

Accounting for AEM's Storage Book

August 2006



Atmos Energy Marketing

- AEM provides a variety of natural gas management services to municipal, utility and industrial customers.
- These services include buying, storing and transporting gas using both proprietary and customer-owned transportation and storage assets.
- AEM segregates its business into marketing activities and storage activities.
- Marketing activities generate relatively stable margins from bundled gas deliveries, peaking sales, etc.
- Storage activities generate more variable margins from trading around AEM's owned and managed storage and transportation assets to capture time and location price differentials.

- AEM maintains a “flat” trading book and avoids mismatches between the volume of gas in storage and the number of associated financial hedges.
- AEM does not engage in speculative trading.
- AEM uses financial hedges to lock in an economic gross profit margin at the time it enters into a storage transaction.
- The relevant accounting rules require us to mark our physical gas in storage to market to reflect current cash prices at the end of the month and to mark the related hedges to market using futures prices that correspond with the term of our customer contracts.

- To determine current cash prices, we use an industry publication called Gas Daily and for our hedges, we use futures prices as quoted on the New York Mercantile Exchange (NYMEX).
- GAAP rules essentially cause us to measure the “liquidation” value of our gas in storage and the associated hedges as of the balance sheet date.
- Movements between these two indices create unrealized (i.e. “noncash”) gains and losses at the end of each reporting period until the underlying transaction is executed (i.e., when gas is withdrawn from storage and delivered and the hedges are settled).

MTM Introduces Volatility



- These unrealized gains and losses are recorded in AEM's gross profit.
- When the underlying transaction is executed, these unrealized gains and losses reverse themselves and the economic gross profit that AEM had captured in the original transaction is recognized.
- As we increase the amount of storage that we own or lease, the mark-to-market impact of unrealized gains/losses will increase, adding volatility to our earnings.
- Because of the volatility introduced by mark-to-market accounting, we have begun to disclose our expected gross profit margin (referred to internally as excess value) in our SEC filings.

