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ATMOS ENERGY CORP  
Form 10-Q  
May 07, 2014

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 March 31, 2014  
or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 1-10042  
Atmos Energy Corporation  
(Exact name of registrant as specified in its charter)

Texas and Virginia  
(State or other jurisdiction of  
incorporation or organization)

75-1743247  
(IRS employer  
identification no.)

Three Lincoln Centre, Suite 1800  
5430 LBJ Freeway, Dallas, Texas  
(Address of principal executive offices)  
(972) 934-9227  
(Registrant's telephone number, including area code)

75240  
(Zip code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ 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. (Check one):

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 Exchange Act) Yes ☐ No ☒

Number of shares outstanding of each of the issuer's classes of common stock, as of May 1, 2014.

Class	Shares Outstanding
No Par Value	100,186,395

GLOSSARY OF KEY TERMS

AEC	Atmos Energy Corporation
AEH	Atmos Energy Holdings, Inc.
AEM	Atmos Energy Marketing, LLC
AOCI	Accumulated other comprehensive income
Bcf	Billion cubic feet
FASB	Financial Accounting Standards Board
Fitch	Fitch Ratings, Ltd.
GAAP	Generally Accepted Accounting Principles
GRIP	Gas Reliability Infrastructure Program
GSRS	Gas System Reliability Surcharge
Mcf	Thousand cubic feet
MMcf	Million cubic feet
Moody's	Moody's Investors Services, Inc.
NYMEX	New York Mercantile Exchange, Inc.
PPA	Pension Protection Act of 2006
PRP	Pipeline Replacement Program
RRC	Railroad Commission of Texas
RRM	Rate Review Mechanism
S&P	Standard & Poor's Corporation
SEC	United States Securities and Exchange Commission
WNA	Weather Normalization Adjustment

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## ATMOS ENERGY CORPORATION

## CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2014 (Unaudited) (In thousands, except share data)	September 30, 2013
<b>ASSETS</b>		
Property, plant and equipment	\$8,014,440	\$7,722,019
Less accumulated depreciation and amortization	1,744,457	1,691,364
Net property, plant and equipment	6,269,983	6,030,655
Current assets		
Cash and cash equivalents	136,740	66,199
Accounts receivable, net	671,021	301,992
Gas stored underground	124,950	244,741
Other current assets	126,450	64,201
Total current assets	1,059,161	677,133
Goodwill	741,363	741,363
Deferred charges and other assets	417,109	485,117
	\$8,487,616	\$7,934,268
<b>CAPITALIZATION AND LIABILITIES</b>		
Shareholders' equity		
Common stock, no par value (stated at \$.005 per share); 200,000,000 shares authorized; issued and outstanding: March 31, 2014 — 100,177,825 shares; September 30, 2013 — 90,640,211 shares	\$501	\$453
Additional paid-in capital	2,163,144	1,765,811
Retained earnings	924,282	775,267
Accumulated other comprehensive income	36,834	38,878
Shareholders' equity	3,124,761	2,580,409
Long-term debt	1,955,829	2,455,671
Total capitalization	5,080,590	5,036,080
Current liabilities		
Accounts payable and accrued liabilities	442,816	241,611
Other current liabilities	420,576	368,891
Short-term debt	—	367,984
Current maturities of long-term debt	500,000	—
Total current liabilities	1,363,392	978,486
Deferred income taxes	1,283,551	1,164,053
Regulatory cost of removal obligation	358,262	359,299
Pension and postretirement liabilities	360,851	358,787
Deferred credits and other liabilities	40,970	37,563
	\$8,487,616	\$7,934,268

See accompanying notes to condensed consolidated financial statements.

ATMOS ENERGY CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended March 31	
	2014	2013
	(Unaudited)	
	(In thousands, except per share data)	
Operating revenues		
Natural gas distribution segment	\$ 1,290,960	\$ 905,176
Regulated transmission and storage segment	73,615	61,848
Nonregulated segment	757,683	428,948
Intersegment eliminations	(157,936)	(86,976)
	1,964,322	1,308,996
Purchased gas cost		
Natural gas distribution segment	905,772	558,170
Regulated transmission and storage segment	—	—
Nonregulated segment	720,094	404,641
Intersegment eliminations	(157,821)	(86,566)
	1,468,045	876,245
Gross profit	496,277	432,751
Operating expenses		
Operation and maintenance	124,675	111,086
Depreciation and amortization	61,307	57,180
Taxes, other than income	60,215	54,307
Total operating expenses	246,197	222,573
Operating income	250,080	210,178
Miscellaneous income (expense)	(1,516)	1,712
Interest charges	31,601	33,331
Income from continuing operations before income taxes	216,963	178,559
Income tax expense	83,596	66,219
Income from continuing operations	133,367	112,340
Income from discontinued operations, net of tax (\$0 and \$2,258)	—	4,085
Net income	\$ 133,367	\$ 116,425
Basic earnings per share		
Income per share from continuing operations	\$ 1.40	\$ 1.24
Income per share from discontinued operations	—	0.04
Net income per share — basic	\$ 1.40	\$ 1.28
Diluted earnings per share		
Income per share from continuing operations	\$ 1.38	\$ 1.23
Income per share from discontinued operations	—	0.04
Net income per share — diluted	\$ 1.38	\$ 1.27
Cash dividends per share	\$0.37	\$0.35
Weighted average shares outstanding:		
Basic	95,264	90,530
Diluted	96,191	91,492

See accompanying notes to condensed consolidated financial statements.



ATMOS ENERGY CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Six Months Ended March 31	
	2014	2013
	(Unaudited)	
	(In thousands, except per share data)	
Operating revenues		
Natural gas distribution segment	\$2,134,825	\$1,571,963
Regulated transmission and storage segment	144,956	122,529
Nonregulated segment	1,205,404	828,842
Intersegment eliminations	(265,715)	(180,183)
	3,219,470	2,343,151
Purchased gas cost		
Natural gas distribution segment	1,450,466	945,326
Regulated transmission and storage segment	—	—
Nonregulated segment	1,149,249	782,076
Intersegment eliminations	(265,479)	(179,364)
	2,334,236	1,548,038
Gross profit	885,234	795,113
Operating expenses		
Operation and maintenance	240,432	217,613
Depreciation and amortization	121,776	116,759
Taxes, other than income	102,226	95,641
Total operating expenses	464,434	430,013
Operating income	420,800	365,100
Miscellaneous income (expense)	(3,648)	2,410
Interest charges	63,716	63,853
Income from continuing operations before income taxes	353,436	303,657
Income tax expense	133,053	113,969
Income from continuing operations	220,383	189,688
Income from discontinued operations, net of tax (\$0 and \$3,986)	—	7,202
Net income	\$220,383	\$196,890
Basic earnings per share		
Income per share from continuing operations	\$2.36	\$2.09
Income per share from discontinued operations	—	0.08
Net income per share — basic	\$2.36	\$2.17
Diluted earnings per share		
Income per share from continuing operations	\$2.34	\$2.07
Income per share from discontinued operations	—	0.08
Net income per share — diluted	\$2.34	\$2.15
Cash dividends per share	\$0.74	\$0.70
Weighted average shares outstanding:		
Basic	93,049	90,445
Diluted	93,976	91,406

See accompanying notes to condensed consolidated financial statements.

