



## COMPANY UPDATE / ESTIMATE CHANGE

### Key Metrics

ATO - NYSE - as of	5/3/17	\$80.11
Price Target		--
52-Week Range	\$68.51 -	\$82.07
Shares Outstanding (mm)		105.2
Market Cap. (\$mm)		\$8,489.7
1-Mo. Average Daily Volume		342,216
Institutional Ownership		73.3%
LT Debt/Total Capital	Q2'17	40.1%
ROE	TTM	11.1%
Book Value / Share	Q2'17	\$36.20
Price / Book Value		2.2x
Dividend Yield		2.2%
LTM EBITDA Margin		30.8%

### EPS FY 9/30 (cont'd ops, ex-mrk-2-mkt & one-time items)

	Prior	Current	Prior	Current
	2016A	2017E	2018E	2018E
1Q	\$0.99	--	\$1.08	A --
2Q	\$1.39	--	\$1.53	A --
3Q	*\$0.67	\$0.63	\$0.65	--
4Q	*\$0.40	\$0.39	\$0.40	--
Year	*\$3.44	\$3.53	\$3.66	\$3.77 \$3.87
P/E	23.6x	21.9x	--	20.7x

\*Needs restating ex-AEM

### Firm Gross Profit (\$MM)

	Prior	Current	Prior	Current
	2016A	2017E	2018E	2018E
1Q	\$434	--	\$469	A --
2Q	*\$518	--	\$561	A --
3Q	*\$407	\$412	\$412	--
4Q	*\$376	\$390	\$390	--
Year	*\$1745	\$1,818	\$1,831	\$1,937 \$1,944

**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.*

### Natural Gas Utilities

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## Atmos Energy Corp.

ATO — NYSE — Neutral-1

### Strong Fiscal Q2'17 Results from ATO; Reiterating Neutral Rating, Awaiting an Entry Point.

#### Investment Highlights

- Atmos reported fiscal Q2'17 (January-March) EPS from continuing ops of \$1.53 vs. \$1.39 in Q1'16. EPS easily hurdled our estimate for \$1.42, which was in line with consensus. Atmos Energy Marketing (AEM) was sold effective 1/1/17, generating a ~\$0.03 gain-on-sale we exclude from continuing ops results.
- Gross profit grew 9.4% in Q2, with the Distribution and Pipeline segments growing by 9.9% and 16.2%, respectively. Q1 gross profit exceeded our target for 5.8% growth, with each of the segments outperforming by \$5MM to \$7MM. We expect upside from the relatively quiet late-December purchase of transmission pipe in N. Texas is partially attributable.
- Operations & Maintenance (O&M) grew 3.4% in Q2, which is adjusted to reflect the sale of AEM. Margin growth has outpaced O&M for the last 6 quarters.
- Atmos Pipeline Texas' (APT) long-awaited general rate case with the TX Railroad Commission remains in progress, with new rates potentially hitting in fiscal Q4. 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 Q2'17 with net debt / total capital of 45.4%, flat yr/yr. The company raised about \$8MM of equity capital in the second quarter.
- ATO reiterated FY 2017 adjusted EPS guidance of \$3.45-\$3.65. Given the upside to our Q2, our 2017E EPS shades just above the top end of the range, with our 2018E EPS rising in sympathy.
- 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 5-6  
Note Analyst Certification on Page 5**

**ADDITIONAL DISCUSSION—FINAL THOUGHTS**

After handling several special items in the latter stages of 2016 and early 2017, we suggest a return to a relatively quiet narrative exiting ATO's second fiscal quarter. Atmos seems to have emerged for the better with its divestiture of its marketing business and acquisition of transmission assets from Enlink Midstream (ENLC—\$17.80, Not Rated); the (for us) unexpected departure of former CFO-Bret Eckert on February 1 has not portended any noteworthy shifts in strategy or performance, so far as we can tell. APT's general rate case proceeding does bring a slight element of debate and uncertainty to the story, although the filing is normal course of business given regulatory statutes in the state.

As such, we continue to suggest ATO as a fine core holding in the gas utility industry, and remind investors the bellwether is our only covered gas company to carry our '1-most conservative' suitability rating.

