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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, 2003

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)*

**75240**  
*(Zip Code)*

**(972) 934-9227**

*(Registrant's telephone number, including area code)*

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

Indicate by check mark whether the registrant is an accelerated filer (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, 2003.

<u>Class</u>	<u>Shares Outstanding</u>
No Par Value	45,681,715

**PART 1. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**ATMOS ENERGY CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS**

	<u>March 31,</u> <u>2003</u>	<u>September 30,</u> <u>2002</u>
	<u>(Unaudited)</u>	
	(In thousands)	
<b>ASSETS</b>		
Property, plant and equipment .....	\$2,471,151	\$2,127,827
Less accumulated depreciation and amortization .....	<u>994,018</u>	<u>827,507</u>
Net property, plant and equipment .....	1,477,133	1,300,320
Current assets		
Cash and cash equivalents .....	63,178	46,827
Cash held on deposit in margin account .....	—	10,192
Accounts receivable, net .....	510,029	136,227
Inventories .....	9,669	3,769
Gas stored underground .....	25,750	91,783
Assets from risk management activities .....	28,555	27,984
Other current assets and prepayments .....	<u>21,615</u>	<u>13,209</u>
Total current assets .....	658,796	329,991
Intangible assets .....	5,465	5,365
Goodwill .....	275,011	185,015
Noncurrent assets from risk management activities .....	280	5,241
Deferred charges and other assets .....	<u>153,793</u>	<u>154,289</u>
	<u>\$2,570,478</u>	<u>\$1,980,221</u>
<b>SHAREHOLDERS' EQUITY AND LIABILITIES</b>		
Shareholders' equity		
Common stock .....	\$ 228	\$ 208
Additional paid-in capital .....	595,381	508,265
Retained earnings .....	154,299	106,142
Accumulated other comprehensive income (loss) .....	<u>(42,179)</u>	<u>(41,380)</u>
Shareholders' equity .....	707,729	573,235
Long-term debt .....	<u>864,228</u>	<u>670,463</u>
Total capitalization .....	1,571,957	1,243,698
Current liabilities		
Current maturities of long-term debt .....	9,157	21,980
Short-term debt .....	29,700	145,791
Accounts payable and accrued liabilities .....	474,740	135,609
Taxes payable .....	32,927	15,626
Customers' deposits .....	39,807	31,147
Liabilities from risk management activities .....	18,755	18,487
Deferred gas cost .....	7,528	21,947
Other current liabilities .....	<u>59,279</u>	<u>72,520</u>
Total current liabilities .....	671,893	463,107
Deferred income taxes .....	168,399	134,540
Noncurrent liabilities from risk management activities .....	616	3,663
Deferred credits and other liabilities .....	<u>157,613</u>	<u>135,213</u>
	<u>\$2,570,478</u>	<u>\$1,980,221</u>

See accompanying notes to condensed consolidated financial statements

**ATMOS ENERGY CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

	Three Months Ended March 31	
	2003	2002
	(In thousands, except per share data)	
Operating revenues .....	\$700,361	\$379,481
Purchased gas cost .....	<u>499,756</u>	<u>229,598</u>
Gross profit .....	200,605	149,883
Gas trading margin .....	2,363	9,604
Operating expenses		
Operation and maintenance .....	55,665	42,254
Depreciation and amortization .....	20,887	20,039
Taxes, other than income .....	<u>18,538</u>	<u>10,861</u>
Total operating expenses .....	<u>95,090</u>	<u>73,154</u>
Operating income .....	107,878	86,333
Miscellaneous expense .....	(1,489)	(6,112)
Interest charges .....	<u>16,158</u>	<u>14,489</u>
Income before income taxes and cumulative effect of accounting change .....	90,231	65,732
Income taxes .....	<u>33,926</u>	<u>24,354</u>
Income before cumulative effect of accounting change .....	56,305	41,378
Cumulative effect of accounting change, net of income tax benefit .....	<u>(7,773)</u>	<u>—</u>
Net income .....	<u>\$ 48,532</u>	<u>\$ 41,378</u>
 Per Share Data		
Basic income per share:		
Income before cumulative effect of accounting change .....	\$ 1.24	\$ 1.01
Cumulative effect of accounting change, net of income tax benefit .....	<u>(.17)</u>	<u>—</u>
Net income .....	<u>\$ 1.07</u>	<u>\$ 1.01</u>
Diluted income per share:		
Income before cumulative effect of accounting change .....	\$ 1.24	\$ 1.01
Cumulative effect of accounting change, net of income tax benefit .....	<u>(.17)</u>	<u>—</u>
Net income .....	<u>\$ 1.07</u>	<u>\$ 1.01</u>
Cash dividends per share .....	<u>\$ .300</u>	<u>\$ .295</u>
Weighted average shares outstanding:		
Basic .....	<u>45,306</u>	<u>41,040</u>
Diluted .....	<u>45,493</u>	<u>41,135</u>

See accompanying notes to condensed consolidated financial statements

**ATMOS ENERGY CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

	Six Months Ended March 31	
	2003	2002
	(In thousands, except per share data)	
Operating revenues .....	\$1,101,908	\$650,823
Purchased gas cost .....	768,717	391,575
Gross profit .....	333,191	259,248
Gas trading margin .....	6,943	16,767
Operating expenses		
Operation and maintenance .....	106,169	84,782
Depreciation and amortization .....	42,081	40,513
Taxes, other than income .....	31,382	20,941
Total operating expenses .....	179,632	146,236
Operating income .....	160,502	129,779
Miscellaneous income (expense) .....	2,635	(711)
Interest charges .....	31,637	30,481
Income before income taxes and cumulative effect of accounting change .....	131,500	98,587
Income taxes .....	49,402	36,576
Income before cumulative effect of accounting change .....	82,098	62,011
Cumulative effect of accounting change, net of income tax benefit .....	(7,773)	—
Net income .....	\$ 74,325	\$ 62,011
 Per Share Data		
Basic income per share:		
Income before cumulative effect of accounting change .....	\$ 1.87	\$ 1.51
Cumulative effect of accounting change, net of income tax benefit .....	(.18)	—
Net income .....	\$ 1.69	\$ 1.51
 Diluted income per share:		
Income before cumulative effect of accounting change .....	\$ 1.86	\$ 1.51
Cumulative effect of accounting change, net of income tax benefit .....	(.18)	—
Net income .....	\$ 1.68	\$ 1.51
Cash dividends per share .....	\$ .60	\$ .59
 Weighted average shares outstanding:		
Basic .....	44,007	40,937
Diluted .....	44,178	41,032

See accompanying notes to condensed consolidated financial statements

**ATMOS ENERGY CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Six Months Ended March 31	
	2003	2002
	(Unaudited) (In thousands)	
Cash Flows From Operating Activities		
Net income .....	\$ 74,325	\$ 62,011
Adjustments to reconcile net income to net cash provided by operating activities:		
Cumulative effect of accounting change, net of income tax benefit .....	7,773	—
Depreciation and amortization:		
Charged to depreciation and amortization .....	42,081	40,513
Charged to other accounts .....	1,004	1,364
Deferred income taxes (benefit) .....	14,912	(7,905)
Other .....	(4,911)	(1,115)
Net assets/liabilities from risk management activities .....	(7,188)	(5,229)
Net change in operating assets and liabilities .....	55,792	163,212
Net cash provided by operating activities .....	183,788	252,851
Cash Flows From Investing Activities		
Capital expenditures .....	(72,691)	(60,869)
Acquisitions .....	(74,650)	(15,747)
Retirements of property, plant and equipment, net .....	576	(746)
Assets for leasing activities .....	(185)	—
Net cash used in investing activities .....	(146,950)	(77,362)
Cash Flows From Financing Activities		
Net decrease in short-term debt .....	(116,091)	(158,686)
Cash dividends paid .....	(26,168)	(24,198)
Repayment of long-term debt .....	(69,058)	(13,696)
Repayment of Mississippi Valley Gas debt .....	(70,938)	—
Net proceeds from issuance of long-term debt .....	249,282	—
Proceeds from Bridge loan .....	147,000	—
Repayment of Bridge loan .....	(147,000)	—
Issuance of common stock .....	12,486	8,941
Net cash used by financing activities .....	(20,487)	(187,639)
Net increase (decrease) in cash and cash equivalents .....	16,351	(12,150)
Cash and cash equivalents at beginning of period .....	46,827	15,263
Cash and cash equivalents at end of period .....	\$ 63,178	\$ 3,113

See accompanying notes to condensed consolidated financial statements

**ATMOS ENERGY CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**  
**March 31, 2003**

**1. Unaudited Interim Financial Information**

In the opinion of management, all material adjustments (consisting of only normal recurring accruals) necessary for a fair presentation have been made to the unaudited interim period financial statements. Because of seasonal and other factors, the results of operations for the six month period ended March 31, 2003 are not indicative of expected results of operations for the year ending September 30, 2003. These interim financial statements and notes 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 in its Annual Report on Form 10-K for the fiscal year ended September 30, 2002.

*Principles of consolidation* — The accompanying condensed consolidated financial statements include the accounts of Atmos Energy Corporation and its wholly-owned subsidiaries. All material intercompany transactions have been eliminated.

*Common stock* — As of March 31, 2003, we had 100,000,000 shares of common stock, no par value (stated at \$.005 per share), authorized and 45,624,705 shares outstanding. At September 30, 2002, we had 41,675,932 shares outstanding.

*Goodwill* — Total goodwill was \$275.0 million and \$185.0 million at March 31, 2003 and September 30, 2002. Goodwill applicable to the utility segment was \$240.3 million and \$150.3 million at March 31, 2003 and September 30, 2002. Goodwill applicable to the natural gas marketing segment was \$22.6 million and \$21.3 million at March 31, 2003 and September 30, 2002. Goodwill applicable to the other non-utility segment was \$12.1 million and \$13.4 million at March 31, 2003 and September 30, 2002. Goodwill applicable to the utility and other non-utility segments resulted from the acquisition of the Louisiana Gas Service Company assets on July 1, 2001 and Mississippi Valley Gas Company on December 3, 2002 and is not subject to amortization under the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets." Goodwill applicable to the natural gas marketing segment was amortized over 20 years through September 30, 2001. Effective October 1, 2001, goodwill has not been amortized pursuant to the provisions of SFAS No. 142.

Under the provisions of SFAS No. 142, we evaluate our goodwill balances for impairment each year during our second fiscal quarter or as impairment indicators arise. Our evaluation during the quarter ended March 31, 2003 resulted in no impairment. We use a present value technique based on discounted cash flows to estimate the fair value of our reporting groups. If our projections of estimated future cash flows change, those changes could result in a reduction in the carrying value of our goodwill.

*Impairment of Long-Lived Assets* — We periodically evaluate whether events or circumstances have occurred that indicate that other long-lived assets may not be recoverable or that the remaining useful life may warrant revision. When such events or circumstances are present, we assess the recoverability of long-lived assets by determining whether the carrying value will be recovered through the expected future cash flows. In the event the sum of the expected future cash flows resulting from the use of the asset is less than the carrying value of the asset, an impairment loss equal to the excess of the asset's carrying value over its fair value is recorded. To date, no such impairment has been recognized.

*Retirement Obligations* — Effective October 1, 2002, we adopted SFAS No. 143, "Accounting for Asset Retirement Obligations." This Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The adoption of this Statement had no material impact to our financial condition or results of operations based on the perpetual nature of our franchise agreements and on our experience in the businesses in which we operate.

## ATMOS ENERGY CORPORATION

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

*Revenue recognition* — Sales of natural gas are billed on a monthly cycle basis; however, the billing cycle periods for certain classes of customers do not necessarily coincide with accounting periods used for financial reporting purposes. We follow the revenue accrual method of accounting for natural gas revenues whereby revenues applicable to gas delivered to customers, but not yet billed under the cycle billing method, are estimated and accrued and the related costs are charged to expense.

*Accounts receivable and allowance for doubtful accounts* — Accounts receivable consists of natural gas sales to residential, commercial, industrial, agricultural and other customers. For the majority of our receivables, we establish an allowance for doubtful accounts based on an aging of those receivable balances. We apply percentages to each aging category based on our collections experience. On certain other receivables where we are aware of a specific customer's inability or reluctance to pay, we record an allowance for doubtful accounts against amounts due to reduce the net receivable balance to the amount we reasonably expect to collect. We believe our allowance for doubtful accounts is adequate. However, if circumstances change, our estimate of the recoverability of accounts receivable could be different.

*Risk management assets and liabilities, natural gas marketing segment* — We use storage, transportation and requirements contracts, forwards, over-the-counter and exchange-traded options, futures and swap contracts to conduct our risk management activities.

On October 25, 2002, through the issuance of Emerging Issues Task Force (EITF) Issue No. 02-03, the EITF rescinded Issue No. 98-10 "Accounting for Energy Trading and Risk Management Activities" thereby precluding mark-to-market accounting for inventory and energy trading contracts that are not derivatives. During the quarter ended December 31, 2002, energy trading contracts entered into on or before October 25, 2002 were marked to market pursuant to the provisions of EITF Issue No. 98-10. Energy trading contracts entered into after October 25, 2002 were prospectively accounted for pursuant to the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities."

Prior to December 31, 2002, we had recorded \$12.9 million of unrealized income in accordance with EITF Issue No. 98-10. Beginning January 1, 2003, all energy trading contracts are being accounted for pursuant to the provisions of SFAS No. 133. On January 1, 2003, we reversed the unrealized income on storage contracts and certain full requirements contracts as a cumulative effect of a change in accounting principle. The cumulative effect of the change in accounting principle was reported in accordance with Accounting Principles Board (APB) Opinion No. 20, "Accounting Changes." Further, many of our index priced contracts qualify for the normal purchases and sales exception under SFAS No. 133 and are not marked to market for changes in value subsequent to December 31, 2002. Generally our fixed price contracts and our portfolio of options, swaps and futures contracts will continue to be accounted for at fair value. In addition, effective January 1, 2003, we designated a portion of our futures contracts as fair value hedges of the natural gas marketing segment's gas inventory. Accordingly, the inventory was adjusted to cost as of January 1, 2003 as part of the cumulative effect adjustment, but subsequent changes in fair value will be recognized as an adjustment to the carrying value of the hedged inventory. The cumulative noncash charge in the second quarter of fiscal 2003 was \$7.8 million, net of \$5.1 million of applicable income tax benefit. As performance under these inventory, storage and transportation contracts is completed, the applicable income will be recognized.