ATMOS ENERGY CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended March 31		Six Months Ended March 31	
	2014	2013	2014	2013
	(Unaudited)			
	(In thousands)			
Net income	\$133,367	\$116,425	\$220,383	\$196,890
Other comprehensive income (loss), net of tax				
Net unrealized holding gains (losses) on available-for-sale securities, net of tax of \$(133), \$(110), \$1,302 and \$(330)	(252	) (200	) 2,142	(573
Cash flow hedges:				
Amortization and unrealized gain (loss) on interest rate agreements, net of tax of \$(15,546), \$13,513, \$(7,533) and \$20,562	(27,047	) 23,509	(13,105	) 35,773
Net unrealized gains on commodity cash flow hedges, net of tax of \$703, \$5,650, \$5,702 and \$5,417	1,101	8,838	8,919	8,473
Total other comprehensive income (loss)	(26,198	) 32,147	(2,044	) 43,673
Total comprehensive income	\$107,169	\$148,572	\$218,339	\$240,563

See accompanying notes to condensed consolidated financial statements.



ATMOS ENERGY CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended March 31	
	2014	2013
	(Unaudited)	
	(In thousands)	
Cash Flows From Operating Activities		
Net income	\$220,383	\$196,890
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization:		
Charged to depreciation and amortization	121,776	118,608
Charged to other accounts	441	265
Deferred income taxes	119,710	106,891
Other	10,746	5,519
Net assets / liabilities from risk management activities	836	(14,709)
Net change in operating assets and liabilities	17,089	(37,123)
Net cash provided by operating activities	490,981	376,341
Cash Flows From Investing Activities		
Capital expenditures	(359,009)	(389,117)
Other, net	(4,904)	(3,700)
Net cash used in investing activities	(363,913)	(392,817)
Cash Flows From Financing Activities		
Net decrease in short-term debt	(369,012)	(342,141)
Net proceeds from equity offering	390,205	—
Net proceeds from issuance of long-term debt	—	493,793
Settlement of Treasury lock agreements	—	(66,626)
Repayment of long-term debt	—	(131)
Cash dividends paid	(71,380)	(64,008)
Repurchase of equity awards	(6,317)	(3,124)
Other	(23)	21
Net cash provided by (used in) financing activities	(56,527)	17,784
Net increase in cash and cash equivalents	70,541	1,308
Cash and cash equivalents at beginning of period	66,199	64,239
Cash and cash equivalents at end of period	\$136,740	\$65,547

See accompanying notes to condensed consolidated financial statements.

ATMOS ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

March 31, 2014

1. Nature of Business

Atmos Energy Corporation (“Atmos Energy” or the “Company”) and our subsidiaries are engaged primarily in the regulated natural gas distribution and transmission and storage businesses as well as certain other nonregulated businesses. For the fiscal year ended September 30, 2013, our regulated businesses generated approximately 95 percent of our consolidated net income.

Through our natural gas distribution business, we deliver natural gas through sales and transportation arrangements to approximately three million residential, commercial, public authority and industrial customers through our six regulated natural gas distribution divisions, which at March 31, 2014, covered service areas located in eight states. On April 1, 2013, we completed the divestiture of our natural gas distribution operations in Georgia, representing approximately 64,000 customers. In addition, we transport natural gas for others through our distribution system. Our regulated businesses also include our regulated pipeline and storage operations, which include the transportation of natural gas to our North Texas distribution system and the management of our underground storage facilities. Our regulated businesses are subject to federal and state regulation and/or regulation by local authorities in each of the states in which our natural gas distribution divisions operate.

Our nonregulated businesses operate primarily in the Midwest and Southeast through various wholly-owned subsidiaries of Atmos Energy Holdings, Inc., (AEH). AEH is wholly owned by the Company and based in Houston, Texas. Through AEH, we provide natural gas management and transportation services to municipalities, natural gas distribution companies, including certain divisions of Atmos Energy and third parties.

2. Unaudited Financial Information

These consolidated interim-period financial statements have been prepared in accordance with accounting principles generally accepted in the United States on the same basis as those used for the Company’s audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2013. In the opinion of management, all material adjustments (consisting of normal recurring accruals) necessary for a fair presentation have been made to the unaudited consolidated interim-period financial statements. These consolidated interim-period financial statements are condensed as permitted by the instructions to Form 10-Q and should be read in conjunction with the audited consolidated financial statements of Atmos Energy Corporation included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2013. Because of seasonal and other factors, the results of operations for the six-month period ended March 31, 2014 are not indicative of our results of operations for the full 2014 fiscal year, which ends September 30, 2014.

Except as noted in Note 7 and Note 8, no events have occurred subsequent to the balance sheet date that would require recognition or disclosure in the condensed consolidated financial statements.

Significant accounting policies

Our accounting policies are described in Note 2 to the consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended September 30, 2013.

During the second quarter of fiscal 2014, we completed our annual goodwill impairment assessment. Based on the assessment performed, we determined that our goodwill was not impaired.

Due to the April 1, 2013 sale of our Georgia distribution operations, prior year financial results for this service area are shown in discontinued operations.

Disclosure requirements for offsetting arrangements for financial instruments became effective for us beginning on October 1, 2013. We have presented these disclosures in Note 8. In connection with the adoption of this standard, prior-year risk management assets and liabilities have been reclassified to conform with the current-year presentation. The adoption of this standard and reclassification did not have an impact on our financial position, results of operations or cash flows. There were no other significant changes to our accounting policies nor were there new

accounting standards announced during the six months ended March 31, 2014 that will become applicable to the Company in future periods.

