Atmos Energy Corporation

1997 Annual Report

Financial Highlights

	YEAR ENDED SEPTEMBER 30,		
	1997	1996	% Change
Operating revenues	906,835	886,691	2.3%
Gross profit	329,654	324,412	1.6%
Net income	23,838	41,151	-42.1%
Utility operations	20,463	36,740	-44.3%
Non-utility operations	3,375	4,411	-23.5%
Assets	1,088,311	1,010,610	7.7%
Total capitalization	630,241	605,744	4.0%
Total volumes handled (MMcf)	213,008	222,439	-4.2%
Heating degree days	3,909	4,043	-3.3%
Percent of normal	98%	101%	-3.0%
Meters in service (average)	984,835	974,767	1.0%
Net income per share	0.81	1.42	-43.0%
Cash dividends per share	1.01	0.98	3.1%
Book value per share at end of year	11.04	11.27	-2.0%
Return on average common shareholders' equity	7.3%	13.0%	-43.8%
Shareholders' equity as a percentage of total capitalization at end of year	40.3%	43.9%	-8.2%
Shareholders of record	29,867	36,472	-18.1%
Average shares outstanding	29,409	28,978	1.5%

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Based in Dallas, Texas, Atmos is known for rapid growth and geographical diversity. Atmos distributes natural gas and propane to more than 1 million customers in Texas, Colorado, Kansas, Missouri, Louisiana, Tennessee, Illinois, Georgia, North Carolina, South Carolina, Virginia, Iowa and Kentucky through its operating companies — Energas Company, Greeley Gas Company, Trans Louisiana Gas Company, United Cities Gas Company, Western Kentucky Gas Company and United Cities Propane Gas.

HEADQUARTERS
Dallas, Texas

MILES OF PIPE
30,902

NUMBER OF EMPLOYEES
2,679

SIZE OF UTILITY SERVICE AREA
173,754 square miles

POPULATION IN UTILITY SERVICE AREA
8.8 million

UTILITY CUSTOMERS SERVED
985,448

PROPANE CUSTOMERS SERVED
29,097

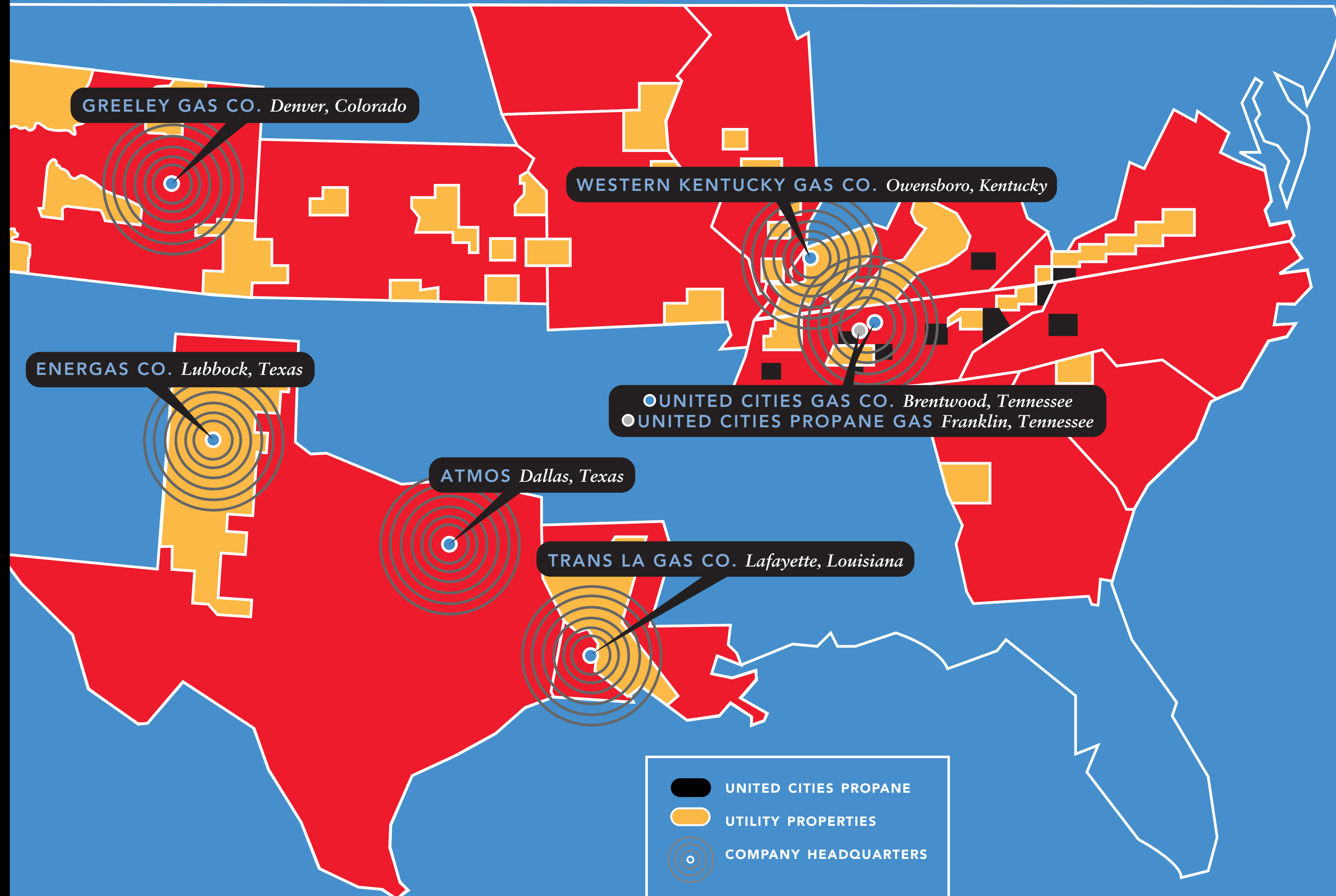
TOTAL COMMUNITIES SERVED (UTILITY AND PROPANE)
1,042

UTILITY DEGREE DAYS, 1997
3,909 (normal 3,990)

PROPANE DEGREE DAYS, 1997
3,930 (normal 4,229)

CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER
Robert W. Best

Atmos Energy Corporation At A



Glance

As of September 30, 1997	ENERGAS	TRANS LA	WESTERN KENTUCKY	GREELEY GAS	UNITED CITIES	TOTAL UTILITY	PROPANE
CUSTOMERS, at end of year							
Residential	268,518	73,546	154,219	99,472	274,992	870,474	23,278
Commercial	25,234	5,409	17,706	13,328	31,026	92,703	4,073
Industrial (including agricultural)	15,589	120	460	385	663	17,217	873
Public authority and other	2,230	978	1,573	-	-	4,781	873
Total	311,571	80,053	173,958	113,185	306,681	985,448	29,097
HEATING DEGREE DAYS							
Actual	3,553	1,523	4,178	6,195	3,980	3,909	3,930
Normal	3,531	1,771	4,333	6,274	4,070	3,990	4,229
Percent of normal	100.6%	86.0%	96.4%	98.7%	97.8%	98.0%	92.9%
SALES VOLUMES – MMcf, except propane in gallons							
Residential	24,292	3,558	13,543	10,227	23,595	75,215	11,598
Commercial	7,912	1,383	6,070	6,731	15,286	37,382	3,958
Industrial (including agricultural)	19,084	1,872	6,128	1,907	17,425	46,416	872
Public authority and other	2,689	951	1,555	-	-	5,195	717
Total	53,977	7,764	27,296	18,865	56,306	164,208	17,145
TRANSPORTATION VOLUMES – MMcf, except propane in gallons	4,479	624	22,398	3,275	18,024	48,800	15,830
TOTAL VOLUMES DELIVERED – MMcf, except propane in gallons	58,456	8,388	49,694	22,140	74,330	213,008	32,975
OTHER STATISTICS							
Operating revenues (000's)	$234,310	$ 51,866	$144,139	$ 91,341	$343,064	$ 864,720	$33,194
Gross plant (000's)	$252,002	$108,822	$175,793	$137,489	$501,972	$1,176,078	$31,728
Net plant (000's)	$153,977	$ 78,354	$105,393	$ 83,371	$314,591	$ 735,686	$19,526
Miles of pipe	13,214	2,241	3,638	3,864	7,945	30,902	-
Employees	534	154	330	250	1,031	2,299	162
Communities served	92	41	163	123	383	802	240

Corporate Information

Common Stock Listing

New York Stock Exchange

Trading Symbol

ATO

Stock Transfer Agent and Registrar

Shareholder inquiries on stock transfers may be directed to Boston EquiServe, L.P., Mail Stop 45-02-64, P.O. Box 644, Boston, MA 02102-0644. You may call the Interactive Voice Response System 24 hours a day at 1-800-543-3038, or to speak to a customer service representative, call between 9 a.m. and 6 p.m. EST Monday through Friday.

Independent Auditors

Ernst & Young LLP
2121 San Jacinto, Suite 1500
Dallas, Texas 75201
(214) 969-8000

Form 10-K

The Atmos Energy Corporation Annual Report on Form 10-K is available on request from Investor Relations, Atmos Energy Corporation, P.O. Box 650205, Dallas, Texas 75265-0205, 1-800-38-ATMOS (382-8667) 7:30 a.m. - 4:30 p.m. CST.