Under the mark-to-market method of accounting, contracts are reflected at fair value, inclusive of future servicing costs and valuation adjustments, with resulting unrealized gains and losses recorded as assets or liabilities from risk management activities on the condensed consolidated balance sheet. Current period changes in the assets and liabilities from risk management activities are recognized as net gains or losses on the condensed consolidated statement of income. Changes in the mark-to-market valuation of assets and liabilities from risk management activities primarily result from changes in the valuation of the portfolio of contracts, maturity and settlement of contracts and newly originated transactions. Market prices and models used to value these transactions reflect our best estimate considering various factors including closing

**ATMOS ENERGY CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

exchange and over-the-counter quotations, time value and volatility factors underlying the contracts. Values are adjusted to reflect the potential impact of an orderly liquidation of our positions over a reasonable period of time under present market conditions. Changes in market prices directly affect our estimate of the fair value of these transactions. For those futures contracts designated as fair value hedges, the market adjustment is offset by the adjustment to the carrying value of the inventory.

*Risk management assets and liabilities, utility segment* — We entered into hedging agreements for the 2002-2003 heating season to protect us and our customers from unusually large winter period gas price increases. We accounted for these activities pursuant to SFAS No. 133. In accordance with SFAS No. 71 “Accounting for the Effects of Certain Types of Regulation”, current period changes in the assets and liabilities from risk management activities are recorded as deferred gas costs on the condensed consolidated balance sheet due to recoverability in rates. Accordingly, there was no earnings impact as a result of the use of these financial instruments. Upon maturity, the contracts were recognized in purchased gas cost on the condensed consolidated statement of income.

*Comprehensive income* — The following table presents the components of comprehensive income, net of related tax, for the three-month and six-month periods ended March 31, 2003 and 2002:

	<b>Three Months Ended March 31</b>	
	<b>2003</b>	<b>2002</b>
	<b>(In thousands)</b>	
Net income .....	\$48,532	\$41,378
Unrealized holding losses on investments, net of tax benefits of \$460 and \$222 .....	(750)	(376)
Comprehensive income .....	<u>\$47,782</u>	<u>\$41,002</u>
	<b>Six Months Ended March 31</b>	
	<b>2003</b>	<b>2002</b>
	<b>(In thousands)</b>	
Net income .....	\$74,325	\$62,011
Unrealized holding gains (losses) on investments, net of taxes (benefit) of \$(489) and \$154 .....	(799)	261
Comprehensive income .....	<u>\$73,526</u>	<u>\$62,272</u>

The only components of accumulated other comprehensive income (loss), net of related tax, relate to unrealized holding gains and losses associated with certain available for sale investments and the minimum pension liability.

*Stock-based compensation plans* — We have two stock-based compensation plans that provide for the granting of stock options and restricted stock to officers, key employees and non-employee directors. The objectives of these plans include attracting and retaining the best personnel, providing for additional performance incentives and promoting our success by providing employees the opportunity to acquire common stock.

***United Cities Long-Term Stock Plan***

Prior to the merger with Atmos, certain United Cities Gas Company officers and key employees participated in the United Cities Long-Term Stock Plan implemented in 1989. At the time of the merger on July 31, 1997, we adopted this plan by registering a total of 250,000 shares of our common stock to be issued under the Long-Term Stock Plan for the Mid-States Division. Under this plan, incentive stock options,

## ATMOS ENERGY CORPORATION

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

nonqualified stock options, stock appreciation rights, restricted stock or any combination thereof may be granted to officers and key employees of the Mid-States Division. Options granted under the plan become exercisable at a rate of 20 percent per year and expire 10 years after the date of grant. For the six months ended March 31, 2003, 5,000 options were exercised under the plan. For the six months ended March 31, 2002, no options were exercised under the plan. At March 31, 2003, there were 14,300 options outstanding, all of which were fully vested. No incentive stock options, nonqualified stock options, stock appreciation rights or restricted stock have been granted under the plan since 1996. Because of the limited activities of this plan, the pro forma effects of applying SFAS No. 123, "Accounting for Stock-Based Compensation" would have less than a \$.01 per diluted share effect on earnings per share or \$753 and \$1,191 for the three months ended March 31, 2003 and 2002 and \$1,506 and \$2,382 for the six months ended March 31, 2003 and 2002.

#### *Long-Term Incentive Plan*

On August 12, 1998, our Board of Directors approved and adopted the 1998 Long-Term Incentive Plan, which became effective October 1, 1998 after approval by our shareholders. An amendment to this plan increasing the share reserve by 2,500,000 shares was approved by the shareholders at the Company's annual meeting on February 13, 2002. The Long-Term Incentive Plan represents a part of our Total Rewards strategy which we developed as a result of a study we conducted of all employee, executive and non-employee director compensation and benefits. The Long-Term Incentive Plan is a comprehensive, long-term incentive compensation plan providing for discretionary awards of incentive stock options, non-qualified stock options, stock appreciation rights, bonus stock, restricted stock and performance-based stock to help attract, retain and reward employees and non-employee directors of Atmos and our subsidiaries.

We are authorized to grant awards for up to a maximum of 4,000,000 shares of common stock under the Long-Term Incentive Plan subject to certain adjustment provisions. As of March 31, 2003, only non-qualified stock options have been issued. The option price is equal to the market price of our stock at the date of grant. The stock options expire 10 years from the date of the grant and options vest annually over a service period ranging from one to three years. At March 31, 2003, we had 1,932,433 options outstanding under the Long-Term Incentive Plan at an exercise price ranging from \$14.68 to \$25.66. At March 31, 2002, we had 1,570,708 options outstanding under the Long-Term Incentive Plan at an exercise price ranging from \$14.68 to \$25.66.

In October 1995, SFAS No. 123, "Accounting for Stock-Based Compensation," was issued. This statement established a fair value-based method of accounting for employee stock options or similar equity instruments and encourages, but does not require, all companies to adopt that method of accounting for all of their employee stock compensation plans. SFAS No. 123 allows companies to continue to measure compensation cost for employee stock options or similar equity instruments using the intrinsic value method of accounting described in APB Opinion No. 25, "Accounting for Stock Issued to Employees". We have elected to continue using the intrinsic value method as prescribed by APB No. 25. Under this method, no compensation cost for stock options is recognized for stock option awards granted at or above fair market value.

**ATMOS ENERGY CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

A summary of activity for grants of stock options under the Long-Term Incentive Plan for the six months ended March 31, 2003 follows:

	<u>Number of Options</u>
Outstanding — September 30, 2002 .....	1,557,606
Granted .....	142,360
Exercised .....	—
Forfeited .....	<u>(30,000)</u>
Outstanding — December 31, 2002 .....	<u>1,669,966</u>
Granted .....	265,300
Exercised .....	(333)
Forfeited .....	<u>(2,500)</u>
Outstanding — March 31, 2003 .....	<u><u>1,932,433</u></u>

A summary of activity for grants of stock options under the Long-Term Incentive Plan for the six months ended March 31, 2002 follows:

	<u>Number of Options</u>
Outstanding — September 30, 2001 .....	1,009,330
Granted .....	148,877
Exercised .....	—
Forfeited .....	<u>(24,499)</u>
Outstanding — December 31, 2001 .....	<u>1,133,708</u>
Granted .....	447,000
Exercised .....	(10,000)
Forfeited .....	<u>—</u>
Outstanding — March 31, 2002 .....	<u><u>1,570,708</u></u>

**ATMOS ENERGY CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

*Pro Forma Fair Value Disclosures*

Had compensation expense for our stock options been recognized based on the fair value on the grant date under the methodology prescribed by SFAS No. 123, our net income and earnings per share for the three months ended March 31, 2003 and 2002 would have been impacted as shown in the following table.

	<b>Three Months Ended March 31</b>	
	<b>2003</b>	<b>2002</b>
	<b>(In thousands)</b>	
Net income — as reported .....	\$48,532	\$41,378
Total stock-based employee compensation expense determined under fair value based method for all awards, net of taxes .....	<u>(261)</u>	<u>(169)</u>
Net income — pro forma .....	<u>\$48,271</u>	<u>\$41,209</u>
Earnings per share:		
Basic earnings per share — as reported .....	<u>\$ 1.07</u>	<u>\$ 1.01</u>
Basic earnings per share — pro forma .....	<u>\$ 1.07</u>	<u>\$ 1.00</u>
Diluted earnings per share — as reported .....	<u>\$ 1.07</u>	<u>\$ 1.01</u>
Diluted earnings per share — pro forma .....	<u>\$ 1.06</u>	<u>\$ 1.00</u>

Had compensation expense for our stock options been recognized based on the fair value on the grant date under the methodology prescribed by SFAS No. 123, our net income and earnings per share for the six months ended March 31, 2003 and 2002 would have been impacted as shown in the following table.

	<b>Six Months Ended March 31</b>	
	<b>2003</b>	<b>2002</b>
	<b>(In thousands)</b>	
Net income — as reported .....	\$74,325	\$62,011
Total stock-based employee compensation expense determined under fair value based method for all awards, net of taxes .....	<u>(440)</u>	<u>(305)</u>
Net income — pro forma .....	<u>\$73,885</u>	<u>\$61,706</u>
Earnings per share:		
Basic earnings per share — as reported .....	<u>\$ 1.69</u>	<u>\$ 1.51</u>
Basic earnings per share — pro forma .....	<u>\$ 1.68</u>	<u>\$ 1.51</u>
Diluted earnings per share — as reported .....	<u>\$ 1.68</u>	<u>\$ 1.51</u>
Diluted earnings per share — pro forma .....	<u>\$ 1.67</u>	<u>\$ 1.50</u>

*Use of estimates* — The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Reclassifications* — Certain prior period amounts have been reclassified to conform with the current year presentation.

## ATMOS ENERGY CORPORATION

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

#### 2. Acquisition of Mississippi Valley Gas Company

On December 3, 2002, we completed the acquisition of Mississippi Valley Gas Company, Mississippi's largest natural gas utility. We paid approximately \$74.7 million cash and \$74.7 million in Atmos Energy common stock consisting of 3,386,287 unregistered shares. We also repaid approximately \$70.9 million of Mississippi Valley Gas' outstanding debt. Beginning in December 2002, results of operations of Mississippi Valley Gas Company have been consolidated with our results of operations.

The following table summarizes the fair values of the assets acquired and liabilities assumed, in thousands:

Net property, plant and equipment .....	\$156,516
Current assets .....	43,848
Other intangible assets .....	11,746
Goodwill .....	89,997
Deferred charges and other assets .....	<u>10,670</u>
Total assets acquired .....	312,777
Current liabilities .....	(47,637)
Noncurrent liabilities .....	(92,613)
Other acquisition related costs .....	<u>(23,227)</u>
Purchase price .....	<u>\$149,300</u>

Other intangible assets represent the fair value of rights-of-way. The value assigned to goodwill was based on our belief that the acquisition of Mississippi Valley Gas Company will enable us to leverage our existing technology in order to add value to Atmos. We expect that the goodwill amount will not be deductible for tax purposes. Other acquisition-related costs consist of \$13.1 million of make-whole premiums related to the repayment of Mississippi Valley Gas' debt and other costs including termination benefits.

The pro forma effects for the three months ended March 31, 2002 of combining the results of operations of Mississippi Valley Gas Company with our consolidated results of operations were a \$91.9 million increase in operating revenues to \$471.4 million, a \$9.9 million increase in net income to \$51.3 million and a \$0.14 increase in diluted earnings per share to \$1.15.

The pro forma effects for the six months ended March 31, 2003 of combining the results of operations of Mississippi Valley Gas Company with our consolidated results of operations were a \$35.8 million increase in operating revenues to \$1.1 billion, a \$3.2 million decrease in net income to \$71.1 million and an \$0.11 decrease in diluted earnings per share to \$1.57.

Such pro forma effects for the six months ended March 31, 2002 were a \$151.2 million increase in operating revenues to \$802.0 million, a \$12.4 million increase in net income to \$74.4 million and a \$0.16 increase in diluted earnings per share to \$1.67.

#### 3. Contingencies

##### *Litigation*

##### *Colorado-Kansas Division*

On September 23, 1999, a suit was filed in the District Court of Stevens County, Kansas, by Quinque Operating Company, Tom Boles and Robert Ditto, against more than 200 companies in the natural gas industry including us and our Colorado-Kansas Division. The plaintiffs, who purport to represent a class consisting of gas producers, royalty owners, overriding royalty owners, working interest owners and state taxing

## ATMOS ENERGY CORPORATION

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

authorities, allege the defendants have underpaid royalties on gas taken from wells situated on non-federal and non-Indian lands throughout the United States and offshore waters predicated upon allegations that the defendants' gas measurements are simply inaccurate and that the defendants failed to comply with applicable regulations and industry standards over the last 25 years. Although the plaintiffs do not specifically allege an amount of damages, they contend that this suit is brought to recover billions of dollars in revenues that the defendants have allegedly unlawfully diverted from the plaintiffs to themselves. On April 10, 2000, this case was consolidated for pre-trial proceedings with other similar pending litigation in federal court in Wyoming in which we are also a defendant along with over 200 other defendants in the case of *In Re Natural Gas Royalties Qui Tam Litigation*. In January 2001, the federal court elected to remand this case back to the Kansas state court. A reconsideration of remand was filed, but it was denied. The state court now has jurisdiction over this proceeding and has issued a preliminary case management order. On April 10, 2003, the court denied the plaintiffs' motion to certify this proceeding as a class action. This ruling was appealed by the plaintiffs. We believe that the plaintiffs' claims are lacking in merit, and we intend to vigorously defend this action. While the results of this litigation cannot be predicted with certainty, we believe the final outcome of such litigation will not have a material adverse effect on our financial condition, results of operations or net cash flows.