### Regulatory assets and liabilities

Accounting principles generally accepted in the United States require cost-based, rate-regulated entities that meet certain criteria to reflect the authorized recovery of costs due to regulatory decisions in their financial statements. As a result, certain costs are permitted to be capitalized rather than expensed because they can be recovered through rates. We record certain costs as regulatory assets when future recovery through customer rates is considered probable. Regulatory liabilities are recorded when it is probable that revenues will be reduced for amounts that will be credited to customers through the ratemaking process. Substantially all of our regulatory assets are recorded as a component of deferred charges and other assets and substantially all of our regulatory liabilities are recorded as a component of deferred credits and other liabilities. Deferred gas costs are recorded either in other current assets or liabilities and the regulatory cost of removal obligation is reported separately.

Significant regulatory assets and liabilities as of March 31, 2014 and September 30, 2013 included the following:

	March 31, 2014 (In thousands)	September 30, 2013
Regulatory assets:		
Pension and postretirement benefit costs <sup>(1)</sup>	\$176,616	\$187,977
Merger and integration costs, net	4,990	5,250
Deferred gas costs	10,004	15,152
Regulatory cost of removal asset	9,716	10,008
Rate case costs	5,037	6,329
Texas Rule 8.209 <sup>(2)</sup>	40,760	30,364
APT annual adjustment mechanism	4,084	5,853
Recoverable loss on reacquired debt	20,156	21,435
Other	6,393	4,380
	\$277,756	\$286,748
Regulatory liabilities:		
Deferred gas costs	\$80,330	\$16,481
Deferred franchise fees	11,523	1,689
Regulatory cost of removal obligation	425,461	427,524
Other	11,683	7,887
	\$528,997	\$453,581

(1) Includes \$18.1 million and \$17.4 million of pension and postretirement expense deferred pursuant to regulatory authorization.

Texas Rule 8.209 is a Railroad Commission rule that allows for the deferral of all expenses associated with capital expenditures incurred pursuant to this rule, including the recording of interest on the deferred expenses until the next rate proceeding (rate case or annual rate filing), at which time investment and costs would be recovered through base rates.

Currently authorized rates do not include a return on certain of our merger and integration costs; however, we recover the amortization of these costs. Merger and integration costs, net, are generally amortized on a straight-line basis over estimated useful lives ranging up to 20 years.

### 3. Segment Information

We operate the Company through the following three segments:

- The natural gas distribution segment, which includes our regulated natural gas distribution and related sales operations,

- The regulated transmission and storage segment, which includes the regulated pipeline and storage operations of our Atmos Pipeline — Texas Division and

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The nonregulated segment, which is comprised of our nonregulated natural gas management, nonregulated natural gas transmission, storage and other services.

Our determination of reportable segments considers the strategic operating units under which we manage sales of various products and services to customers in differing regulatory environments. Although our natural gas distribution segment operations are geographically dispersed, they are reported as a single segment as each natural gas distribution division has similar economic characteristics. The accounting policies of the segments are the same as those described in the summary of

significant accounting policies found in our Annual Report on Form 10-K for the fiscal year ended September 30, 2013. We evaluate performance based on net income or loss of the respective operating units.

Income statements for the three and six month periods ended March 31, 2014 and 2013 by segment are presented in the following tables:

	Three Months Ended March 31, 2014				
	Natural Gas Distribution	Regulated Transmission and Storage	Nonregulated	Eliminations	Consolidated
	(In thousands)				
Operating revenues from external parties	\$1,289,429	\$21,002	\$653,891	\$—	\$1,964,322
Intersegment revenues	1,531	52,613	103,792	(157,936)	—
	1,290,960	73,615	757,683	(157,936)	1,964,322
Purchased gas cost	905,772	—	720,094	(157,821)	1,468,045
Gross profit	385,188	73,615	37,589	(115)	496,277
Operating expenses					
Operation and maintenance	106,776	16,595	1,419	(115)	124,675
Depreciation and amortization	50,020	10,156	1,131	—	61,307
Taxes, other than income	60,606	(1,232)	841	—	60,215
Total operating expenses	217,402	25,519	3,391	(115)	246,197
Operating income	167,786	48,096	34,198	—	250,080
Miscellaneous income (expense)	97	(1,081)	443	(975)	(1,516)
Interest charges	22,828	9,155	593	(975)	31,601
Income before income taxes	145,055	37,860	34,048	—	216,963
Income tax expense	56,312	13,751	13,533	—	83,596
Net income	\$88,743	\$24,109	\$20,515	\$—	\$133,367
Capital expenditures	\$139,555	\$39,000	\$(113)	\$—	\$178,442

	Three Months Ended March 31, 2013				
	Natural Gas Distribution (In thousands)	Regulated Transmission and Storage	Nonregulated	Eliminations	Consolidated
Operating revenues from external parties	\$904,181	\$19,655	\$385,160	\$—	\$1,308,996
Intersegment revenues	995	42,193	43,788	(86,976)	) —
	905,176	61,848	428,948	(86,976)	) 1,308,996
Purchased gas cost	558,170	—	404,641	(86,566)	) 876,245
Gross profit	347,006	61,848	24,307	(410)	) 432,751
Operating expenses					
Operation and maintenance	89,344	15,390	6,763	(411)	) 111,086
Depreciation and amortization	47,631	8,690	859	—	57,180
Taxes, other than income	49,592	4,277	438	—	54,307
Total operating expenses	186,567	28,357	8,060	(411)	) 222,573
Operating income	160,439	33,491	16,247	1	210,178
Miscellaneous income (expense)	2,591	(99)	) (91)	) (689)	) 1,712
Interest charges	25,664	7,857	498	(688)	) 33,331
Income from continuing operations before income taxes	137,366	25,535	15,658	—	178,559
Income tax expense	51,176	9,005	6,038	—	66,219
Income from continuing operations	86,190	16,530	9,620	—	112,340
Income from discontinued operations, net of tax	4,085	—	—	—	4,085
Net income	\$90,275	\$16,530	\$9,620	\$—	\$116,425
Capital expenditures	\$131,465	\$67,208	\$417	\$—	\$199,090

