that these actions have contributed to air pollution and visibility impairment and have increased the risk of adverse health effects and environmental damage. The Sierra Club seeks both declaratory and injunctive relief to bring the co-owners of the Big Stone Station into compliance with the Clean Air Act and the South Dakota SIP and to require them to remedy the alleged violations. The Sierra Club also seeks unspecified civil penalties, including a beneficial mitigation project. The Company believes that these claims are without merit and that Big Stone Station has been and is being operated in compliance with the Clean Air Act and the South Dakota SIP. The ultimate outcome of these matters cannot be determined at this time.

Natural Gas Storage Based on reservoir and well pressure data and other information, Williston Basin believes that reservoir pressure (and therefore the amount of gas) in the EBSR, one of its natural gas storage reservoirs, has decreased as a result of Howell and Anadarko's drilling and production activities in areas within and near the boundaries of the EBSR. As of June 30, 2008, Williston Basin estimated that between 10.25 and 10.75 Bcf of storage gas had been diverted from the EBSR as a result of Howell and Anadarko's drilling and production.

Williston Basin filed suit in Montana Federal District Court in January 2006, seeking to recover unspecified damages from Howell and Anadarko, and to enjoin Howell and Anadarko's present and future production from specified wells in and near the EBSR. The Montana Federal District Court entered an Order in July 2006, dismissing the case for lack of subject matter jurisdiction. Williston Basin appealed and on May 9, 2008, the Ninth Circuit affirmed the Montana Federal District Court's decision.

In related litigation, Howell filed suit in Wyoming State District Court against Williston Basin in February 2006 asserting that it is entitled to produce any gas that might escape from the EBSR. In August 2006, Williston Basin moved for a preliminary injunction to halt Howell and Anadarko's production in and near the EBSR. The Wyoming State District Court denied Williston Basin's motion in July 2007. In December 2007, motions were argued to a court appointed special master concerning the application of certain legal principles to the production of Williston Basin's storage gas, including gas residing outside the certificated boundaries of the EBSR, by Howell and Anadarko. On March 17, 2008, the special master issued recommendations to the Wyoming State District Court. The special master recommended that the Wyoming State District Court adopt a ruling that gas injected into an underground reservoir belongs to the injector and the injector does not lose title to that gas unless the gas escapes or migrates from the reservoir because it was not well defined or well maintained or if the injector is unable to identify such injected gas because it

has been commingled with native gas. The special master also recommended that the Wyoming State District Court adopt a ruling that generally would allow Howell and Anadarko to produce native gas residing inside or outside the certificated boundaries of the EBSR from its wells completed outside the certificated boundaries. The special master recognized that there are other issues yet to be developed that may be determinative of whether Howell and Anadarko may produce native or injected gas, or both. On July 1, 2008, the Wyoming State District Court adopted the special master's report. On July 16, 2008, Williston Basin filed a petition requesting the Wyoming Supreme Court to review a ruling by the Wyoming State District Court that the Natural Gas Act does not preempt the state law that permits an oil and gas producer to take gas that has been dedicated for use in a federally certificated gas storage reservoir. The petition was denied on August 5, 2008 by the Wyoming Supreme Court. The Wyoming State District Court has scheduled the case for trial beginning March 16, 2009.

In a related proceeding, the FERC issued an order on July 18, 2008, in response to a petition filed by Williston Basin on April 24, 2008, declaring that the certification of a storage facility under the Natural Gas Act conveys to the certificate holder the right to acquire native gas within the certificated boundaries of the storage facility. The FERC also concurred that a state law precluding the certificate holder from acquiring the right to native gas would be preempted by federal law.

As previously noted, Williston Basin estimates that as of June 30, 2008, Howell and Anadarko had diverted between 10.25 and 10.75 Bcf from the EBSR. Williston Basin believes Howell and Anadarko continue to divert gas from the EBSR and Williston Basin continues to monitor and analyze the situation. At trial, Williston Basin will seek recovery based on the amount of gas that has been and continues to be diverted as well as on the amount of gas that must be recovered as a result of the equalization of the pressures of various interconnected geological formations.

In expert reports filed with the Wyoming State District Court in January 2008, Williston Basin's experts are of the opinion that all of the gas produced by Howell and Anadarko is Williston Basin's gas and will have to be replaced. Williston Basin's experts estimate that the replacement cost of the gas produced by Howell and Anadarko through October 2007 is approximately \$106 million if injection is completed by the end of the 2010 injection season. Williston Basin's experts also estimate that Williston Basin will expend \$8.7 million to mitigate the damages that Williston Basin suffered during the period of Howell and Anadarko's production if the replacement gas is injected by the end of the 2010 injection season. Williston Basin believes that its experts' opinions are based on sound law, economics, reservoir engineering, geology and geochemistry. The expert reports filed by Howell and Anadarko claim that storage gas owned by Williston Basin has migrated outside the EBSR into areas in which Howell and Anadarko have oil and gas rights. They theorize that Williston Basin is accountable to Howell and Anadarko for the migration of such gas. Although Howell and Anadarko have not specified the amount of damages they seek to recover, Williston Basin believes Howell and Anadarko's proposed methodology for valuing their alleged injury, if any, is flawed, inconsistent and lacking in factual and legal support. Williston Basin continues to evaluate the Howell and Anadarko reports. The deadline to file rebuttal reports with the Wyoming State District Court is August 18, 2008.

Williston Basin intends to vigorously defend its rights and interests in these proceedings, to assess further avenues for recovery through the regulatory process at the FERC, and to pursue the recovery of any and all economic losses it may have suffered. Williston Basin cannot predict the ultimate outcome of these proceedings.

In light of the actions of Howell and Anadarko, Williston Basin installed temporary compression at the site in 2006 in order to maintain deliverability into the transmission system. Williston Basin leased working gas for the 2007 - 2008 heating season to supplement its cushion gas. While installation of the additional compression and leased working gas during the 2007 – 2008 heating season both provided temporary relief, Williston Basin believes that the adverse physical and operational effects occasioned by the continued loss of storage gas, if left unchecked, could threaten the operation and viability of the EBSR, impair Williston Basin's ability to comply with the EBSR certificated operating requirements mandated by the FERC and adversely affect Williston Basin's ability to meet its contractual storage and transportation service commitments to customers. In another effort to protect the viability of the EBSR, Williston Basin, on April 18, 2008, filed an application with the FERC to expand the boundaries of the EBSR. The proposed expansion includes the areas from which Howell and Anadarko are producing.

The Company also is involved in other legal actions in the ordinary course of its business. Although the outcomes of any such legal actions cannot be predicted, management believes that the outcomes with respect to these other legal proceedings will not have a material adverse effect upon the Company's financial position or results of operations.

Environmental matters

Portland Harbor Site In December 2000, MBI was named by the EPA as a Potentially Responsible Party in connection with the cleanup of a riverbed site adjacent to a commercial property site acquired by MBI from Georgia Pacific-West, Inc. in 1999. The riverbed site is part of the Portland, Oregon, Harbor Superfund Site. Sixty-eight other parties were also named in this administrative action. The EPA wants responsible parties to share in the cleanup of sediment contamination in the Willamette River. To date, costs of the overall remedial investigation and feasibility study of the harbor site are being recorded, and initially paid, through an administrative consent order by the LWG, a group of several entities, which does not include MBI or Georgia-Pacific West, Inc. Although the LWG originally estimated the overall remedial investigation and feasibility study would cost approximately \$10 million, it is now anticipated, on the basis of costs incurred to date and delays attributable to an additional round of sampling and potential further investigative work, that such cost could increase to a total in excess of \$60 million. It is not possible to estimate the cost of a corrective action plan until the remedial investigation and feasibility study have been completed, the EPA has decided on a strategy and a record of decision has been published. It is also not possible to estimate the costs of natural resource damages until investigation and allocations are undertaken. While the remedial investigation and feasibility study for the harbor site has commenced, it is expected to take several more years to complete. The development of a proposed plan and ROD on the harbor site is not anticipated to occur until 2010, after which a cleanup plan will be undertaken. MBI also received notice in January 2008 that the Portland Harbor Natural Resource Trustee Council intends to perform an injury assessment to natural resources resulting from the release of hazardous substances at the Harbor Superfund Site. The Trustee Council indicates the injury

determination is appropriate to facilitate early settlement of damages and restoration for natural resource injuries.

Based upon a review of the Portland Harbor sediment contamination evaluation by the Oregon DEQ and other information available, MBI does not believe it is a Responsible Party. In addition, MBI has notified Georgia-Pacific West, Inc., that it intends to seek indemnity for any and all liabilities incurred in relation to the above matters, pursuant to the terms of their sale agreement. MBI has entered into an agreement tolling the statute of limitation in connection with the LWG's potential claim for contribution to the costs of the remedial investigation and feasibility study.

The Company believes it is not probable that it will incur any material environmental remediation costs or damages in relation to the above referenced administrative action.

Manufactured Gas Plant Sites There are three claims against Cascade for cleanup of environmental contamination at manufactured gas plant sites operated by Cascade's predecessors.

The first claim is for soil and groundwater contamination at a site in Oregon and was received in 1995. There are potentially responsible parties in addition to Cascade that may be liable for cleanup of the contamination. Some of these other parties have shared in the investigation costs. It is expected that these and other potentially responsible parties will share in the cleanup costs. Several alternatives for cleanup have been identified, with preliminary cost estimates ranging from approximately \$500,000 to \$11.0 million. It is not known at this time what share of the cleanup costs will actually be borne by Cascade. In November 2007, the Oregon DEQ provided notice that additional ecological risk assessment of the site was necessary. Completion of the assessment is anticipated by the end of 2008. The results of the assessment may affect the selection and implementation of a cleanup alternative.

