HILLIARD LYONS

Natural Gas Utilities
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COMPANY UPDATE / ESTIMATE CHANGE

Key Metrics

ATO - NYSE - as of	2/7/17	$75.97
Price Target		--
52-Week Range		$68.15 - $81.97
Shares Outstanding (mm)		104.0
Market Cap. ($mm)		$7,898.2
1-Mo. Average Daily Volume		387,684
Institutional Ownership		71.0%
LT Debt/Total Capital	Q1'17	40.9%
ROE	TTM	10.8%
Book Value / Share	Q1'17	$35.07
Price / Book Value		2.2x
Dividend Yield		2.4%
LTM EBITDA Margin		28.9%

EPS FY 9/30 (ex-mark to market adj & one-time items)

	2016A	Prior 2017E	Current 2017E		Prior 2018E	Current 2018E
1Q	$0.99	--	$1.08	A	--	--
2Q	*$1.40	$1.43	$1.42		--	--
3Q	*$0.67	$0.63	$0.63		--	--
4Q	*$0.40	$0.42	$0.39		--	--
Year	*$3.39	$3.58	$3.53		$3.83	$3.77
P/E	22.4x		21.5x		--	20.2x

**Needs restating ex-AEM*

Firm Gross Profit ($MM)

	2016A	Prior 2017E	Current 2017E		Prior 2018E	Current 2018E
1Q	$434	--	$469	A	--	--
2Q	*$518	$547	$548		--	--
3Q	*$407	$411	$412		--	--
4Q	*$376	$394	$390		--	--
Year	*$1745	$1,824	$1,818		$1,939	$1,937

Company Description: *Headquartered in Dallas, Texas, Atmos is the largest fully regulated natural gas-only distributor in the US with customers in 9 states. It also provides natural gas marketing and procurement services and manages company owned natural gas storage and pipeline assets, including one of the largest intrastate natural gas pipeline systems in Texas.*

Atmos Energy Corp.

ATO — NYSE — Neutral-1

Fiscal Q1'17 Results from ATO; Reiterating Neutral Rating.

Investment Highlights

- Atmos reported fiscal Q1'17 (October-December) adj. EPS from continuing ops of $1.08 vs. $0.99 in Q1'16. EPS fell between our target for $1.10 and consensus at $1.04. Atmos Energy Marketing (AEM) was sold effective 1/1/17, and contributed discontinued EPS of $0.11, mostly on the unwind of non-cash hedges.
- Gross profit grew 7.9% in Q1, with the Distribution and Pipeline segments growing by 7.8% and 10.7%, respectively. Q1 gross profit roughly met our target.
- Operations & Maintenance (O&M) grew 4.3% in Q1, which is adjusted to reflect the sale of AEM. Guidance for full year O&M of $535MM-$560MM was reiterated. Our model falls within this range, though comps will be skewed until yr/yr quarters are restated.
- Atmos Pipeline Texas filed its long-awaited general rate case with the TX Railroad Commission on January 6. ATO is requesting a 13.5% ROE and 59.83% equity cap structure; the current metrics are 11.8% ROE with a balanced 50/50 capital structure.
- ATO ended Q1'17 with net debt / total capital of 48.3%, down 70bps yr/yr. The company raised nearly $60MM of equity in the first quarter, but we remind investors that ATO has been steadfast in baking funding costs into EPS guidance.
- ATO purchased 140 miles of transmission pipe in north Texas on 12/20; the system addition will be GRIP-eligible with APT's next filing.
- ATO reiterated FY 2017 adjusted EPS guidance of $3.45-$3.65. Our 2017 and 2018 EPS estimates slip following Q1, but are still in line with guidance.
- We are reiterating our Neutral rating. ATO remains one of our favorite core holdings in the gas space, although we await a more compelling entry at which to potentially get more aggressive.

Note Important Disclosures on Pages 6-7
Note Analyst Certification on Page 6

ADDITIONAL DISCUSSION—MULTIPLE ITEMS

The sale of Atmos Energy Marketing closed effective January 1, 2017, which was technically in fiscal Q2, so impact of the sale to consolidated financial statements will not be visible for another few months. ATO noted a working capital estimate of ~$103MM on this morning's conference call attributable to AEM, so we more/less expect this amount to fall off in Q2, in lieu of a $140MM cash payment that we expect to be quickly applied to funding the regulated Cap Ex budget. Well worth emphasizing, in our view, ATO is now operating as a fully regulated company, with assets split between the Distribution (utility) and Pipeline & Storage (intrastate transmission) segments. On the margin, we believe the divesture makes Atmos a more attractive acquisition candidate, and commanding of a slightly higher valuation.