Annual Meeting

The Annual Meeting of Shareholders will be held at the Ambassador Hotel, 3100 I-40 West, Amarillo, Texas, at 11 a.m. CST on Feb. 11, 1998.

Direct Stock Purchase Plan

Atmos Energy Corporation has a Direct Stock Purchase Plan, which is open to all investors.

For an Initial Investment Form or Enrollment Authorization Form and Plan Prospectus, please call Atmos Shareholder Relations at 1-800-38-ATMOS (382-8667) 7:30 a.m. – 4:30 p.m. CST; Boston EquiServe, LP. at 1-800-543-3038. The Prospectus is also available on the Internet, at the address listed. You may also obtain such information by writing to Shareholder Relations, Atmos Energy Corporation, P.O. Box 650205, Dallas, Texas 75265-0205.

This is not an offer to sell nor a solicitation to buy any securities of Atmos. Shares of Atmos common stock purchased through the Direct Stock Purchase Plan will be offered only by Prospectus.

Atmos Information by Phone or Internet

Atmos Energy Corporation shareholder information is available by phone seven days a week, 24 hours a day through the Boston EquiServe, L.P. Interactive Voice Response System. To perform stock transfer inquiries, listen to current company information and access daily stock quotes without the assistance of a customer service representative, call 1-800-543-3038, and have your Atmos Energy shareholder account number and Social Security or taxpayer ID number ready.

Atmos financial information also may be obtained free of charge over the Internet and from a fax on demand service. The World Wide Web address on the Internet is http://www.atmosenergy.com. For fax on demand, call (614) 844-3860.

Atmos Energy Corporation Contacts

Shareholder and Direct Stock Purchase Plan Information:
Amber Mullins
1-800-38-ATMOS (382-8667), 7:30 a.m. - 4:30 p.m. CST

Financial Information for Securities Analysts,
Investment Managers, and General Information:
Lynn Hord
(972) 855-3729

Atmos would like to extend a special thank you to all our customers and friends who contributed information, artwork and mementos for the famous facts featured in this annual report.

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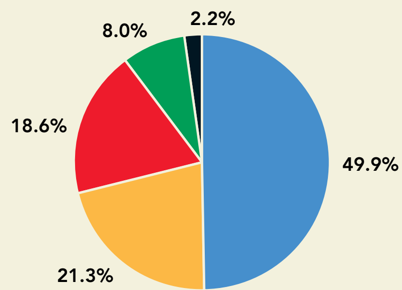
Each year in the impressive history of **Atmos Energy Corporation** has been marked by significant achievements and events. In 1997, the company completed its merger with United Cities Gas Company, becoming the 12th largest U.S. natural gas distribution company, and launched a number of significant customer service initiatives. We are proud of the company's accomplishments to date, and we are poised for even greater achievements in the years ahead. ¶ Atmos' future success depends on the performance of our five distinct operating companies, plus the performance of our non-utility subsidiary companies. In this annual report, we highlight our operating companies, their management, and the notable way each company serves its customers. The fact is, all of the companies of Atmos provide their communities with dependable, efficient service. It's **what we're famous for.** And the communities we serve also have their own claims to fame, some of which are presented in this report, demonstrating both the pride we have in being part of these communities and our commitment to offering them the best level of service possible. That is our promise to our customers, our shareholders and ourselves.

Dear Fellow Shareholders:

This year, fiscal 1997, is a milestone in the history of Atmos Energy Corporation. ¶ Atmos has been a successful company in every respect — financial results, total return to shareholders, customer growth and customer service. In 1997, the company took steps to sustain that performance into the future. Some of our key accomplishments in 1997 included: ➢ Completing the merger with United Cities Gas Company, making Atmos the 12th largest natural gas utility in the country, and the fifth largest pure natural gas utility; ➢ Reaching the milestone of serving over 1 million customers; ➢ Redesigning the organization to enhance customer service, integrate United Cities' operations and achieve additional efficiency in Atmos' utility operations, which are already among the most efficient in the industry; ➢ Putting in place a new management team prepared to build on Atmos' successful past but clearly focused on the future; and ➢ Confirming Atmos' vision and strategy for the future, and establishing key initiatives for success. ¶ We ended the year a much larger company, better equipped than ever to be a winner in the evolving and increasingly competitive marketplace.



Sources of Revenue

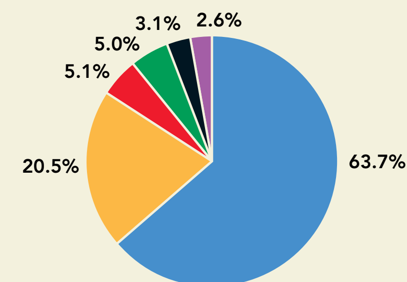
- residential
- commercial
- industrial (including agricultural)
- other sales & miscellaneous
- transportation

Financial Performance

In terms of performance measures for 1997, our total return to shareholders was 10.4 percent for 1997, assuming reinvestment of dividends. Even more noteworthy, our five-year annual total return to shareholders has been 15.1 percent, and for the 10 years has been 15.8 percent, among the best of our local distribution company peer group. The company's market capitalization increased to almost $737 million at fiscal year-end, up from $481 million at the end of fiscal 1996.

The Board of Directors increased the quarterly dividend to $.255 per share or $1.02 annually in August 1997, as agreed as a part of the United Cities merger. The Board increased the quarterly dividend 4 percent to $.265 per share or $1.06 per year in November 1997, a 6 percent increase since November 1996. This was our 10th consecutive annual dividend increase. The dividend has increased by approximately 5 percent per year in the last five years.

For the fiscal year ended September 30, 1997, net income was $23.8 million or $.81 per share on operating revenues of $906.8 million. The 1997 net income includes the effects of after-tax charges related to certain management changes ($2.8 million or $.10 per share) and reserves related to the United Cities merger and integration ($12.6 million or $.43 per share). Excluding the effect of the charges and reserves, the company's net income would have been $39.3 million or $1.34 per share in 1997, compared to $41.2 million or $1.42 per share for 1996. The 1997 results include United Cities, and prior year results have been restated to reflect the pooling of interests accounting that was used for the merger.



Uses of Revenue

- purchased gas
- operation & maintenance
- taxes
- depreciation & amortization
- interest
- common dividends & retained earnings

The decline in net income from 1996 to 1997, excluding the charges and reserves, was the result of warmer than normal weather during the winter months, which negatively impacted gas throughput and sales as well as propane sales. In addition, the spring months were wetter than normal, which adversely impacted sales of natural gas to farmers in West Texas for irrigation. These negative effects of weather were partially offset by rate increases implemented in fiscal 1996 and 1997 in Texas, Kentucky, Georgia, Iowa, Virginia, Tennessee, Missouri and Illinois. Normal weather conditions would have added about $.12 per share to the 1997 financial results.

The cost of the merger and integration totaled approximately $17 million for the transaction costs and $32 million for the separation and other costs. The company recorded these costs as regulatory assets in the fourth quarter of fiscal year 1997 when the merger was completed, separation plans were approved by the Board of Directors and announcements were made to employees.

There are substantial longer term benefits to our customers and our shareholders from the merger of the two companies, which the company expects to result in cost savings over the next 10 years totaling about $375 million. The company believes a significant amount of the costs to achieve these benefits will be recovered through rates and future operating efficiencies of the combined operations, and therefore, the company recorded the costs of the merger with and integration of United Cities as regulatory assets. However, the company established a general reserve of approximately $20 million ($12.6 million after-tax) to account for a portion of the costs that may be shared by our shareholders for their portion of the benefits.

Redesigning the Organization

Atmos has a long record as one of the most efficient providers of natural gas service in the country, with a dedication to reliable and responsive service to our customers. We regularly monitor our service efficiency by reviewing ratios of employees and costs per natural gas customer served. Atmos, excluding United Cities, served 457 customers per employee in 1997, compared with 396 served on average by our local distribution company peer group. Our normalized operating and maintenance expenses of $147 per customer are also among the lowest in our peer group, which averages $198.

Although we are already among the most efficient LDCs, we are focused on continuing to improve our operations and our service to our customers. In that continuing quest, we began in 1997 to redesign the customer service departments of our company to provide extended service hours and a variety of payment locations to customers, to develop a central customer call center to handle calls from customers in all our service areas around the clock, and through the use of new technology to streamline our work processes to further improve our service and efficiency.

Charles K. Vaughan retired as chairman of the Board of Atmos Energy Corporation in 1997, although he remains an active member of the Board. Charles established the vision for growth through acquisitions and led the company as chairman, president and chief executive officer from the inception of the company in 1983 with the spinoff of Energas Company from Pioneer Corporation until his retirement. As he ends his distinguished career, we pay tribute to Charles for his foresight and his leadership, and to the success Atmos has enjoyed while he has been at the helm. Charles had a vision, a passion for excellence, a high standard for performance and left a very large footprint to follow.

In addition, we realigned our leadership team. As part of that realignment, several new officers have joined the company. Larry J. Dagley, previously with Pacific Enterprises, joined Atmos in May as executive vice president and chief financial officer. Joining Atmos from United Cities are Tom S. Hawkins, Jr., vice president, Planning and Budgeting; Lynn L. Hord, vice president, Investor Relations and Corporate Communications; Ron W. McDowell, vice president, New Business Ventures; Mark G. Thessin, vice president, Regulatory Affairs; and Thomas R. Blose, Jr., president of United Cities.