The second claim is for contamination at a site in Washington and was received in 1997. Although a preliminary investigation has concluded the site is contaminated, it appears that other property owners may have contributed to the contamination. There is currently not enough information available to estimate the potential liability associated with this claim and no formal investigation plan has been communicated to Cascade.

The third claim is also for contamination at a site in Washington. Cascade received notice from a party in May 2008 that Cascade may be a potentially responsible party, along with other parties, for contamination from a manufactured gas plant owned by Cascade's predecessor from about 1946 to 1962. The notice indicates that current estimates to perform a comprehensive remedial investigation/feasibility study and prepare a cleanup action plan exceed \$8.0 million. There is currently not enough information available to estimate the potential liability to Cascade associated with this claim.

To the extent these claims are not covered by insurance, Cascade will seek recovery through the OPUC and WUTC of contamination remediation costs in its natural gas rates charged to customers.

Guarantees

In connection with the sale of MPX in June 2005 to Petrobras, an indirect wholly owned subsidiary of the Company has agreed to indemnify Petrobras for 49 percent of any losses that Petrobras may incur from certain contingent liabilities specified in the purchase agreement. Centennial has agreed to unconditionally guarantee payment of the indemnity obligations to Petrobras for periods ranging up to five and a half years from the date of sale. The guarantee was required by Petrobras as a condition to closing the sale of MPX.

Centennial continues to guarantee CEM's obligations under a construction contract for a 550-MW combined-cycle electric generating facility near Hobbs, New Mexico. As described in Note 3, Centennial Resources sold CEM in July 2007 to Bicent Power LLC, which has provided a \$10 million bank letter of credit to Centennial in support of that guarantee obligation. The guarantee, which has no fixed maximum, expires when CEM has completed its obligations under the construction contract. Substantial completion of construction is expected to occur during the third quarter of 2008, and the warranty period associated with this project will expire one year after the date of substantial completion of the construction.

In addition, WBI Holdings has guaranteed certain of Fidelity's natural gas and oil price swap and collar agreement obligations. There is no fixed maximum amount guaranteed in relation to the natural gas and oil price swap and collar agreements as the amount of the obligation is dependent upon natural gas and oil commodity prices. The amount of hedging activity entered into by the subsidiary is limited by corporate policy. The guarantees of the natural gas and oil price swap and collar agreements at June 30, 2008, expire in the years ranging from 2008 to 2011; however, Fidelity continues to enter into additional hedging activities and, as a result, WBI Holdings from time to time may issue additional guarantees on these hedging obligations. The amount outstanding by Fidelity was \$66.0 million and was reflected on the Consolidated Balance Sheets at June 30, 2008. In the event Fidelity defaults under its obligations, WBI Holdings would be required to make payments under its guarantees.

Certain subsidiaries of the Company have outstanding guarantees to third parties that guarantee the performance of other subsidiaries of the Company. These guarantees are related to construction contracts, natural gas transportation and sales agreements, gathering contracts, a conditional purchase agreement and certain other guarantees. At June 30, 2008, the fixed maximum amounts guaranteed under these agreements aggregated \$334.9 million. The amounts of scheduled expiration of the maximum amounts guaranteed under these agreements aggregate \$5.1 million in 2008; \$294.7 million in 2009; \$600,000 in 2010; \$25.1 million in 2011; \$2.4 million in 2012; \$800,000 in 2013; \$1.2 million in 2018; \$1.0 million, which is subject to expiration 30 days after the receipt of written notice; and \$4.0 million, which has no scheduled maturity date. The amount outstanding by subsidiaries of the Company under the above guarantees was \$600,000 and was reflected on the Consolidated Balance Sheet at June 30, 2008. In the event of default under these guarantee obligations, the subsidiary issuing the guarantee for that particular obligation would be required to make payments under its guarantee.

Certain subsidiaries have outstanding letters of credit to third parties related to insurance policies, materials obligations, natural gas transportation agreements and other agreements

that guarantee the performance of other subsidiaries of the Company. At June 30, 2008, the fixed maximum amounts guaranteed under these letters of credit, aggregated \$42.0 million. In 2008 and 2009, \$32.3 million and \$9.7 million, respectively, of letters of credit are scheduled to expire. There were no amounts outstanding under the above letters of credit at June 30, 2008.

Fidelity and WBI Holdings have outstanding guarantees to Williston Basin. These guarantees are related to natural gas transportation and storage agreements that guarantee the performance of Prairielands. At June 30, 2008, the fixed maximum amounts guaranteed under these agreements aggregated \$24.0 million. Scheduled expiration of the maximum amounts guaranteed under these agreements aggregate \$20.0 million in 2009 and \$4.0 million in 2011. In the event of Prairielands' default in its payment obligations, the subsidiary issuing the guarantee for that particular obligation would be required to make payments under its guarantee. The amount outstanding by Prairielands under the above guarantees was \$1.7 million, which was not reflected on the Consolidated Balance Sheet at June 30, 2008, because these intercompany transactions are eliminated in consolidation.

In addition, Centennial and Knife River have issued guarantees to third parties related to the Company's routine purchase of maintenance items, materials and lease obligations for which no fixed maximum amounts have been specified. These guarantees have no scheduled maturity date. In the event a subsidiary of the Company defaults under its obligation in relation to the purchase of certain maintenance items, materials or lease obligations, Centennial or Knife River would be required to make payments under these guarantees. Any amounts outstanding by subsidiaries of the Company for these maintenance items and materials were reflected on the Consolidated Balance Sheet at June 30, 2008.

In the normal course of business, Centennial has purchased surety bonds related to construction contracts and reclamation obligations of its subsidiaries. In the event a subsidiary of Centennial does not fulfill a bonded obligation, Centennial would be responsible to the surety bond company for completion of the bonded contract or obligation. A large portion of the surety bonds is expected to expire within the next 12 months; however, Centennial will likely continue to enter into surety bonds for its subsidiaries in the future. As of June 30, 2008, approximately \$556 million of surety bonds were outstanding, which were not reflected on the Consolidated Balance Sheet.

20. Pending acquisition

On July 1, 2008, the Company entered into an agreement to acquire Intermountain, which is headquartered in Boise, Idaho, and serves more than 300,000 customers in 74 communities in Idaho. The acquisition is a cash-for-stock transaction. The enterprise value of the transaction, including outstanding indebtedness, is approximately \$328 million.

The completion of the acquisition is subject to various regulatory reviews, as well as clearance under the Hart-Scott-Rodino Act, and satisfaction of other customary closing conditions. It is anticipated that closing will occur during the fourth quarter of 2008.

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

OVERVIEW

The Company's strategy is to apply its expertise in energy and transportation infrastructure industries to increase market share, increase profitability and enhance shareholder value through:

- Organic growth as well as a continued disciplined approach to the acquisition of well-managed companies and properties
- The elimination of system-wide cost redundancies through increased focus on integration of operations and standardization and consolidation of various support services and functions across companies within the organization
 - The development of projects that are accretive to earnings per share and return on invested capital

The Company has capabilities to fund its growth and operations through various sources, including internally generated funds, commercial paper facilities and the issuance from time to time of debt securities and the Company's equity securities. For more information on the Company's net capital expenditures, see Liquidity and Capital Commitments.

The key strategies for each of the Company's business segments, and certain related business challenges, are summarized below. For a summary of the Company's business segments, see Note 15.

Key Strategies and Challenges

Electric and Natural Gas Distribution

Strategy Provide competitively priced energy to customers while working with them to ensure efficient usage. Both the electric and natural gas distribution segments continually seek opportunities for growth and expansion of their customer base through extensions of existing operations and through selected acquisitions of companies and properties at prices that will provide stable cash flows and an opportunity for the Company to earn a competitive return on investment. The natural gas distribution segment also continues to pursue growth by expanding its level of energy-related services.

Challenges Both segments are subject to extensive regulation in the state jurisdictions where they conduct operations with respect to costs and permitted returns on investment as well as subject to certain operational regulations at the federal level. The ability of these segments to grow through acquisitions is subject to significant competition from other energy providers. In addition, as to the electric business, the ability of this segment to grow its service territory and customer base is affected by significant competition from other energy providers, including rural electric cooperatives. The construction of electric generating facilities and transmission lines are subject to increasing cost and lead time, as well as extensive permitting procedures.

Construction Services

Strategy Provide a competitive return on investment while operating in a competitive industry by: building new and strengthening existing customer relationships; effectively controlling costs; retaining, developing and recruiting talented employees; focusing business development efforts on project areas that will permit higher margins; and properly managing risk. This segment continuously seeks opportunities to expand through strategic acquisitions.

Challenges This segment operates in highly competitive markets with many jobs subject to competitive bidding. Maintenance of effective operational and cost controls, retention of key personnel and managing through down turns in the economy are ongoing challenges.

Pipeline and Energy Services

Strategy Leverage the segment's existing expertise in energy infrastructure and related services to increase market share and profitability through optimization of existing operations, internal growth, and acquisitions of energy-related assets and companies. Incremental and new growth opportunities include: access to new sources of natural gas for storage, gathering and transportation services; expansion of existing gathering and transmission facilities; and incremental expansion of pipeline capacity to allow customers access to more liquid and higher-priced markets.

Challenges Energy price volatility; natural gas basis differentials; regulatory requirements; ongoing litigation; recruitment and retention of a skilled workforce; and increased competition from other natural gas pipeline and gathering companies.

Natural Gas and Oil Production

Strategy Apply technology and leverage existing exploration and production expertise, with a focus on operated properties, to increase production and reserves from existing leaseholds, and to seek additional reserves and production opportunities in new areas to further diversify the segment's asset base. By optimizing existing operations and taking advantage of new and incremental growth opportunities, this segment's goal is to increase both production and reserves over the long term so as to generate competitive returns on investment.