	Six Months Ended March 31, 2014				
	Natural Gas Distribution	Regulated Transmission and Storage	Nonregulated	Eliminations	Consolidated
	(In thousands)				
Operating revenues from external parties	\$2,131,861	\$42,172	\$ 1,045,437	\$—	\$3,219,470
Intersegment revenues	2,964	102,784	159,967	(265,715 )	—
	2,134,825	144,956	1,205,404	(265,715 )	3,219,470
Purchased gas cost	1,450,466	—	1,149,249	(265,479 )	2,334,236
Gross profit	684,359	144,956	56,155	(236 )	885,234
Operating expenses					
Operation and maintenance	196,439	33,895	10,334	(236 )	240,432
Depreciation and amortization	99,571	19,942	2,263	—	121,776
Taxes, other than income	97,690	3,431	1,105	—	102,226
Total operating expenses	393,700	57,268	13,702	(236 )	464,434
Operating income	290,659	87,688	42,453	—	420,800
Miscellaneous income (expense)	(374 )	(2,262 )	767	(1,779 )	(3,648 )
Interest charges	46,153	18,112	1,230	(1,779 )	63,716
Income from before income taxes	244,132	67,314	41,990	—	353,436
Income tax expense	92,632	23,759	16,662	—	133,053
Net income	\$151,500	\$43,555	\$25,328	\$—	\$220,383
Capital expenditures	\$267,061	\$91,921	\$27	\$—	\$359,009



	Six Months Ended March 31, 2013				
	Natural Gas Distribution	Regulated Transmission and Storage	Nonregulated	Eliminations	Consolidated
	(In thousands)				
Operating revenues from external parties	\$1,569,730	\$38,354	\$735,067	\$—	\$2,343,151
Intersegment revenues	2,233	84,175	93,775	(180,183)	—
	1,571,963	122,529	828,842	(180,183)	2,343,151
Purchased gas cost	945,326	—	782,076	(179,364)	1,548,038
Gross profit	626,637	122,529	46,766	(819)	795,113
Operating expenses					
Operation and maintenance	173,080	31,710	13,645	(822)	217,613
Depreciation and amortization	97,691	17,080	1,988	—	116,759
Taxes, other than income	86,343	8,226	1,072	—	95,641
Total operating expenses	357,114	57,016	16,705	(822)	430,013
Operating income	269,523	65,513	30,061	3	365,100
Miscellaneous income (expense)	2,460	(226)	1,576	(1,400)	2,410
Interest charges	49,227	14,728	1,295	(1,397)	63,853
Income from continuing operations before income taxes	222,756	50,559	30,342	—	303,657
Income tax expense	83,473	17,924	12,572	—	113,969
Income from continuing operations	139,283	32,635	17,770	—	189,688
Income from discontinued operations, net of tax	7,202	—	—	—	7,202
Net income	\$146,485	\$32,635	\$17,770	\$—	\$196,890
Capital expenditures	\$277,336	\$111,039	\$742	\$—	\$389,117

Balance sheet information at March 31, 2014 and September 30, 2013 by segment is presented in the following tables.

	March 31, 2014				
	Natural Gas Distribution	Regulated Transmission and Storage	Nonregulated	Eliminations	Consolidated
	(In thousands)				
ASSETS					
Property, plant and equipment, net	\$4,889,160	\$1,322,441	\$58,382	\$—	\$6,269,983
Investment in subsidiaries	908,939	—	(2,096)	(906,843)	—
Current assets					
Cash and cash equivalents	73,165	—	63,575	—	136,740
Assets from risk management activities	58,746	—	7,940	—	66,686
Other current assets	609,806	14,363	610,515	(378,949)	855,735
Intercompany receivables	786,428	—	—	(786,428)	—
Total current assets	1,528,145	14,363	682,030	(1,165,377)	1,059,161
Goodwill	574,190	132,462	34,711	—	741,363
Noncurrent assets from risk management activities	30,665	—	8,910	—	39,575
Deferred charges and other assets	350,362	19,585	7,587	—	377,534
	\$8,281,461	\$1,488,851	\$789,524	\$(2,072,220)	\$8,487,616
CAPITALIZATION AND LIABILITIES					
Shareholders' equity	\$3,124,761	\$439,977	\$468,962	\$(908,939)	\$3,124,761
Long-term debt	1,955,829	—	—	—	1,955,829
Total capitalization	5,080,590	439,977	468,962	(908,939)	5,080,590
Current liabilities					
Current maturities of long-term debt	500,000	—	—	—	500,000
Short-term debt	343,000	—	—	(343,000)	—
Other current liabilities	658,106	13,654	225,485	(33,853)	863,392
Intercompany payables	—	708,046	78,382	(786,428)	—
Total current liabilities	1,501,106	721,700	303,867	(1,163,281)	1,363,392
Deferred income taxes	943,831	324,879	14,841	—	1,283,551
Regulatory cost of removal obligation	358,262	—	—	—	358,262
Pension and postretirement liabilities	360,851	—	—	—	360,851
Deferred credits and other liabilities	36,821	2,295	1,854	—	40,970
	\$8,281,461	\$1,488,851	\$789,524	\$(2,072,220)	\$8,487,616

	September 30, 2013				
	Natural Gas Distribution	Regulated Transmission and Storage	Nonregulated	Eliminations	Consolidated
	(In thousands)				
ASSETS					
Property, plant and equipment, net	\$4,719,873	\$1,249,767	\$61,015	\$—	\$6,030,655
Investment in subsidiaries	831,136	—	(2,096)	(829,040)	—
Current assets					
Cash and cash equivalents	4,237	—	61,962	—	66,199
Assets from risk management activities	1,837	—	10,129	—	11,966
Other current assets	428,366	11,709	452,126	(293,233)	598,968
Intercompany receivables	783,738	—	—	(783,738)	—
Total current assets	1,218,178	11,709	524,217	(1,076,971)	677,133
Goodwill	574,190	132,462	34,711	—	741,363
Noncurrent assets from risk management activities	109,354	—	—	—	109,354
Deferred charges and other assets	347,687	19,227	8,849	—	375,763
	\$7,800,418	\$1,413,165	\$626,696	\$(1,906,011)	\$7,934,268
CAPITALIZATION AND LIABILITIES					
Shareholders' equity	\$2,580,409	\$396,421	\$434,715	\$(831,136)	\$2,580,409
Long-term debt	2,455,671	—	—	—	2,455,671
Total capitalization	5,036,080	396,421	434,715	(831,136)	5,036,080
Current liabilities					
Current maturities of long-term debt	—	—	—	—	—
Short-term debt	645,984	—	—	(278,000)	367,984
Liabilities from risk management activities	1,543	—	—	—	1,543
Other current liabilities	491,681	20,288	110,306	(13,316)	608,959
Intercompany payables	—	712,768	70,970	(783,738)	—
Total current liabilities	1,139,208	733,056	181,276	(1,075,054)	978,486
Deferred income taxes	871,360	283,554	8,960	179	1,164,053
Regulatory cost of removal obligation	359,299	—	—	—	359,299
Pension and postretirement liabilities	358,787	—	—	—	358,787
Deferred credits and other liabilities	35,684	134	1,745	—	37,563
	\$7,800,418	\$1,413,165	\$626,696	\$(1,906,011)	\$7,934,268