Now-former CFO Bret Eckert left the company, effective 2/1/17. The departure came relatively quickly following a January 20 announcement, although Christopher Forsythe has already elevated from the Controller position to fill the vacancy. Mr. Eckert was with ATO for a period of about 5 years, during which the Atmos experienced considerable financial improvement in terms of both balance sheet strengthening and earnings growth. We believe the departure brings a slight element of risk to what has been a stable and resilient story over the past few years, although we look forward to working with Mr. Forsythe moving forward.

As partially discussed in our opening bullet points, management reiterated all prior continuing operations guidance ranges (i.e. ex-Atmos Energy Marketing): Operations & Maintenance expense $535-$560MM; Depreciation & Amortization $310-$330MM; Interest $115-$125MM; Income Tax $210-$230MM (37%-38% effective rate); EPS $3.45-$3.65. We are not surprised by this per se, but are pleased to see the reiteration given what was a slow start to heating season.

ATO simultaneously signed and closed an agreement to acquire 140 miles of North Texas Pipeline assets from Enlink Midstream (ENLC—$18.75, Not Rated) in late-December. Parsing from the Q1 cash flow statement, we believe the purchase price fell within the $80MM-$90MM range that we suggested in our morning commentaries, a nice sized deal but not necessarily large enough to materially impact the longer-term capital plans. The newly acquired assets are not included in the recently filed rate case from Atmos Pipeline Texas, although the incremental spending will be immediately eligible for GRIP treatment, beginning with the 'stub' filing that covers the months of October 2016-December 2016.

SUITABILITY

We assign ATO a suitability rating of '1.' A full description of our rating scale can be found on page 6. Atmos is the largest standalone publicly traded gas utility company in the country, and marks an attractive core holding, in our view. Though heavily reliant on the state of Texas and smaller than some Utility sector peers, ATO operates monopoly franchises in 9 states and has historically proved capable of returning capital to shareholders. Sector-appropriate leverage, and a soon-to-be fully regulated business mix help keep Atmos just above our more aggressive '2' rating.

CONSIDERATIONS AND RISKS

Utility operations are weather sensitive. Warmer weather can lead to lower total margin from lower volumes of natural gas sold or transported, while extremely cold weather may lead to conservation.

Atmos' CFO left the company somewhat abruptly in February 2016. We see a slight element of risk tied to this event.

Gas utilities face competition from alternative fuels. In the industrial market, many customers have the capability of using both natural gas as well as another source of energy. Increases in the price of natural gas can negatively impact a competitive position by decreasing the price benefits of natural gas to the end user. The cost of natural gas from non-domestic sources may play a greater role in establishing the market price of natural gas in the future.

Gas utilities are subject to regulation at the federal and state levels. Regulatory commissions and policies vary from state to state, and have a significant bearing on the profitability of gas utilities. Additionally, we anticipate a high level of capital expenditure over the coming years; inability to access the capital markets may negatively impact the company's growth prospects.

Our Suitability rating is 1 on a 1-to-4 scale (1 = most conservative, 4 = most aggressive).

Additional information is available upon request.