Challenges Fluctuations in natural gas and oil prices; ongoing environmental litigation and administrative proceedings; timely receipt of necessary permits and approvals; recruitment and retention of a skilled workforce; availability of drilling rigs, materials and auxiliary equipment, and industry-related field services; inflationary pressure on development and operating costs; and increased competition from other natural gas and oil companies.

Construction Materials and Contracting

Strategy Focus on high-growth strategic markets located near major transportation corridors and desirable mid-sized metropolitan areas; strengthen long-term, strategic aggregate reserve position through purchase and/or lease opportunities; enhance profitability through cost containment, margin discipline and vertical integration of the segment's operations; and continue growth through organic and acquisition opportunities. Ongoing efforts to increase margin are being pursued through the implementation of a variety of continuous improvement programs, including corporate purchasing of equipment, parts and commodities (liquid asphalt, diesel fuel, cement and other materials), and negotiation of contract price escalation provisions. Vertical integration allows the segment to manage operations from aggregate mining to final lay-down of concrete and asphalt, with control of and access to adequate quantities of permitted aggregate reserves being significant. A key element of the Company's long-term strategy for this business is to further expand its presence, through acquisition, in the higher-margin materials business (rock, sand, gravel, liquid asphalt, ready-mixed concrete and related products), complementing and expanding on the Company's expertise.

Challenges The economic slow-down has adversely impacted operations, particularly in the private market. This business unit expects to continue cost containment efforts and a greater emphasis on industrial, energy and public works projects. The Company is experiencing significant increases in the

cost of raw materials such as diesel, gasoline, liquid asphalt and steel. Increased competition in certain construction markets has also lowered margins.

For further information on the risks and challenges the Company faces as it pursues its growth strategies and other factors that should be considered for a better understanding of the Company's financial condition, see Part II, Item 1A – Risk Factors, as well as Part I, Item 1A – Risk Factors in the 2007 Annual Report. For further information on each segment's key growth strategies, projections and certain assumptions, see Prospective Information. For information pertinent to various commitments and contingencies, see Notes to Consolidated Financial Statements.

Earnings Overview

The following table summarizes the contribution to consolidated earnings by each of the Company's businesses.

	Three Months Ended		Six Months Ended	
	2008	June 30, 2007	2008	June 30, 2007
	(Dollars in millions, where applicable)			
Electric	\$ 2.8	\$ 3.6	\$ 8.3	\$ 7.4
Natural gas distribution	5.4	(.6)	21.8	5.6
Construction services	14.1	13.0	24.9	20.3
Pipeline and energy services	6.8	6.1	14.0	11.8
Natural gas and oil production	71.7	35.2	122.3	65.8
Construction materials and contracting	12.7	25.5	(8.4)	15.7
Other	1.8	(1.0)	3.3	(3.5)
Earnings before discontinued operations	115.3	81.8	186.2	123.1
Income from discontinued operations, net of tax	---	7.5	---	12.7
Earnings on common stock	\$ 115.3	\$ 89.3	\$ 186.2	\$ 135.8
Earnings per common share – basic:				
Earnings before discontinued operations	\$.63	\$.45	\$ 1.02	\$.68
Discontinued operations, net of tax	---	.04	---	.07
Earnings per common share – basic	\$.63	\$.49	\$ 1.02	\$.75
Earnings per common share – diluted:				
Earnings before discontinued operations	\$.63	\$.45	\$ 1.01	\$.67
Discontinued operations, net of tax	---	.04	---	.07
Earnings per common share – diluted	\$.63	\$.49	\$ 1.01	\$.74
Return on average common equity for the 12 months ended			19.3%	15.2%

Three Months Ended June 30, 2008 and 2007 Consolidated earnings for the quarter ended June 30, 2008, increased \$26.0 million from the comparable prior period largely due to:

- Higher average realized natural gas and oil prices of 35 percent and 97 percent, respectively, and increased oil and natural gas production of 22 percent and 9 percent, respectively, partially offset by higher depreciation, depletion and amortization expense at the natural gas and oil production business

- Increased earnings at the natural gas distribution business, largely earnings at Cascade, which was acquired on July 2, 2007

Partially offsetting these increases were construction workloads and margins as well as product volumes that were significantly lower at the construction materials and contracting business as a result of the economic slowdown and unfavorable weather conditions, and the absence in 2008 of earnings from discontinued operations as discussed in Note 3.

Six Months Ended June 30, 2008 and 2007 Consolidated earnings for the six months ended June 30, 2008, increased \$50.4 million primarily due to:

- Higher average realized oil and natural gas prices of 94 percent and 26 percent, respectively, and increased natural gas and oil production of 8 percent and 17 percent, respectively, partially offset by higher depreciation, depletion and amortization expense at the natural gas and oil production business
- Increased earnings at the natural gas distribution business, largely earnings at Cascade as previously discussed
 - Higher construction workloads at the construction services business

Partially offsetting these increases were construction workloads and margins as well as product volumes that were significantly lower at the construction materials and contracting business as previously discussed, and the absence in 2008 of earnings from discontinued operations as discussed in Note 3.

FINANCIAL AND OPERATING DATA

Below are key financial and operating data for each of the Company's businesses.

Electric

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Dollars in millions, where applicable)			
Operating revenues	\$ 45.9	\$ 44.6	\$ 98.1	\$ 91.7
Operating expenses:				
Fuel and purchased power	15.7	15.5	34.5	32.6
Operation and maintenance	16.5	14.5	31.4	29.5
Depreciation, depletion and amortization	6.1	5.6	12.1	11.2
Taxes, other than income	2.2	2.1	4.4	4.3
	40.5	37.7	82.4	77.6
Operating income	5.4	6.9	15.7	14.1
Earnings	\$ 2.8	\$ 3.6	\$ 8.3	\$ 7.4
Retail sales (million kWh)	577.7	596.3	1,285.5	1,242.0
Sales for resale (million kWh)	51.5	47.0	99.9	91.2
Average cost of fuel and purchased power per kWh	\$.024	\$.024	\$.024	\$.024

Three Months Ended June 30, 2008 and 2007 Electric earnings decreased \$800,000, primarily due to higher operation and maintenance costs of \$1.1 million (after tax), including higher payroll and materials costs, as well as increased depreciation, depletion and amortization expense of \$300,000

(after tax) related to higher property, plant and equipment balances. Partially offsetting the decrease were increased sales for resale volumes of 10 percent and higher retail sales margins.

Six Months Ended June 30, 2008 and 2007 Electric earnings increased \$900,000 due to:

- Increased retail sales margins and volumes of \$2.3 million (after tax), largely due to the resolution of a rate proceeding and higher system load
- Higher sales for resale volumes of 10 percent, largely due to the addition of the wind-powered electric generating station near Baker, Montana, and higher plant availability

Partially offsetting these increases were:

- Higher operations and maintenance costs of \$1.1 million (after tax), primarily higher payroll and benefit related costs, as well as electric generating station costs associated with scheduled maintenance
 - Increased depreciation, depletion and amortization expense of \$600,000 (after tax), as previously discussed

Natural Gas Distribution

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
	(Dollars in millions, where applicable)			
Operating revenues	\$ 197.0	\$ 53.4	\$ 559.1	\$ 189.5
Operating expenses:				
Purchased natural gas sold	137.4	34.3	420.0	140.5
Operation and maintenance	28.7	15.6	55.7	31.2
Depreciation, depletion and amortization	7.2	2.5	14.3	5.0
Taxes, other than income	11.0	1.5	25.6	3.2
	184.3	53.9	515.6	179.9
Operating income (loss)	12.7	(.5)	43.5	9.6
Earnings (loss)	\$ 5.4	\$ (.6)	\$ 21.8	\$ 5.6
Volumes (MMdk):				
Sales	15.4	5.3	46.6	21.2
Transportation	18.5	2.9	45.1	6.3
Total throughput	33.9	8.2	91.7	27.5
Degree days (% of normal)*				
Montana-Dakota	117%	94%	104%	94%
Cascade	120%	---	111%	---
Average cost of natural gas, including transportation, per dk**				
Montana-Dakota	\$ 9.45	\$ 6.44	\$ 8.16	\$ 6.64
Cascade	\$ 8.55	---	\$ 8.07	---

* Degree days are a measure of the daily temperature-related demand for energy for heating.

** Regulated natural gas sales only.

Note: Cascade was acquired on July 2, 2007.

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Three Months Ended June 30, 2008 and 2007 Earnings at the natural gas distribution business increased \$6.0 million compared to the prior year due to:

- Earnings of \$5.3 million, including a \$4.4 million (after tax) gain on the sale of its natural gas management service, at Cascade which was acquired on July 2, 2007
- Increased retail sales volumes from existing operations resulting from 25 percent colder weather than last year
 - Higher nonregulated energy-related services of \$200,000 (after tax)

Six Months Ended June 30, 2008 and 2007 Earnings at the natural gas distribution business increased \$16.2 million due to:

- Earnings of \$15.2 million at Cascade, as previously discussed
- Increased retail sales volumes from existing operations resulting from 12 percent colder weather than last year
 - Higher nonregulated energy-related services of \$400,000 (after tax)

Partially offsetting these increases was higher operation and maintenance expense, excluding Cascade, of \$800,000 (after tax), largely payroll and benefit related costs.