Conceptual Illustration of MTM Effect on Storage

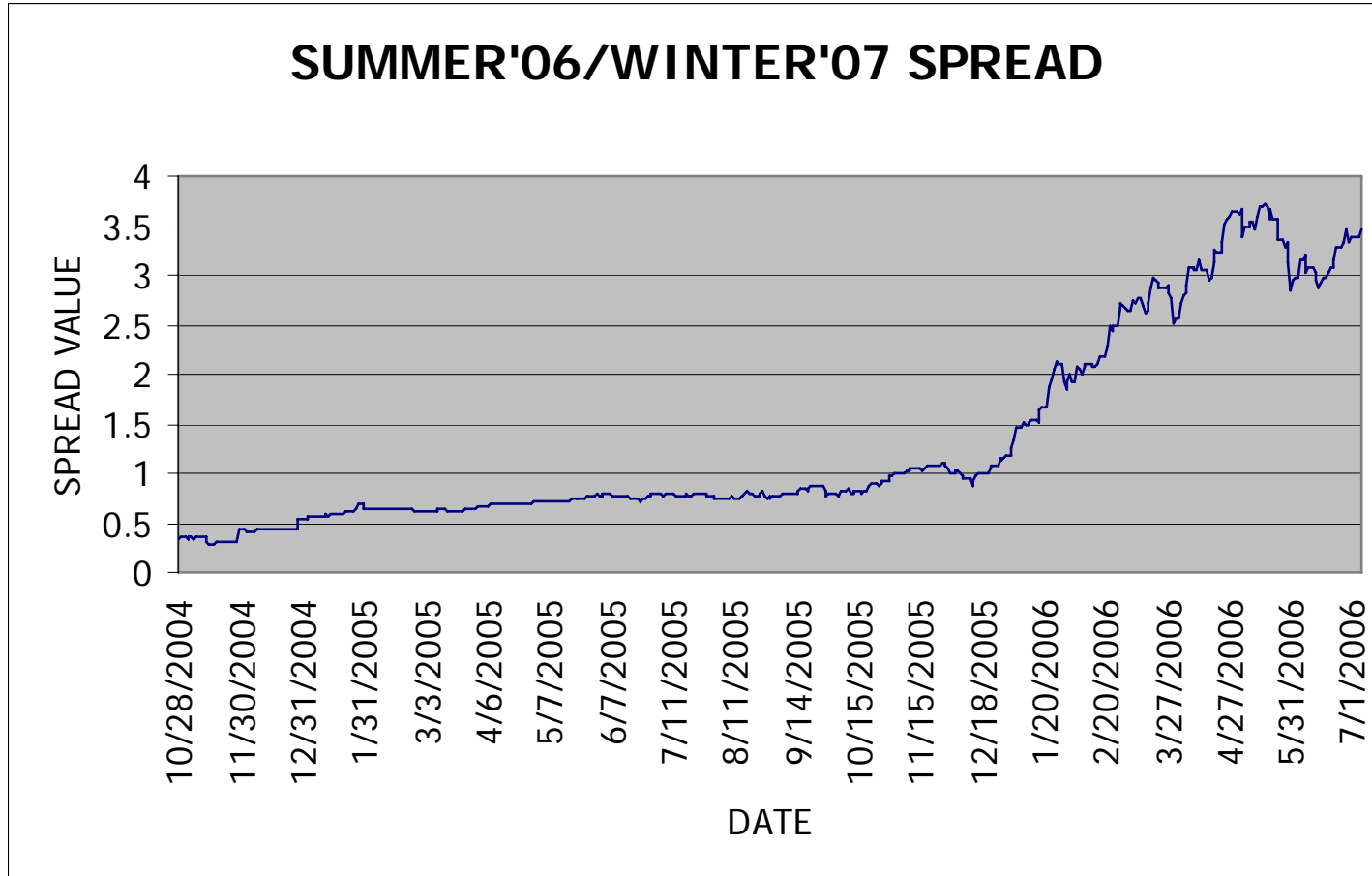


Month	Inject	Withdraw	Gas Cost/Mcf	Prompt Month Gas Daily Index	Hedge	Volume	Hedge Price	January 2007 Futures	Spread	P&L \$MM	Economic Value \$MM
June	1 Bcf	0	\$7.00	N/A	Sell Futures	1 Bcf	\$11.00	\$11.00	\$4.00	\$0	\$4.0
July	0	0	\$7.00	\$6.00	N/A	1 Bcf	-	\$10.50	\$4.50	(\$0.5)	\$4.0
Sept.	0	0	\$7.00	\$6.00	N/A	1 Bcf	-	\$11.50	\$5.50	(\$1.0)	\$4.0
Jan.	0	1 Bcf	\$7.00	\$10.00	Buy Futures	1 Bcf	-	\$10.00	\$0.00	\$5.5	\$4.0
									Total	\$4.0	\$4.0

Cash Versus Futures Spread

- “Spread” refers to the difference between cash prices (Gas Daily) and futures prices (NYMEX) for the month of delivery.
- The greater the change in spread, the larger our unrealized gain/loss.
- Historically, spreads have tended to be less than \$1.00/Mcf; however, since last year’s hurricane season, spreads have approached \$4.00/Mcf as shown in the next chart.

Summer/Winter Spreads



Schedule of Economic Value

This is the economic value of our storage book at June 30.

Period Ending	Net Physical Position (Bcf)	Economic Value (EV)				GAAP Reported Value		Excess Value	
		(\$ per Mcf)			Total	(\$ per Mcf)	Total	(\$ per Mcf)	Total
		WASP	WACOG	EV	(\$ in Mil)		(\$ in Mil)		(\$ in Mil)
9/30/05	6.9	\$ 6.3466	\$ 4.4435	\$ 1.9031	\$ 13.1	\$ (2.1502)	\$ (14.8)	\$ 4.0533	\$ 27.9
12/31/05	12.8	\$ 9.3918	\$ 8.8366	\$ 0.5552	\$ 7.1	\$ (3.0094)	\$ (38.6)	\$ 3.5646	\$ 45.7
3/31/06	23.6	\$ 10.3880	\$ 9.0806	\$ 1.3074	\$ 30.8	\$ (1.5195)	\$ (35.8)	\$ 2.8269	\$ 66.6
6/30/06	19.0	\$ 10.2353	\$ 8.7417	\$ 1.4936	\$ 28.4	\$ (3.0300)	\$ (57.7)	\$ 4.5236	\$ 86.1
Variance	(4.6)	\$ (0.1527)	\$ (0.3389)	\$ 0.1862	\$ (2.4)	\$ (1.5105)	\$ (21.9)	\$ 1.6967	\$ 19.5

- WASP: Weighted average sales price for gas held in storage.
- WACOG: Weighted average cost of AEM's gas in storage.
- EV: "Economic Value" which equals gas sales price (WASP) minus cost of gas (WACOG) on a per unit basis.

Conclusions

- Our marketing line of business has been profitable in every year since we acquired our initial interest in Woodward Marketing via the 1997 acquisition of United Cities.
- For this fiscal year, AEM is expected to earn between \$39-\$41 million of net income.

Conclusions

- Mark-to-market accounting treatment has introduced temporary yet significant earnings volatility to our marketing line of business.
- Higher levels of gas in storage and wider spreads between cash and futures prices serve to magnify unrealized (non-cash) gains and losses.
- Because of the significance of these accounting adjustments, we have begun to report the economic gross profit associated with the transactions that we have entered into.

Conclusions

- The forecasted gross profit margin, less the effect of unrealized gains or losses recognized in our financial statements, provides a measure of the net change in the future gross profit margin that should occur if AEM's optimization efforts are fully successful.
- While unrealized gains/losses reverse when transactions are settled, they can cause significant swings in reported earnings.
- We will continue to educate our investors on the non-cash nature of these accounting entries and focus on the underlying economic value to be received when the storage transactions are realized.