**SUITABILITY**

We assign ATO a suitability rating of '1.' A full description of our rating scale can be found on page 5 in the Important Disclosures section of this report. 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 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 2017. 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.*

Atmos Energy Corp. FYE Sept			Rst'd Q1'17		Rst'd Q2'17									
	FY'14	FY'15	dec	mar	jun	sept	dec	mar	jun	sept	FY'17E	FY'18E		
Income Statement ('000s)			Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17E	Q4'17E			
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	512,684	407,311	376,011	1,744,896	468,863	560,692	411,812	389,604	1,830,970	1,944,463	
Operating Expenses														
O & M	505,154	541,868	119,828	127,857	137,444	164,808	560,766	124,938	132,239	132,560	158,250	547,990	568,660	
D & A	253,987	274,796	70,656	71,391	73,459	76,426	293,096	76,958	77,667	80,750	83,880	319,260	354,470	
Other Tax	211,936	231,958	51,214	61,780	59,244	50,144	223,016	57,049	65,614	63,380	52,890	238,930	251,560	
Impairments	-	-	-	-	-	-	-	-	-	-	-	-	-	
Total Op Exp	971,077	1,048,622	241,698	261,028	270,147	291,378	1,076,878	258,945	275,520	276,690	295,020	1,106,180	1,174,690	
Operating Income	611,349	631,395	192,729	251,656	137,164	84,633	668,018	209,918	285,172	135,122	94,584	724,790	769,773	
Misc Inc / (Exp)	(5,235)	(4,389)	(879)	(329)	833	(532)	(1,593)	(994)	833	830	(530)	140	140	
Interest	129,295	116,241	29,537	27,559	27,698	30,207	115,948	31,030	26,944	26,232	25,782	109,990	106,850	
Pre-Tax Income	476,819	510,765	162,313	223,768	110,299	53,894	550,477	177,894	259,061	109,720	68,272	614,940	663,063	
Income Tax	187,002	195,690	60,767	80,765	39,106	19,654	200,373	63,856	97,049	41,150	25,600	227,660	248,660	
Net Income--Cont'd Ops	289,817	315,075	101,546	143,003	71,193	34,240	350,104	114,038	162,012	68,570	42,672	387,280	414,403	
Net Income--Disc Ops	-	-	1,315	(1,193)	-	-	122	10,994	2,716	-	-	13,710	-	
Net Income	\$289,817	\$315,075	102,861	141,810	71,193	34,240	\$350,226	125,032	164,728	68,570	42,672	\$400,990	\$414,403	
Average Shares Outstanding (FD)	97,608	101,892	102,713	102,946	103,750	104,687	103,524	105,475	105,935	106,245	106,554	106,052	107,329	
Net Income per Share	\$3.02	\$3.10	\$1.00	\$1.38	\$0.69	\$0.33	\$3.39	\$1.19	\$1.55	\$0.65	\$0.40	\$3.79	\$3.87	
MTM gains (losses)	\$0.07	(\$0.01)			\$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	\$0.00	
Adjusted EPS [Cont'd Ops]	\$2.95	\$3.11	\$0.99	\$1.39	\$0.67	\$0.40	\$3.44	\$1.08	\$1.53	\$0.65	\$0.40	\$3.66	\$3.87	
Adjusted EPS	\$2.95	\$3.11	\$1.00	\$1.38	\$0.67	\$0.40	\$3.44	\$1.19	\$1.55	\$0.65	\$0.40	\$3.79	\$3.87	
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	
									*AEM sale closed in Jan--\$40MM cash					
				*tightened guide by \$0.05 on both ends										Cont'd Ops EPS Guide: \$3.45-\$3.65
<b>Rate of Change Analysis:</b>														
Gross Margin	12.1%	6.2%	2.6%	-1.5%	6.7%	6.1%	3.9%	7.9%	9.4%	1.1%	3.6%	4.9%	6.2%	
O&M Expense	3.5%	7.3%	1.1%	-4.2%	3.8%	4.7%	3.5%	4.3%	3.4%	-3.6%	-4.0%	-2.3%	3.8%	
Operating Income	21.8%	3.3%	2.7%	0.6%	16.6%	11.6%	5.8%	8.9%	13.3%	-1.5%	11.8%	8.5%	6.2%	
Adjusted EPS	16.5%	5.2%	10.0%	1.0%	23.0%	36.9%	10.8%	18.4%	12.9%	-3.1%	0.9%	10.0%	2.1%	
Adjusted EPS--Cont'd Ops	19.4%	5.2%	8.6%	1.9%	23.0%	36.9%	10.8%	9.4%	10.1%	-3.1%	0.9%	6.3%	5.7%	
<b>Margin Analysis:</b>														
O&M / GM	31.9%	32.3%	27.6%	24.9%	33.7%	43.8%	32.1%	26.6%	23.6%	32.2%	40.6%	29.9%	29.2%	
Other Tax / GM	13.4%	13.8%	11.8%	12.1%	14.5%	13.3%	12.8%	12.2%	11.7%	15.4%	13.6%	13.0%	12.9%	
Operating Income / GM	38.6%	37.6%	44.4%	49.1%	33.7%	22.5%	38.3%	44.8%	50.9%	32.8%	24.3%	39.6%	39.6%	
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	Q2'17	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	\$45,403	\$59,090	\$57,540	\$57,540	\$67,170
A/R	343,400	295,160	456,904	361,582	277,362	300,007	300,007	458,813	336,637	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	120,026	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	61,018	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	563,084	651,320	702,720	702,720	723,680