Construction Services

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
	(In millions)			
Operating revenues	\$ 324.7	\$ 263.8	\$ 632.1	\$ 500.6
Operating expenses:				
Operation and maintenance	286.6	230.6	560.5	442.4
Depreciation, depletion and amortization	3.1	3.4	6.5	6.9
Taxes, other than income	10.4	7.5	22.4	16.2
	300.1	241.5	589.4	465.5
Operating income	24.6	22.3	42.7	35.1
Earnings	\$ 14.1	\$ 13.0	\$ 24.9	\$ 20.3

Three Months Ended June 30, 2008 and 2007 Construction services earnings increased \$1.1 million due to higher construction workloads of \$5.0 million (after tax), largely in the Southwest region. Partially offsetting the increase were lower construction margins in certain regions, as well as higher general and administrative expense of \$1.2 million (after tax), largely payroll related.

Six Months Ended June 30, 2008 and 2007 Construction services earnings increased \$4.6 million due to:

- Higher construction workloads of \$9.5 million (after tax), largely in the Southwest region
 - Increased equipment sales and rentals

Partially offsetting the increases were lower construction margins in certain regions of \$4.4 million (after tax) and higher general and administrative expense of \$1.3 million (after tax), largely payroll related.

Pipeline and Energy Services

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
	(Dollars in millions)			
Operating revenues	\$ 155.1	\$ 112.2	\$ 288.9	\$ 225.3
Operating expenses:				
Purchased natural gas sold	116.6	75.8	210.7	155.4
Operation and maintenance	16.7	16.6	34.3	30.6
Depreciation, depletion and amortization	5.9	5.2	11.5	10.6
Taxes, other than income	2.8	2.7	5.6	5.5
	142.0	100.3	262.1	202.1
Operating income	13.1	11.9	26.8	23.2
Income from continuing operations	6.8	6.1	14.0	11.8
Income from discontinued operations, net of tax	---	.1	---	.1
Earnings	\$ 6.8	\$ 6.2	\$ 14.0	\$ 11.9
Transportation volumes (MMdk):				
Montana-Dakota	7.2	7.1	15.5	15.1
Other	26.8	29.7	48.2	50.2
	34.0	36.8	63.7	65.3
Gathering volumes (MMdk)	25.5	22.5	49.5	44.7

Three Months Ended June 30, 2008 and 2007 The pipeline and energy services segment experienced an increase in earnings of \$600,000 due to:

- Higher storage and gathering rates of \$700,000 (after tax), partially offset by lower storage balances
 - Increased gathering volumes of 14 percent
- Increased on- and off-system transportation and demand fees of \$600,000 (after tax), largely offset by a decrease in volumes transported to storage

Partially offsetting these increases was increased depreciation, depletion and amortization expense of \$400,000 (after tax) resulting from higher property, plant and equipment balances.

Six Months Ended June 30, 2008 and 2007 Pipeline and energy services earnings increased \$2.1 million due to:

- Higher storage and gathering rates of \$1.4 million (after tax), partially offset by lower storage balances
 - Increased gathering volumes of 11 percent
- Increased off-system transportation and demand fees mainly related to an expansion of the Grasslands system (\$1.2 million after tax), partially offset by a decrease in volumes transported to storage

Partially offsetting these increases were higher operation and maintenance costs of \$800,000 (after tax), largely higher materials and legal costs, as well as higher depreciation, depletion and amortization expense of \$500,000 (after tax) as previously discussed.

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Natural Gas and Oil Production

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
	(Dollars in millions, where applicable)			
Operating revenues:				
Natural gas	\$ 140.5	\$ 96.1	\$ 258.0	\$ 190.0
Oil	74.6	31.2	126.7	55.8
Other	.1	.1	.1	.2
	215.2	127.4	384.8	246.0
Operating expenses:				
Purchased natural gas sold	.1	---	.1	.3
Operation and maintenance:				
Lease operating costs	19.2	15.6	37.5	31.1
Gathering and transportation	6.2	5.0	11.9	9.5
Other	13.7	9.1	22.6	17.5
Depreciation, depletion and amortization	41.7	29.8	81.0	59.6
Taxes, other than income:				
Production and property taxes	16.3	9.3	29.9	18.2
Other	.3	.3	.5	.5
	97.5	69.1	183.5	136.7
Operating income	117.7	58.3	201.3	109.3
Earnings	\$ 71.7	\$ 35.2	\$ 122.3	\$ 65.8
Production:				
Natural gas (MMcf)	16,531	15,231	33,092	30,671
Oil (MBbls)	717	589	1,338	1,145
Total Production (MMcf equivalent)	20,830	18,770	41,118	37,543
Average realized prices (including hedges):				
Natural gas (per Mcf)	\$ 8.50	\$ 6.31	\$ 7.80	\$ 6.20
Oil (per barrel)	\$ 104.19	\$ 52.83	\$ 94.72	\$ 48.71
Average realized prices (excluding hedges):				
Natural gas (per Mcf)	\$ 9.33	\$ 5.82	\$ 8.11	\$ 5.78
Oil (per barrel)	\$ 105.34	\$ 52.83	\$ 95.60	\$ 48.71
Average depreciation, depletion and amortization rate, per equivalent Mcf	\$ 1.94	\$ 1.52	\$ 1.91	\$ 1.52
Production costs, including taxes, per equivalent Mcf:				
Lease operating costs	\$.92	\$.83	\$.91	\$.83
Gathering and transportation	.30	.27	.29	.25
Production and property taxes	.78	.50	.73	.49
	\$ 2.00	\$ 1.60	\$ 1.93	\$ 1.57

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Three Months Ended June 30, 2008 and 2007 Natural gas and oil production earnings increased \$36.5 million due to:

- Higher average realized natural gas prices of 35 percent and higher average realized oil prices of 97 percent
- Increased oil and natural gas production of 22 percent and 9 percent, respectively, largely related to the East Texas property acquired in January 2008 and additional drilling activity including wells in the Bakken formation and Paradox Basin

Partially offsetting these increases were:

- Higher depreciation, depletion and amortization expense of \$7.4 million (after tax) due to higher depletion rates and increased production
 - Higher production taxes of \$4.3 million (after tax) associated with increased revenue
 - Increased lease operating expenses of \$2.2 million (after tax)

Six Months Ended June 30, 2008 and 2007 The natural gas and oil production business experienced an increase in earnings of \$56.5 million due to:

- Higher average realized oil prices of 94 percent and higher average realized natural gas prices of 26 percent
- Increased natural gas and oil production of 8 percent and 17 percent, respectively, as previously discussed

Partially offsetting these increases were:

- Higher depreciation, depletion and amortization expense of \$13.3 million (after tax) due to higher depletion rates and increased production
 - Higher production taxes of \$7.3 million (after tax) associated with increased revenue
 - Increased lease operating expenses of \$4.0 million (after tax)

Construction Materials and Contracting

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Dollars in millions)			
Operating revenues	\$ 427.4	\$ 455.5	\$ 628.7	\$ 683.0
Operating expenses:				
Operation and maintenance	366.1	372.8	561.3	581.6
Depreciation, depletion and amortization	25.4	23.2	50.9	45.8
Taxes, other than income	10.4	13.9	19.5	21.6
	401.9	409.9	631.7	649.0
Operating income (loss)	25.5	45.6	(3.0)	34.0
Earnings (loss)	\$ 12.7	\$ 25.5	\$ (8.4)	\$ 15.7
Sales (000's):				
Aggregates (tons)	8,719	10,339	12,960	15,896
Asphalt (tons)	1,452	1,769	1,648	2,105
Ready-mixed concrete (cubic yards)	1,052	1,092	1,663	1,718

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Three Months Ended June 30, 2008 and 2007 Earnings at the construction materials and contracting business decreased \$12.8 million due to:

- Decreased construction workloads, margins and product volumes that were significantly lower as a result of the economic slowdown and unfavorable weather conditions as well as significantly higher diesel fuel costs at existing operations had a combined negative effect on earnings of \$13.4 million (after tax)
- Higher depreciation, depletion and amortization expense, largely the result of higher property, plant and equipment balances

Partially offsetting these decreases were earnings from companies acquired since the comparable prior period which contributed 11 percent to earnings for the current quarter.

Six Months Ended June 30, 2008 and 2007 The construction materials and contracting business experienced a loss of \$8.4 million compared to earnings of \$15.7 million for the comparable prior period. The decrease of \$24.1 million is due to:

- Decreased construction workloads, margins and product volumes that were significantly lower as previously described as well as significantly higher diesel fuel costs at existing operations had a combined negative effect on earnings of \$23.2 million (after tax)
 - Higher depreciation, depletion and amortization expense, as previously discussed

Partially offsetting these decreases were earnings from companies acquired since the comparable prior period.

Other and Intersegment Transactions

Amounts presented in the preceding tables will not agree with the Consolidated Statements of Income due to the Company's other operations and the elimination of intersegment transactions. The amounts relating to these items are as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
	(In millions)			
Other:				
Operating revenues	\$ 2.7	\$ 2.4	\$ 5.3	\$ 4.9
Operation and maintenance	2.8	3.7	5.5	7.5
Depreciation, depletion and amortization	.3	.4	.6	.8
Taxes, other than income	.1	---	.1	.1
Intersegment transactions:				
Operating revenues	\$ 116.2	\$ 76.9	\$ 223.3	\$ 171.1
Purchased natural gas sold	109.0	69.8	209.1	157.1
Operation and maintenance	7.2	7.1	14.2	14.0

For further information on intersegment eliminations, see Note 15.

PROSPECTIVE INFORMATION

The following information highlights the key growth strategies, projections and certain assumptions for the Company and its subsidiaries and other matters for each of the Company's businesses. Many of

these highlighted points are “forward-looking statements.” There is no assurance that the Company’s projections, including estimates for growth and changes in earnings, will in fact be achieved. Please refer to assumptions contained in this section, as well as the various important factors listed in Part II, Item 1A – Risk Factors, as well as Part I, Item 1A – Risk Factors in the 2007 Annual Report. Changes in such assumptions and factors could cause actual future results to differ materially from growth and earnings projections.

MDU Resources Group, Inc.