			Rst'd Q1'17						non-reg from Q				
Atmos Energy Corp. FYE Sept			dec	mar	jun	sept		dec	mar	jun	sept		
Income Statement ('000s)	**FY'14**	**FY'15**	Q1'16	Q2'16	Q3'16	Q4'16	**FY'16**	Q1'17	Q2'17E	Q3'17E	Q4'17E	**FY'17E**	**FY'18E**
Total Operating Revenues	**4,940,916**	**4,142,136**					**3,349,949**					-	-
Total Purchased Gas Cost	**3,358,490**	**2,462,119**					**1,605,053**						
Gross Profit	**1,582,426**	**1,680,017**	434,427	517,811	407,311	376,011	**1,744,896**	468,863	547,866	411,812	389,604	**1,818,144**	**1,937,181**
Operating Expenses													
O & M	**505,154**	**541,868**	119,828	133,666	137,444	164,808	**560,766**	124,938	128,850	132,560	158,250	**544,600**	**565,130**
D & A	**253,987**	**274,796**	70,656	71,972	73,459	76,426	**293,096**	76,958	79,300	80,520	83,650	**320,430**	**354,250**
Other Tax	**211,936**	**231,958**	51,214	62,157	59,244	50,144	**223,016**	57,049	68,470	63,380	52,890	**241,790**	**252,880**
Impairments	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Op Exp	**971,077**	**1,048,622**	241,698	267,795	270,147	291,378	**1,076,878**	258,945	276,620	276,460	294,790	**1,106,820**	**1,172,260**
Operating Income	**611,349**	**631,395**	192,729	250,016	137,164	84,633	**668,018**	209,918	271,246	135,352	94,814	**711,324**	**764,921**
Misc Inc / (Exp)	**(5,235)**	**(4,389)**	(879)	(685)	833	(532)	**(1,593)**	(994)	(690)	830	(530)	**(1,380)**	**(1,380)**
Interest	**129,295**	**116,241**	29,537	27,560	27,698	30,207	**115,948**	31,030	29,405	28,693	28,243	**117,370**	**116,700**
Pre-Tax Income	**476,819**	**510,765**	162,313	221,771	110,299	53,894	**550,477**	177,894	241,151	107,489	66,041	**592,574**	**646,841**
Income Tax	**187,002**	**195,690**	60,767	79,961	39,106	19,654	**200,373**	63,856	90,430	40,310	24,770	**219,370**	**242,560**
Net Income--Cont'd Ops	**289,817**	**315,075**	101,546	141,810	71,193	34,240	**350,104**	114,038	150,721	67,179	41,271	**373,204**	**404,281**
Net Income--Disc Ops	-	-	1,315	-	-	-	**1,315**	10,994	-	-	-	**10,994**	-
Net Income	**$289,817**	**$315,075**	102,861	141,810	71,193	34,240	**$351,419**	125,032	150,721	67,179	41,271	**$384,198**	**$404,281**
Average Shares Outstanding (FD)	**97,608**	**101,892**	102,713	102,946	103,750	104,687	**103,524**	105,475	105,804	106,133	106,462	**105,968**	**107,284**
Net Income per Share	**$3.02**	**$3.10**	$1.00	$1.38	$0.69	$0.33	**$3.39**	$1.19	$1.42	$0.63	$0.39	**$3.63**	**$3.77**
MTM gains (losses)	**$0.07**	**($0.01)**		($0.02)	$0.02	($0.07)	**$0.00**					**$0.00**	**$0.00**
One-time benefits (charges)	**$0.00**	**$0.00**	$0.00	$0.00	$0.00	$0.00	**$0.00**	$0.00				**$0.00**	**$0.00**
Adjusted EPS [Cont'd Ops]	**$2.95**	**$3.11**	$0.99	$1.40	$0.67	$0.40	**$3.45**	$1.08	$1.42	$0.63	$0.39	**$3.53**	**$3.77**
Adjusted EPS	**$2.95**	**$3.11**	$1.00	$1.40	$0.67	$0.40	**$3.46**	$1.19	$1.42	$0.63	$0.39	**$3.63**	**$3.77**
Dividends per share	**$1.480**	**$1.560**	$0.420	$0.420	$0.420	$0.420	**$1.680**	$0.450	*$0.450*	*$0.450*	*$0.450*	***$1.800***	***$1.920***
				*tightened guide by $0.05 on both ends					*AEM sale closed in Jan-- $40MM cash			**Cont'd Ops EPS Guide: $3.45-$3.65**	
Rate of Change Analysis:													
Gross Margin	**12.1%**	**6.2%**	2.6%	-0.6%	6.7%	6.1%	**3.9%**	7.9%	5.8%	1.1%	3.6%	**4.2%**	**6.5%**
O&M Expense	**3.5%**	**7.3%**	1.1%	0.2%	3.8%	4.7%	**3.5%**	4.3%	-3.6%	-3.6%	-4.0%	**-2.9%**	**3.8%**
Operating Income	**21.8%**	**3.3%**	2.7%	-0.1%	16.6%	11.6%	**5.8%**	8.9%	8.5%	-1.3%	12.0%	**6.5%**	**7.5%**
Adjusted EPS	**16.5%**	**5.2%**	10.0%	2.5%	23.0%	36.9%	**11.5%**	18.4%	1.9%	-5.0%	-2.4%	**4.9%**	**3.9%**
Adjusted EPS--Cont'd Ops	**19.4%**	**5.2%**	8.6%	2.5%	23.0%	36.9%	**11.1%**	9.4%	1.9%	-5.0%	-2.4%	**2.2%**	**7.0%**
Margin Analysis:													
O&M / GM	**31.9%**	**32.3%**	27.6%	25.8%	33.7%	43.8%	**32.1%**	26.6%	23.5%	32.2%	40.6%	**30.0%**	**29.2%**
Other Tax / GM	**13.4%**	**13.8%**	11.8%	12.0%	14.5%	13.3%	**12.8%**	12.2%	12.5%	15.4%	13.6%	**13.3%**	**13.1%**
Operating Income / GM	**38.6%**	**37.6%**	44.4%	48.3%	33.7%	22.5%	**38.3%**	44.8%	49.5%	32.9%	24.3%	**39.1%**	**39.5%**
Tax Rate	**39.2%**	**38.3%**	37.4%	36.1%	35.5%	36.5%	**36.4%**	35.9%	37.5%	37.5%	37.5%	**37.0%**	**37.5%**