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	8,738,487	8,957,740	9,173,860	9,173,860	9,954,390
Goodwill & Intangibles	742,029	742,702	742,029	742,702	742,702	743,407	743,407	729,673	729,673	729,670	729,670	729,670	729,670
Deferred Charges and Other	350,929	288,678	296,067	308,899	282,206	305,285	305,285	317,088	330,222	296,320	320,550	320,550	336,580
<b>Total Assets</b>	<b>\$8,594,704</b>	<b>9,092,945</b>	<b>\$9,554,653</b>	<b>\$9,543,926</b>	<b>\$9,727,368</b>	<b>\$10,010,889</b>	<b>\$10,010,889</b>	<b>\$10,579,155</b>	<b>\$10,361,466</b>	<b>\$10,635,050</b>	<b>\$10,926,800</b>	<b>\$10,926,800</b>	<b>\$11,744,320</b>
ST Debt	196,695	457,927	763,236	373,783	410,452	829,811	829,811	940,747	670,607	785,610	1,005,610	1,005,610	1,035,610
A/P + Othr Accrued	308,086	238,942	280,487	226,641	198,882	259,434	259,434	268,647	185,212	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	390,253	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	1,496,072	1,688,480	1,736,530	1,736,530	2,240,100
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	2,314,620	2,564,620	2,564,620	2,564,620	2,364,620
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	1,810,160	1,830,740	1,831,740	1,831,740	2,026,320
Deferred Credits and Other	855,220	876,622	870,689	958,659	939,699	967,714	967,714	890,733	905,750	914,810	914,810	914,810	942,530
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	\$3,834,864	\$3,636,400	\$3,879,100	\$3,879,100	\$4,170,750
<b>Total Liab &amp; SE</b>	<b>\$8,594,704</b>	<b>\$9,092,945</b>	<b>\$9,554,653</b>	<b>\$9,543,926</b>	<b>\$9,727,368</b>	<b>\$10,010,889</b>	<b>\$10,010,889</b>	<b>\$10,579,155</b>	<b>\$10,361,466</b>	<b>\$10,635,050</b>	<b>\$10,926,800</b>	<b>\$10,926,800</b>	<b>\$11,744,320</b>
Summary Cash Flow (000's)	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17E	Q4'17E	FY'17E	FY'18E
Net Income	289,817	315,075	102,861	141,810	71,193	34,240	350,226	125,032	164,728	68,570	42,670	400,990	414,400
D&A	253,987	274,796	71,239	71,972	74,442	75,443	293,096	77,143	77,667	80,750	83,880	319,440	354,470
Impairments	-	-	-	-	-	-	-	-	-	-	-	-	-
Deferred Income Tax	189,952	192,886	59,299	73,157	38,586	22,514	193,556	67,241	81,416	20,575	1,000	170,230	194,580
Cash Provided (Used) by Wrk Cap	(13,062)	114,191	(127,111)	81,123	38,065	(12,323)	(20,246)	(147,058)	130,524	52,856	(24,900)	11,420	12,240
Operating C.F.	720,694	896,948	106,288	368,062	222,286	119,874	816,632	122,358	454,335	222,751	102,650	902,080	975,690
Cap Ex	(835,251)	(975,132)	(291,674)	(246,559)	(257,775)	(290,942)	(1,086,950)	(297,962)	(261,423)	(300,000)	(300,000)	(1,159,390)	(1,135,000)
(Acquisitions) / Divestitures	-	-	-	-	-	-	-	(85,714)	133,560	-	-	47,850	-
Dividends	(146,248)	(160,018)	(43,636)	(43,173)	(43,554)	(44,763)	(175,126)	(47,740)	(47,574)	(47,810)	(47,950)	(191,070)	(206,060)
Free C.F.	(260,805)	(238,202)	(229,022)	78,330	(79,043)	(215,831)	(445,444)	(309,058)	278,898	(125,059)	(245,300)	(400,530)	(365,370)
Net Proceeds (Repayment) ST Debt	(165,865)	254,780	305,309	(136,307)	43,537	159,345	371,884	110,936	(270,140)	115,000	220,000	175,800	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)	-
Issued Stock	394,479	30,952	8,729	8,912	107,519	7,692	132,852	58,398	7,986	25,000	25,000	116,380	100,000
Repurchased Stock & Eq Awards	(8,717)	(7,985)	-	-	-	-	-	-	-	(1,250)	(1,250)	(2,500)	(5,000)
Net C.F.	(40,908)	46,447	85,016	(49,065)	72,013	(48,794)	59,292	(14,724)	16,744	13,691	(1,550)	14,150	9,630
Selected Financial Statistics	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	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	\$36.20	\$34.23	\$36.40	\$36.40	\$38.69
Tangible BV	\$23.15	\$23.99	\$24.63	\$25.27	\$26.26	\$25.98	\$25.98	\$28.15	\$29.31	\$27.36	\$29.56	\$29.56	\$31.92
Price / Book	1.6x	1.9x	2.0x	2.3x	2.4x	2.3x	2.3x	2.1x	2.2x	2.4x	2.2x	2.2x	2.1x
LTD / Total Capital	44.3%	43.5%	42.9%	42.3%	41.5%	41.3%	41.3%	40.9%	40.1%	41.4%	39.8%	39.8%	40.3%
Total Net Debt / Total Capital	45.8%	47.4%	49.0%	45.4%	44.7%	48.2%	48.2%	48.3%	45.4%	47.5%	47.5%	47.5%	47.6%
ROE(TTM)	9.9%	10.0%	10.1%	10.0%	10.3%	10.5%	10.5%	10.8%	11.1%	10.8%	10.8%	10.8%	10.3%