- Earnings per common share for 2008 are projected in the range of \$2.10 to \$2.35. The Company expects the percentage of 2008 earnings per common share by quarter to be in the following approximate ranges:
 - o Third quarter – 30 percent to 35 percent
 - o Fourth quarter – 25 percent to 30 percent
- Long-term compound annual growth goals on earnings per share from operations are in the range of 7 percent to 10 percent.

Electric

- The Company is analyzing potential projects for accommodating load growth and replacing an expired purchased power contract with company-owned generation, which will add to base-load capacity and rate base. The Company is a participant in the Big Stone Station II project. A final decision on construction of the Big Stone Station II project will be made when major permits are issued and certain regulatory approvals are obtained. Those permits and approvals include a certificate of need and route permit from the MNPUC for construction and operation of a portion of the transmission line for delivery of the electric energy from the Big Stone Station II. In May 2008, administrative law judges from the Minnesota Office of Administrative Hearings recommended the MNPUC deny issuance of the certificate of need and route permit, or alternatively impose certain conditions on project participants subject to rate regulation by the MNPUC. On June 5, 2008, the MNPUC voted to delay its decision on the Big Stone Station II application for a transmission certificate of need and a route permit. The decision to delay was made so that the MNPUC can receive information from an independent expert on construction costs, natural gas prices and potential costs related to carbon dioxide. A hearing and decision is expected by the fall of 2008. If the decision is to proceed with construction of the plant, it is projected to be completed in 2013. The Company anticipates it would own at least 116 MW of this plant or other generation sources.

- This business continues to pursue expansion of energy-related services.

Natural gas distribution

- As discussed in Note 20, the Company has entered into an agreement to acquire Intermountain for approximately \$328 million, pending regulatory approvals. It is anticipated that closing will occur during the fourth quarter of 2008.
- This business continues to pursue expansion of energy-related services and expects continued strong customer growth in Washington and Oregon.

Construction services

- The Company anticipates margins in 2008 to be slightly lower than 2007.

- The Company continues to focus on costs and efficiencies to enhance margins.
- Work backlog as of June 30, 2008, was approximately \$655 million, compared to \$765 million at June 30, 2007.
- This business continually seeks opportunities to expand through strategic acquisitions and organic growth opportunities.

Pipeline and energy services

- Based on indicated demand from a recent open season, an incremental expansion to the Grasslands Pipeline in the range of 40,000 Mcf per day or more is now anticipated for 2009. Through additional compression, the pipeline firm capacity could ultimately reach 200,000 Mcf per day, an increase from the current firm capacity of 138,000 Mcf per day.
- The Company is pursuing the development of the Bakken Pipeline, a new natural gas pipeline designed to transport natural gas from the fast-growing Bakken Play in northwestern North Dakota and northeastern Montana to a new pipeline interconnect with Alliance Pipeline. The Bakken Pipeline is anticipated to have an initial capacity of approximately 100,000 Mcf per day, with the flexibility to expand capacity to 200,000 Mcf per day. The pipeline project remains subject to shipper commitment and regulatory approvals.
- In 2008, total gathering and transportation throughput is expected to be slightly higher than 2007 record levels.

Natural gas and oil production

- The Company expects a combined natural gas and oil production increase in 2008 in the range of 10 percent to 14 percent over 2007 levels. Meeting these targets will depend on the success of exploration activities and the timely receipt of regulatory approvals.
- The Company is involved in exploratory drilling in the Bakken area in North Dakota and in the Paradox Basin in Utah. Net acreage in the Bakken includes over 65,000 acres with plans to participate in 50 to 60 wells in 2008, roughly half of which will be operated. If the Three Forks/Sanish formation proves to be a separate reservoir from the middle Bakken, the Company expects the Three Forks/Sanish will provide additional opportunities to grow reserves and production within our existing leasehold position. In the Paradox Basin, the Company has net acreage of approximately 90,000 acres with plans to drill approximately 5 wells in 2008.
- Currently, this segment's net combined natural gas and oil production is approximately 225,000 Mcf equivalent to 240,000 Mcf equivalent per day.
- The Company's combined proved natural gas and oil reserves as of December 31, 2007, were 707 Bcf equivalent. In January, 97 Bcf equivalent of proved reserves were added with the East Texas property acquisition. The Company is pursuing continued reserve growth through further exploitation of its existing properties, exploratory drilling and property acquisitions.

- Earnings guidance reflects estimated natural gas prices for August through December as follows:

Index*	Price Per Mcf
Ventura	\$7.75 to \$8.25
NYMEX	\$8.50 to \$9.00
CIG	\$6.00 to \$6.50

* Ventura is an index pricing point related to Northern Natural Gas Co.'s system; CIG is an index pricing point related to Colorado Interstate Gas Co.'s system.

During 2007, more than three-fourths of natural gas production was priced at non-NYMEX prices, the majority of which was at Ventura pricing.

- Earnings guidance reflects estimated NYMEX crude oil prices for August through December in the range of \$110 to \$115 per barrel.
- For the last six months of 2008, the Company has hedged approximately 45 percent to 50 percent of its estimated natural gas production and less than 5 percent of its estimated oil production. Of its estimated 2009 natural gas production, the Company has hedged approximately 30 percent to 35 percent and less than 5 percent for 2010 and 2011. The hedges that are in place as of August 1, 2008, are summarized in the following chart:

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Commodity	Type	Index*	Period Outstanding	Forward Notional Volume (MMBtu/Bbl)	Price (Per MMBtu/Bbl)
Natural Gas	Collar	Ventura	7/08 - 10/08	615,000	\$7.00-\$8.05
Natural Gas	Collar	Ventura	7/08 - 10/08	615,000	\$7.00-\$8.06
Natural Gas	Swap	Ventura	7/08 - 10/08	615,000	\$7.45
Natural Gas	Collar	Ventura	7/08 - 10/08	615,000	\$7.50-\$8.70
Natural Gas	Swap	Ventura	7/08 - 10/08	615,000	\$8.005
Natural Gas	Collar	Ventura	7/08 - 10/08	430,500	\$7.25-\$8.02
Natural Gas	Collar	CIG	7/08 - 10/08	430,500	\$5.75-\$7.40
Natural Gas	Collar	Ventura	7/08 - 12/08	920,000	\$7.00-\$8.45
Natural Gas	Collar	Ventura	7/08 - 12/08	920,000	\$7.50-\$8.34
Natural Gas	Swap	Ventura	7/08 - 12/08	1,656,000	\$8.55
Natural Gas	Collar	NYMEX	7/08 - 12/08	920,000	\$7.50-\$10.15
Natural Gas	Swap	HSC	7/08 - 12/08	1,251,200	\$7.91
Natural Gas	Collar	CIG	7/08 - 12/08	920,000	\$6.75-\$7.04
Natural Gas	Swap	CIG	7/08 - 12/08	920,000	\$6.35
Natural Gas	Swap	CIG	7/08 - 12/08	920,000	\$6.41
Natural Gas	Swap	Ventura	7/08 - 12/08	2,576,000	\$9.10
Natural Gas	Collar	NYMEX	7/08 - 12/08	920,000	\$9.00-\$10.50
Natural Gas	Swap	Ventura	11/08 - 12/08	427,000	\$9.25
Natural Gas	Swap	Ventura	11/08 - 12/08	610,000	\$8.85
Natural Gas	Swap	Ventura	11/08 - 12/08	915,000	\$12.465
Natural Gas	Swap	CIG	1/09 - 3/09	225,000	\$8.45
Natural Gas	Swap	HSC	1/09 - 12/09	2,482,000	\$8.16
Natural Gas	Collar	Ventura	1/09 - 12/09	1,460,000	\$7.90-\$8.54
Natural Gas	Collar	Ventura	1/09 - 12/09	4,380,000	\$8.25-\$8.92
Natural Gas	Swap	Ventura	1/09 - 12/09	3,650,000	\$9.02
Natural Gas	Collar	CIG	1/09 - 12/09	3,650,000	\$6.50-\$7.20
Natural Gas	Swap	CIG	1/09 - 12/09	912,500	\$7.27
Natural Gas	Collar	NYMEX	1/09 - 12/09	1,825,000	\$8.75-\$10.15
Natural Gas	Swap	Ventura	1/09 - 12/09	3,650,000	\$9.20
Natural Gas	Collar	NYMEX	1/09 - 12/09	3,650,000	\$11.00-\$12.78
Natural Gas	Basis	NYMEX to Ventura	1/09 - 12/09	3,650,000	\$0.61
Natural Gas	Swap	HSC	1/10 - 12/10	1,606,000	\$8.08
Natural Gas	Swap	HSC	1/11 - 12/11	1,350,500	\$8.00
Crude Oil	Collar	NYMEX	7/08 - 12/08	36,800	\$67.50-\$78.70

*Ventura is an index pricing point related to Northern Natural Gas Co.'s system; CIG is an index pricing point related to Colorado Interstate Gas Co.'s system; HSC is the Houston Ship Channel hub in southeast Texas which connects to several pipelines.

Construction materials and contracting

- The economic slowdown has adversely impacted operations. It is expected that 2008 earnings will be significantly lower than 2007.

- The Company continues its strong emphasis on industrial, energy and public works projects and cost containment. It is also pursuing expansion of its liquid asphalt materials business to cost effectively meet the liquid asphalt and diesel requirements of the Company, as well as third party customers.
- Work backlog as of June 30, 2008, was approximately \$634 million, compared to \$662 million at June 30, 2007. Margins on the backlog have declined as a result of a shift to more public sector work and increased competition.
 - A key long-term strategy for the Company is its 1.2 billion tons of strategically located aggregate reserves.

NEW ACCOUNTING STANDARDS

For information regarding new accounting standards, see Note 9, which is incorporated by reference.