Source: Company reports and Hilliard Lyons estimates

Atmos Energy Corp. FYE Sept

Summary Balance Sheet ('000s)	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17E	Q3'17E	Q4'17E	FY'17E	FY'18E
Cash	$42,258	$28,653	$78,903	$47,918	$66,206	$47,534	$47,534	$44,624	$10,180	$11,640	$8,500	$8,500	$3,140
A/R	343,400	295,160	456,904	361,582	277,362	300,007	300,007	458,813	372,430	285,680	309,010	309,010	318,280
Gas Stored Underground	278,917	236,603	236,017	190,961	244,841	233,316	233,316	163,763	190,960	244,840	233,320	233,320	233,320
Other CAs	111,265	70,569	91,446	52,451	60,504	100,829	100,829	312,232	53,500	61,710	102,850	102,850	104,910
Total Current Assets	775,840	630,985	863,270	652,912	648,913	681,686	681,686	979,432	627,070	603,870	653,680	653,680	659,650
Net PP&E	6,725,906	7,430,580	7,653,287	7,839,413	8,053,547	8,280,511	8,280,511	8,552,962	8,713,660	8,933,140	9,149,490	9,149,490	9,930,240
Goodwill & Intangibles	742,029	742,702	742,029	742,702	742,702	743,407	743,407	729,673	709,670	709,670	709,670	709,670	709,670
Deferred Charges and Other	350,929	288,678	296,067	308,899	282,206	305,285	305,285	317,088	324,340	296,320	320,550	320,550	336,580
Total Assets	$8,594,704	9,092,945	$9,554,653	$9,543,926	$9,727,368	$10,010,889	$10,010,889	$10,579,155	$10,374,740	$10,543,000	$10,833,390	$10,833,390	$11,636,140
ST Debt	196,695	457,927	763,236	373,783	410,452	829,811	829,811	940,747	690,750	805,750	1,025,750	1,025,750	1,055,750
A/P + Othr Accured	308,086	238,942	280,487	226,641	198,882	259,434	259,434	268,647	226,640	198,880	259,430	259,430	259,430
Current Maturity LT Debt	-	-	-	-	250,000	250,000	250,000	250,000	250,000	-	-	-	450,000
Other CLs	405,869	457,954	471,333	626,929	670,466	449,036	449,036	490,421	658,280	703,990	471,490	471,490	495,060
Total Current Liabilities	910,650	1,154,823	1,515,056	1,227,353	1,529,800	1,788,281	1,788,281	1,949,815	1,825,670	1,708,620	1,756,670	1,756,670	2,260,240
LTD	2,455,986	2,455,388	2,455,474	2,455,559	2,205,645	2,188,779	2,188,779	2,314,199	2,314,200	2,564,200	2,564,200	2,564,200	2,364,200
Deferred Income Tax	1,286,616	1,411,315	1,441,325	1,557,790	1,585,500	1,603,056	1,603,056	1,725,433	1,814,050	1,834,210	1,835,210	1,835,210	2,025,060
Deferred Credits and Other	855,220	876,622	870,689	958,659	939,699	967,714	967,714	890,733	899,640	908,640	908,640	908,640	936,180
Shareholders' Equity	$3,086,232	$3,194,797	$3,272,109	$3,344,565	$3,466,724	$3,463,059	$3,463,059	$3,698,975	$3,521,180	$3,527,330	$3,768,670	$3,768,670	$4,050,460
Total Liab & SE	$8,594,704	$9,092,945	$9,554,653	$9,543,926	$9,727,368	$10,010,889	$10,010,889	$10,579,155	$10,374,740	$10,543,000	$10,833,390	$10,833,390	$11,636,140
Summary Cash Flow (000's)	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17E	Q3'17E	Q4'17E	FY'17E	FY'18E