#### *Texas Division*

On February 13, 2002, a suit was filed in the 287th District Court of Parmer County, Texas by Anderson Brothers, a Partnership, against Atmos Energy Corporation, et al. The plaintiffs' claims arise out of an alleged breach of contract by us and by a number of our divisions and subsidiaries concerning the sale of natural gas used in irrigation activities since 1998 and an alleged violation of the Texas Agricultural Gas Users Act of 1985. The court has ruled proper venue to be in Parmer County, Texas. We have been responding to numerous discovery requests from the plaintiffs. We also filed suit in Travis County, Texas to have the Texas Agricultural Gas Users Act of 1985 declared unconstitutional. The court denied our motion for summary judgment which we have appealed. The plaintiffs seek class action status and to recover unspecified damages plus attorneys' fees. We have denied any liability and intend to vigorously defend against the plaintiffs' claims. While the results of this litigation cannot be predicted with certainty, we believe the final outcome of such litigation will not have a material adverse effect on our financial condition, results of operations or net cash flows.

We are a plaintiff in a case styled *Energas Company, a Division of Atmos Energy Corporation v. ONEOK Energy Marketing and Trading Company, L.P., ONEOK Westex Transmission, Inc. and ONEOK Energy Marketing and Trading Company II*, filed in December 2001, pending in the District Court of Lubbock County, Texas, 72nd Judicial District. In this case, we are seeking to collect our receivable related to approximately 5.0 Bcf of natural gas that we believe was not delivered. We believe the recorded receivable is fully recoverable.

#### *United Cities Propane Gas, Inc.*

United Cities Propane Gas, Inc., one of our wholly-owned subsidiaries, is a party to an action filed in June 2000 which is pending in the Circuit Court of Sevier County, Tennessee. The plaintiffs' claims arise out of injuries alleged to have been caused by a low-level propane explosion. The plaintiffs seek to recover damages of \$13.0 million. Discovery activities have begun in this case. We have denied any liability, and we intend to vigorously defend against the plaintiffs' claims. While the results of this litigation cannot be predicted with certainty, we believe the final outcome of such litigation will not have a material adverse effect on our financial condition, results of operations or net cash flows.

We are a party to other litigation and claims that arise in the ordinary course of our business. While the results of such litigation and claims cannot be predicted with certainty, we believe the final outcome of such

## ATMOS ENERGY CORPORATION

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

litigation and claims will not have a material adverse effect on our financial condition, results of operations or net cash flows.

#### *Environmental Matters*

##### *Manufactured Gas Plant Sites*

We are the owner or previous owner of manufactured gas plant sites in Johnson City and Bristol, Tennessee and Hannibal, Missouri which were used to supply gas prior to the availability of natural gas. The gas manufacturing process resulted in certain by-products and residual materials including coal tar. The manufacturing process used by our predecessors was an acceptable and satisfactory process at the time such operations were being conducted. Under current environmental protection laws and regulations, we may be responsible for response actions with respect to such materials if response actions are necessary.

United Cities Gas Company and the Tennessee Department of Environment and Conservation (TDEC) entered into a consent order effective January 23, 1997, to facilitate the investigation, removal and remediation of the Johnson City site. Prior to our merger with United Cities Gas Company in July 1997, United Cities Gas Company began the implementation of the consent order in the first quarter of 1997 which we have continued through March 31, 2003. The investigative phase of the work at the site has been completed. An interim removal action was completed in June 2001. We installed four groundwater monitoring wells at the site in 2002 and have submitted the analytical results to the TDEC. We have completed a risk assessment report which is currently under review by the TDEC. The Tennessee Regulatory Authority granted us permission to defer, until our next rate case in Tennessee, all costs incurred in Tennessee in connection with state and federally mandated environmental control requirements.

In March 2002, the TDEC contacted us about conducting an investigation at a former manufactured gas plant located in Bristol, Tennessee. We agreed to perform a preliminary investigation at the site which was completed in June 2002. The investigation identified manufactured gas plant residual materials in the soil beneath the site and we have proposed performing a focused removal action to remove any such residuals in fiscal 2003. The TDEC has requested that the focused removal action be conducted pursuant to a voluntary agreement. We intend to conduct the focused removal action later this year.

On July 22, 1998, we entered into an Abatement Order on Consent with the Missouri Department of Natural Resources addressing the former manufactured gas plant located in Hannibal, Missouri. We agreed to perform a removal action, a subsequent site evaluation and to reimburse the response costs incurred by the state of Missouri in connection with the property. The removal action was conducted and completed in August 1998, and the site evaluation field work was conducted in August 1999. A risk assessment for the site has been completed and is currently under review by the Missouri Department of Natural Resources. In preparation for the risk assessment, we executed and recorded certain site use limitations including restricting use of the site to commercial and industrial purposes and prohibiting the withdrawal of groundwater for use as drinking water.

As of March 31, 2003, we had incurred costs of approximately \$1.1 million for the investigations of the Johnson City and Bristol, Tennessee and Hannibal, Missouri sites and had a remaining accrual relating to these sites of \$0.8 million.

##### *Mercury Contamination Sites*

We have completed investigation and remediation activities pursuant to Consent Orders between the Kansas Department of Health and Environment (KDHE) and United Cities Gas Company. The Orders provided for the investigation and remediation of mercury contamination at gas pipeline sites which utilize or formerly utilized mercury meter equipment in Kansas. The Final Interim Characterization and Remediation Report has been submitted to the KDHE. We have amended the Orders with the KDHE to include all

## ATMOS ENERGY CORPORATION

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

mercury meters that belonged to our Colorado-Kansas Division before the merger with United Cities Gas Company on July 31, 1997. All work on these sites has been completed. A report describing the results of the work has been submitted to the KDHE. As of March 31, 2003, we had incurred costs of \$0.1 million for these sites and had a remaining accrual of \$0.3 million for recovery. The Kansas Corporation Commission has authorized us to defer these costs and seek recovery in a future rate case.

We are a party to other environmental matters and claims that arise out of our ordinary business. While the ultimate results of response actions to these environmental matters and claims cannot be predicted with certainty, we believe the final outcome of such response actions will not have a material adverse effect on our financial condition, results of operations or net cash flows because we believe that the expenditures related to such response actions will either be recovered through rates, shared with other parties or adequately covered by insurance.

#### 4. Short-Term Debt

At March 31, 2003, short-term debt consisted of \$29.7 million of commercial paper.

##### *Committed Credit Facilities*

We have short-term committed credit facilities totaling \$318.0 million. One short-term unsecured credit facility is for \$300.0 million and serves as a backup liquidity facility for our commercial paper program. Our commercial paper is rated A-2 by Standard and Poor's, P-2 by Moody's and F-2 by Fitch. At March 31, 2003, \$29.7 million of commercial paper was outstanding. We have a second unsecured facility in place for \$18.0 million. At March 31, 2003, there were no borrowings under this credit facility. These credit facilities are negotiated at least annually and are used for working capital purposes.

On October 7, 2002, we entered into a \$150.0 million short-term unsecured committed credit facility. This credit facility was used to provide initial funding for the cash portion of the Mississippi Valley Gas Company acquisition and to repay Mississippi Valley Gas Company's existing debt. A total of \$147.0 million was borrowed under this credit facility during the first quarter. This amount was refinanced in January 2003 with a portion of the proceeds of our \$250.0 million debt offering, as discussed below.

##### *Uncommitted Credit Facilities*

Our Woodward Marketing subsidiary has a \$210.0 million uncommitted demand working capital credit facility. Atmos Energy Holdings, Inc. and Atmos Energy Marketing, L.L.C., our wholly-owned subsidiaries, are guarantors of all amounts outstanding under this facility. At March 31, 2003, no amount was outstanding under this credit facility, although letters of credit totaling \$179.0 million reduced the amount available. The amount available under this credit facility is also limited by various covenants, including covenants based on working capital. Under the most restrictive covenant, the amount available to Woodward Marketing under this credit facility at March 31, 2003 was \$31.0 million. During the quarter ended March 31, 2003, Woodward Marketing was not in technical compliance with one of the covenants contained in this uncommitted demand credit facility. Woodward Marketing has obtained a waiver for the period of non-compliance. This credit facility expires on March 31, 2004.

We also have an unsecured short-term uncommitted credit line for \$20.0 million. There were no borrowings under this uncommitted credit facility at March 31, 2003. This uncommitted line is renewed or renegotiated at least annually with varying terms and we pay no fee for the availability of the line. Borrowings under this line are made on a when- and as-available basis at the discretion of the bank. This facility is also used for working capital purposes.

In addition, Woodward Marketing has up to \$100.0 million for its non-utility business available from Atmos Energy Holdings. At March 31, 2003, \$42.0 million was outstanding. Any outstanding amounts under

**ATMOS ENERGY CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

the Atmos Energy Holdings facility are subordinated to Woodward Marketing's \$210.0 million uncommitted demand credit facility described above. This intercompany loan is eliminated in the consolidated financial statements.

**5. Long-Term Debt**

On January 16, 2003, we issued \$250.0 million of 5<sup>1</sup>/<sub>8</sub>% Senior Notes due 2013. The net proceeds of \$249.3 million were used to repay \$147.0 million under an acquisition credit facility used to provide the initial financing of our acquisition of Mississippi Valley Gas Company, which closed in December 2002, as well as for general corporate purposes.

In addition, the net proceeds were used to repay \$54.0 million in unsecured senior notes held by institutional lenders and for the repayment of short-term debt under our commercial paper program. The repayment of the unsecured senior notes resulted in a make-whole premium of \$9.3 million.

**6. Earnings Per Share**

Basic earnings per share has been computed by dividing net income for the period by the weighted average number of common shares outstanding during the period. Diluted earnings per share has been computed by dividing net income for the period by the weighted average number of common shares outstanding during the period adjusted for restricted stock and other contingently issuable shares of common stock. Net income for basic and diluted earnings per share are the same, as there are no contingently issuable shares of stock whose issuance would have impacted net income. A reconciliation between basic and diluted weighted average common shares outstanding follows:

	For the Three Months Ended March 31	
	2003	2002
	(In thousands)	
Weighted average common shares — basic .....	45,306	41,040
Effect of dilutive securities:		
Restricted stock .....	121	67
Stock options .....	66	28
Weighted average common shares — assuming dilution .....	45,493	41,135
	For the Six Months Ended March 31	
	2003	2002
	(In thousands)	
Weighted average common shares — basic .....	44,007	40,937
Effect of dilutive securities:		
Restricted stock .....	121	67
Stock options .....	50	28
Weighted average common shares — assuming dilution .....	44,178	41,032

## ATMOS ENERGY CORPORATION

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

#### 7. Derivative Instruments and Hedging Activities

##### *Weather Insurance*

In June 2001, we purchased a three year weather insurance policy with an option to cancel the third year of coverage. The policy is for our Texas and Louisiana operations and covers the entire heating season of October to March beginning with the 2001-2002 heating season. The cost of the three year policy was \$13.2 million which was prepaid and is being amortized over the appropriate heating seasons based on degree days. The insurance is designed to protect against weather that is at least seven percent warmer than normal for the entire heating season. During the quarter ended December 31, 2001, we recognized \$5.9 million in income relating to this insurance policy. During the quarter ended March 31, 2002, weather was colder than normal resulting in the reversal of the \$5.9 million income that was recognized earlier. Because weather was not at least seven percent warmer than normal, no income was recognized under this insurance policy during the three months and six months ended March 31, 2003. Amortization expense of \$2.5 million was recognized during the three months ended March 31, 2003 and 2002. Amortization expense of \$4.4 million was recognized during the six months ended March 31, 2003 and 2002. In April 2003, we canceled the third year of coverage on this policy primarily as a result of rate relief in Louisiana and prospects for WNA in Texas. The remaining amount of prepaid cost, less cash received for early termination of this policy, will be written off in the third quarter of fiscal 2003 resulting in a pretax charge of approximately \$0.6 million.

##### *Utility Hedging Activities*

For the 2002-2003 heating season, we covered approximately 51 percent of our anticipated flowing gas requirements through a combination of storage, financial hedges and fixed forward contracts at a weighted average cost of less than \$4.00 per Mcf. This provided a measure of protection to us and our customers against potential sharp increases in the price of natural gas during the 2002-2003 heating season.

In accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," we use the mark-to-market method, discussed previously, to account for our financial instruments. In accordance with SFAS No. 71 "Accounting for the Effects of Certain Types of Regulation", current period changes in the assets and liabilities from risk management activities are recorded as deferred gas costs on the condensed consolidated balance sheet as these costs ultimately will be recovered from ratepayers. Accordingly, there is no earnings impact as a result of the use of these financial instruments. Upon maturity, the contracts are recognized in purchased gas cost on the condensed consolidated statement of income.

##### *Non-Utility Hedging Activities*

At the close of business on March 31, 2003, we had outstanding contracts representing 0.4 Bcf of net notional volumes with average contract maturities of less than three years. Contracts representing 99 percent of the fair value of these contracts are scheduled to mature within three years.

For the three months ended March 31, 2003, our gas trading margin consisted of a \$10.1 million realized trading loss and a \$12.5 million unrealized trading gain. For the three months ended March 31, 2002, our gas trading margin consisted of a \$31.5 million realized trading gain and a \$21.9 million unrealized trading loss.

For the six months ended March 31, 2003, our gas trading margin consisted of a \$4.4 million realized trading loss and an \$11.3 million unrealized trading gain. For the six months ended March 31, 2002, our gas trading margin consisted of a \$34.4 million realized trading gain and a \$17.6 million unrealized trading loss.