#### 4. Earnings Per Share

We use the two-class method of computing earnings per share because we have participating securities in the form of non-vested restricted stock units with a nonforfeitable right to dividend equivalents, for which vesting is predicated solely on the passage of time. The calculation of earnings per share using the two-class method excludes income attributable to these participating securities from the numerator and excludes the dilutive impact of those shares from the denominator. Basic and diluted earnings per share for the three and six months ended March 31, 2014 and 2013 are calculated as follows:

	Three Months Ended March 31		Six Months Ended March 31	
	2014	2013	2014	2013
	(In thousands, except per share amounts)			
Basic Earnings Per Share from continuing operations				
Income from continuing operations	\$ 133,367	\$ 112,340	\$ 220,383	\$ 189,688
Less: Income from continuing operations allocated to participating securities	337	304	578	634
Income from continuing operations available to common shareholders	\$ 133,030	\$ 112,036	\$ 219,805	\$ 189,054
Basic weighted average shares outstanding	95,264	90,530	93,049	90,445
Income from continuing operations per share — Basic	\$ 1.40	\$ 1.24	\$ 2.36	\$ 2.09
Basic Earnings Per Share from discontinued operations				
Income from discontinued operations	\$ —	\$ 4,085	\$ —	\$ 7,202
Less: Income from discontinued operations allocated to participating securities	—	11	—	24
Income from discontinued operations available to common shareholders	\$ —	\$ 4,074	\$ —	\$ 7,178
Basic weighted average shares outstanding	95,264	90,530	93,049	90,445
Income from discontinued operations per share — Basic	\$ —	\$ 0.04	\$ —	\$ 0.08
Net income per share — Basic	\$ 1.40	\$ 1.28	\$ 2.36	\$ 2.17

	Three Months Ended March 31		Six Months Ended March 31	
	2014	2013	2014	2013
(In thousands, except per share amounts)				
Diluted Earnings Per Share from continuing operations				
Income from continuing operations available to common shareholders	\$ 133,030	\$ 112,036	\$ 219,805	\$ 189,054
Effect of dilutive stock options and other shares	2	2	4	5
Income from continuing operations available to common shareholders	\$ 133,032	\$ 112,038	\$ 219,809	\$ 189,059
Basic weighted average shares outstanding	95,264	90,530	93,049	90,445
Additional dilutive stock options and other shares	927	962	927	961
Diluted weighted average shares outstanding	96,191	91,492	93,976	91,406
Income from continuing operations per share — Diluted	\$ 1.38	\$ 1.23	\$ 2.34	\$ 2.07
Diluted Earnings Per Share from discontinued operations				
Income from discontinued operations available to common shareholders	\$—	\$ 4,074	\$—	\$ 7,178
Effect of dilutive stock options and other shares	—	—	—	—
Income from discontinued operations available to common shareholders	\$—	\$ 4,074	\$—	\$ 7,178
Basic weighted average shares outstanding	95,264	90,530	93,049	90,445
Additional dilutive stock options and other shares	927	962	927	961
Diluted weighted average shares outstanding	96,191	91,492	93,976	91,406
Income from discontinued operations per share — Diluted	\$—	\$ 0.04	\$—	\$ 0.08
Net income per share — Diluted	\$ 1.38	\$ 1.27	\$ 2.34	\$ 2.15

There were no out-of-the-money stock options excluded from the computation of diluted earnings per share for the three and six months ended March 31, 2014 and 2013 as their exercise price was less than the average market price of the common stock during those periods.

#### 2014 Equity Offering

On February 18, 2014, we completed the public offering of 9,200,000 shares of our common stock including the underwriters' exercise of their overallotment option of 1,200,000 shares under our existing shelf registration statement. The offering was priced at \$44.00 and generated net proceeds of \$390.2 million, which were used to repay short-term debt outstanding under our \$950 million commercial paper program, to fund infrastructure spending primarily to enhance the safety and reliability of our system and for general corporate purposes.

#### 2011 Share Repurchase Program

We did not repurchase any shares during the six months ended March 31, 2014 and 2013 under our 2011 share repurchase program.

## 5. Debt

The nature and terms of our debt instruments and credit facilities are described in detail in Note 5 to the consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended September 30, 2013. Except as noted below, there were no material changes in the terms of our debt instruments during the six months ended March 31, 2014.

### Long-term debt

Long-term debt at March 31, 2014 and September 30, 2013 consisted of the following:

	March 31, 2014 (In thousands)	September 30, 2013
Unsecured 4.95% Senior Notes, due October 2014	\$500,000	\$500,000
Unsecured 6.35% Senior Notes, due 2017	250,000	250,000
Unsecured 8.50% Senior Notes, due 2019	450,000	450,000
Unsecured 5.95% Senior Notes, due 2034	200,000	200,000
Unsecured 5.50% Senior Notes, due 2041	400,000	400,000
Unsecured 4.15% Senior Notes, due 2043	500,000	500,000
Medium-term note Series A, 1995-1, 6.67%, due 2025	10,000	10,000
Unsecured 6.75% Debentures, due 2028	150,000	150,000
Total long-term debt	2,460,000	2,460,000
Less:		
Original issue discount on unsecured senior notes and debentures	4,171	4,329
Current maturities	500,000	—
	\$1,955,829	\$2,455,671

### Short-term debt

Our short-term debt is utilized to fund ongoing working capital needs, such as our seasonal requirements for gas supply, general corporate liquidity and capital expenditures. Our short-term borrowing requirements are affected primarily by the seasonal nature of the natural gas business. Changes in the price of natural gas and the amount of natural gas we need to supply our customers' needs could significantly affect our borrowing requirements. Our short-term borrowings typically reach their highest levels in the winter months.

We currently finance our short-term borrowing requirements through a combination of a \$950 million commercial paper program, four committed revolving credit facilities and one uncommitted revolving credit facility with third-party lenders. These facilities provide approximately \$1 billion of working capital funding. At March 31, 2014, there were no short-term debt borrowings outstanding. At September 30, 2013, there was a total of \$368.0 million outstanding under our commercial paper program.