Organizational change is never easy, and through the realignment a number of Atmos and United Cities officers and employees have left or soon will be leaving the company. These officers and employees made significant contributions that positioned Atmos and United Cities where they are today, and we wish them the best in the future.

Board Expanded

We welcome four new board members to the Atmos Board from the United Cities Board of Directors: Gene C. Koonce, formerly chairman of United Cities' Board and now vice chairman of the Atmos Board, Nashville, Tennessee; Richard W. Cardin, consultant and private investor, Nashville, Tennessee; Thomas J. Garland, executive in residence and a distinguished service professor of the Civic Arts, Tusculum College, Greeneville, Tennessee; and Vincent J. Lewis, senior vice president of Legg Mason Wood Walker, Inc., Rutherford, New Jersey.

Ready to Compete

Our leadership team is in place, enthusiastic and excited about the challenges and opportunities that lie ahead. This is a time of change in the energy industry: unbundling of traditional utility services; customer choice in who provides energy and related services; trends toward relaxation of regulation; convergence of gas and electricity in wholesale and retail markets; increasing competition for customers, including competition from non-utility players; technology enabling change; and consolidation in the industry.

Wholesale and large industrial and commercial customers already have a choice of energy suppliers in the areas we serve. They can buy from anyone, and we deliver that gas for them. We believe that eventually we will see some form of unbundling of services for residential customers so that they, like our wholesale and large commercial and industrial customers, will have choices. Customers, regulators, legislatures and business leaders in many of the states where Atmos serves are currently discussing unbundling, but have not yet established how that unbundling will take shape. We are participating in these discussions, not as an advocate or as an opponent, but as a company interested in providing the best service to our customers and the best return to our shareholders. We believe that residential unbundling will occur, and when it occurs, we will be ready to serve our customers just as we do today.

We do not fear the changing environment. In fact, we see opportunity. We have already begun customer service enhancements for residential customers. We have been competing with other gas suppliers for large industrial customers for a decade — over 50 percent of our Kentucky throughput is transported for industrial customers. We also compete against some very efficient electric utilities as well as other energy sources for residential and commercial customers. We're putting our experience to work in preparing for further competition for customers. Atmos is physically linked to about 1 million customers through our five operating companies, and each company has a strong local brand identity. We believe our low rates, service geared for customer convenience, and a strong local presence will be difficult for our competitors to match.

Focused on the Future

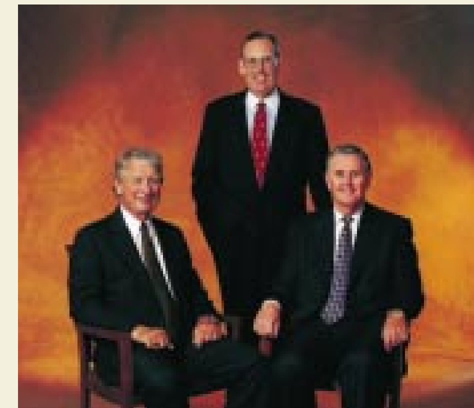
This was a monumental year for Atmos. We expect our results in 1998 and beyond to reflect the investments made this year. We are confident that we have the right organization and the right people to capitalize on opportunities ahead. As we end this monumental year and look forward, our initiatives are directed in four areas: running our utility operations exceptionally well; increasing the scope, scale and market share of our non-utility operations (gas marketing and propane); developing plans to participate in retail energy services behind the meter; and growing through acquisitions.

We end 1997 and begin 1998 well-positioned to build in the future on our successful past. This is the result of the efforts of many people to whom I would like to express our appreciation. To our employees for their dedication, enthusiasm, tireless efforts and commitment to excellence; to our Board of Directors for their sound counsel, encouragement and support; and to you our shareholders for your confidence in our management, our company and our future.

Robert W. Best

Robert W. Best
Chairman, President and Chief Executive Officer

November 12, 1997



LEFT TO RIGHT

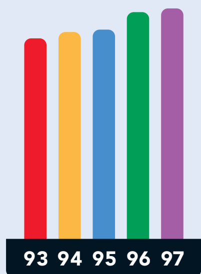
Gene C. Koonce
Vice Chairman of the Board

Robert W. Best
Chairman of the Board, President and Chief Executive Officer

Charles K. Vaughan
Board member and former Chairman of the Board

Strategy: Building on the past ... focusing on the future.

Robert W. Best joined Atmos Energy Corporation as chairman of the board, president and chief executive officer on March 8, 1997. Best has more than 23 years of experience in the distribution and transmission industry. Prior to joining Atmos, he was senior vice president – regulated businesses for Consolidated Natural Gas Company of Pittsburgh, Pa., responsible for the transmission and distribution companies.



Gross Profit

- **93** *$289,394*
- **94** *$297,020*
- **95** *$300,158*
- **96** *$324,412*
- **97** *$329,654*

Describe Atmos today.

BEST: Atmos has been an extremely successful company. This is shown in the company's financial performance and its outstanding customer growth. Over the last 10 years, our returns to shareholders have been among the best in the industry, and we believe that investors perceive Atmos as a company with considerable growth opportunity.

Just 15 years ago, Atmos started with 280,000 customers in West Texas. Today, Atmos is a regional distribution company with about 1 million utility customers in 12 states. The company is the 12th largest natural gas utility in the country based on number of customers and the fifth largest pure natural gas utility. We primarily serve small urban and rural areas across a vast geographic area, so we have diversity in economic conditions, regulatory climates, weather patterns and markets. Our five operating divisions have strong identities in the communities they serve. We have some of the lowest rates in the country because we are an extremely efficient provider of service, we have a lower plant investment than many of our peers, and we also capitalize on the economies of scale due to our size and shared services philosophy. We have successfully made acquisitions of other natural gas distribution properties without delays, undue expense or damage to local brand equity. The merger with United Cities this year brought us additional non-utility opportunities with propane and wholesale natural gas marketing.

How do you expect to sustain this track record of performance in the future?

We are going to build upon our past successes and to focus on the best ways to be a winner in the future, in a changing environment. Our senior management team has spent considerable time this year analyzing the company's strengths, what the environment is likely to be in the next few years and the course of action we should pursue to continue to create value for our shareholders. We will focus on four initiatives.

First, we plan to run our utility operations exceptionally well. This means remaining customer focused and delivering high quality, reliable service at a low cost. We also will continue working to increase the number of customers served in our existing service areas, manage our costs and expenses carefully, and work to establish incentive rate structures in every jurisdiction possible.

Second, we want to increase the scope, scale and market share of our non-utility operations. We see many opportunities for extending the use of propane in service areas where it would be difficult to install natural gas distribution systems. We also are going to pursue opportunities to increase the customer base of Woodward Marketing, a wholesale natural gas marketing and gas services limited liability corporation in which we own a 45 percent interest.

Third, we intend to develop a plan to participate in retail energy services behind the meter. We also intend to survey and evaluate customer preferences, now and for the future, and develop specific strategies to deliver those services that we choose to provide. Our strategy is to seek partners to join us in providing retail energy services to customers. These partners, we expect, will be experienced in retail services and marketing and will recognize the value of our connection to over 1 million customers and our brand equity.

Fourth, we are going to continue our acquisition strategy to add new customers and service areas for both our natural gas distribution and propane operations. We have an excellent track record of acquiring LDC operations that provide us with diversity in weather, regulation, economies and markets. We have achieved synergies and benefits quickly, while preserving brand equity.

What paths for growth do not make sense for Atmos?

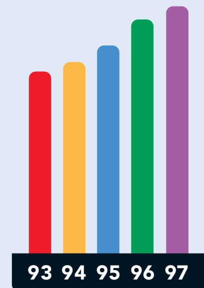
Our management team has invested considerable time this year analyzing our strengths, core competencies and distinctive assets. From these discussions came our focused initiatives I have previously outlined. But it also was important not just to identify initiatives we should pursue, but also areas we should not pursue. We will not be investing to create a national position in retail marketing. We will look, however, for joint venture partners, as I explained earlier. We are not interested in investing in the sector of natural gas production, gathering, processing, or in international distribution projects. We will not pursue electric acquisitions, although we, along with Woodward, will look for an electric partner for the Woodward L.L.C. We believe these kinds of projects would dilute our energy and take away financial resources from our main business focus.

What are the performance targets that the company expects to achieve?

Our objective is to continue to provide total returns to our shareholders that are in the top quartile when compared to other LDCs of comparable size. We expect to do this through growth in our customer base and in earnings annually.

When do you expect to see results of this plan for growth?

We made a number of investments in 1997 from which we expect to see benefits beginning in 1998 and extending into 1999 and beyond. The United Cities integration is in progress and on schedule — their organization has been restructured to match Atmos' operating model. Our customer service initiative will be completed in September 1998, when all our operating divisions are using the central call center. The management reorganization is complete, with a new leadership team in place to build on our successful past with our focus firmly on the future.