The principal business of Atmos Energy Marketing, L.L.C., including the activities of Woodward Marketing, L.L.C. and Trans Louisiana Industrial Gas Company, Inc., is the overall management of natural gas requirements for municipalities, local gas utility companies and industrial customers located primarily in the southeastern and midwestern United States. This business involves the sale of natural gas by

## ATMOS ENERGY CORPORATION

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Atmos Energy Marketing to its customers and the management of storage and transportation contracts for its customers under contracts generally having one to two-year terms. At March 31, 2003, Atmos Energy Marketing had a total of 154 municipal customers and 638 industrial customers. Atmos Energy Marketing also sells natural gas to certain of its industrial customers on a delivered burner tip basis under contract terms from 30 days to two years. In addition, Atmos Energy Marketing supplies our regulated operations with a portion of our natural gas requirements on a competitive bid basis. Any mark-to-market gains or losses on these affiliate contracts are eliminated in consolidation.

In the management of natural gas requirements for municipal and other local utilities, Atmos Energy Marketing sells physical natural gas to customers for future delivery and manages the associated price risk through the use of gas futures, including forwards, over-the-counter and exchange-traded options and swap contracts with counterparties. These financial contracts are marked-to-market daily at the close of business. Atmos Energy Marketing links gas futures to physical delivery of natural gas and typically balances its futures positions at the end of each trading day. Over-the-counter swap agreements require Atmos Energy Marketing to receive or make payments based on the difference between a fixed price and the market price of natural gas on the settlement date. Atmos Energy Marketing uses these futures and swaps to manage margins on the sale of inventory or the offsetting fixed-price purchase or sale commitments for physical quantities of natural gas which are also carried on a mark-to-market basis. Mark-to-market accounting refers to the measurement of contracts at fair value determined at the balance sheet date with any gains and losses included in earnings. Options held to manage price risk provide the right, but not the requirement, to buy or sell energy commodities at a fixed price. Atmos Energy Marketing uses options to manage margins and to limit overall price risk exposure. At any point in time, Atmos Energy Marketing may not have completely offset its price risk on these activities. See Note 1 for a discussion of the change in accounting principle related to mark-to-market accounting.

Energy related services provided by Atmos Energy Marketing include the sale of natural gas to its various customer classes and management of transportation and storage assets and inventories. More specifically, energy services include contract negotiation and administration, load forecasting, storage acquisition, natural gas purchase and delivery and capacity utilization strategies. In providing these services, Atmos Energy Marketing generates income from its utility, municipal and industrial customers through negotiated prices based on the volume of gas supplied to the customer. Atmos Energy Marketing also generates income by taking advantage of the difference between near-term gas prices and prices for future delivery as well as the daily movement of gas prices by utilizing storage and transportation capacity that it controls.

Atmos Energy Marketing manages its financial trading for hedging (risk management) purposes related to its physical trading positions. With regard to its physical trading business, Atmos Energy Marketing does engage in limited speculative natural gas trading for its own account primarily related to its storage activity, subject to a risk management policy established by us which limits the level of trading loss to a maximum of 25 percent of the budgeted annual operating income of Atmos Energy Holdings. Physical trading involves utilizing physical assets (storage and transportation) to sell and deliver gas to customers or to take a position in the market based on anticipated price movement.

Compliance with such risk management policy is monitored daily. In addition, Woodward Marketing's bank credit facility limits trading positions that are not closed at the end of the day (open positions) to 5.0 Bcf of natural gas. At March 31, 2003, Atmos Energy Marketing's net open positions in its trading operations totaled 0.4 Bcf. Atmos Energy Marketing's open trading positions are monitored daily but are not required to be closed if they remain within the limits set by the bank loan agreement. In addition to the price risk of any net open position at the end of each trading day, the financial exposure that results from intra-day fluctuations of gas prices and the potential for daily price movements constitutes a risk of loss since the price of natural gas purchased or sold for future delivery at the beginning of the day may not be hedged until later in the day.

## ATMOS ENERGY CORPORATION

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Financial instruments, which subject Atmos Energy Marketing to counterparty risk, consist primarily of financial instruments arising from trading and risk management activities that are not insured. Counterparty risk is the risk of loss from nonperformance by financial counterparties to a contract. Exchange-traded future and option contracts are generally guaranteed by the exchanges.

Atmos Energy Marketing's operations are concentrated in the natural gas industry, and its customers and suppliers may be subject to economic risks affecting that industry.

From time to time, Woodward Marketing borrows money to fund its natural gas purchases and to fulfill its obligations to maintain deposit accounts with its counterparties. See Note 4 of notes to condensed consolidated financial statements.

#### 8. Segment Information

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. The accounting policies of the segments are the same as those described in the summary of significant accounting policies included in Note 1 of notes to consolidated financial statements in our Annual Report on Form 10-K for the year ended September 30, 2002. All intersegment sales prices are market based. We evaluate performance based on net income or loss of the respective operating units.

Included in purchased gas cost were purchases from Atmos Energy Marketing of \$127.3 million and \$53.7 million for the three months ended March 31, 2003 and 2002 and \$190.7 million and \$103.5 million for the six months ended March 31, 2003 and 2002. Volumes purchased were 20.1 Bcf and 21.7 Bcf for the three months ended March 31, 2003 and 2002 and 35.5 Bcf and 41.2 Bcf for the six months ended March 31, 2003 and 2002. These purchases were made in a competitive open bidding process and reflect market prices. Average prices per Mcf for gas purchased from Atmos Energy Marketing were \$6.34 and \$2.47 for the three months ended March 31, 2003 and 2002 and \$5.37 and \$2.51 for the six months ended March 31, 2003 and 2002. In addition, our regulated utility divisions have entered into contracts with Atmos Energy Marketing to manage a significant portion of our regulated utility divisions' underground storage facilities. Atmos Energy Marketing has acted as agent in placing financial instruments for the various regulated utility divisions that partially protect us and our customers from unusually large winter period gas price increases.

In accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information", we have identified the Utility, Natural Gas Marketing and Other Non-Utility segments. For an expanded description of these segments, please refer to Note 1 of notes to consolidated financial statements in our Annual Report on Form 10-K for the year ended September 30, 2002. We consider each division within our utility segment to be a reporting unit of the utility segment and not a reportable segment. The individual operations that comprise the other non-utility segment are not currently material to our consolidated financial position or results of operations and therefore do not require separate reporting. Income from our other non-utility segment is generated primarily from pipeline and storage operations.

**ATMOS ENERGY CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Summarized financial information concerning our reportable segments for the three months and six months ended March 31, 2003 and 2002 are shown in the following table:

	<u>Utility</u>	<u>Natural Gas Marketing</u>	<u>Other Non-Utility</u>	<u>Total</u>
	(In thousands)			
<b><u>For the three months ended March 31, 2003:</u></b>				
Operating revenues for reportable segments .....	\$ 696,561	\$ 150	\$ 9,657	\$ 706,368
Elimination of intersegment revenues .....	<u>(429)</u>	<u>(150)</u>	<u>(5,428)</u>	<u>(6,007)</u>
Total operating revenues .....	696,132	—	4,229	700,361
Gas trading margin .....	—	2,363	—	2,363
Cumulative effect of accounting change, net of income tax benefit .....	—	(7,773)	—	(7,773)
Net income (loss) .....	54,052	(8,847)	3,327	48,532
<b><u>March 31, 2002:</u></b>				
Operating revenues for reportable segments .....	\$ 376,811	\$ 170	\$ 9,494	\$ 386,475
Elimination of intersegment revenues .....	<u>(309)</u>	<u>—</u>	<u>(6,685)</u>	<u>(6,994)</u>
Total operating revenues .....	376,502	170	2,809	379,481
Gas trading margin .....	—	9,604	—	9,604
Net income .....	36,687	1,931	2,760	41,378
<b><u>As of and for the six months ended March 31, 2003:</u></b>				
Operating revenues for reportable segments .....	\$1,096,529	\$ 316	\$12,557	\$1,109,402
Elimination of intersegment revenues .....	<u>(712)</u>	<u>(316)</u>	<u>(6,466)</u>	<u>(7,494)</u>
Total operating revenues .....	1,095,817	—	6,091	1,101,908
Gas trading margin .....	—	6,943	—	6,943
Cumulative effect of accounting change, net of income tax benefit .....	—	(7,773)	—	(7,773)
Net income (loss) .....	75,111	(8,079)	7,293	74,325
Total assets .....	2,263,241	380,627	95,224	2,739,092
<b><u>March 31, 2002:</u></b>				
Operating revenues for reportable segments .....	\$ 641,967	\$ 340	\$16,959	\$ 659,266
Elimination of intersegment revenues .....	<u>(948)</u>	<u>—</u>	<u>(7,495)</u>	<u>(8,443)</u>
Total operating revenues .....	641,019	340	9,464	650,823
Gas trading margin .....	—	16,767	—	16,767
Net income .....	53,521	4,559	3,931	62,011
Total assets .....	1,833,446	208,807	75,365	2,117,618

**ATMOS ENERGY CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

A reconciliation of total assets for the reportable segments to total consolidated assets for March 31, 2003 and 2002 is presented below:

	<u>March 31</u>	
	<u>2003</u>	<u>2002</u>
	(In thousands)	
Total assets for reportable segments .....	\$2,739,092	\$2,117,618
Elimination of intercompany accounts.....	<u>(168,614)</u>	<u>(157,216)</u>
Total consolidated assets .....	<u>\$2,570,478</u>	<u>\$1,960,402</u>

**ATMOS ENERGY CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**9. Supplemental Disclosures**

The following supplemental condensed financial statements show our three operating segments and the elimination of material intercompany transactions. The following supplemental condensed balance sheet is as of March 31, 2003.

	<u>Utility</u>	<u>Natural Gas Marketing</u>	<u>Other Non-Utility</u>	<u>Eliminations</u>	<u>Consolidated</u>
			(In thousands)		
<b>ASSETS</b>					
Property, plant and equipment, net . . . . .	\$1,409,360	\$ 8,916	\$ 58,857	\$ —	\$1,477,133
Investment in subsidiaries . . . . .	123,249	(2,585)	—	(120,664)	—
Current assets					
Cash and cash equivalents . . . . .	10,313	52,236	629	—	63,178
Accounts receivable, net . . . . .	276,913	281,341	(372)	(47,853)	510,029
Inventories . . . . .	9,452	—	217	—	9,669
Gas stored underground . . . . .	13,092	10,808	1,850	—	25,750
Assets from risk management activities . . . . .	1,202	27,450	—	(97)	28,555
Other current assets and prepayments	3,987	14,461	3,167	—	21,615
Intercompany receivables . . . . .	<u>74,259</u>	<u>(43,038)</u>	<u>(31,221)</u>	<u>—</u>	<u>—</u>
Total current assets . . . . .	389,218	343,258	(25,730)	(47,950)	658,796
Intangible assets . . . . .	—	5,465	—	—	5,465
Goodwill . . . . .	240,284	22,600	12,127	—	275,011
Noncurrent assets from risk management activities . . . . .	—	280	—	—	280
Deferred charges and other assets . . . . .	<u>101,130</u>	<u>2,693</u>	<u>49,970</u>	<u>—</u>	<u>153,793</u>
	<u>\$2,263,241</u>	<u>\$380,627</u>	<u>\$ 95,224</u>	<u>\$(168,614)</u>	<u>\$2,570,478</u>
<b>SHAREHOLDERS' EQUITY AND LIABILITIES</b>					
Shareholders' equity . . . . .	\$ 707,729	\$ 67,651	\$ 55,598	\$(123,249)	\$ 707,729
Long-term debt . . . . .	<u>861,880</u>	<u>—</u>	<u>2,348</u>	<u>—</u>	<u>864,228</u>
Total capitalization . . . . .	1,569,609	67,651	57,946	(123,249)	1,571,957
Current liabilities					
Current maturities of long-term debt	8,207	—	950	—	9,157
Short-term debt . . . . .	29,700	—	—	—	29,700
Liabilities from risk management activities . . . . .	—	18,755	—	—	18,755
Deferred gas cost . . . . .	(5,682)	9,561	3,649	—	7,528
Other current liabilities . . . . .	<u>351,496</u>	<u>285,340</u>	<u>15,282</u>	<u>(45,365)</u>	<u>606,753</u>
Total current liabilities . . . . .	383,721	313,656	19,881	(45,365)	671,893
Deferred income taxes . . . . .	164,578	(3,228)	7,049	—	168,399
Noncurrent liabilities from risk management activities . . . . .	—	616	—	—	616
Deferred credits and other liabilities . . . . .	<u>145,333</u>	<u>1,932</u>	<u>10,348</u>	<u>—</u>	<u>157,613</u>
	<u>\$2,263,241</u>	<u>\$380,627</u>	<u>\$ 95,224</u>	<u>\$(168,614)</u>	<u>\$2,570,478</u>

**ATMOS ENERGY CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The following supplemental condensed statement of income is for the three months ended March 31, 2003.

	<u>Utility</u>	<u>Natural Gas Marketing</u>	<u>Other Non-Utility</u>	<u>Eliminations</u>	<u>Consolidated</u>
			(In thousands)		
Operating revenues . . . . .	\$696,561	\$608,460	\$9,657	\$(614,317)	\$700,361
Purchased gas cost . . . . .	<u>502,728</u>	<u>618,752</u>	<u>2,134</u>	<u>(623,858)</u>	<u>499,756</u>
Gross profit . . . . .	193,833	(10,292)	7,523	9,541	200,605
Gas trading margin . . . . .	—	12,532	—	(10,169)	2,363
Operating expenses . . . . .	<u>89,853</u>	<u>3,378</u>	<u>1,898</u>	<u>(39)</u>	<u>95,090</u>
Operating income (loss) . . . . .	103,980	(1,138)	5,625	(589)	107,878
Miscellaneous income (expense)	(1,377)	344	467	(923)	(1,489)
Interest charges . . . . .	<u>(16,161)</u>	<u>(388)</u>	<u>(532)</u>	<u>923</u>	<u>(16,158)</u>
Income (loss) before income taxes and cumulative effect of accounting change . . . . .	86,442	(1,182)	5,560	(589)	90,231
Provision (benefit) for income taxes . . . . .	<u>32,390</u>	<u>(1,493)</u>	<u>2,233</u>	<u>796</u>	<u>33,926</u>
Income (loss) before cumulative effect of accounting change . . .	54,052	311	3,327	(1,385)	56,305
Cumulative effect of accounting change, net of income taxes (benefit) . . . . .	<u>—</u>	<u>(9,710)</u>	<u>—</u>	<u>1,937</u>	<u>(7,773)</u>
Net income (loss) . . . . .	<u>\$ 54,052</u>	<u>\$ (9,399)</u>	<u>\$3,327</u>	<u>\$ 552</u>	<u>\$ 48,532</u>

**ATMOS ENERGY CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The following supplemental condensed statement of income is for the six months ended March 31, 2003.