Net Income	289,817	315,075	102,861	141,810	71,193	34,240	351,419	125,032	150,720	67,180	41,270	384,200	404,280
D&A	253,987	274,796	71,239	71,972	74,442	75,443	293,096	77,143	79,300	80,520	83,650	320,610	354,250
Impairments	-	-	-	-	-	-	-	-	-	-	-	-	-
Deferred Income Tax	189,952	192,886	59,299	73,157	38,586	22,514	193,556	67,241	88,621	20,155	1,000	177,020	189,850
Cash Provided (Used) by Wrk Cap	(13,062)	114,191	(127,111)	81,123	38,065	(12,323)	(20,246)	(147,058)	140,770	42,610	(24,900)	11,420	12,240
Operating C.F.	720,694	896,948	106,288	368,062	222,286	119,874	817,825	122,358	459,411	210,465	101,020	893,250	960,620
Cap Ex	(835,251)	(975,132)	(291,674)	(246,559)	(257,775)	(290,942)	(1,086,950)	(297,962)	(260,000)	(300,000)	(300,000)	(1,157,960)	(1,135,000)
(Acquisitions) / Divestitures	-	-	-	-	-	-	-	(85,714)	40,000	-	-	(45,710)	-
Dividends	(146,248)	(160,018)	(43,636)	(43,173)	(43,554)	(44,763)	(175,126)	(47,740)	(47,610)	(47,760)	(47,910)	(191,020)	(205,990)
Free C.F.	(260,805)	(238,202)	(229,022)	78,330	(79,043)	(215,831)	(444,251)	(309,058)	191,801	(137,295)	(246,890)	(501,440)	(380,370)
Net Proceeds (Repayment) ST Debt	(165,865)	254,780	305,309	(136,307)	43,537	159,345	371,884	110,936	(250,000)	115,000	220,000	195,940	30,000
LT Debt Proceeds	-	493,538	-	-	-	-	-	125,000	-	250,000	-	375,000	250,000
(Repayment) of LT debt	-	(500,000)	-	-	-	-	-	-	-	(250,000)	-	(250,000)	-
Treasury Unlock	-	13,364	-	-	-	-	-	-	-	-	-	-	-
Issued Stock	394,479	30,952	8,729	8,912	107,519	7,692	132,852	58,398	25,000	25,000	25,000	133,400	100,000
Repurchased Stock & Eq Awards	(8,717)	(7,985)	-	-	-	-	-	-	(1,250)	(1,250)	(1,250)	(3,750)	(5,000)
Net C.F.	(40,908)	46,447	85,016	(49,065)	72,013	(48,794)	60,485	(14,724)	(34,449)	1,455	(3,140)	(50,850)	(5,370)
EBITDA	$865,336	$906,191	$263,385	$321,988	$210,623	$161,059	$961,114	$286,876	$350,546	$215,872	$178,464	$1,031,754	$1,119,171
EBITDA / GM	54.7%	53.9%	60.6%	62.2%	51.7%	42.8%	55.1%	61.2%	64.0%	52.4%	45.8%	56.7%	57.8%
EBITDA / Share	$8.55	$8.86	$2.56	$3.13	$2.03	$1.54	$9.18	$2.72	$3.31	$2.03	$1.68	$9.74	$10.43
Yr-End EV/EBITDA	8.4x	9.2x					10.6x					10.3x	9.8x
Selected Financial Statistics	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17E	Q3'17E	Q4'17E	FY'17E	FY'18E
Book Value	$30.48	$31.25	$31.86	$32.49	$33.41	$33.08	$33.08	$35.07	$33.28	$33.24	$35.40	$35.40	$37.58
Tangible BV	$23.15	$23.99	$24.63	$25.27	$26.26	$25.98	$25.98	$28.15	$26.57	$26.55	$28.73	$28.73	$31.00
Price / Book	1.6x	1.9x	2.0x	2.3x	2.4x	2.3x	2.3x	2.1x	2.3x	2.3x	2.1x	2.1x	2.0x
LTD / Total Capital	44.3%	43.5%	42.9%	42.3%	41.5%	41.3%	41.3%	40.9%	42.1%	42.1%	40.5%	40.5%	41.0%
Total Net Debt / Total Capital	45.8%	47.4%	49.0%	45.4%	44.7%	48.2%	48.2%	48.3%	48.0%	48.8%	48.7%	48.7%	48.8%
ROE (TTM)	9.9%	10.0%	10.1%	10.0%	10.3%	10.5%	10.5%	10.8%	10.9%	10.7%	10.7%	10.7%	10.5%