Total Assets

- **93** *$786,739*
- **94** *$829,385*
- **95** *$900,948*
- **96** *$1,010,610*
- **97** *$1,088,311*

Book Value Per Share

- **93** *$9.98*
- **94** *$10.33*
- **95** *$10.77*
- **96** *$11.27*
- **97** *$11.04*

Update: Utility Operations

provided about 95 percent of Atmos' total revenues and 86 percent of net income in 1997. Our strategy is to enhance the market position and profitability of each of our five operating companies. We plan to do this by staying focused on our customers, increasing the number of customers served, continuing to provide excellent service, managing our rates and controlling our costs.

Customer Focus

The company has achieved growth in customers served through programs designed to attract residential customers in new development and construction areas and by encouraging commercial and industrial customers to convert to the use of natural gas from other energy sources. The company also promotes the use of efficient new natural gas equipment for commercial cooling, and residential cooling and heating. Following are some examples of our success:

➢ United Cities is a leader in installations of residential gas heating and cooling systems, a new technology introduced in the last five years that provides superior comfort and energy efficiency. The company has sold 174 of these residential systems to date, including 45 units in custom and patio homes in a golf community outside Johnson City, Tennessee. Gas cooling provides increased gas load during the summer months. United Cities also has been selected to assist a large theater company based in Georgia to install commercial natural gas cooling, which will showcase the new technology.

➢ Trans Louisiana Gas also has been a leader in installing commercial natural gas cooling in Louisiana. Trans La is currently working with a hospital in Lafayette, Louisiana, in adding a second natural gas cooling unit and installing dessicant dehumidification equipment in an ice hockey complex.

➢ Energas has successfully promoted the use of on-site natural gas generators to its large agricultural market in West Texas. The farmers use the gas-fired generators to produce electricity to run irrigation pumps at a lower cost than purchasing electricity. Energas provides natural gas to power engines for 22,000 irrigation wells in this agricultural region. Energas also recently won the bid to serve a proposed electric generating station in Lubbock, Texas, in a very competitive bidding process. When completed, the generating facility will be Atmos' largest customer in terms of throughput.

➢ Greeley Gas has significant opportunities for conversion of residential customers to the use of natural gas from other energy sources. The company has successfully targeted subdivisions, such as a 300-home subdivision near Durango, Colorado. The company is also promoting clean-burning natural gas logs and other uses of natural gas to preserve air quality in Colorado.

➢ Western Kentucky Gas skillfully networks with builders and key energy decision-makers on the installation of gas in both residential and commercial new construction. Employees serve on economic development boards throughout the state, and a major emphasis is placed on state-wide industrial development to maintain and further develop our 52 percent throughput to Kentucky industries.

Customer Service Enhancements

In March 1997, Atmos announced a 12-month plan to enhance the service it provides to customers and incorporate business process changes that will make the company even more efficient. The customer service initiative is driven by our goal of providing the best quality service to our customers while remaining a low-cost provider, as well as the need to develop the infrastructure to operate in an increasingly competitive environment. The investments in technology we have made

will support additional acquisitions and enable us to integrate acquisitions in a timely manner.

Atmos will open a central customer call center available to respond to customer questions and service needs 24 hours each day, seven days each week to customers throughout its service areas. This center will be located in Amarillo, Texas, which awarded the company a $1.2 million grant as an incentive to locate there. A new state-of-the-art customer information system will support the call center and allow service orders to be automatically dispatched to service technicians in the field. Field technicians have begun using electronic meter reading devices to improve accuracy and speed. The company also has streamlined business processes to reduce the number of service trips required to start up service for a new customer.

Atmos has set up a network of approximately 300 payment centers in grocery stores, convenience stores and other locations through an outside vendor that offer extended hours and additional payment locations for customers who want to pay their bills in person. The company is closing its business offices to walk-in traffic and consolidating the operations of its field service centers located within 30 miles of each other.

Our Energas employees have adopted a slogan that puts Atmos' service philosophy in a nutshell: "First Time, Every Time." The company's goal is to consistently receive high marks in customer satisfaction surveys by delivering convenient, reliable service at the lowest possible cost.

Managing Our Rates

Rate and regulatory initiatives are at the heart of our utility operations and are important to both our shareholders and customers. Our objective is to achieve rates that provide fair returns for our shareholders while having these rates at low, competitive levels for our customers. As the energy environment and our industry change, we recognize that the process for setting rates in the future may also need to change. In that regard, the company is participating in a performance-based rate experimental program in Tennessee, which is designed to reward the company for performing better than certain benchmarks relating to purchased gas cost. A similar program is under way in Georgia. Atmos believes that performance-based rate programs benefit customers and shareholders and reward efficient service providers like Atmos. Atmos intends to seek gas cost incentive arrangements and incentive rates in every jurisdiction possible.

Controlling Our Costs

Atmos is one of the most efficient providers of natural gas service in the country. The customer service initiative and business process improvements will further enhance the company's efficiency. At the end of fiscal year 1997, Atmos' normalized utility operations and maintenance cost per customer was $147 compared with the industry average of $198 per customer. With the integration of United Cities' operations and the completion of the company's customer service initiatives, our target is to serve about 470 customers per employee by the end of 1998. The industry average is 396 customers per employee.

Local Presence

Each of Atmos' operating companies has a significant and well-respected reputation in the communities served. By design, Atmos has retained the local operating company name of the companies it has acquired. Our companies are good citizens in the communities they serve, with employees serving in civic and charitable organizations and on local economic development boards. With the closing of offices to local business traffic and consolidation of some field locations, we have assigned public affairs managers to maintain close relations with local officials and community groups. We believe that our local identity is a major competitive advantage, along with our dedication to customer service and convenience, and competitive rates.

We would now like to introduce you to our utility divisions, some of our leaders in these divisions, and some "famous" things from our service territories about which we are very proud.

Energas Co. serves a large agricultural market, which uses natural gas for fueling irrigation engines in the spring and summer, and is pioneering the use of on-site natural gas-powered generators to produce electricity for irrigation pumps.

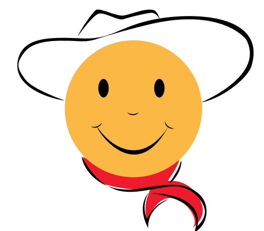
CENTER:
Eugene A. Ehler, President

REAR FROM LEFT:
Donna Lemma, Vice President, Human Resources
David Gates, Vice President, Technical Services
Gary Carter, Vice President and Controller
Mike Mancil, Vice President of Operations, Southern Region
Dan Brown, Vice President, Business Development
Kelvin Betzen, Vice President of Operations, Northern Region
Anthony Looney, Vice President of Operations, Central Region

Energas is known for creating expanded uses for natural gas. For example, 7,000 Energas agricultural customers use natural gas to power their irrigation equipment.

Lubbock is the hometown of rock 'n' roll legend Buddy Holly. It's also home to Energas headquarters.

We aim to put smiles on the faces of all Energas customers the first time, every time, a job that's somewhat easier in Happy, Texas — the "Town Without a Frown."



ABOUT ENERGAS CO.: ENERGAS OPERATIONS ARE HEADQUARTERED IN LUBBOCK, TEXAS, WITH REGIONAL OFFICES IN AMARILLO, LUBBOCK AND MIDLAND, TEXAS. ENERGAS HAS **534** EMPLOYEES AND **13,214** MILES OF PIPE. OUR SERVICE AREA IS **30,000** SQUARE MILES, HOME TO A POPULATION OF **950,000.** WE SERVE AN AVERAGE OF **311,571** CUSTOMERS IN **92** COMMUNITIES. WE HAD **3,553** DEGREE DAYS IN 1997; **3,531** DAYS IS NORMAL. AS A PUBLIC UTILITY COMPANY ENERGAS IS REGULATED BY THE MUNICIPALITIES WE SERVE AND THE RAILROAD COMMISSION OF TEXAS.

ENERGAS

Every summer, for more than 30 years, the outdoor musical "Texas" has been performed on the floor of Palo Duro Canyon, south of Amarillo. At Energas, we too pride ourselves on a reliable performance record.

Historic Route 66 runs right through Energas country in Amarillo. Energas has traveled a long road, too, providing natural gas service for almost 100 years.

On October 14, 1987, rescue workers and volunteers worked in Midland, Texas, to free 18-month-old Jessica McClure, trapped in an 8-inch pipe for 58 hours. Local Energas employees were instrumental in Jessica's rescue, providing manpower and equipment.

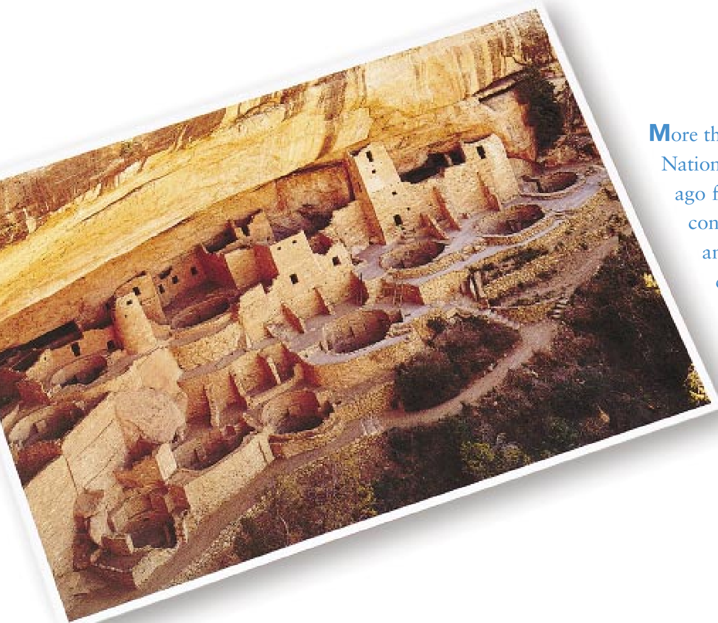
At Energas, we are famous for our efficiency, serving an average of 578 meters per employee.