	<u>Utility</u>	<u>Natural Gas Marketing</u>	<u>Other Non-Utility</u>	<u>Eliminations</u>	<u>Consolidated</u>
			(In thousands)		
Operating revenues . . . . .	\$1,096,529	\$952,713	\$12,557	\$(959,891)	\$1,101,908
Purchased gas cost . . . . .	<u>773,223</u>	<u>958,260</u>	<u>1,008</u>	<u>(963,774)</u>	<u>768,717</u>
Gross profit . . . . .	323,306	(5,547)	11,549	3,883	333,191
Gas trading margin . . . . .	—	9,148	—	(2,205)	6,943
Operating expenses . . . . .	<u>170,179</u>	<u>5,991</u>	<u>3,823</u>	<u>(361)</u>	<u>179,632</u>
Operating income (loss) . . . . .	153,127	(2,390)	7,726	2,039	160,502
Miscellaneous income (expense) . . . . .	(2,219)	1,273	5,405	(1,824)	2,635
Interest charges . . . . .	<u>(30,996)</u>	<u>(1,428)</u>	<u>(1,037)</u>	<u>1,824</u>	<u>(31,637)</u>
Income (loss) before income taxes and cumulative effect of accounting change . . . . .	119,912	(2,545)	12,094	2,039	131,500
Provision (benefit) for income taxes . . . . .	<u>44,801</u>	<u>(1,010)</u>	<u>4,801</u>	<u>810</u>	<u>49,402</u>
Income (loss) before cumulative effect of accounting change . . . . .	75,111	(1,535)	7,293	1,229	82,098
Cumulative effect of accounting change, net of income taxes (benefit) . . . . .	<u>—</u>	<u>(9,710)</u>	<u>—</u>	<u>1,937</u>	<u>(7,773)</u>
Net income (loss) . . . . .	<u>\$ 75,111</u>	<u>\$(11,245)</u>	<u>\$ 7,293</u>	<u>\$ 3,166</u>	<u>\$ 74,325</u>

*Organization* — Atmos Energy Corporation distributes natural gas in 12 states through its regulated utility operating divisions — Colorado-Kansas Division, Kentucky Division, Louisiana Division, Mid-States Division, Mississippi Valley Gas Company Division and Texas Division. Our nonutility operations are organized under Atmos Energy Holdings, Inc., which includes Atmos Energy Marketing, L.L.C., Atmos Pipeline and Storage, Inc., Atmos Power Systems, Inc. and an indirect equity interest in Heritage Propane Partners, L.P. Atmos Energy Marketing includes the operations of Woodward Marketing and Trans Louisiana Industrial Gas Company.

*Consolidating Financial Statements* — The column headed “Utility” consists of the operations of Atmos’ six operating divisions. The column headed “Natural Gas Marketing” consists of Atmos Energy Marketing, Woodward Marketing and Trans Louisiana Industrial Gas Company. The column headed “Other Non-Utility” consists of our nonutility operations excluding natural gas marketing. Operating revenues and purchased gas costs from our natural gas marketing operations are shown on a gross basis in the “Natural Gas Marketing” column. Such natural gas marketing activities are reclassified in the elimination column as gas trading margin.

Current and noncurrent assets and liabilities from risk management activities on the supplemental condensed consolidated balance sheet consist of the fair value, inclusive of future servicing costs and valuation adjustments, of our storage, transportation and requirements contracts, forwards, over-the-counter and exchange traded options, futures and swap contracts.

ATMOS ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The gas trading margin on the supplemental condensed consolidated statement of income consists primarily of the difference between revenue arising from Natural Gas Marketing's sale of physical natural gas to its customers less the cost to purchase natural gas and current period changes in assets and liabilities from risk management activities.

*Eliminations* — Included in purchased gas cost in the Utility column are natural gas purchases from Atmos Energy Marketing. These purchases were made in a competitive open bidding process and reflect market prices. In addition, our utility divisions have entered into contracts with Atmos Energy Marketing to manage a significant portion of their underground storage facilities. Atmos Energy Marketing has acted as agent in obtaining hedging agreements for our utility divisions that protect them and our utility customers from unusually large winter period gas price increases.

## INDEPENDENT ACCOUNTANTS' REVIEW REPORT

The Board of Directors  
Atmos Energy Corporation

We have reviewed the accompanying condensed consolidated balance sheet of Atmos Energy Corporation as of March 31, 2003 and the related condensed consolidated statements of income for the three-month periods and six-month periods ended March 31, 2003 and 2002 and the condensed consolidated statements of cash flows for the six-month periods ended March 31, 2003 and 2002. These financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, which will be performed for the full year with the objective of expressing an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying condensed consolidated financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States.

We have previously audited, in accordance with auditing standards generally accepted in the United States, the consolidated balance sheet of Atmos Energy Corporation as of September 30, 2002, and the related consolidated statements of income, shareholders' equity and cash flows for the year then ended (not presented herein) and in our report dated November 8, 2002, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of September 30, 2002 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

ERNST & YOUNG LLP

Dallas, Texas  
May 12, 2003

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**Cautionary Statement for the Purposes of the Safe Harbor under the Private Securities Litigation Reform Act of 1995**

The statements contained in this Quarterly Report on Form 10-Q may contain "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934. All statements other than statements of historical fact included in this Report are forward-looking statements made in good faith by the Company and are intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. When used in this Report, or any other of the Company's documents or oral presentations, the words "anticipate," "expect," "estimate," "plans," "believes," "objective," "forecast," "goal" or similar words are intended to identify forward-looking statements. Such forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed or implied in the statements relating to the Company's strategy, operations, markets, services, rates, recovery of costs, availability of gas supply and other factors. These risks and uncertainties include the following: adverse weather conditions such as warmer than normal weather in the Company's service territories; national, regional and local economic conditions, including competition from other energy suppliers as well as alternative forms of energy; regulatory approvals, including the impact of rate proceedings before various state regulatory commissions; successful completion and integration of future acquisitions; inflation and increased gas costs, including their effect on commodity prices for natural gas; increased competition; further deregulation or "unbundling" of the natural gas distribution industry; hedging and market risk activities and other uncertainties, all of which are difficult to predict and many of which are beyond the control of the Company. A discussion of these risks and uncertainties may be found in the Company's Form 10-K for the year ended September 30, 2002. Accordingly, while the Company believes these forward-looking statements to be reasonable, there can be no assurance that they will approximate actual experience or that the expectations derived from them will be realized. Further, the Company undertakes no obligation to update or revise any of its forward-looking statements whether as a result of new information, future events or otherwise.

**Introduction**

The following discussion should be read in conjunction with the condensed consolidated financial statements in this Quarterly Report on Form 10-Q and Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended September 30, 2002.

Atmos Energy Corporation and its subsidiaries are primarily engaged in the natural gas utility business as well as certain non-utility businesses. Our operations are divided into three segments: the utility segment, which includes our regulated natural gas distribution and sales operations; the natural gas marketing segment, which includes Atmos Energy Marketing, L.L.C., Woodward Marketing, L.L.C. and Trans Louisiana Industrial Gas Company, Inc.; and our other non-utility segment, which includes all of our other non-utility operations.

Our utility business distributes natural gas through sales and transportation arrangements to approximately 1.7 million residential, commercial, public authority and industrial customers. Our utility business is composed of six regulated utility divisions: Atmos Energy Colorado-Kansas Division, Atmos Energy Kentucky Division, Atmos Energy Louisiana Division, Atmos Energy Mid-States Division, Mississippi Valley Gas Company Division and Atmos Energy Texas Division. The service areas of our divisions are located in Colorado, Georgia, Illinois, Iowa, Kansas, Kentucky, Louisiana, Mississippi, Missouri, Tennessee, Texas and Virginia. Our utility business is subject to regulation by state and/or local authorities in each of the states in which we operate. Our business is primarily affected by seasonal weather patterns, competitive factors within the energy industry and economic conditions in the areas that we serve. We also transport natural gas for others through our distribution system.

Our natural gas marketing and other non-utility segments, which are organized under Atmos Energy Holdings, Inc., have operations in 18 states. Atmos Energy Marketing, L.L.C., together with its wholly-owned subsidiaries, comprise our natural gas marketing segment. Atmos Energy Marketing provides a variety of natural gas management services to natural gas utility systems, municipalities and industrial natural gas

consumers in several states and to our Colorado-Kansas, Kentucky, Louisiana and Mid-States divisions. These services primarily consist of the furnishing of natural gas supplies at fixed and market-based prices, load forecasting and management, gas storage and transportation services, peaking sales and balancing services and gas price hedging through the use of derivative products. In addition, Trans Louisiana Industrial Gas Company markets natural gas primarily to commercial customers in Louisiana.

We provide natural gas storage services and own or hold an interest in natural gas storage fields in Kansas, Kentucky, Louisiana and Mississippi to supplement natural gas used by customers in Kansas, Kentucky, Louisiana, Mississippi, Tennessee and other states. We construct and operate electrical peaking power generating plants and associated facilities and may enter into agreements to either lease or sell such plants. In addition, we market natural gas to agricultural customers primarily in West Texas.

### ***Weather and Seasonality***

Our utility business and irrigation sales business are seasonal and dependent on weather conditions in our service areas. Natural gas sales to residential, commercial and public authority customers are affected by winter heating season requirements. This generally results in higher operating revenues and net income during the period from October through March of each year and lower operating revenues and either lower net income or net losses during the period from April through September of each year. Sales to industrial customers are much less weather sensitive. Sales to agricultural customers, who typically use natural gas to power irrigation pumps during the period from March through September, are affected by rainfall amounts and the price of natural gas.

The effects of weather that is above or below normal are offset partially in the Tennessee and Georgia jurisdictions served by the Mid-States Division, in the Mississippi jurisdiction served by the Mississippi Valley Gas Company Division and in the Kentucky jurisdiction served by the Kentucky Division through weather normalization adjustments (WNA). The Tennessee Regulatory Authority, the Georgia Public Service Commission, the Mississippi Public Service Commission and the Kentucky Public Service Commission have approved WNA. WNA, effective from October through May each year in Georgia, November through May each year in Mississippi and November through April each year in Tennessee and Kentucky, allow us to increase the base rate portion of customers' bills when weather is warmer than normal and decrease the base rate when weather is colder than normal. Weather in our WNA service areas was colder than normal for the three and six month periods ended March 31, 2003. The net effect of WNA, excluding Mississippi, was a decrease in revenues of \$0.9 million for the three months ended March 31, 2003, compared with an increase of \$2.9 million for the three months ended March 31, 2002. For the six months ended March 31, 2003, the net effect of WNA, excluding Mississippi, was a decrease in revenues of \$2.7 million compared with an increase of \$5.7 million for the six months ended March 31, 2002. Approximately 658,000 or 39 percent of our meters in service are located in Tennessee, Georgia, Mississippi and Kentucky. We do not have WNA in our other service areas.

In June 2001, we purchased a three-year weather insurance policy with an option to cancel the third year of coverage. The policy is for our Texas and Louisiana operations and covers the entire heating season of October through March beginning with the 2001-2002 heating season. The cost of the three-year policy was \$13.2 million which was prepaid and is being amortized over the appropriate heating seasons based on degree days. The insurance is designed to protect against weather that is at least seven percent warmer than normal for the entire heating season. During the quarter ended December 31, 2001, we recognized \$5.9 million in income relating to this insurance policy. During the quarter ended March 31, 2002, weather was colder than normal resulting in the reversal of the \$5.9 million income that was recognized earlier. Because weather was not at least seven percent warmer than normal, no income was recognized under this insurance policy during the three months and six months ended March 31, 2003. Amortization expense of \$1.9 million and \$2.5 million was recognized during the first and second quarters of our 2002 and 2003 fiscal years. In April 2003, we canceled the third year of coverage on this policy primarily as a result of rate relief in Louisiana and prospects for WNA in Texas. The remaining amount of prepaid cost, less cash received for early termination of this policy, will be written off in the third quarter of fiscal 2003 resulting in a pretax charge of approximately \$0.6 million.

### ***Gas Supply***

We receive gas deliveries in our utility operations through 36 pipeline transportation companies, both interstate and intrastate, to satisfy our sales requirements under contracts which anticipate no interruptions. The pipeline transportation agreements are uninterruptible and many of them have pipeline no-notice storage service, which provides for daily balancing between system requirements and physical quantities requested by our customers.

We own or hold an interest in and operate numerous natural gas storage facilities in Kentucky, Kansas, Louisiana and Mississippi which are used to help meet customer requirements during peak demand periods and to reduce the need to contract for additional pipeline capacity to meet such peak demand periods.

We normally inject gas into pipeline storage systems and company owned storage facilities during the summer months and withdraw it in the winter months. Our underground storage facilities in Kansas, Kentucky, Louisiana and Mississippi have a combined maximum daily output capacity of approximately 392,000 Mcf.

We purchase our gas supply from various producers and marketers. Supply arrangements are contracted on an uninterruptible basis with various terms and at market prices.

For the 2002-2003 heating season, we covered approximately 51 percent of our anticipated flowing gas requirements through a combination of storage, financial hedges and fixed forward contracts at a weighted average cost of less than \$4.00 per Mcf. This provided a measure of protection to us and our customers against potential sharp increases in the price of natural gas during the 2002-2003 heating season.