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

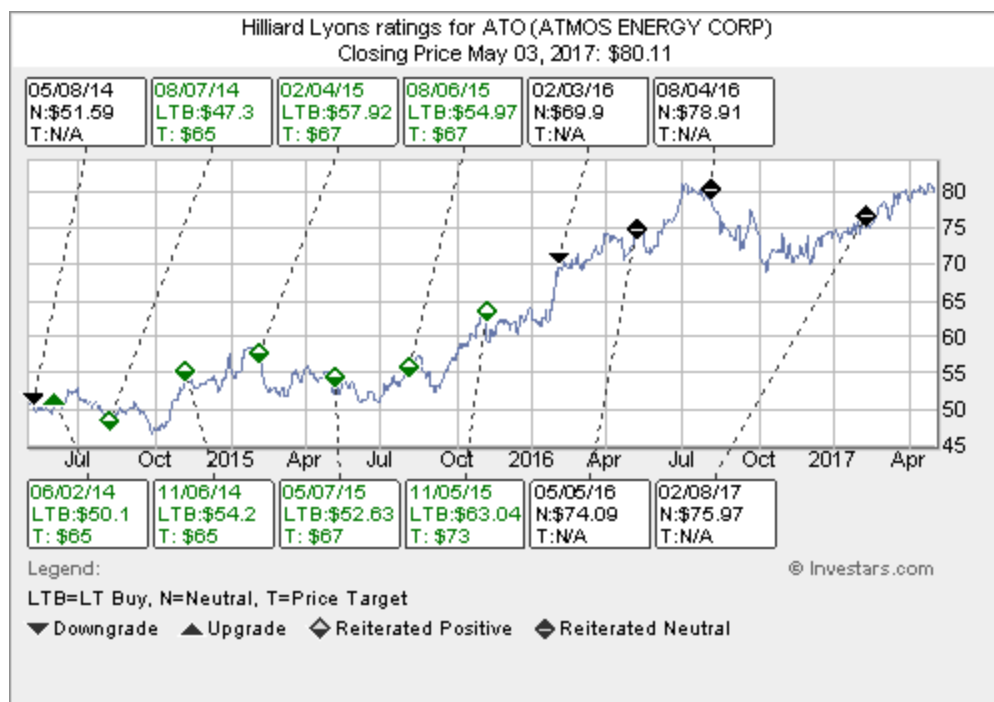
### **Investment Ratings**

**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%	14%	86%
Hold/Neutral	71	58%	6%	94%
Sell	15	12%	7%	93%

As of 5 April 2017

**Other Disclosures**

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