Clean-burning natural gas is a winning energy solution. Brownfield native Sheryl Swoopes knows all about being a winner; she won a gold medal on the Olympic U.S. Women's Basketball team, and she's a star in the WNBA.

Greeley Gas Co. serves fast-growing Colorado ski and resort areas, including Durango, Steamboat Springs and Crested Butte, and is aggressively converting customers using other energy sources.

CENTER:
Gary Schlessman, President
REAR FROM LEFT:
John Paris, Vice President, Operations, Eastern Region
Roger Nash, Vice President, Operations, Western Region
Joann Mikolajczak, Vice President, Human Resources
Conrad Gruber, Vice President, Technical Services
Jack Mars, Senior Vice President, Operations
Gary Durossette, Vise President, Business Development
David Dupont, Vice President of Accounting

Greeley Gas' service area is home to one of the nation's only operational coal-fired, steam-operated, narrow gauge trains. "The Silverton" makes daily runs from Durango to Silverton. Greeley Gas has been running strong for our customers for more than 50 years.



More than 1,000 archaeological ruins at the Mesa Verde National Park show visitors what life was like 800 years ago for the Anasazi Indians. Today, Greeley Gas contributes to the quality of life in Colorado, Kansas and Missouri by providing our customers with a clean-burning natural fuel source.

The Neoplan Bus Factory, one of our customers in Lamar, Colo., prides itself on catering to its customers' individual needs — as do we. Neoplan's buses — sold nationwide — vary in design according to the purchaser's specifications.

ABOUT GREELEY GAS CO.: GREELEY GAS OPERATIONS ARE HEADQUARTERED IN DENVER, COLO., WITH REGIONAL OFFICES IN GREELEY, COLO., AND BONNER SPRINGS, KAN. GREELEY GAS HAS **250** EMPLOYEES AND **3,864** MILES OF PIPE. OUR SERVICE AREA IS **53,849** SQUARE MILES, HOME TO A POPULATION OF **228,000.** WE SERVE AN AVERAGE OF **113,185** CUSTOMERS IN **123** COMMUNITIES. WE HAD **6,195** DEGREE DAYS IN 1997; **6,274** DAYS IS NORMAL. AS A PUBLIC UTILITY COMPANY GREELEY GAS IS REGULATED BY THE COLORADO PUBLIC UTILITIES COMMISSION, THE KANSAS CORPORATION COMMISSION AND THE MISSOURI PUBLIC SERVICE COMMISSION.

No matter where they live, our customers always come first — even in Last Chance, Colo., 75 miles east of Denver. When the town was founded in 1926 at the crossroads of two highways, it was the "last chance" for travelers to get gas and water for nearly 40 miles in any direction.

From winter sports to summer's glorious wildflowers, Crested Butte, Colo., offers many attractive diversions for residents and visitors in Greeley Gas' service area.

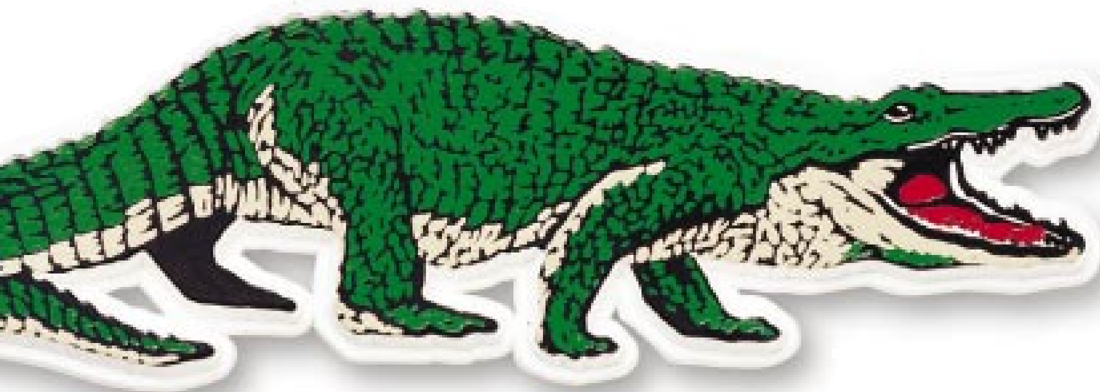
Rapid development of ski resort areas, including Steamboat Springs, Colo., is one factor that is fueling the growth of Greeley Gas.

Greeley Gas is committed to providing our customers with the highest level of service possible. Another commitment to great heights resulted in Colorado's Royal Gorge Bridge — the world's highest suspension bridge.

Trans La Gas Co. has promoted natural gas technology for commercial buildings, such as natural gas cooling at a Lafayette hospital that was nominated for a national efficient building award, and dessicant technology at an ice hockey complex.

CENTER:
B. J. Hackler, President
REAR FROM LEFT:
Art Courville, Vice President, Operations
Tom Meyers, Vice President, Technical Services
Frank Marino, Vice President, Business Development
David Hebert, Vice President, Human Resources
Melissa Bowers, Vice President, Accounting

Founded in 1714, Natchitoches, La., is the oldest permanent settlement in the Louisiana Purchase. Customers have purchased their natural gas from Trans La since our founding in 1928.



At Trans La, we have our teeth in a number of diverse industries, including alligator farms throughout our service area.

Trans La is headquartered in Lafayette, which is also home to our customer Huval Bakery. Huval began baking Evangeline Maid bread in 1937, and today distributes its bakery goods to 50 percent of the state.

ABOUT TRANS LOUISIANA GAS CO.: TRANS LA OPERATIONS ARE HEADQUARTERED IN LAFAYETTE, LA., WITH REGIONAL OFFICES IN LAFAYETTE AND NATCHITOCHES, LA. TRANS LA HAS 154 EMPLOYEES AND 2,241 MILES OF PIPE. OUR SERVICE AREA IS 7,000 SQUARE MILES, HOME TO A POPULATION OF 250,000. WE SERVE AN AVERAGE OF 80,053 CUSTOMERS IN 41 COMMUNITIES. WE HAD 1,523 DEGREE DAYS IN 1997; 1,771 DAYS IS NORMAL. AS A PUBLIC UTILITY COMPANY TRANS LA IS REGULATED BY THE LOUISIANA PUBLIC SERVICE COMMISSION.

Trans La customer Lafayette General Hospital received a general merit award in the 1997 Energy User News Efficient Building awards program. The hospital has two natural gas units as part of its hybrid heating/cooling system.

Use of clean-burning natural gas helps preserve the environment for all of us. Toledo Bend Dam & Reservoir in Many, La., is a great place to catch a big one and enjoy the great outdoors.

We believe in partnering with our customers to help them achieve their goals. It's been our pleasure to share in the success of New Iberia customer Bayou Pipe Coating Company — in business for more than 55 years.

Louisiana is famous for good eating. And Prejean's in Lafayette serves up some of the best Cajun cooking in Trans La territory.

United Cities Gas Co. serves high growth areas surrounding Nashville, Tennessee; East Tennessee and Overland Park, Kansas, and has been a leader in installing residential natural gas heating and cooling units.

United Cities has a diverse client base, serving customers in many industries. The grain fields of the Midwest are home to many of United Cities' agricultural customers.

CENTER:
Tom Blose, President

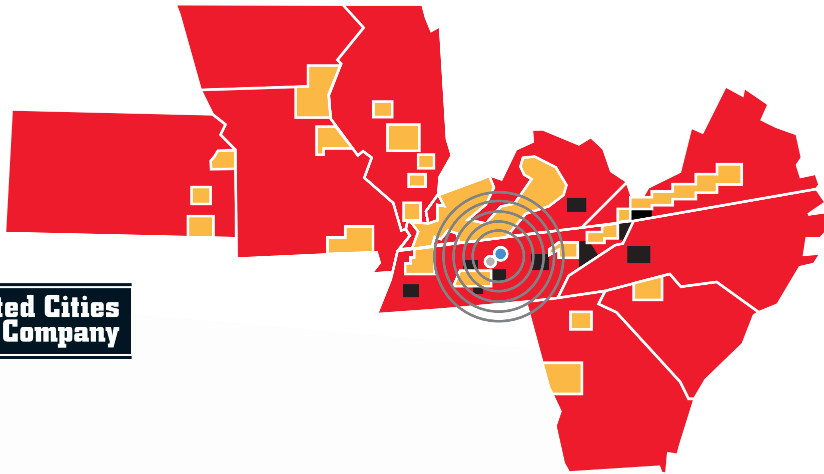
REAR FROM LEFT:
David Anglin, Vice President, Operations, Southern Region
Wendy Sadler, Vice President, Human Resources
Gary Price, Vice President, Operations, Central Region
Adrienne Brandon, Vice President and Controller
Bob Elam, Vice President, Operations, Eastern Region
Craig Carmon, Vice President, Business Development
Dan Lindsey, Vice President, Technical Services

United Cities customer Fort Benning is a three-time winner of the "Best Army Installation in the World" award.