### ***Completion of Acquisition of Mississippi Valley Gas Company***

On December 3, 2002, we completed the acquisition of Mississippi Valley Gas Company, a privately held utility, for approximately \$150.0 million, which consisted of approximately \$74.7 million in cash and 3,386,287 unregistered shares of our common stock. In addition, we paid \$70.9 million to repay outstanding debt of Mississippi Valley Gas Company. Our Mississippi Valley Gas Company Division provides natural gas distribution service to approximately 282,000 residential, industrial and other customers located primarily in the northern and central regions of Mississippi.

### **Critical Accounting Policies and Estimates**

*General* — Our consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States. Preparation of these financial statements required us to make estimates and judgments that affected the reported amounts of assets, liabilities, revenues and expenses and the related disclosures of contingent assets and liabilities. We based our estimates on historical experience and various other assumptions that we believed to be reasonable under the circumstances. On an ongoing basis, we evaluate our estimates, including those related to risk management and trading activities, allowance for doubtful accounts, goodwill and pension and other post retirement plans. Actual results may differ from estimates.

*Regulation* — Our utility operations are subject to regulation with respect to rates, service, maintenance of accounting records and various other matters by the respective regulatory authorities in the states in which we operate. Our accounting policies recognize the financial effects of the ratemaking and accounting practices and policies of the various regulatory commissions. Regulated utility operations are accounted for in accordance with Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation." This statement requires 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.

*Risk management assets and liabilities, natural gas marketing segment* — We use storage, transportation and requirements contracts, forwards, over-the-counter and exchange-traded options, futures and swap contracts to conduct our risk management activities.

On October 25, 2002, through the issuance of Emerging Issues Task Force (EITF) Issue No. 02-03, the EITF rescinded Issue No. 98-10 “Accounting for Energy Trading and Risk Management Activities” thereby precluding mark-to-market accounting for inventory and energy trading contracts that are not derivatives. During the quarter ended December 31, 2002, energy trading contracts entered into on or before October 25, 2002 were marked to market pursuant to the provisions of EITF Issue No. 98-10. Energy trading contracts entered into after October 25, 2002 were prospectively accounted for pursuant to the provisions of SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities.”

Prior to December 31, 2002, we had recorded \$12.9 million of unrealized income in accordance with EITF Issue No. 98-10. Beginning January 1, 2003, all energy trading contracts are being accounted for pursuant to the provisions of SFAS No. 133. On January 1, 2003, we reversed the unrealized income on storage contracts and certain full requirements contracts as a cumulative effect of a change in accounting principle. The cumulative effect of the change in accounting principle was reported in accordance with Accounting Principles Board (APB) Opinion No. 20, “Accounting Changes.” Further, many of our index priced contracts qualify for the normal purchases and sales exception under SFAS No. 133 and are not marked to market for changes in value subsequent to December 31, 2002. Generally our fixed price contracts and our portfolio of options, swaps and futures contracts will continue to be accounted for at fair value. In addition, effective January 1, 2003, we designated a portion of our futures contracts as fair value hedges of the natural gas marketing segment’s gas inventory. Accordingly, the inventory was adjusted to cost as of January 1, 2003 as part of the cumulative effect adjustment, but subsequent changes in fair value will be recognized as an adjustment to the carrying value of the hedged inventory. The cumulative noncash charge in the second quarter of fiscal 2003 was \$7.8 million, net of \$5.1 million of applicable income tax benefit. As performance under these inventory, storage and transportation contracts is completed, the applicable income will be recognized.

*Allowance for Doubtful Accounts* — For the majority of our receivables, we establish an allowance for doubtful accounts based on an aging of those receivable balances. We apply percentages to each aging category based on our collections experience. On certain other receivables where we are aware of a specific customer’s inability or reluctance to pay, we record an allowance for doubtful accounts against amounts due to reduce the net receivable balance to the amount we reasonably expect to collect. We believe our allowance for doubtful accounts is adequate. However, if circumstances change, our estimate of the recoverability of accounts receivable could be different.

*Goodwill* — At March 31, 2003, we had \$275.0 million of goodwill, \$240.3 million of which was attributable to our utility segment, \$22.6 million was attributable to our natural gas marketing segment and \$12.1 million was attributable to our other non-utility segment. The goodwill in our utility segment resulted from our acquisitions of the assets of Louisiana Gas Service Company in July 2001 and Mississippi Valley Gas Company in December 2002. We evaluate our goodwill balances for impairment each year during our second fiscal quarter or as impairment indicators arise. Our evaluation during the quarter ended March 31, 2003 resulted in no impairment. We use a present value technique based on discounted cash flows to estimate the fair value of our reporting groups. If our projections of estimated future cash flows change, those changes could result in a reduction in the carrying value of our goodwill.

*Pension and Other Postretirement Plans* — Pension and other postretirement plan expenses and liabilities are determined on an actuarial basis and are affected by the market value of plan assets, estimates of the expected return on plan assets and assumed discount rates. Actual changes in the fair market value of plan assets and differences between the actual return on plan assets and the expected return on plan assets could have a material effect on the amount of pension expense ultimately recognized. The assumed return on plan assets is based on management’s expectation of the long-term return on the portfolio of plan assets. The discount rate used to compute the present value of plan liabilities generally is based on rates of high grade corporate bonds with maturities similar to the average period over which benefits will be paid.

## Financial Condition

For the six months ended March 31, 2003, our operating activities provided cash of \$183.8 million compared to providing cash of \$252.9 million during the six months ended March 31, 2002. The decrease was primarily the result of a larger increase in accounts receivable over the same period a year ago, an increase in deferred gas costs and decreases in cash held on deposit in margin accounts and other current liabilities. This decrease was partially offset by a larger decrease in gas stored underground and a larger increase in accounts payable over the same period a year ago. Net income increased primarily due to higher gross profit partially offset by lower gas trading margin and higher operating expenses.

For the six months ended March 31, 2003, our investing activities used cash of \$147.0 million compared with cash used of \$77.4 million for the six months ended March 31, 2002. Capital expenditures were \$72.7 million during the six months ended March 31, 2003 compared to \$60.9 million for the six months ended March 31, 2002. Capital expenditures for fiscal 2003, excluding acquisitions, are expected to be approximately \$150.0 million to \$160.0 million compared to actual capital expenditures of \$132.3 million for fiscal 2002. Capital projects for fiscal 2003 include expenditures for additional mains, services, meters and equipment and approximately \$24.0 million for Mississippi Valley Gas Company Division capital expenditures. Capital expenditures for fiscal 2003 are financed from internally generated funds and financing activities as discussed below. For the six months ended March 31, 2003, investing activities included \$74.7 million for the cash portion of the Mississippi Valley Gas Company acquisition completed in December 2002. For the six months ended March 31, 2002, investing activities included \$15.7 million for the acquisition of Kentucky-based market area storage and associated pipeline facility assets, certain natural gas purchase and sales contracts and the outstanding common stock of Southern Resources, Inc.

For the six months ended March 31, 2003, our financing activities used cash of \$20.5 million compared with cash used of \$187.6 million for the six months ended March 31, 2002. For the six-month period ended March 31, 2003, short-term debt decreased \$116.1 million compared with a decrease of \$158.7 million for the six months ended March 31, 2002. The decrease for the six months ended March 31, 2003 was due to the repayment of short-term debt with the proceeds of our January 2003 debt offering, discussed below, partially offset by the need for additional working capital funds as a result of higher gas prices and weather that was colder than the same period a year ago. Repayments of long-term debt totaled \$69.1 million for the six months ended March 31, 2003 compared with \$13.7 million for the six months ended March 31, 2002. During the six months ended March 31, 2003, we received \$147.0 million from our credit facility which was used for the initial funding of the cash portion of the Mississippi Valley Gas Company acquisition in December 2002 and to repay Mississippi Valley Gas' outstanding debt. For the six months ended March 31, 2003, we repaid \$70.9 million of outstanding Mississippi Valley Gas debt in connection with the acquisition in December 2002 as discussed above. For the six months ended March 31, 2003, we received net proceeds from the issuance of long-term debt of \$249.3 million. The net proceeds from the issuance of this long-term debt were used to repay the \$147.0 million we received from our credit facility which was used to fund the cash portion of the Mississippi Valley Gas Company acquisition, to repay outstanding debt and for general corporate purposes. We paid \$26.2 million in cash dividends during the six months ended March 31, 2003 compared with dividends of \$24.2 million during the six months ended March 31, 2002. This change reflects increases in the quarterly dividend rate and in the number of shares outstanding. During the six months ended March 31, 2003, we issued 3,948,773 shares of common stock. Of these, 3,386,287 shares were issued in December 2002 for the stock portion of the Mississippi Valley Gas Company acquisition.

The following table shows the number of shares issued for the six-month periods ended March 31, 2003 and 2002:

	Six Months Ended March 31	
	<u>2003</u>	<u>2002</u>
Shares issued:		
Retirement Savings Plan . . . . .	192,137	151,577
Direct Stock Purchase Plan . . . . .	275,462	255,566
Outside Directors Stock-for-Fee Plan . . . . .	1,254	1,237
Long-Term Stock Plan for Mid-States Division . . . . .	5,000	—
Long-Term Incentive Plan . . . . .	88,633	42,031
Acquisition of Mississippi Valley Gas Company . . . . .	<u>3,386,287</u>	<u>—</u>
Total shares issued . . . . .	<u><u>3,948,773</u></u>	<u><u>450,411</u></u>

We believe that internally generated funds, our credit facilities, our commercial paper program and access to the public debt and equity capital markets will provide necessary working capital and liquidity for capital expenditures and other cash needs for the remainder of fiscal 2003.

We have short-term committed credit facilities totaling \$318.0 million. One short-term unsecured credit facility is for \$300.0 million and serves as a backup liquidity facility for our commercial paper program. Our commercial paper is rated A-2 by Standard and Poor's, P-2 by Moody's and F-2 by Fitch. At March 31, 2003, \$29.7 million of commercial paper was outstanding. We have a second unsecured facility in place for \$18.0 million. At March 31, 2003, there were no borrowings under this credit facility. These credit facilities are negotiated at least annually and are used for working capital purposes.

On October 7, 2002, we entered into a \$150.0 million short-term unsecured committed credit facility. This credit facility was used to provide initial funding for the cash portion of the Mississippi Valley Gas Company acquisition and to repay Mississippi Valley Gas Company's existing debt. A total of \$147.0 million was borrowed under this credit facility during the first quarter. This amount was refinanced in January 2003 with a portion of the proceeds of our \$250.0 million debt offering.

Our Woodward Marketing subsidiary has a \$210.0 million uncommitted demand working capital credit facility. Atmos Energy Holdings, Inc. and Atmos Energy Marketing, L.L.C., our wholly-owned subsidiaries, are guarantors of all amounts outstanding under this facility. At March 31, 2003, no amount was outstanding under this credit facility, although letters of credit totaling \$179.0 million reduced the amount available. The amount available under this credit facility is also limited by various covenants, including covenants based on working capital. Under the most restrictive covenant, the amount available to Woodward Marketing under this credit facility at March 31, 2003 was \$31.0 million. During the quarter ended March 31, 2003, Woodward Marketing was not in technical compliance with one of the covenants contained in this uncommitted demand credit facility. Woodward Marketing has obtained a waiver for the period of non-compliance. This credit facility expires on March 31, 2004.

We also have an unsecured short-term uncommitted credit line for \$20.0 million. There were no borrowings under this uncommitted credit facility at March 31, 2003. This uncommitted line is renewed or renegotiated at least annually with varying terms and we pay no fee for the availability of the line. Borrowings under this line are made on a when- and as-available basis at the discretion of the bank. This facility is also used for working capital purposes.

In addition, Woodward Marketing has up to \$100.0 million for its non-utility business available from Atmos Energy Holdings. At March 31, 2003, \$42.0 million was outstanding. Any outstanding amounts under the Atmos Energy Holdings facility are subordinated to Woodward Marketing's \$210.0 million uncommitted demand credit facility described above. This intercompany loan is eliminated in the consolidated financial statements.

In December 2001, we filed a shelf registration statement with the Securities and Exchange Commission (SEC) to issue, from time to time, up to \$600.0 million in new common stock and/or debt. The registration statement was declared effective by the SEC on January 30, 2002. On January 16, 2003, we issued \$250.0 million of 5<sup>1</sup>/<sub>8</sub>% Senior Notes due 2013 under the registration statement reducing the amount available to \$350.0 million. The net proceeds were used to repay debt under an acquisition credit facility used to finance our acquisition of Mississippi Valley Gas Company, which closed in December 2002, as well as for general corporate purposes, including repayment of short-term debt under our commercial paper program. The remaining proceeds were used to repay unsecured senior notes held by institutional lenders.

The availability of funds under our credit facilities is subject to conditions specified therein, which we currently meet. 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 our \$300.0 million credit facility to maintain a ratio of total debt to total capitalization of no greater than 70 percent. As of March 31, 2003, we were in compliance with this leverage ratio requirement.

Our credit capacity and the amount of unused borrowing capacity are affected by the seasonal nature of the natural gas business and our short-term borrowing requirements, which are typically highest during colder months. Our working capital needs can vary significantly due to changes in the price of natural gas charged by suppliers and the increased gas supplies required to meet customers' needs during periods of cold weather.

Our internally generated funds may change in the future due to a number of factors, some of which we cannot control. These include regulatory changes, the price for our products and services, the demand for such products and services, margin requirements resulting from significant changes in commodity prices, operational risks and other factors.

Our credit ratings directly affect our ability to obtain short-term and long-term financing, in addition to the cost of such financing. In determining our credit ratings, the rating agencies consider a number of quantitative factors, including debt to total capitalization, operating cash flow relative to outstanding debt, operating cash flow coverage of interest and pension liabilities and funding status. In addition, the rating agencies consider qualitative factors such as consistency of our earnings over time, the quality of our management and business strategy, the risk associated with our utility and non-utility businesses and the regulatory structures that govern our rates in the states where we operate.