### Regulated Operations

We fund our regulated operations as needed, primarily through our commercial paper program and three committed revolving credit facilities with third-party lenders that provide approximately \$985 million of working capital funding, including a five-year \$950 million unsecured facility with an accordion feature, which, if utilized would increase the borrowing capacity to \$1.2 billion, a \$25 million unsecured facility and a \$10 million unsecured revolving credit facility, which is used primarily to issue letters of credit. Due to outstanding letters of credit, the total amount available to us under our \$10 million revolving credit facility was \$4.1 million at March 31, 2014.

In addition to these third-party facilities, our regulated operations have a \$500 million intercompany revolving credit facility with AEH, which bears interest at the lower of (i) the Eurodollar rate under the five-year revolving credit facility or (ii) the rate outstanding under the commercial paper program. Applicable state regulatory commissions have approved our use of this facility through December 31, 2014.



#### Nonregulated Operations

Atmos Energy Marketing, LLC (AEM), which is wholly owned by AEH, had two \$25 million 364-day bilateral credit facilities that expired in December 2013. In December 2013, the \$25 million 364-day uncommitted bilateral facility was extended to December 2014. In January 2014, this facility was amended to temporarily increase the amount available to \$50 million to address the increase in volumes and prices driven by colder than normal weather this winter-heating season. The maximum available under the facility will return to \$25 million on June 30, 2014. The \$25 million committed bilateral facility was replaced with a \$15 million committed 364-day bilateral credit facility in December 2013. These facilities are used primarily to issue letters of credit. Due to outstanding letters of credit, the total amount available to us under these bilateral credit facilities was \$33.7 million at March 31, 2014.

AEH has a \$500 million intercompany demand credit facility with AEC. This facility bears interest at a rate equal to the one-month LIBOR rate plus 3.00 percent or (ii) the rate for AEM's borrowings under its committed credit facility plus 0.75 percent. Applicable state regulatory commissions have approved our use of this facility through December 31, 2014.

#### Shelf Registration

We filed a shelf registration statement with the Securities and Exchange Commission (SEC) on March 28, 2013 that originally permitted us to issue a total of \$1.75 billion in common stock and/or debt securities. On February 18, 2014, we completed the public offering of 9,200,000 shares of our common stock, which generated net proceeds of \$390.2 million. As of March 31, 2014, \$1.35 billion of securities remained available for issuance under the shelf registration statement until March 28, 2016.

#### Debt Covenants

The availability of funds under our regulated credit facilities is subject to conditions specified in the respective credit agreements, all of which we currently satisfy. These conditions include our compliance with financial covenants and the continued accuracy of representations and warranties contained in these agreements. We are required by the financial covenants in each of these facilities to maintain, at the end of each fiscal quarter, a ratio of total debt to total capitalization of no greater than 70 percent. At March 31, 2014, our total-debt-to-total-capitalization ratio, as defined in the agreements, was 46 percent. In addition, both the interest margin and the fee that we pay on unused amounts under certain of these facilities are subject to adjustment depending upon our credit ratings.

In addition to these financial covenants, our credit facilities and public indentures contain usual and customary covenants for our business, including covenants substantially limiting liens, substantial asset sales and mergers. Additionally, our public debt indentures relating to our senior notes and debentures, as well as certain of our revolving credit agreements, each contain a default provision that is triggered if outstanding indebtedness arising out of any other credit agreements in amounts ranging from in excess of \$15 million to in excess of \$100 million becomes due by acceleration or is not paid at maturity.

We were in compliance with all of our debt covenants as of March 31, 2014. If we were unable to comply with our debt covenants, we would likely be required to repay our outstanding balances on demand, provide additional collateral or take other corrective actions.

#### 6. Interim Pension and Other Postretirement Benefit Plan Information

The components of our net periodic pension cost for our pension and other postretirement benefit plans for the three and six months ended March 31, 2014 and 2013 are presented in the following table. Most of these costs are recoverable through our gas distribution rates; however, a portion of these costs is capitalized into our gas distribution rate base. The remaining costs are recorded as a component of operation and maintenance expense. On October 2, 2013, due to the retirement of one of our executive officers, we recognized a settlement loss of \$4.5 million associated with our Supplemental Executive Benefits Plan (SEBP). In association with the retirement, on October 2, 2013, we made a \$16.8 million benefit payment from the SEBP.



	Three Months Ended March 31			
	Pension Benefits		Other Benefits	
	2014	2013	2014	2013
	(In thousands)			
Components of net periodic pension cost:				
Service cost	\$4,738	\$5,203	\$4,196	\$4,700
Interest cost	6,824	6,023	3,988	3,241
Expected return on assets	(5,900)	) (5,738)	) (1,292)	) (997)
Amortization of transition obligation	—	—	68	270
Amortization of prior service credit	(34)	) (36)	) (362)	) (363)
Amortization of actuarial loss	3,930	5,562	158	1,049
Net periodic pension cost	\$9,558	\$11,014	\$6,756	\$7,900
	Six Months Ended March 31			
	Pension Benefits		Other Benefits	
	2014	2013	2014	2013
	(In thousands)			
Components of net periodic pension cost:				
Service cost	\$9,476	\$10,405	\$8,392	\$9,400
Interest cost	13,648	12,048	7,976	6,482
Expected return on assets	(11,801)	) (11,477)	) (2,584)	) (1,994)
Amortization of transition obligation	—	—	136	540
Amortization of prior service credit	(68)	) (71)	) (725)	) (725)
Amortization of actuarial loss	7,862	11,123	316	2,098
Settlement loss	4,539	—	—	—
Net periodic pension cost	\$23,656	\$22,028	\$13,511	\$15,801

The assumptions used to develop our net periodic pension cost for the three and six months ended March 31, 2014 and 2013 are as follows:

	Pension Benefits		Other Benefits		
	2014	2013	2014	2013	
Discount rate	4.95	% 4.04	% 4.95	% 4.04	%
Rate of compensation increase	3.50	% 3.50	% N/A	N/A	
Expected return on plan assets	7.25	% 7.75	% 4.60	% 4.70	%

The discount rate used to compute the present value of a plan's liabilities generally is based on rates of high-grade corporate bonds with maturities similar to the average period over which the benefits will be paid. Generally, our funding policy has been to contribute annually an amount in accordance with the requirements of the Employee Retirement Income Security Act of 1974. In accordance with the Pension Protection Act of 2006 (PPA), we determined the funded status of our plans as of January 1, 2014. During the first six months of fiscal 2014, we contributed \$9.1 million to our defined benefit plans and we anticipate contributing approximately \$10 million to \$35 million during fiscal 2014.