The Dollywood Express is a favorite attraction at Dolly Parton's family entertainment park in Pigeon Forge, Tenn. Pigeon Forge is a United Cities propane town.

At the Cessna Aircraft plant in Independence, Kan., natural gas cures the seal on airplane fuel tanks, dries the paint that covers the planes, and heats three massive buildings.

ABOUT UNITED CITIES GAS CO.: UNITED CITIES OPERATIONS ARE HEADQUARTERED IN BRENTWOOD, TENN., WITH REGIONAL OFFICES IN BRENTWOOD AND JOHNSON CITY, TENN., JOHNSON COUNTY, KAN., AND COLUMBUS, GA. UNITED CITIES HAS **1,193** EMPLOYEES AND **7,945** MILES OF PIPE. OUR SERVICE AREA IS **70,905** SQUARE MILES, HOME TO A POPULATION OF **6.7 MILLION.** WE HAD **3,980** DEGREE DAYS IN 1997; **4,070** DAYS IS NORMAL.WE SERVE AN AVERAGE OF **306,681** CUSTOMERS IN **383** COMMUNITIES. AS A PUBLIC UTILITY COMPANY UNITED CITIES IS REGULATED BY AGENCIES IN EIGHT STATES.



The only Saturn automobile plant in the world is the pride of Spring Hill, Tenn. — and a United Cities customer. We're proud to play a role in the manufacture of these popular cars.

Swift Denim in Columbus, Ga., is the world's largest producer of denim. Natural gas from United Cities keeps Swift's 1,300 employees comfortable as they turn out the fabric used to make the most comfortable of pants.

Mark Twain's boyhood home in Hannibal, Mo., is a famous historical landmark. The history of United Cities dates back to 1929.

Western Kentucky Gas Co. serves a large industrial customer base and continues to increase residential and commercial customers through grass-roots networking with homebuilders and serving on local economic development boards.

CENTER:
Earl Fischer, President
REAR FROM LEFT:
Kevin Akers, Vice President, Operations, Western Region
Steve Loyal, Vice President, Human Resources
Ric Kissinger, Vice President, Operations, Western Region
Gary Smith, Vice President, Business Development
David Doggette, Vice President, Engineering and Measurement
Betty Adams, Controller

Western Kentucky Gas has a driving ambition to serve the needs of all our customers, including the Bowling Green, Ky., plant that is the world's only manufacturer of Corvettes.

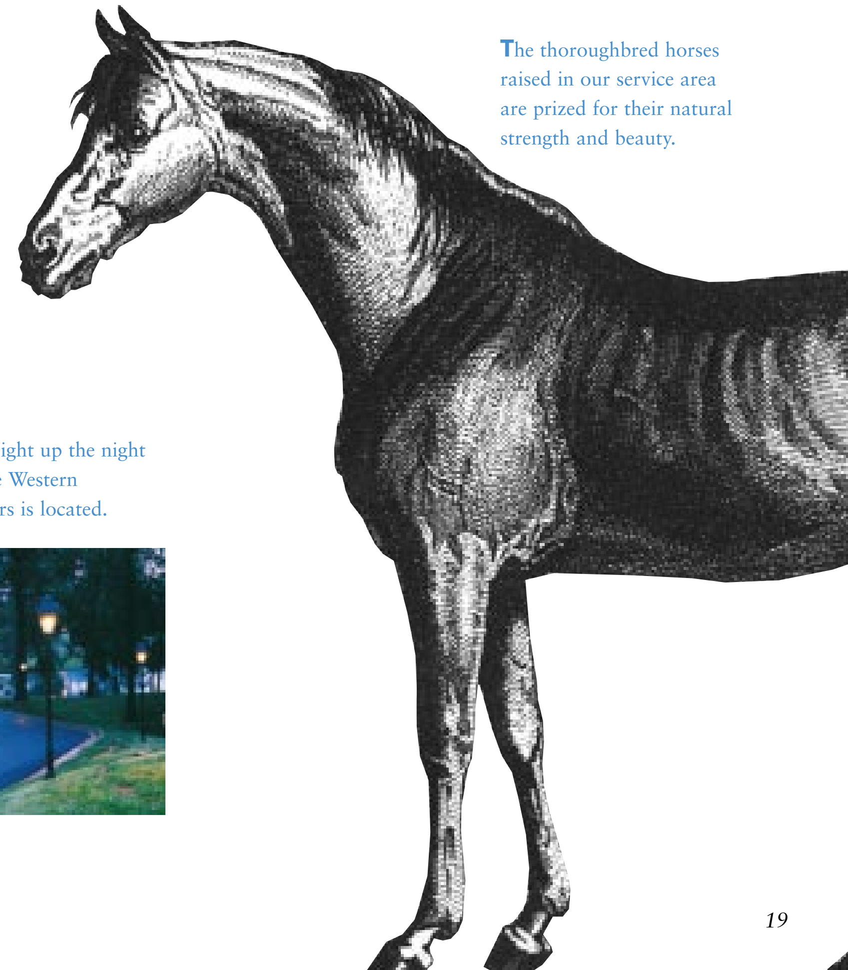
We share a taste for success with all our customers no matter what their business. Success is especially yummy for our customer Lipton, whose Owensboro plant makes Ragu tomato sauce.

The unmistakable sound of banjo-driven bluegrass music was born in Kentucky's bluegrass region. Western Kentucky Gas was born here too, in 1934.

ABOUT WESTERN KENTUCKY GAS CO.: WESTERN KENTUCKY GAS OPERATIONS ARE HEADQUARTERED IN OWENSBORO, KY., WITH REGIONAL OFFICES IN BOWLING GREEN AND MADISONVILLE, KY. WKG HAS **330** EMPLOYEES AND **3,638** MILES OF PIPE. OUR SERVICE AREA IS **12,000** SQUARE MILES, HOME TO A POPULATION OF **680,000.** WE SERVE AN AVERAGE OF **173,958** CUSTOMERS IN **163** COMMUNITIES. WE HAD **4,178** DEGREE DAYS IN 1997; **4,333** DAYS IS NORMAL. AS A PUBLIC UTILITY COMPANY WESTERN KENTUCKY GAS IS REGULATED BY THE KENTUCKY PUBLIC SERVICE COMMISSION.

The benefits of natural gas — it's efficient and environmentally friendly — are worth cheering about. "Big Red" — one of the cutest mascots in the nation — leads the cheering at Western Kentucky University sporting events.

WKG's strong tradition of customer service is as old as the state's world-famous bourbon distillers.



The thoroughbred horses raised in our service area are prized for their natural strength and beauty.

Natural gas street lamps light up the night in Owensboro, Ky., where Western Kentucky Gas headquarters is located.

Update: Non-Utility Operations

accounted for 5 percent of revenues and 14 percent of net income for Atmos in 1997. Our strategy is to expand the non-utility operations, which became a part of the company with the merger of United Cities Gas Company in 1997. These include a propane division and Woodward Marketing, L.L.C., a wholesale natural gas marketing and gas service limited liability corporation in which Atmos owns a 45 percent interest.

Atmos intends to expand its propane operations through acquisitions and by entering markets in its other territories where propane is an attractive alternative to natural gas.

Propane

The company's Propane Division sells and transports propane to both wholesale and retail customers and is engaged in direct merchandising and repair of propane gas appliances. The 30th largest propane distributor in the nation, the company serves approximately 29,000 propane customers in Tennessee, Kentucky, Virginia and North Carolina. The company has retail storefronts in major operating centers and has approximately 160 employees. The division sold 33 million gallons of propane in 1997, compared with 41 million gallons in 1996. The decrease in volume was the result of warmer than normal winter weather.

United Cities began the propane division in 1976. The propane division has grown through a series of acquisitions, including the addition of 3,100 customers in 1997 from the purchase of Harlan LP Gas Inc. for approximately $2.2 million. United Cities Propane Gas' primary competitors in the propane market are independent operators and co-ops.

The company plans to continue growth through propane acquisitions and to expand in propane markets in Atmos service areas where natural gas distribution systems are difficult or expensive to construct. The division also is continuing a program of reducing operating costs in order to increase its market share by offering the best possible price.