CRITICAL ACCOUNTING POLICIES INVOLVING SIGNIFICANT ESTIMATES

The Company's critical accounting policies involving significant estimates include impairment testing of long-lived assets and intangibles, impairment testing of natural gas and oil production properties, revenue recognition, purchase accounting, asset retirement obligations, pension and other postretirement benefits, and income taxes. There were no material changes in the Company's critical accounting policies involving significant estimates from those reported in the 2007 Annual Report. For more information on critical accounting policies involving significant estimates, see Part II, Item 7 in the 2007 Annual Report.

LIQUIDITY AND CAPITAL COMMITMENTS

Cash flows

Operating activities Net income before depreciation, depletion and amortization is a significant contributor to cash flows from operating activities. The changes in cash flows from operating activities generally follow the results of operations as discussed in Financial and Operating Data and also are affected by changes in working capital.

Cash flows provided by operating activities in the first six months of 2008 increased \$100.2 million from the comparable 2007 period, the result of:

- Higher income from continuing operations of \$63.1 million, largely reflecting increases at the natural gas and oil production and natural gas distribution businesses, partially offset by the loss at the construction materials and contracting business
- The absence in 2008 of cash used in 2007 by discontinued operations of \$41.9 million, primarily the result of quarterly income tax payments due to the estimated gain on the sale of the domestic independent power production assets
- Higher depreciation, depletion and amortization expense of \$37.1 million, largely at the natural gas and oil production business

Partially offsetting the increase in cash flows from operating activities was increased cash used for working capital requirements.

Investing activities Cash flows used in investing activities in the first six months of 2008 increased \$334.2 million from the comparable period in 2007, primarily the result of increased cash used for

acquisitions of \$270.9 million and higher ongoing capital expenditures of \$143.3 million, both primarily at the natural gas and oil production business.

Partially offsetting this increase was an increase in cash flows provided by investments of \$63.1 million, primarily due to the sale of auction rate securities, partially offset by the proceeds received from the sale of equity method investments in 2007.

Financing activities Cash flows provided by financing activities in the first six months of 2008 increased \$215.1 million from the comparable period in 2007, primarily the result of an increase in the issuance of long-term debt of \$193.1 million and an increase in the issuance of short-term borrowings of \$80.0 million. Partially offsetting this increase was an increase in the repayment of long-term debt of \$40.6 million and a decrease in the issuance of common stock of \$10.8 million.

Defined benefit pension plans

There were no material changes to the Company's qualified noncontributory defined benefit pension plans from those reported in the 2007 Annual Report. For further information, see Note 17 and Part II, Item 7 in the 2007 Annual Report.

Capital expenditures

Net capital expenditures for the first six months of 2008 were \$640.6 million and are estimated to be approximately \$1.4 billion for 2008. Estimated capital expenditures include:

- Completed acquisitions
- Anticipated acquisition of Intermountain
 - System upgrades
 - Routine replacements
 - Service extensions
- Routine equipment maintenance and replacements
 - Buildings, land and building improvements
 - Pipeline and gathering projects
- Further enhancement of natural gas and oil production and reserve growth
- Power generation opportunities, including certain costs for additional electric generating capacity
 - Other growth opportunities

Approximately 45 percent of estimated 2008 net capital expenditures referred to previously are associated with completed acquisitions and the anticipated acquisition of Intermountain. The Company continues to evaluate potential future acquisitions and other growth opportunities; however, they are dependent upon the availability of economic opportunities and, as a result, capital expenditures may vary significantly from the estimated 2008 capital expenditures referred to previously. It is anticipated that all of the funds required for capital expenditures will be met from various sources, including internally generated funds; the Company's credit facilities, as described below; and through the issuance of long-term debt and the Company's equity securities.

Capital resources

Certain debt instruments of the Company and its subsidiaries, including those discussed below, contain restrictive covenants, all of which the Company and its subsidiaries were in compliance with at June 30, 2008.

MDU Resources Group, Inc. The Company has a revolving credit agreement with various banks totaling \$125 million (with provision for an increase, at the option of the Company on stated conditions, up to a maximum of \$150 million). There were no amounts outstanding under the credit agreement at June 30, 2008. The credit agreement supports the Company's \$100 million commercial paper program. Under the Company's commercial paper program, \$64.3 million was outstanding at June 30, 2008. The commercial paper borrowings are classified as long-term debt as they are intended to be refinanced on a long-term basis through continued commercial paper borrowings (supported by the credit agreement, which expires on June 21, 2011).

The Company's objective is to maintain acceptable credit ratings in order to access the capital markets through the issuance of commercial paper. Minor fluctuations in the Company's credit ratings have not limited, nor would they be expected to limit, the Company's ability to access the capital markets. In the event of a minor downgrade, the Company may experience a nominal basis point increase in overall interest rates with respect to its cost of borrowings. If the Company were to experience a significant downgrade of its credit ratings, it may need to borrow under its credit agreement.

Prior to the maturity of the credit agreement, the Company expects that it will negotiate the extension or replacement of this agreement. If the Company is unable to successfully negotiate an extension of, or replacement for, the credit agreement, or if the fees on this facility became too expensive, which the Company does not currently anticipate, the Company would seek alternative funding.

In order to borrow under the Company's credit agreement, the Company must be in compliance with the applicable covenants and certain other conditions. For information on the covenants and certain other conditions of the Company's credit agreement, see Part II, Item 8 – Note 10, in the 2007 Annual Report. The Company was in compliance with these covenants and met the required conditions at June 30, 2008. In the event the Company does not comply with the applicable covenants and other conditions, alternative sources of funding may need to be pursued.

There are no credit facilities that contain cross-default provisions between the Company and any of its subsidiaries.

The Company's issuance of first mortgage debt is subject to certain restrictions imposed under the terms and conditions of its Mortgage. Generally, those restrictions require the Company to fund \$1.43 of unfunded property or use \$1.00 of refunded bonds for each dollar of indebtedness incurred under the Mortgage and, in some cases, to certify to the trustee that annual earnings (pretax and before interest charges), as defined in the Mortgage, equal at least two times its annualized first mortgage bond interest costs. Under the more restrictive of the tests, as of June 30, 2008, the Company could have issued approximately \$570 million of additional first mortgage bonds.

The Company's coverage of fixed charges including preferred dividends was 7.3 times and 6.4 times for the 12 months ended June 30, 2008 and December 31, 2007, respectively. Common stockholders' equity as a percent of total capitalization was 61 percent and 66 percent at June 30, 2008 and December 31, 2007, respectively.

The Company has repurchased, and may from time to time seek to repurchase, outstanding first mortgage bonds through open market purchases or privately negotiated transactions. The Company will evaluate any such transactions in light of then existing market conditions, taking into account its liquidity and prospects for future access to capital. As of June 30, 2008, the Company had \$50.5 million of first mortgage bonds outstanding, \$30.0 million of which were held by the Indenture trustee for the benefit of the senior note holders. The aggregate principal amount of the Company's outstanding first mortgage bonds, other than those held by the Indenture trustee, is \$20.5 million and

satisfies the lien release requirements under the Indenture. As a result, the Company may at any time, subject to satisfying certain specified conditions, require that any debt issued under its Indenture become unsecured and rank equally with all of the Company's other unsecured and unsubordinated debt (as of June 30, 2008, the only such debt outstanding under the Indenture was \$30.0 million in aggregate principal amount of the Company's 5.98% Senior Notes due in 2033).

The Company has entered into a Sales Agency Financing Agreement, as amended June 25, 2007, with Wells Fargo Securities, LLC with respect to the issuance and sale of up to 3,000,000 shares of the Company's common stock, par value \$1.00 per share, together with preference share purchase rights appurtenant thereto. The common stock may be offered for sale, from time to time, in accordance with the terms and conditions of the agreement, which terminates on December 1, 2008. Proceeds from the sale of shares of common stock under the agreement are expected to be used for corporate development purposes and other general corporate purposes. The Company has not issued any stock under the Sales Agency Financing Agreement through June 30, 2008.

On May 28, 2008, the Company filed a registration statement with the SEC, pursuant to Rule 415 under the Securities Act, relating to the possible issuance from time to time of common stock or debt securities of the Company. The amount of securities issuable by the Company is established from time to time by its board of directors. At June 30, 2008, the Company's board of directors had authorized the issuance of up to an aggregate offering price of \$1.0 billion of registered securities. The Company may sell all or a portion of such securities if warranted by market conditions and the Company's capital requirements. Any offer and sale of such securities will be made only by means of a prospectus meeting the requirements of the Securities Act and the rules and regulations thereunder.

MDU Energy Capital, LLC MDU Energy Capital has a master shelf agreement that allows for borrowings up to \$125 million. Under the terms of the master shelf agreement, \$85.0 million was outstanding at June 30, 2008. MDU Energy Capital may incur additional indebtedness under the master shelf agreement until the earlier of August 14, 2010, or such time as the agreement is terminated by either of the parties thereto.

In order to borrow under its master shelf agreement, MDU Energy Capital must be in compliance with the applicable covenants and certain other conditions. For information on the covenants and certain other conditions of the MDU Energy Capital master shelf agreement, see Part II, Item 8 – Note 10, in the 2007 Annual Report. MDU Energy Capital was in compliance with these covenants and met the required conditions at June 30, 2008.

Cascade Natural Gas Corporation Cascade has a revolving credit agreement with various banks totaling \$50 million with certain provisions allowing for increased borrowings, up to a maximum of \$75 million. The \$50 million credit agreement expires on December 28, 2012, with provisions allowing for an extension of up to two years upon consent of the banks. Cascade also has a \$20 million uncommitted line of credit which may be terminated by the bank or Cascade at any time. There were no amounts outstanding under the Cascade credit agreements at June 30, 2008. As of June 30, 2008, there were outstanding letters of credit, as discussed in Note 19, of which \$1.9 million reduced amounts available under the \$50 million credit agreement.