We contributed \$11.6 million to our other post-retirement benefit plans during the six months ended March 31, 2014. We expect to contribute a total of approximately \$20 million to \$25 million to these plans during fiscal 2014.

## 7. Commitments and Contingencies

### Litigation and Environmental Matters

With respect to the specific litigation and environmental-related matters or claims that were disclosed in Note 10 to the financial statements in our Annual Report on Form 10-K for the fiscal year ended September 30, 2013, except as noted below, there were no material changes in the status of such litigation and environmental-related matters or claims during the six months ended March 31, 2014.

#### Kentucky Litigation

Since April 2009, Atmos Energy and two subsidiaries of AEH, Atmos Energy Marketing, LLC (AEM) and Atmos Gathering Company, LLC (AGC) (collectively, the Atmos Entities), have been involved in a lawsuit filed in the Circuit Court of Edmonson County, Kentucky related to our Park City Gathering Project. The dispute which gave rise to the litigation involves the amount of royalties due from a third party producer to landowners (who own the mineral rights) for natural gas produced from the landowners' properties. The third party producer was operating pursuant to leases between the landowners and certain investors/working interest owners. The third party producer filed a petition in bankruptcy, which was subsequently dismissed due to the lack of meaningful assets to reorganize or liquidate. Although certain Atmos Energy companies entered into contracts with the third party producer to gather, treat and ultimately sell natural gas produced from the landowners' properties, no Atmos Energy company had a contractual relationship with the landowners or the investors/working interest owners. After the lawsuit was filed, the landowners were successful in terminating for non-payment of royalties the leases related to the production of natural gas from their properties. Subsequent to termination, the investors/working interest owners under such leases filed additional claims against us for the termination of the leases.

During the trial, the landowners and the investors/working interest owners requested an award of compensatory damages plus punitive damages against us. On December 17, 2010, the jury returned a verdict in favor of the landowners and investor/working interest owners and awarded compensatory damages of \$3.8 million and punitive damages of \$27.5 million payable by Atmos Energy and the two AEH subsidiaries.

A hearing was held on February 28, 2011 to hear a number of motions, including a motion to dismiss the jury verdict and a motion for a new trial. The motions to dismiss the jury verdict and for a new trial were denied. However, the total punitive damages award was reduced from \$27.5 million to \$24.7 million. On October 17, 2011, we filed our brief of appellants with the Kentucky Court of Appeals, appealing the verdict of the trial court. The appellees in this case subsequently filed their appellees' brief with the Court of Appeals on January 16, 2012, with our reply brief being filed with the Court of Appeals on March 19, 2012. Oral arguments were held in the case on August 27, 2012.

In an opinion handed down on January 25, 2013, the Court of Appeals overturned the \$28.5 million jury verdict returned against the Atmos Entities. In a unanimous decision by a three-judge panel, the Court of Appeals reversed the claims asserted by the landowners and investors/working interest owners. The Court of Appeals concluded that all of such claims that the Atmos Entities appealed should have been dismissed by the trial court as a matter of law. The Court of Appeals let stand the jury verdict on one claim that Atmos Energy and our subsidiaries chose not to appeal, which was a trespass claim. The jury had awarded a total of \$10,000 in compensatory damages to one landowner on that claim. The Court of Appeals vacated all of the other damages awarded by the jury and remanded the case to the trial court for a new trial, solely on the issue of whether punitive damages should be awarded to that landowner and, if so, in what amount.

The investors/working interest owners, on February 25, 2013, and the landowners, on March 19, 2013, each filed with the Supreme Court of Kentucky, separate motions for discretionary review of the opinion of the Court of Appeals. We filed responses to the motions. The Kentucky Supreme Court denied the motions for discretionary review on February 12, 2014. The decision of the Court of Appeals became final on February 21, 2014. Atmos has filed a motion with the trial court for entry of judgment dismissing all claims against it, except for the trespass claim. Atmos' motion seeks a ruling by the trial court that the remaining landowner is not entitled to any punitive damages on that claim. That motion is currently scheduled to be heard on May 19, 2014.

We had previously accrued what we believed to be an adequate amount for the anticipated resolution of this matter. This accrual was reversed during the second fiscal quarter as the appellate process in this case has been completed.

In addition, in a related matter, on July 12, 2011, the Atmos Entities filed a lawsuit in the United States District Court, Western District of Kentucky, Atmos Energy Corporation et al. vs. Resource Energy Technologies, LLC and Robert Thorpe and John F. Charles, against the third party producer and its affiliates to recover all costs, including attorneys' fees, incurred by the Atmos Entities, which are associated with the defense and appeal of the case discussed above as well as for all damages awarded to the plaintiffs in such case against the Atmos Entities. The total amount of damages being claimed in the lawsuit is "open-ended" since the appellate process and related costs are ongoing. This lawsuit is based upon the indemnification

provisions agreed to by the third party producer in favor of Atmos Gathering that are contained in an agreement entered into between Atmos Gathering and the third party producer in May 2009. The defendants filed a motion to dismiss the case on August 25, 2011, with Atmos Energy filing a brief in response to such motion on September 19, 2011. On March 27, 2012 the court denied the motion to dismiss. Discovery has been completed, and dispositive motions are due on June 30, 2014. This case is scheduled for trial beginning October 6, 2014.

#### Tennessee Business License Tax

Atmos Energy, through its affiliate, AEM, has been involved in a dispute with the Tennessee Department of Revenue (TDOR) regarding sales business tax audits over a period of several years. The cumulative assessment approximated \$12 million as of March 31, 2014, which AEM has challenged. We had previously accrued in prior years what we believed to be an adequate amount for the anticipated resolution of this matter. With respect to certain issues, AEM and the TDOR filed competing Partial Motions for Summary Judgment with the Chancery Court. On August 2, 2013, the Chancery Court granted the TDOR's Partial Motion for Summary Judgment and denied AEM's Partial Motion for Summary Judgment. A filing deadline was set for filing any cross motions for partial summary judgment as to the remaining issues. On May 2, 2014, the Company and the TDOR executed an agreed order of dismissal with prejudice whereby AEM agreed to pay \$6.2 million to resolve all business tax-related liabilities outstanding through September 2014. The order of dismissal will become effective upon approval of the Chancery Court.

We are a party to other litigation and environmental-related matters or claims that have arisen in the ordinary course of our business. While the results of such litigation and response actions to such environmental-related matters or claims cannot be predicted with certainty, we continue to believe the final outcome of such litigation and matters or claims will not have a material adverse effect on our financial condition, results of operations or cash flows.