CENTER
Tony Slayden, Vice President and General Manager

REAR FROM LEFT
Sherry Taylor, Vice President, Accounting

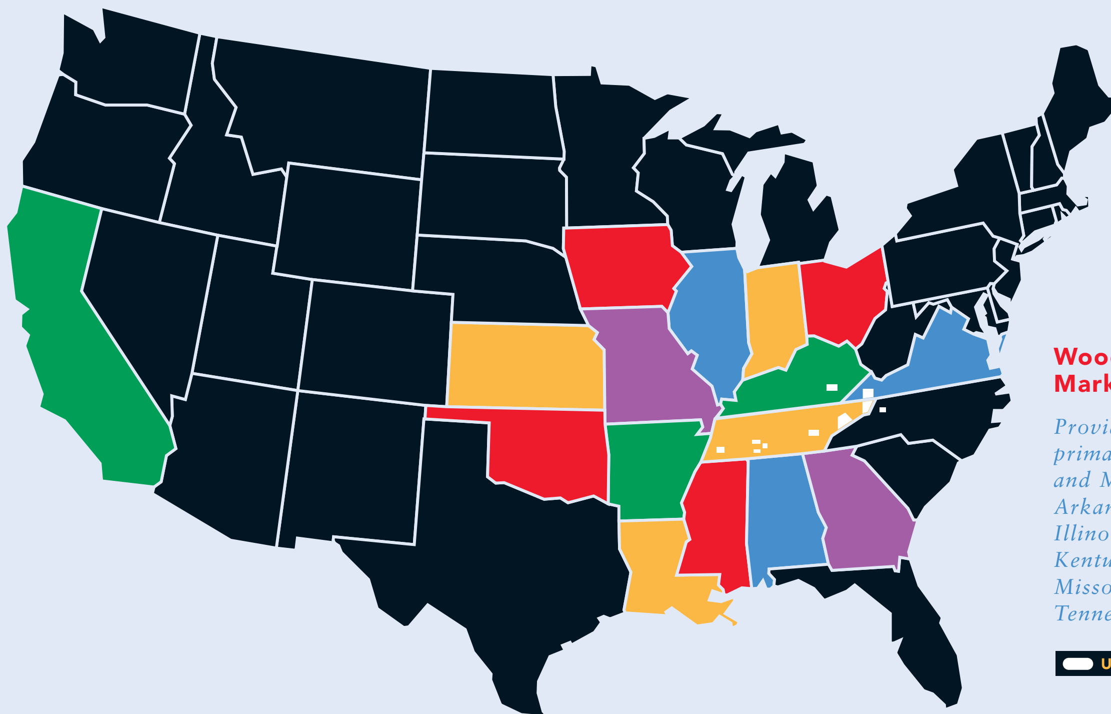
Angie Cundiff, Coordinator, Human Resources

Woodward Marketing

The company owns a 45 percent interest in Woodward Marketing, L.L.C. of Houston, Texas, which it acquired in 1995. Woodward provides natural gas services to the company, industrial customers, municipalities and natural gas utilities primarily in the Southeast and Midwest (see map). With the unbundling of the natural gas industry at the industrial, wholesale and large commercial customer level, the responsibility for management of natural gas supply acquisition, transportation and storage has shifted from the interstate pipeline system to utilities and industrial customers. Woodward Marketing provides cost-competitive, efficient, re-bundled city gate services to customers. Management services include contract negotiation and administration, load forecasting, nominations and scheduling, storage management, capacity utilization and pricing/risk management. Woodward enjoys a high level of customer satisfaction. In a 1997 industry survey, Woodward Marketing was rated the second highest in customer satisfaction.

Established in 1986, Woodward Marketing is headed by President J.D. Woodward III, who has more than 26 years of experience in the energy industry, and Executive Vice President James M. Kifer, who has more than 15 years of experience in the industry. Kifer held various energy-related management positions with a number of large industrial companies before joining Woodward in 1987.

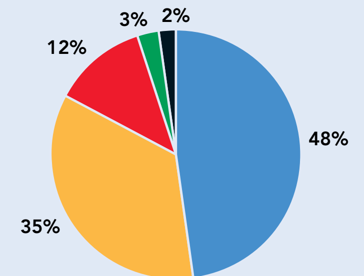
Atmos intends to assist Woodward in increasing its natural gas customer base and in exploring the opportunities for electricity marketing as an added service for its growing customer base.



Woodward Marketing, L.L.C.

Provides services to customers primarily throughout the Southeast and Midwest including: Alabama, Arkansas, California, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Mississippi, Missouri, Ohio, Oklahoma, Tennessee and Virginia.

UNITED CITIES PROPANE



Propane Sales Volumes (Gallons)

- transportation
- residential
- commercial
- industrial
- public authority and other

Shared Services

Atmos has achieved important economies of scale and efficiencies in its day-to-day operations by providing services to its operating divisions through units with exceptional technical expertise and transaction processing capabilities that benefit every Atmos division. These "shared services" units include important processes such as accounting, customer billing, remittance processing, treasury, purchasing, legal, human resources, marketing, information technology, price, policy and administration, investor relations and corporate communications, and gas supply. Atmos believes there is a competitive advantage in providing these expertise and transaction-based services from one unit rather than replicating them in every division. The shared services structure also has enabled Atmos to quickly and cost effectively integrate the operations of acquired companies. The company is equipped to accommodate future growth without significant shared services staff additions. ¶ Many companies are striving to achieve this structure, which Atmos has used successfully for more than a decade. The shared services concept has worked well at Atmos in the past, and we expect this to continue into the future. As in every area of our business, we are working to further enhance the quality and responsiveness of our shared services to our business units.

Senior Management Team

CENTER:

Robert W. Best, Chairman of the Board, President and Chief Executive Officer

REAR FROM LEFT:

Wynn D. McGregor, Vice President, Human Resources

Larry J. Dagley, Executive Vice President and Chief Financial Officer

J. Charles Goodman, Executive Vice President, Operations

Glen A. Blanscet, Vice President, General Counsel and Corporate Secretary

Mary S. Lovell, Senior Vice President, Utility Services

Donald E. James, Senior Vice President, Public Affairs

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Shared Services

GROUP ONE, FROM LEFT

Gordon J. Roy, Vice President, Gas Supply
Lynn L. Hord, Vice President, Investor Relations and Corporate Communications
Don P. Burman, Treasurer

GROUP TWO FRONT, FROM LEFT

Lee A. Everett, Vice President, Price Policy and Administration
David L. Bickerstaff, Vice President and Controller

REAR FROM LEFT

Gene Mattingly, Vice President, Business Development
Cleaburne H. Fritz, Vice President, Information Technology
Mark G. Thessin, Vice President, Regulatory Affairs
Tom S. Hawkins, Jr., Vice President, Planning and Budgeting
Ron W. McDowell, Vice President, New Business Ventures

Consolidated Balance Sheets

(In thousands, except share data)

	September 30, 1997	1996
ASSETS		
Property, plant and equipment	$1,301,004	$1,198,557
Construction in progress	31,668	21,217
	1,332,672	1,219,774
Less accumulated depreciation and amort.	483,545	449,563
Net property, plant and equipment	849,127	770,211
Current assets		
Cash and cash equivalents	6,016	11,134
Accounts receivable, less allowance for doubtful accounts of $2,188 in 1997 and $2,462 in 1996	71,217	103,415
Inventories	12,333	13,895
Gas stored underground	48,122	43,350
Prepayments	6,017	2,809
Total current assets	143,705	174,603
Deferred charges and other assets	95,479	65,796
	$1,088,311	$1,010,610
CAPITALIZATION AND LIABILITIES		
Shareholders' equity		
Common stock, no par value (stated at $.005 per share); authorized 75,000,000 shares; issued and outstanding 1997 – 29,642,437 shares, 1996 – 29,241,859 shares	$ 148	$ 146
Additional paid-in capital	251,174	241,658
Retained earnings	75,938	87,778
Total shareholders' equity	327,260	329,582
Long-term debt	302,981	276,162
Total capitalization	630,241	605,744
Current liabilities		
Current maturities of long-term debt	15,201	16,679
Notes payable to banks	167,300	128,488
Accounts payable	62,626	80,321
Taxes payable	416	11,201
Customers' deposits	15,098	16,812
Other current liabilities	52,582	23,866
Total current liabilities	313,223	277,367
Deferred income taxes	87,828	72,073
Deferred credits and other liabilities	57,019	55,426
	$1,088,311	$1,010,610

See accompanying notes to consolidated financial statements.

Consolidated Statements of Income

(In thousands, except per share data)	Year ended September 30,		
	1997	1996	1995
Operating revenues	$906,835	$ 886,691	$ 749,555
Purchased gas cost	577,181	562,279	449,397
Gross profit	329,654	324,412	300,158
Operating expenses			
Operation	173,683	148,196	146,624
Maintenance	11,974	11,719	11,350
Depreciation and amortization	45,257	41,666	40,597
Taxes, other than income	32,131	30,254	29,626
Income taxes	14,298	23,316	16,544
Total operating expenses	277,343	255,151	244,741
Operating income	52,311	69,261	55,417
Other income (expense)			
Interest and investment income	5,410	3,867	3,290
Other, net	(288)	(300)	287
Total other income (expense)	5,122	3,567	3,577
Interest charges	33,595	31,677	30,186
Net income	$ 23,838	$ 41,151	$ 28,808
Net income per share	$ .81	$ 1.42	$ 1.06
Cash dividends per share	$ 1.01	$ .98	$ .96
Average shares outstanding	29,409	28,978	27,208

See accompanying notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

(In thousands, except share data)