Our debt is rated by three rating agencies: Standard & Poor's Corporation (S&P), Moody's Investors Service (Moody's) and Fitch Ratings, Inc. (Fitch). Our current debt ratings are as follows:

	<u>S&amp;P</u>	<u>Moody's</u>	<u>Fitch</u>
Long-term debt . . . . .	A-	A3	A-
Commercial paper . . . . .	A-2	P-2	F-2

Our credit ratings may be revised or withdrawn at any time by the rating agencies, and each rating should be evaluated independently of any other rating. There can be no assurance that a rating will remain in effect for any given period of time or that a rating will not be lowered, or withdrawn entirely, by a rating agency if, in its judgment, circumstances so warrant.

On January 10, 2003, S&P changed the outlook on our long-term debt rating from "stable" to "negative." In its press release explaining this action, S&P cited, among other factors, their concern that we have not made significant progress in reducing our debt to total capitalization ratio. Moody's and Fitch each continue to maintain a "stable" outlook for our ratings.

We do not have any trigger events in our debt instruments that are tied to changes in specified credit ratings or stock price, and we have not entered into any transactions that would require us to issue equity based on our credit rating or other trigger events. At March 31, 2003, we are in compliance with all existing debt provisions.

The following tables provide information about contractual obligations and commercial commitments at March 31, 2003.

	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
	(In thousands)				
<b>Contractual Obligations</b>					
Long-Term Debt . . . . .	\$873,385	\$ 9,157	\$10,916	\$ 9,463	\$843,849
Capital Lease Obligations . . . . .	5,754	876	1,719	866	2,293
Operating Leases . . . . .	<u>68,198</u>	<u>9,860</u>	<u>18,974</u>	<u>15,958</u>	<u>23,406</u>
Total Contractual Obligations . . . . .	<u>\$947,337</u>	<u>\$19,893</u>	<u>\$31,609</u>	<u>\$26,287</u>	<u>\$869,548</u>

	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
	(In thousands)				
<b>Other Commercial Commitments</b>					
Lines of Credit . . . . .	\$29,700	\$29,700	\$—	\$—	\$—

Our Pension Account Plan was underfunded at September 30, 2002 primarily due to negative investment returns from plan assets during fiscal 2002, lump sum distributions to participants and a decrease in interest rates. A minimum pension liability of \$63.6 million before applicable income taxes was recorded as of September 30, 2002, which decreased shareholders' equity by \$39.4 million.

Because of the Pension Account Plan's underfunded status, we must fund the Plan by a minimum of \$5.4 million to meet ERISA requirements, which funding must occur no later than June 30, 2003. However, if funding is done only at this minimum level, future funding requirements likely would increase substantially over the next several years, assuming that no significant improvement occurs in the investment returns from the plan assets or no significant increase in interest rates. We are in the process of determining the amount to be funded currently, taking into consideration possible increases in funding requirements as well as the appropriate balance between cash and Atmos common stock.

The projected pension liability and future funding requirements for the Plan are subject to change, depending upon the actuarial value of plan assets from time to time and future benefit obligations as of each subsequent actuarial calculation date.

### Risk Management and Trading Activities

We conduct our risk management activities through both our utility and natural gas marketing segments. The following table shows our risk management assets and liabilities by segment at March 31, 2003.

	Utility	Natural Gas Marketing	Total
	(In thousands)		
Assets from risk management activities, current . . . . .	\$1,202	\$ 27,353	\$ 28,555
Assets from risk management activities, noncurrent . . . . .	—	280	280
Liabilities from risk management activities, current . . . . .	—	(18,755)	(18,755)
Liabilities from risk management activities, noncurrent . . . . .	—	(616)	(616)
Net assets (liabilities) . . . . .	<u>\$1,202</u>	<u>\$ 8,262</u>	<u>\$ 9,464</u>

In accordance with SFAS No. 71 "Accounting for the Effects of Certain Types of Regulation", current period changes in the assets and liabilities from risk management activities related to our utility segment are recorded as deferred gas costs on the condensed consolidated balance sheet as these costs ultimately will be recovered from ratepayers. Accordingly, there is no earnings impact as a result of the use of these financial

instruments. Upon maturity, the contracts are recognized in purchased gas cost on the condensed consolidated statement of income.

We use storage, transportation and requirements contracts, forwards, over-the-counter and exchange-traded options, futures and swap contracts to conduct our risk management activities in our natural gas marketing segment.

On October 25, 2002, through the issuance of EITF Issue No. 02-03, the EITF rescinded Issue No. 98-10 "Accounting for Energy Trading and Risk Management Activities" thereby precluding mark-to-market accounting for our natural gas marketing segment inventory and energy trading contracts that are not derivatives. Beginning January 1, 2003, energy trading contracts are being accounted for pursuant to the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The cumulative effect of the change in accounting principle was reported in accordance with APB Opinion No. 20, "Accounting Changes." The cumulative noncash charge in the second quarter of fiscal 2003 was \$7.8 million. As performance under these inventory, storage and transportation contracts is completed, the applicable income will be recognized. Originally, \$6.0 million was expected to be realized in net income in fiscal 2003, \$1.2 million in fiscal 2004 and \$0.6 million thereafter. However, as discussed below, actual results to date are less than originally estimated, due to the extreme market volatility.

Under the mark-to-market method of accounting, contracts are reflected at fair value, inclusive of future servicing costs and valuation adjustments, with resulting unrealized gains and losses recorded as assets or liabilities from risk management activities on the condensed consolidated balance sheet. Current period changes in the assets and liabilities from risk management activities are recognized as net gains or losses on the condensed consolidated statement of income. Changes in the mark-to-market valuation of assets and liabilities from risk management activities primarily result from changes in the valuation of the portfolio of contracts, maturity and settlement of contracts and newly originated transactions. Market prices and models used to value these transactions reflect our best estimate considering various factors including closing exchange and over-the-counter quotations, time value and volatility factors underlying the contracts. Values are adjusted to reflect the potential impact of an orderly liquidation of our positions over a reasonable period of time under present market conditions. Changes in market prices directly affect our estimate of the fair value of these transactions. For those futures contracts designated as fair value hedges, the market adjustment is offset by the adjustment to the carrying value of the inventory.

The following table shows the components of the change in fair value of our natural gas marketing energy trading contract activities for the three months ended March 31, 2003 (in thousands).

Fair value of contracts at December 31, 2002 .....	\$ 2,980
Contracts realized/settled .....	8,763
Fair value of new contracts .....	1,773
Other changes in value .....	3,545
Cumulative effect of accounting change .....	<u>(8,799)</u>
Fair value of contracts at March 31, 2003 .....	<u>\$ 8,262</u>

The following table shows the components of the change in fair value of our natural gas marketing energy trading contract activities for the six months ended March 31, 2003 (in thousands).

Fair value of contracts at September 30, 2002 .....	\$ 6,651
Contracts realized/settled .....	11,577
Fair value of new contracts .....	4,631
Other changes in value .....	(5,798)
Cumulative effect of accounting change .....	<u>(8,799)</u>
Fair value of contracts at March 31, 2003 .....	<u>\$ 8,262</u>

The fair value of our natural gas marketing energy trading contracts at March 31, 2003, is segregated below, by time period and fair value source.

	Fair Value of Contracts at March 31, 2003				Total Fair Value
	Maturity Less than 1 Year	Maturity 1-3 Years	Maturity 4-5 Years	Maturity Excess of 5 Years	
	(In thousands)				
<b>Source of Fair Value</b>					
Prices actively quoted . . . . .	\$17,145	\$ 119	\$—	\$—	\$17,264
Prices provided by other external sources	(8,325)	(270)	51	—	(8,544)
Prices based on models and other valuation methods . . . . .	(222)	(236)	—	—	(458)
Total Fair Value . . . . .	<u>\$ 8,598</u>	<u>\$(387)</u>	<u>\$51</u>	<u>\$—</u>	<u>\$ 8,262</u>

## Results of Operations

### *Three Months Ended March 31, 2003, Compared with Three Months Ended March 31, 2002*

Net income for the three months ended March 31, 2003 was \$48.5 million compared to \$41.4 million in the same period last year.

The primary factors that impact our results of operations are seasonal weather patterns, competitive factors in the energy industry and economic conditions in our service areas. Our second fiscal quarter historically has been our most critical earnings quarter with an average of 76 percent of our net income having been earned in the second quarter during the three most recently completed fiscal years.

*Gross profit* — Gross profit primarily consists of gas service margins generated by our six utility operating divisions from the sale of natural gas to approximately 1.7 million residential, commercial, industrial, agricultural and other customers in the twelve states that comprise our utility service areas. Gross profit increased to \$200.6 million for the three months ended March 31, 2003 from \$149.9 million for the three months ended March 31, 2002. The increase in gross profit primarily was due to the additional gross profit resulting from the Mississippi Valley Gas Company acquisition in December 2002. Also adding to the increase in gross profit was a \$3.9 million increase in our base charges primarily in Louisiana as a result of our annual rate stabilization clause filing which became effective in November 2002. These increases were partially offset by a \$0.9 million decrease in gross profit from WNA, excluding Mississippi. Weather in our WNA service areas was colder than normal for the three months ended March 31, 2003. We have WNA in Tennessee, Georgia, Mississippi and Kentucky. Changes in the cost of gas impact revenue but do not directly affect gross profit of our utility business because the fluctuations in gas prices are passed through to the customer.

Throughput is a measure of the volume of natural gas that moved through our system and consists of natural gas sold to our customers and natural gas that is transported for others. Total throughput generated by our utility business was 100.8 billion cubic feet (Bcf) during the current quarter compared to 82.6 Bcf during the same quarter last year. The increase in throughput primarily resulted from volumes associated with the assets of Mississippi Valley Gas Company acquired in December 2002. Total throughput during the current quarter from the Mississippi Valley Gas Company Division was 16.6 Bcf. There was no throughput from the Mississippi Valley Gas Company Division in our results during the second quarter of last year because that period was prior to the date of our acquisition of that division.

*Gas trading margin* — Our gas trading margin consists of both realized and unrealized components. Our gas trading margin income was \$2.4 million for the three months ended March 31, 2003 compared to income of \$9.6 million for the three months ended March 31, 2002. For the three months ended March 31, 2003, we incurred a realized loss of \$10.1 million in gas trading margin from the sale of 94.4 Bcf of natural gas to our customers compared to realized income of \$31.5 million in gas trading margin from the sale of 82.0 Bcf of natural gas for the three months ended March 31, 2002.

At times, we maintain a net open position related to our physical storage when we believe that future changes in prices and market conditions may result in profitable positions. Net open positions may result in an adverse impact on our financial condition or results of operations if the market price does not react in the manner or direction that we expected. Our risk management control policy contains limits associated with the overall size of open positions.

Our natural gas marketing segment's performance during the second quarter was adversely affected by a shorter than expected physical position because we were unable to withdraw planned volumes from storage and therefore were required to buy gas at market prices in a rising market to meet contractual requirements with customers. We were unable to withdraw such volumes from storage due to contractual and regulatory limitations relating to our storage facilities. Our inability to withdraw gas from storage also prevented the matching of unwinding our financial spreads to capture storage margins and therefore cover the cumulative costs of the discount we incurred for use of the storage capacity.

The structure of certain asset management contracts we recently acquired results in increased price risk when there is sustained cold weather. Customers increased their demand due to cold weather and we were required to purchase gas to cover the unplanned incremental customer requirements at market prices in a rising market. Only a portion of these costs can be passed through to customers.

We are taking steps to eliminate or minimize any future negative impact of the events that caused the lower-than-expected earnings from our natural gas marketing segment during the second quarter. We plan to negotiate new contracts which transfer the risk of volatile gas prices to our customers and provide higher margins and we will investigate the possibility of acquiring high deliverability storage to increase supply during sustained periods of cold weather.

*Operating expenses* — Operating expenses increased 30 percent to \$95.1 million for the three months ended March 31, 2003 from \$73.2 million for the three months ended March 31, 2002. Operation and maintenance expense increased primarily due to the addition of \$10.7 million relating to the Mississippi Valley Gas Company acquisition in December 2002 and a \$4.9 million increase in the provision for doubtful accounts as a result of higher revenues. Taxes other than income taxes increased \$7.7 million primarily due to additional franchise, payroll and property taxes associated with the Mississippi Valley Gas assets acquired in December 2002.

*Operating income* — Operating income increased 25 percent for the three months ended March 31, 2003 to \$107.9 million from \$86.3 million for the three months ended March 31, 2002. The increase in operating income primarily resulted from the increase in gross profit described above partially offset by a decrease from our gas trading margin and an increase in operating expenses.

*Miscellaneous income (expense)* — Miscellaneous expense for the three months ended March 31, 2003 was \$1.5 million, compared with expense of \$6.1 million for the three months ended March 31, 2002. The \$4.6 million change primarily was attributable to the reversal of \$5.9 million in income during the three months ended March 31, 2002 that had been recognized during the three months ended December 31, 2001 from our weather insurance policy. No income from our weather insurance policy was recognized during the three months ended March 31, 2003 because weather in the covered service areas did not meet the seven percent warmer than normal threshold required to recognize income from the policy. Partially offsetting this change was lower earnings from our equity earnings in Heritage Propane Partners, L.P. during the three months ended March 31, 2003 compared to the three months ended March 31, 2002.

*Interest charges* — Interest charges increased 12 percent for the three months ended March 31, 2003 to \$16.2 million from \$14.5 million for the three months ended March 31, 2002. The increase primarily was due to an increase in interest charges resulting from a higher average outstanding debt balance.

*Cumulative effect of change in accounting principle* — On January 1, 2003, we recorded a cumulative effect of a change in accounting principle to reflect a change in the way we account for our storage and transportation contracts. Previously we accounted for those contracts under EITF 98-10 which required us to record estimated future gains on our storage and transportation contracts at the time we entered into the contracts and to mark those contracts to market value each month. Effective January 1, 2003, we no longer

mark those contracts to market. As a result, we expensed \$7.8 million, net of applicable income tax benefit as a cumulative effect of change in accounting principle.

#### *Six Months Ended March 31, 2003, Compared with Six Months Ended March 31, 2002*

Net income for the six months ended March 31, 2003 was \$74.3 million compared to \$62.0 million in the same period last year.