#### Purchase Commitments

AEH has commitments to purchase physical quantities of natural gas under contracts indexed to the forward NYMEX strip or fixed price contracts. At March 31, 2014, AEH was committed to purchase 100.5 Bcf within one year, 15.9 Bcf within one to three years and 0.8 Bcf after three years under indexed contracts. AEH is committed to purchase 9.5 Bcf within one year and 0.8 Bcf within one to three years under fixed price contracts with prices ranging from \$3.75 to \$6.36 per Mcf. Purchases under these contracts totaled \$621.1 million and \$327.8 million for the three months ended March 31, 2014 and 2013 and \$971.3 million and \$617.3 million for the six months ended March 31, 2014 and 2013.

Our natural gas distribution divisions maintain supply contracts with several vendors that generally cover a period of up to one year. Commitments for estimated base gas volumes are established under these contracts on a monthly basis at contractually negotiated prices. Commitments for incremental daily purchases are made as necessary during the month in accordance with the terms of the individual contract.

Our nonregulated segment maintains long-term contracts related to storage and transportation. The estimated contractual demand fees for contracted storage and transportation under these contracts are detailed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2013. There were no material changes to the estimated storage and transportation fees for the six months ended March 31, 2014.

#### Regulatory Matters

Various regulatory agencies, including the SEC and the Commodities Futures Trading Commission, continue to adopt regulations implementing many of the provisions of the Dodd-Frank Act of 2010. We continue to enact new procedures and modify existing business practices and contractual arrangements to comply with such regulations. Additional rulemakings are pending which we believe will result in new reporting and disclosure obligations. The costs associated with hedging certain risks inherent in our business may be further increased when these expected additional regulations are adopted.

As of March 31, 2014, rate cases were in progress in our Kansas, Kentucky, Virginia and West Texas service areas, annual rate filing mechanisms were in progress in Louisiana and Mid-Tex and infrastructure program filings were in progress in Mid-Tex and Atmos Pipeline-Texas. These regulatory proceedings are discussed in further detail below in Management's Discussion and Analysis — Recent Ratemaking Developments.

#### 8. Financial Instruments

We use financial instruments to mitigate commodity price risk and interest rate risk. The objectives and strategies for using financial instruments have been tailored to our regulated and nonregulated businesses. The accounting for these financial instruments is fully described in Note 2 to the consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended September 30, 2013. During the six months ended March 31, 2014 there were no changes in our objectives, strategies and accounting for these financial instruments. Currently, we utilize financial instruments in our natural gas

distribution and nonregulated segments. We currently do not manage commodity price risk with financial instruments in our regulated transmission and storage segment.

Our financial instruments do not contain any credit-risk-related or other contingent features that could cause payments to be accelerated when our financial instruments are in net liability positions.

#### Regulated Commodity Risk Management Activities

Although our purchased gas cost adjustment mechanisms essentially insulate our natural gas distribution segment from commodity price risk, our customers are exposed to the effects of volatile natural gas prices. We manage this exposure through a combination of physical storage, fixed-price forward contracts and financial instruments, primarily over-the-counter swap and option contracts, in an effort to minimize the impact of natural gas price volatility on our customers during the winter heating season.

Our natural gas distribution gas supply department is responsible for executing this segment's commodity risk management activities in conformity with regulatory requirements. In jurisdictions where we are permitted to mitigate commodity price risk through financial instruments, the relevant regulatory authorities may establish the level of heating season gas purchases that can be hedged. Historically, if the regulatory authority does not establish this level, we seek to hedge between 25 and 50 percent of anticipated heating season gas purchases using financial instruments. For the 2013-2014 heating season (generally October through March), in the jurisdictions where we are permitted to utilize financial instruments, we hedged approximately 32 percent, or 24.6 Bcf of the winter flowing gas requirements. We have not designated these financial instruments as hedges for accounting purposes.

The costs associated with the gains and losses arising from the use of financial instruments to mitigate commodity price risk are included in our purchased gas cost adjustment mechanisms in accordance with regulatory requirements. Therefore, changes in the fair value of these financial instruments are initially recorded as a component of deferred gas costs and recognized in the consolidated statement of income as a component of purchased gas cost when the related costs are recovered through our rates and recognized in revenue in accordance with applicable authoritative accounting guidance. Accordingly, there is no earnings impact on our natural gas distribution segment as a result of the use of financial instruments.

#### Nonregulated Commodity Risk Management Activities

Our nonregulated operations aggregate and purchase gas supply, arrange transportation and/or storage logistics and ultimately deliver gas to our customers at competitive prices. To provide these services, we utilize proprietary and customer-owned transportation and storage assets to provide the various services our customers request. In an effort to offset the demand fees paid to contract for storage capacity and to maximize the value of this capacity, AEH sells financial instruments to earn a gross profit margin through the arbitrage of pricing differences in various locations and by recognizing pricing differences that occur over time.

As a result of these activities, our nonregulated segment is exposed to risks associated with changes in the market price of natural gas. We manage our exposure to such risks through a combination of physical storage and financial instruments, including futures, over-the-counter and exchange-traded options and swap contracts with counterparties. Future contracts provide the right, but not the obligation, to buy or sell the commodity at a fixed price. Option contracts provide the right, but not the requirement, to buy or sell the commodity at a fixed price. Swap contracts require receipt of payment for the commodity based on the difference between a fixed price and the market price on the settlement date.

We use financial instruments, designated as cash flow hedges of anticipated purchases and sales at index prices, to mitigate the commodity price risk in our nonregulated operations associated with deliveries under fixed-priced forward contracts to deliver gas to customers. These financial instruments have maturity dates ranging from one to 49 months. We use financial instruments, designated as fair value hedges, to hedge our natural gas inventory used in asset optimization activities in our nonregulated segment.

Our nonregulated operations also use storage swaps and futures to capture additional storage arbitrage opportunities that arise subsequent to the execution of the original fair value hedge associated with our physical natural gas inventory, basis swaps to insulate and protect the economic value of our fixed price and storage books and various over-the-counter and exchange-traded options. These financial instruments have not been designated as hedges for accounting purposes.

Interest Rate Risk Management Activities

We periodically manage interest rate risk by entering into financial instruments to effectively fix the Treasury yield component of the interest cost associated with anticipated financings.

As of March 31, 2014, we had forward starting interest rate swaps to effectively fix the Treasury yi