In order to borrow under Cascade's \$50 million credit agreement, Cascade must be in compliance with the applicable covenants and certain other conditions. For information on the covenants and certain other conditions of Cascade's \$50 million credit agreement, see Part II, Item 8 – Note 9, in the 2007 Annual Report. Cascade was in compliance with these covenants and met the required conditions at June 30, 2008.

Cascade's \$50 million credit agreement contains cross-default provisions. These provisions state that if Cascade fails to make any payment with respect to any indebtedness or contingent obligation, in excess of a specified amount, under any agreement that causes such indebtedness to be due prior to its stated maturity or the contingent obligation to become payable, the agreement will be in default. Certain of Cascade's financing agreements and Cascade's practices limit the amount of subsidiary indebtedness.

Centennial Energy Holdings, Inc. Centennial has a revolving credit agreement and an uncommitted line of credit with various banks and institutions totaling \$425 million with certain provisions allowing for increased borrowings. These credit agreements support Centennial's \$400 million commercial paper program. There were no outstanding borrowings under the Centennial credit agreements at June 30, 2008. Under the Centennial commercial paper program, \$276.5 million was outstanding at June 30, 2008. The Centennial commercial paper borrowings are classified as long-term debt as Centennial intends to refinance these borrowings on a long-term basis through continued Centennial commercial paper borrowings (supported by Centennial credit agreements). The revolving credit agreement is for \$400 million, which includes a provision for an increase, at the option of Centennial on stated conditions, up to a maximum of \$450 million and expires on December 13, 2012. The uncommitted line of credit for \$25 million may be terminated by the bank at any time. As of June 30, 2008, Centennial had letters of credit outstanding, as discussed in Note 19, of which \$24.3 million reduced amounts available under these agreements.

Centennial has an uncommitted long-term master shelf agreement that allows for borrowings of up to \$550 million. Under the terms of the master shelf agreement, \$517.5 million was outstanding at June 30, 2008. The ability to request additional borrowings under this master shelf agreement expires on May 8, 2009. To meet potential future financing needs, Centennial may pursue other financing arrangements, including private and/or public financing.

Centennial's objective is to maintain acceptable credit ratings in order to access the capital markets through the issuance of commercial paper. Minor fluctuations in Centennial's credit ratings have not limited, nor would they be expected to limit, Centennial's ability to access the capital markets. In the event of a minor downgrade, Centennial may experience a nominal basis point increase in overall interest rates with respect to its cost of borrowings. If Centennial were to experience a significant downgrade of its credit ratings, it may need to borrow under its committed bank lines.

Prior to the maturity of the Centennial credit agreements, Centennial expects that it will negotiate the extension or replacement of these agreements, which provide credit support to access the capital markets. In the event Centennial was unable to successfully negotiate these agreements, or in the event the fees on such facilities became too expensive, which Centennial does not currently anticipate, it would seek alternative funding.

In order to borrow under Centennial's credit agreements and the Centennial uncommitted long-term master shelf agreement, Centennial and certain of its subsidiaries must be in compliance with the applicable covenants and certain other conditions. For more information on the covenants and certain other conditions for the \$400 million credit agreement and the master shelf agreement, see Part II,

Item 8 – Note 10, in the 2007 Annual Report. Centennial and such subsidiaries were in compliance with these covenants and met the required conditions at June 30, 2008. In the event Centennial or such subsidiaries do not comply with the applicable covenants and other conditions, alternative sources of funding may need to be pursued.

On June 27, 2008, Centennial entered into an \$80 million term loan agreement which matures on December 26, 2008. At June 30, 2008, \$80.0 million was outstanding under the term loan agreement. The term loan agreement contains customary covenants and default provisions, including a covenant not to permit, as of the end of any fiscal quarter, Centennial's ratio of total debt to total capitalization to exceed 65 percent. The covenants also include certain limitations on subsidiary indebtedness and restrictions on the sale of certain assets and on the making of certain loans and investments. Centennial was in compliance with these covenants and met the required conditions at June 30, 2008.

Certain of Centennial's financing agreements contain cross-default provisions. These provisions state that if Centennial or any subsidiary of Centennial fails to make any payment with respect to any indebtedness or contingent obligation, in excess of a specified amount, under any agreement that causes such indebtedness to be due prior to its stated maturity or the contingent obligation to become payable, the applicable agreements will be in default. Certain of Centennial's financing agreements and Centennial's practices limit the amount of subsidiary indebtedness.

Williston Basin Interstate Pipeline Company Williston Basin has an uncommitted long-term master shelf agreement that allows for borrowings of up to \$100 million. Under the terms of the master shelf agreement, \$80.0 million was outstanding at June 30, 2008. The ability to request additional borrowings under this master shelf agreement expires on December 20, 2008.

In order to borrow under its uncommitted long-term master shelf agreement, Williston Basin must be in compliance with the applicable covenants and certain other conditions. For more information on the covenants and certain other conditions for the uncommitted long-term master shelf agreement, see Part II, Item 8 – Note 10, in the 2007 Annual Report. Williston Basin was in compliance with these covenants and met the required conditions at June 30, 2008. In the event Williston Basin does not comply with the applicable covenants and other conditions, alternative sources of funding may need to be pursued.

Off balance sheet arrangements

In connection with the sale of MPX in June 2005 to Petrobras, an indirect wholly owned subsidiary of the Company has agreed to indemnify Petrobras for 49 percent of any losses that Petrobras may incur from certain contingent liabilities specified in the purchase agreement. For further information, see Note 19.

Centennial continues to guarantee CEM's obligations under a construction contract for a 550-MW combined-cycle electric generating facility near Hobbs, New Mexico. For further information, see Note 19.

Contractual obligations and commercial commitments

There are no material changes in the Company's contractual obligations relating to estimated interest payments, operating leases and uncertain tax positions from those reported in the 2007 Annual Report.

There are no material changes to the Company's contractual obligations relating to purchase commitments, except for the anticipated acquisition of Intermountain. For more information, see Note 20.

The Company's contractual obligations relating to long-term debt at June 30, 2008, increased \$253.8 million or 19 percent from December 31, 2007. At June 30, 2008, the Company's contractual obligations related to long-term debt aggregated \$1,562.3 million. The scheduled amounts of redemption (for the twelve months ended June 30, of each year listed) aggregate \$87.4 million in 2009; \$22.6 million in 2010; \$131.6 million in 2011; \$61.4 million in 2012; \$550.3 million in 2013; and \$709.0 million thereafter.

For more information on contractual obligations and commercial commitments, see Part II, Item 7 in the 2007 Annual Report.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to the impact of market fluctuations associated with commodity prices, interest rates and foreign currency. The Company has policies and procedures to assist in controlling these market risks and utilizes derivatives to manage a portion of its risk.

Commodity price risk

Fidelity utilizes derivative instruments to manage a portion of the market risk associated with fluctuations in the price of natural gas and oil on its forecasted sales of natural gas and oil production. Cascade utilizes derivative instruments to manage a portion of the market risk associated with fluctuations in the price of natural gas on its forecasted purchases of natural gas. For more information on derivative instruments and commodity price risk, see Part II, Item 7A in the 2007 Annual Report, and Notes 10 and 13.

The following table summarizes hedge agreements entered into by Fidelity and Cascade as of June 30, 2008. These agreements call for Fidelity to receive fixed prices and pay variable prices, and for Cascade to receive variable prices and pay fixed prices.

(Forward notional volume and fair value in thousands)

	Weighted Average Fixed Price (Per MMBtu)	Forward Notional Volume (MMBtu)	Fair Value
Fidelity			
Natural gas swap agreements maturing in 2008	\$8.52	10,505	\$ (38,377)
Natural gas swap agreements maturing in 2009	\$8.73	10,920	\$ (32,224)
Natural gas swap agreements maturing in 2010	\$8.08	1,606	\$ (4,273)
Natural gas swap agreements maturing in 2011	\$8.00	1,351	\$ (3,007)
Natural gas basis swap agreement maturing in 2009	\$0.61	3,650	\$ (484)
Cascade			
Natural gas swap agreements maturing in 2008	\$8.08	9,217	\$ 36,600
Natural gas swap agreements maturing in 2009	\$8.17	14,945	\$ 40,068
Natural gas swap agreements maturing in 2010	\$8.03	7,107	\$ 12,138
	Weighted Average Floor/Ceiling Price (Per MMBtu/Bbl)	Forward Notional Volume (MMBtu/Bbl)	Fair Value
Fidelity	\$7.33/\$8.60	7,306	\$ (25,413)

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Natural gas collar agreements maturing
in 2008

Natural gas collar agreements maturing
in 2009

Oil collar agreement maturing in 2008

\$8.52/\$9.56	14,965	\$	(32,232)
\$67.50/\$78.70	37	\$	(2,275)

Interest rate risk

There were no material changes to interest rate risk faced by the Company from those reported in the 2007 Annual Report. For more information on interest rate risk, see Part II, Item 7A in the 2007 Annual Report.

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At June 30, 2008 and 2007, and December 31, 2007, the Company had no outstanding interest rate hedges.

Foreign currency risk

MDU Brasil's equity method investments in the Brazilian Transmission Lines are exposed to market risks from changes in foreign currency exchange rates between the U.S. dollar and the Brazilian Real. For further information on foreign currency risk, see Part II, Item 8 – Note 4 in the 2007 Annual Report.

At June 30, 2008 and 2007, and December 31, 2007, the Company had no outstanding foreign currency hedges.