*Gross profit* — Gross profit increased to \$333.2 million for the six months ended March 31, 2003 from \$259.2 million for the six months ended March 31, 2002. The increase in gross profit primarily was due to the additional gross profit resulting from the Mississippi Valley Gas Company acquisition in December 2002 and an increase in volumes sold to weather sensitive customers. Also adding to gross profit was the \$6.8 million increase in our base charges primarily in Louisiana as a result of our annual rate stabilization clause filing which became effective in November 2002. These increases were partially offset by a \$2.7 million decrease in revenues from WNA, excluding Mississippi. Changes in the cost of gas impact revenue but do not directly affect gross profit because the fluctuations in gas prices are passed through to the customer.

Total throughput was 172.0 Bcf during the six months ended March 31, 2003 compared to 139.7 Bcf during the same period last year. The increase in throughput primarily resulted from volumes associated with the assets of Mississippi Valley Gas Company acquired in December 2002 and from weather that was four percent colder than last year. Total throughput during the six months ended March 31, 2003 from the Mississippi Valley Gas Company Division was 21.7 Bcf. There was no throughput from the Mississippi Valley Gas Company Division in our results during the six months ended March 31, 2002 because that period was prior to the date of our acquisition of that division.

*Gas trading margin* — Our gas trading margin consists of both realized and unrealized components. Our gas trading margin income was \$6.9 million for the six months ended March 31, 2003 compared to income of \$16.8 million for the six months ended March 31, 2002. For the six months ended March 31, 2003, we incurred a realized loss of \$4.4 million in gas trading margin from the sale of 169.4 Bcf of natural gas to our customers compared to a realized gain of \$34.4 million in gas trading margin from the sale of 146.3 Bcf of natural gas for the six months ended March 31, 2002.

At times, we maintain a net open position related to our physical storage when we believe that future changes in prices and market conditions may result in profitable positions. Net open positions may result in an adverse impact on our financial condition or results of operations if the market price does not react in the manner or direction that we expected. Our risk management control policy contains limits associated with the overall size of open positions.

Our natural gas marketing segment's performance during the six months ended March 31, 2003 was adversely affected by a shorter than expected physical position because we were unable to withdraw planned volumes from storage and therefore were required to buy gas at market prices in a rising market to meet contractual requirements with customers. We were unable to withdraw such volumes from storage due to contractual and regulatory limitations relating to our storage facilities. Our inability to withdraw gas from storage also prevented the matching of unwinding our financial spreads to capture storage margins and therefore cover the cumulative costs of the discount we incurred for use of the storage capacity.

The structure of certain asset management contracts we recently acquired results in increased price risk when there is sustained cold weather. Customers increased their demand due to cold weather and we were required to purchase gas to cover the unplanned incremental customer requirements at market prices in a rising market. Only a portion of these costs can be passed through to customers.

We are taking steps to eliminate or minimize any future negative impact of the events that caused the lower-than-expected earnings from our natural gas marketing segment during the six months ended March 31, 2003. We plan to negotiate new contracts which transfer the risk of volatile gas prices to our customers and provide higher margins and we will investigate the possibility of acquiring high deliverability storage to increase supply during sustained periods of cold weather.

*Operating expenses* — Operating expenses increased 23 percent to \$179.6 million for the six months ended March 31, 2003 from \$146.2 million for the six months ended March 31, 2002. Operation and maintenance expense increased primarily due to the addition of \$14.5 million related to the Mississippi Valley Gas Company acquisition in December 2002 and a \$6.6 million increase in the provision for doubtful accounts as a result of higher revenues. Taxes other than income taxes increased \$10.4 million primarily due to additional franchise, payroll and property taxes associated with the Mississippi Valley Gas Company assets acquired in December 2002.

*Operating income* — Operating income increased 24 percent for the six months ended March 31, 2003 to \$160.5 million from \$129.8 million for the six months ended March 31, 2002. The increase in operating income primarily resulted from the increase in gross profit described above partially offset by a decrease from our gas trading margin and an increase in operating expenses.

*Miscellaneous income (expense)* — Miscellaneous income for the six months ended March 31, 2003 was \$2.6 million, compared with expense of \$0.7 million for the six months ended March 31, 2002. The \$3.3 million change primarily was attributable to a \$3.9 million gain associated with a sales-type lease of a distributed electric generation plant which was recognized in the first quarter of 2003.

## Consolidated Operating Statistics

The following tables show our consolidated operating statistics for the three-month and six-month periods ended March 31, 2003 and 2002. See Note 8 of notes to condensed consolidated financial statements for additional information about operating results of our segments.

	Three Months Ended March 31	
	2003	2002
HEATING DEGREE DAYS(1)		
Actual (weighted average) .....	1,812	1,877
Percent of normal .....	100%	98%
SALES VOLUMES — MMcf(2)		
Residential .....	48,876	39,458
Commercial .....	20,166	15,722
Public authority and other .....	4,376	2,646
Industrial (including agricultural) .....	8,595	5,627
Total .....	82,013	63,453
Transportation volumes — MMcf(2) .....	18,774	19,183
Total throughput — MMcf(2) .....	<u>100,787</u>	<u>82,636</u>
OPERATING REVENUES (000's)		
Gas sales revenues		
Residential .....	\$424,586	\$238,062
Commercial .....	165,631	89,745
Public authority and other .....	33,290	13,208
Industrial (including agricultural) .....	58,412	23,233
Total gas sales revenues .....	681,919	364,248
Transportation revenues .....	8,047	9,528
Other revenues .....	10,395	5,705
Total operating revenues .....	<u>\$700,361</u>	<u>\$379,481</u>
Cost of gas (excluding non-utility) .....	<u>\$502,728</u>	<u>\$231,668</u>
Average gas sales revenues per Mcf .....	\$ 8.31	\$ 5.74
Average transportation revenue per Mcf .....	\$ .43	\$ .50
Average cost of gas per Mcf sold .....	\$ 6.13	\$ 3.65

(1) Adjusted for weather normalized operations.

(2) Volumes are reported as metered in million cubic feet (MMcf).

	Six Months Ended March 31	
	2003	2002
METERS IN SERVICE, end of period		
Residential .....	1,502,374	1,247,431
Commercial .....	152,226	122,885
Public authority and other .....	9,959	7,353
Industrial (including agricultural) .....	13,075	12,995
Total meters .....	<u>1,677,634</u>	<u>1,390,664</u>
HEATING DEGREE DAYS(1)		
Actual (weighted average) .....	3,219	3,092
Percent of normal .....	102%	94%
SALES VOLUMES — MMcf(2)		
Residential .....	79,901	62,290
Commercial .....	34,085	26,740
Public authority and other .....	7,220	4,645
Industrial (including agricultural) .....	14,544	10,735
Total .....	135,750	104,410
Transportation volumes — MMcf(2) .....	<u>36,257</u>	<u>35,251</u>
Total throughput — MMcf(2) .....	<u>172,007</u>	<u>139,661</u>
OPERATING REVENUES (000's)		
Gas sales revenues		
Residential .....	\$ 664,321	\$ 395,990
Commercial .....	265,536	158,341
Public authority and other .....	51,058	24,362
Industrial (including agricultural) .....	89,822	44,854
Total gas sales revenues .....	1,070,737	623,547
Transportation revenues .....	17,305	16,562
Other revenues .....	13,866	10,714
Total operating revenues .....	<u>\$1,101,908</u>	<u>\$ 650,823</u>
Cost of gas (excluding non-utility) .....	<u>\$ 773,223</u>	<u>\$ 391,605</u>
Average gas sales revenues per Mcf .....	\$ 7.89	\$ 5.97
Average transportation revenue per Mcf .....	\$ .48	\$ .47
Average cost of gas per Mcf sold .....	\$ 5.70	\$ 3.75

(1) Adjusted for weather normalized operations.

(2) Volumes are reported as metered in million cubic feet (MMcf).

The following tables show our utility operating income by division for the three-month and six-month periods ended March 31, 2003 and 2002. These results of our utility operating income are presented for financial reporting purposes and may not be appropriate for rate-making purposes.

	<b>Three Months Ended</b>	
	<b>March 31</b>	
	<b>2003</b>	<b>2002</b>
	<b>(In thousands)</b>	
Colorado-Kansas Division .....	\$ 15,851	\$14,947
Kentucky Division .....	11,596	11,387
Louisiana Division .....	22,482	17,106
Mid-States Division .....	23,611	24,130
Mississippi Valley Gas Company Division .....	20,690	—
Texas Division .....	10,538	10,917
Other .....	(788)	653
Total utility operating income.....	<u>\$103,980</u>	<u>\$79,140</u>

	<b>Six Months Ended</b>	
	<b>March 31</b>	
	<b>2003</b>	<b>2002</b>
	<b>(In thousands)</b>	
Colorado-Kansas Division .....	\$ 25,237	\$ 21,969
Kentucky Division .....	17,916	17,955
Louisiana Division .....	30,742	21,012
Mid-States Division .....	39,064	37,380
Mississippi Valley Gas Company Division .....	26,245	—
Texas Division .....	15,648	16,212
Other .....	(1,725)	1,306
Total utility operating income.....	<u>\$153,127</u>	<u>\$115,834</u>

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There have been no material changes from the information provided in Item 7A of our Annual Report on Form 10-K for the year ended September 30, 2002.

**Item 4. Controls and Procedures**

Within the 90 days prior to the date of this report, we carried out an evaluation, under the supervision and with the participation of our management, including the Chairman, President and Chief Executive Officer and Senior Vice President and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Chairman, President and Chief Executive Officer, and Senior Vice President and Chief Financial Officer have concluded that our disclosure controls and procedures are effective.

Such disclosure controls and procedures are controls and procedures designed to ensure that all information required to be disclosed in our reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods set forth in applicable Securities and Exchange Commission forms, rules and regulations. In addition, we have reviewed our internal controls and have concluded that there have been no significant changes in such internal controls or other factors that could significantly affect those controls subsequent to the date of our review.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

See Note 3 of notes to condensed consolidated financial statements herein for a description of legal proceedings.

**Item 4. Submission of Matters to a Vote of Security Holders**

At the Annual Meeting of Shareholders of Atmos Energy Corporation on February 12, 2003, 41,514,920 votes were cast as follows:

	<u>Votes For</u>	<u>Votes Withheld</u>
<b>Class II Directors:</b>		
Richard W. Cardin .....	39,871,809	1,643,111
Thomas C. Meredith .....	39,919,454	1,595,466
Carl S. Quinn .....	37,936,727	3,578,193
Richard Ware II .....	39,889,566	1,625,354

The other directors will continue to serve until the expiration of their terms. The term of the Class III directors, Robert W. Best, Thomas J. Garland, Phillip E. Nichol and Charles K. Vaughan will expire in 2004. The term of the Class I directors, Travis W. Bain II, Dan Busbee, Richard K. Gordon and Gene C. Koonce will expire in 2005. The term of the Class II directors, listed above, will expire in 2006.

**Item 6. Exhibits and Reports on Form 8-K**

(a) Exhibits

A list of exhibits required by Item 601 of Regulation S-K and filed as part of this report is set forth in the Exhibits Index, which immediately precedes such exhibits.

(b) Reports on Form 8-K

The Company filed a Form 8-K Current Report, Item 2, Other Events, dated January 13, 2003, announcing that the Company and Banc One Capital Markets, Inc., on behalf of the underwriters named in Schedule A to that certain Underwriting Agreement (collectively the "Underwriters"), executed the

Underwriting Agreement in connection with the sale by the Company to the Underwriters of a total of \$250 million of the Company's 5<sup>1</sup>/<sub>8</sub>% Senior Notes due 2013. Under Item 7, Financial Statements and Exhibits, exhibits were attached: an Underwriting Agreement dated January 13, 2003, a Global Security to be dated January 16, 2003, an Opinion and Consent of Gibson, Dunn & Crutcher LLP dated January 16, 2003 and a Consent of Ernst & Young LLP dated January 13, 2003.







## EXHIBITS INDEX

### Item 6(a)

<u>Exhibit Number</u>	<u>Description</u>	<u>Page Number</u>
10.1	First Amendment, entered into effective as of December 23, 2002, to the Uncommitted Amended and Restated Credit Agreement, dated as of July 1, 2002, among Woodward Marketing, L.L.C., Fortis Capital Corp., BNP Paribas and the other financial institutions which may become parties hereto	
10.2	Second Amendment, entered into effective as of February 7, 2003, to the Uncommitted Amended and Restated Credit Agreement, dated as of July 1, 2002, among Woodward Marketing, L.L.C., Fortis Capital Corp., BNP Paribas and the other financial institutions which may become parties hereto	
10.3	Third Amendment, entered into effective as of February 28, 2003, to the Uncommitted Amended and Restated Credit Agreement, dated as of July 1, 2002, among Woodward Marketing, L.L.C., Fortis Capital Corp., BNP Paribas and the other financial institutions which may become parties hereto	
10.4	Fourth Amendment, entered into effective as of March 31, 2003, to the Uncommitted Amended and Restated Credit Agreement, dated as of July 1, 2002, among Woodward Marketing, L.L.C., Fortis Capital Corp., BNP Paribas and the other financial institutions which may become parties hereto	
10.5	Fifth Amendment and Waiver, entered into effective as of April 28, 2003, to the Uncommitted Amended and Restated Credit Agreement, dated as of July 1, 2002, among Woodward Marketing, L.L.C., Fortis Capital Corp., BNP Paribas and the other financial institutions which may become parties hereto	
12	Computation of ratio of earnings to fixed charges	
15	Letter regarding unaudited interim financial information	
99.1	Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by the Company's Chief Executive Officer*	
99.2	Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by the Company's Chief Financial Officer*	

\* These certifications pursuant to 18 U.S.C. Section 1350 by the Company's Chief Executive Officer and Chief Financial Officer, furnished as Exhibits 99.1 and 99.2, respectively, to this Quarterly Report on Form 10-Q, will not be deemed to be filed with the Commission or incorporated by reference into any filing by the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the Company specifically incorporates such certifications by reference.