Source: Company reports and Hilliard Lyons Estimates

Analyst Certification

I, Spencer E. Joyce, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

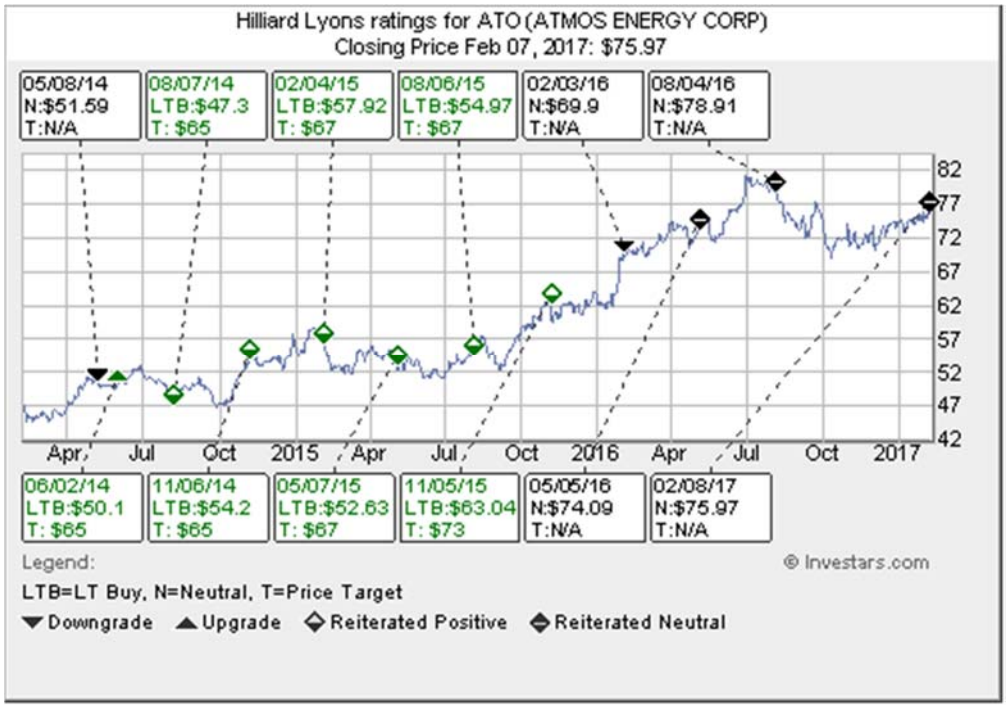
Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Suitability Ratings

1 - A large cap, core holding with a solid history
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
4 - Speculative, due to small size, inconsistent profitability, erratic revenues, volatility, low trading volume or a narrow customer or product base

Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.
Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.
Underperform - We believe the stock is vulnerable to a price setback in the next 12 months.



	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	**# of Stocks Covered**	**% of Stocks Covered**	**Banking**	**No Banking**
Buy	36	30%	17%	83%
Hold/Neutral	76	62%	7%	93%
Sell	10	8%	0%	100%

As of 6 February 2017

Other Disclosures

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