ITEM 4. CONTROLS AND PROCEDURES

The following information includes the evaluation of disclosure controls and procedures by the Company's chief executive officer and the chief financial officer, along with any significant changes in internal controls of the Company.

Evaluation of disclosure controls and procedures

The term "disclosure controls and procedures" is defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. These rules refer to the controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods. The Company's chief executive officer and chief financial officer have evaluated the effectiveness of the Company's disclosure controls and procedures and they have concluded that, as of the end of the period covered by this report, such controls and procedures were effective.

Changes in internal controls

The Company maintains a system of internal accounting controls that is designed to provide reasonable assurance that the Company's transactions are properly authorized, the Company's assets are safeguarded against unauthorized or improper use, and the Company's transactions are properly recorded and reported to permit preparation of the Company's financial statements in conformity with generally accepted accounting principles in the United States of America. There were no changes in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2008, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II -- OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

For information regarding legal proceedings, see Note 19, which is incorporated by reference.

ITEM 1A. RISK FACTORS

This Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Exchange Act. Forward-looking statements are all statements other than statements of historical fact, including without limitation those statements that are identified by the words "anticipates," "estimates," "expects," "intends," "plans," "predicts" and similar expressions.

The Company is including the following factors and cautionary statements in this Form 10-Q to make applicable and to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 for any forward-looking statements made by, or on behalf of, the Company. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions (many of which are based, in turn, upon further assumptions) and other statements that are other than statements of historical facts. From time to time, the Company may publish or otherwise make available forward-looking statements of this nature, including statements contained within Prospective Information. All these subsequent forward-looking statements, whether written or oral and whether made by or on behalf of the Company, also are expressly qualified by these factors and cautionary statements.

Forward-looking statements involve risks and uncertainties, which could cause actual results or outcomes to differ materially from those expressed. The Company's expectations, beliefs and projections are expressed in good faith and are believed by the Company to have a reasonable basis, including without limitation, management's examination of historical operating trends, data contained in the Company's records and other data available from third parties. Nonetheless, the Company's expectations, beliefs or projections may not be achieved or accomplished.

Any forward-looking statement contained in this document speaks only as of the date on which the statement is made, and the Company undertakes no obligation to update any forward-looking statement or statements to reflect events or circumstances that occur after the date on which the statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for management to predict all of the factors, nor can it assess the effect of each factor on the Company's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statement.

There are no material changes in the Company's risk factors from those reported in Part I, Item 1A – Risk Factors in the 2007 Annual Report other than the risk associated with the regulatory approval, permitting, construction, startup and operation of power generation facilities; the risk related to environmental laws and regulations; the risk related to a pending utility company acquisition; and the risk related to litigation with a nonaffiliated natural gas producer; as discussed below. These factors and the other matters discussed herein are important factors that could cause actual results or outcomes for the Company to differ materially from those discussed in the forward-looking statements included elsewhere in this document.

Economic Risks

The regulatory approval, permitting, construction, startup and operation of power generation facilities may involve unanticipated changes or delays that could negatively impact the Company's business and its results of operations and cash flows.

The construction, startup and operation of power generation facilities involves many risks, including: delays; breakdown or failure of equipment; competition; inability to obtain required governmental

permits and approvals; inability to negotiate acceptable acquisition, construction, fuel supply, off-take, transmission or other material agreements; changes in market price for power; cost increases; as well as the risk of performance below expected levels of output or efficiency. Such unanticipated events could negatively impact the Company's business, its results of operations and cash flows.

The Company is analyzing potential projects for accommodating load growth and replacing an expired purchased power contract with company-owned generation, which will add base-load capacity and rate base. A potential project is the planned participation in Big Stone Station II. Should regulatory approvals and permits not be received on a timely basis, the project could be at risk and the Company would need to pursue other generation sources.

Environmental and Regulatory Risks

Some of the Company's operations are subject to extensive environmental laws and regulations that may increase costs of operations, impact or limit business plans, or expose the Company to environmental liabilities.

The Company is subject to extensive environmental laws and regulations affecting many aspects of its present and future operations including air quality, water quality, waste management and other environmental considerations. These laws and regulations can result in increased capital, operating and other costs, and delays as a result of ongoing litigation and administrative proceedings and compliance, remediation, containment and monitoring obligations, particularly with regard to laws relating to power plant emissions and CBNG development. These laws and regulations generally require the Company to obtain and comply with a wide variety of environmental licenses, permits, inspections and other approvals. Public officials and entities, as well as private individuals and organizations, may seek injunctive relief or other remedies to enforce applicable environmental laws and regulations. The Company cannot predict the outcome (financial or operational) of any related litigation or administrative proceedings that may arise.

Existing environmental regulations may be revised and new regulations seeking to protect the environment may be adopted or become applicable to the Company. Various proposals related to the emission of greenhouse gases, such as carbon dioxide, are being considered at both the federal and state level. Revised or additional regulations, which result in increased compliance costs or additional operating restrictions, particularly if those costs are not fully recoverable from customers, could have a material adverse effect on the Company's results of operations and cash flows.

Other Risks

The Company's pending acquisition of Intermountain may be delayed or may not occur if certain conditions are not satisfied. Upon completion of the acquisition, if the Company is unable to integrate the Intermountain operations effectively, its future financial position or results of operations may be adversely affected.

The Company has entered into an agreement to acquire Intermountain. The total value of the transaction, including outstanding indebtedness, is approximately \$328 million. The completion of the acquisition is subject to the approval of various regulatory authorities and the satisfaction of other customary closing conditions. The Company's pending acquisition of Intermountain may be delayed or may not occur if the Company is unable to timely obtain necessary regulatory approvals, satisfy closing conditions or obtain financing. If the Company is unable to integrate the Intermountain operations effectively, its future financial position or results of operations may be adversely affected.

One of the Company's subsidiaries is engaged in litigation with a nonaffiliated natural gas producer that has been conducting drilling and production operations that the subsidiary believes is causing diversion and loss of quantities of storage gas from one of its storage reservoirs. If the subsidiary is not able to obtain relief through the courts or the regulatory process, its storage operations could be materially and adversely affected.

Based on relevant information, including reservoir and well pressure data, Williston Basin believes that EBSR pressures have decreased and that the storage reservoir has lost gas and continues to lose gas as a result of the drilling and production activities of Anadarko and its wholly owned subsidiary, Howell. Williston Basin filed suit in Montana Federal District Court seeking to recover unspecified damages from Anadarko and Howell, and to enjoin Anadarko and Howell's present and future production operations in and near the EBSR. This suit was dismissed by the Montana Federal District Court. The dismissal was affirmed by the Ninth Circuit. In related litigation, Howell filed suit in Wyoming State District Court against Williston Basin asserting that it is entitled to produce any gas that might escape from Williston Basin's storage reservoir. Williston Basin has answered Howell's complaint and has asserted counterclaims. If Williston Basin is unable to obtain timely relief through the courts or regulatory process, its present and future gas storage operations, including its ability to meet its contractual storage and transportation obligations to customers, could be materially and adversely affected.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Between April 1, 2008 and June 30, 2008, the Company issued 133,640 shares of common stock, \$1.00 par value, and the preference share purchase rights appurtenant thereto, as part of the consideration paid by the Company in the acquisition of businesses acquired by the Company in a prior period. The common stock and preference share purchase rights issued by the Company in these transactions were issued in a private transaction exempt from registration under the Securities Act of 1933, as amended, pursuant to Section 4(2) thereof, Rule 506 promulgated thereunder, or both. The classes of persons to whom these securities were sold were either accredited investors or other persons to whom such securities were permitted to be offered under the applicable exemption.

The following table includes information with respect to the Company's purchase of equity securities:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a)	(b)	(c)	(d)
	Total Number of Shares (or Units) Purchased (1)		Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs (2)
April 1 through April 30, 2008	36,625	\$ 28.51		
May 1 through May 31, 2008				
June 1 through June 30, 2008				
Total	36,625			

(1) Represents 175 shares of common stock withheld by the Company to pay taxes in connection with the vesting of shares granted pursuant to a compensation plan and 36,450 shares of common stock purchased on the open market in connection with annual stock grants made to the Company's non-employee directors.

(2) Not applicable. The Company does not currently have in place any publicly announced plans or programs to repurchase equity securities.

ITEM 6. EXHIBITS

See the index to exhibits immediately preceding the exhibits filed with this report.

SIGNATURES

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

MDU RESOURCES GROUP, INC.

DATE: August 7, 2008

BY: /s/ Vernon A. Raile
Vernon A. Raile
Executive Vice President, Treasurer
and Chief Financial Officer

BY: /s/ Doran N. Schwartz
Doran N. Schwartz
Vice President and Chief Accounting Officer

EXHIBIT INDEX

Exhibit No.

- 2 Stock Purchase Agreement by and between Intermountain Industries, Inc. and MDU Resources Group, Inc., dated as of July 1, 2008
- +10(a) Deferred Compensation Plan for Directors, as amended May 15, 2008
- +10(b) Directors' Compensation Policy, as amended May 15, 2008
- +10(c) Non-Employee Director Long-Term Incentive Compensation Plan, as amended May 15, 2008
- +10(d) Non-Employee Director Stock Compensation Plan, as amended May 15, 2008
- 12 Computation of Ratio of Earnings to Fixed Charges and Combined Fixed Charges and Preferred Stock Dividends
- 31(a) Certification of Chief Executive Officer filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31(b) Certification of Chief Financial Officer filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification of Chief Executive Officer and Chief Financial Officer furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

+ Management contract, compensatory plan or arrangement.

MDU Resources Group, Inc. agrees to furnish to the SEC upon request any instrument with respect to long-term debt that MDU Resources Group, Inc. has not filed as an exhibit pursuant to the exemption provided by Item 601(b)(4)(iii)(A) of Regulation S-K.