	Common Stock		Additional paid-in capital	Retained earnings
	Number of shares	Stated value		
Balance, September 30, 1994	25,910,607	$130	$196,487	$ 70,967
Net income	-	-	-	28,808
Cash dividends ($.96 per share)	-	-	-	(26,197)
Common stock issued:				
Restricted stock grant plan	13,000	-	202	-
Direct stock purchase plans	388,484	2	5,832	-
ESOP/401(k) plans	233,789	1	4,173	-
Woodward Marketing acq.	320,512	2	4,998	-
Public offering	1,380,000	6	18,893	-
Other	-	-	45	-
Balance, September 30, 1995	28,246,392	141	230,630	73,578
Net income	-	-	-	41,151
Cash dividends ($.98 per share)	-	-	-	(28,478)
Common stock issued:				
Restricted stock grant plan	41,700	1	733	-
Direct stock purchase plans	268,124	1	4,563	-
Outside directors stock-for-fee plan	3,389	-	76	-
ESOP	161,477	1	3,641	-
Monarch Gas Co. acq.	207,366	1	1,499	933
Oceana Heights acq.	313,411	1	304	594
Other	-	-	212	-
Balance, September 30, 1996	29,241,859	146	241,658	87,778
Net income	-	-	-	23,838
Cash dividends ($1.01 per share)	-	-	-	(26,415)
Common stock issued:				
Restricted stock grant plan	100,000	1	2,443	-
Direct stock purchase plans	85,243	-	1,888	-
Outside directors stock-for-fee plan	3,008	-	72	-
ESOP/401(k) plans	212,327	1	5,113	-
Less: UCGC net income for the quarter ended December 31, 1996	-	-	-	(9,263)
Balance, September 30, 1997	29,642,437	$148	$251,174	$ 75,938

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(In thousands)	Year ended September 30, 1997	1996	1995
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 14,575	$ 41,151	$ 28,808
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization			
Charged to depreciation and amortization	39,970	41,666	40,597
Charged to other accounts	2,237	3,580	3,601
Deferred income taxes	5,807	7,585	4,652
Other	-	(1,866)	293
Change in assets and liabilities			
(Increase) decrease in accounts receivable	32,198	(12,697)	(9,199)
(Increase) decrease in inventories	1,562	(1,238)	(827)
(Increase) decrease in gas stored underground	(4,772)	(15,949)	11,707
(Increase) decrease in prepayments	(3,208)	1,966	(419)
Increase in deferred charges and other assets	(29,683)	(4,623)	(10,832)
Increase (decrease) in accounts payable	(17,695)	23,796	3,415
Increase (decrease) in taxes payable	(837)	7,099	162
Increase (decrease) in customers' deposits	(1,714)	592	1,235
Increase (decrease) in other current liabilities	28,716	(4,165)	5,096
Increase in deferred credits and other liabilities	1,593	4,836	854
Net cash provided by operating activities	68,749	91,733	79,143
CASH FLOWS FROM INVESTING ACTIVITIES			
Capital expenditures	(122,312)	(117,589)	(103,904)
Retirements of property, plant and equipment	1,189	5,708	2,456
Net cash used in investing activities	(121,123)	(111,881)	(101,448)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net increase (decrease) in notes payable	38,812	62,675	(38,475)
Proceeds from issuance of long-term debt	40,000	-	67,000
Repayment of long-term debt	(14,659)	(20,734)	(10,347)
Cash dividends paid	(26,415)	(28,478)	(26,197)
Issuance of common stock	9,518	8,523	34,109
Net cash provided by financing activities	47,256	21,986	26,090
Net increase (decrease) in cash and cash equivalents	(5,118)	1,838	3,785
Cash and cash equivalents at beginning of year	11,134	9,296	5,511
Cash and cash equivalents at end of year	$ 6,016	$ 11,134	$ 9,296

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

ONE Summary of significant accounting policies

Description of business Atmos Energy Corporation and its subsidiaries ("Atmos" or the "Company") are in the business of distributing natural gas to residential, commercial, industrial and agricultural customers within service areas located in Texas, Louisiana, Kentucky, Colorado, Kansas, Illinois, Tennessee, Iowa, Virginia, Georgia, South Carolina and Missouri. Such business is subject to federal and state regulation and/or regulation by local authorities in each of the twelve states in which the Company operates. In connection with the acquisition of United Cities Gas Company (See Note 2), the Company also acquired non-utility businesses operated through UCG Energy Corporation ("UCG Energy") and United Cities Gas Storage Company ("UCG Storage"). They are involved in propane sales and distribution, gas marketing, rental of real estate, equipment and appliances, and natural gas storage services. None of the non-utility operations constitute a material business segment.

Principles of consolidation The accompanying consolidated financial statements include the accounts of Atmos Energy Corporation and its subsidiaries. Each subsidiary is wholly owned and all material intercompany items have been eliminated. Investments in 50%-or-less owned joint ventures or partnerships are accounted for by the equity method or the cost method, as appropriate.

Restatement for pooling of interests The consolidated financial statements for all prior periods presented have been restated for the pooling of interests of the Company with United Cities Gas Company in July 1997. Certain changes in account classifications have been made to conform United Cities Gas Company's classifications to Atmos' presentation.

Regulation The Company's 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 it operates. The consolidated financial statements are based on generally accepted accounting principles. Atmos' accounting policies recognize the financial effects of the ratemaking and accounting practices and policies of the various regulatory commissions.

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. The Company follows 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. Estimated losses due to credit risk are reserved at the time revenue is recognized.

Property, plant and equipment Property, plant and equipment is stated at original cost net of contributions in aid of construction. The cost of additions includes an allowance for funds used during construction and applicable overhead charges. Major renewals and betterments are capitalized, while the costs of maintenance and repairs are charged to expense as incurred. Property, plant and equipment is depreciated at various rates on a straight-line basis over the estimated useful lives of the assets. The composite rates were 3.9% and 3.7% for the years ended September 30, 1997 and 1996, respectively. At the time property, plant and equipment is retired, the cost, plus removal expenses and less salvage, is charged to accumulated depreciation.

Inventories Inventories consist of materials and supplies and merchandise held for resale. Inventories are stated at the lower of average cost or market.

Gas stored underground Net additions of inventory gas to underground storage and withdrawals of inventory gas from storage are priced using the average cost method for Atmos, except for the United Cities Division, where it is priced on the first-in first-out method. Propane is priced at average cost. Gas stored underground and owned by UCG Storage is priced on the last-in first-out ("LIFO") method. In accordance with the United Cities Division's PGA clause, the liquidation of a LIFO layer would be reflected in subsequent gas adjustments in customer rates and does not affect the results of operations. Non-current gas in storage is classified as property, plant and equipment and is priced at cost.

Income taxes The Company provides deferred income taxes for significant temporary differences in the recognition of revenues and expenses for tax and financial reporting purposes.

Cash and cash equivalents The Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Deferred charges and other assets Deferred charges and other assets at September 30, 1997 and 1996 include assets of the Company's qualified defined benefit retirement plans in excess of the plans' obligations in the amounts of $11,557,000 and $11,810,000, respectively, and Company assets related to the nonqualified retirement plans at September 30, 1997 and 1996 of $21,210,000 and $17,808,000, respectively.

Deferred credits and other liabilities Deferred credits and other liabilities include customer advances for construction of $10,072,000 and $9,753,000 at September 30, 1997 and 1996, respectively; obligations under capital leases of $3,047,000 and $2,769,000 at September 30, 1997 and 1996, respectively; and obligations under the Company's nonqualified retirement plans of $22,167,000 and $20,313,000 at September 30, 1997 and 1996, respectively.

Earnings per share The calculation of primary earnings per share is based on reported net income divided by weighted average common shares outstanding. The Company does not have other classes of stock or dilutive common stock equivalents.

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.

Recently issued accounting standards not yet adopted The Company has not yet adopted Statement of Financial Accounting Standards No. 128 "Earnings per Share." The Statement is effective for Atmos' fiscal year 1998 and earlier adoption is not permitted. The Statement requires restatement of all prior-period EPS data presented.

The Company has not yet adopted Statement of Financial Accounting Standards No. 130 "Reporting Comprehensive Income." The Statement will be effective for Atmos' fiscal year 1999. It establishes standards for reporting and display of comprehensive income and its components (revenues, expenses, gains, and losses) in a full set of general-purpose financial statements. Reclassification of financial statements for earlier periods provided for comparative purposes is required.

The Company has not yet adopted Statement of Financial Accounting Standards No. 131 "Disclosures about Segments of an Enterprise and Related Information." The Statement will be effective for Atmos' fiscal year 1999. It establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports issued to shareholders. In the initial year of application, comparative information for earlier years is to be restated.

The Company believes that adoption of these Statements will not have a material impact on its financial condition, results of operations, or cash flows.

TWO Business combinations

On July 31, 1997 Atmos acquired by means of a merger all of the assets and liabilities of United Cities Gas Company ("UCGC") in accordance with the terms and provisions of an Agreement and Plan of Reorganization dated July 19, 1996 and amended October 3, 1996. A total of 13,320,221 shares of Atmos common stock were issued in a one-for-one exchange for all outstanding shares of UCGC common stock. UCGC was a natural gas utility company engaged in the distribution and sale of natural gas to approximately 306,000 customers in Georgia, Illinois, Iowa, Kansas, Missouri, South Carolina, Tennessee, and Virginia, and in the sale of propane to approximately 29,000 customers in Kentucky, North Carolina, Tennessee, and Virginia. Its assets consisted of the property, plant and equipment used in its natural gas and propane sales and distribution businesses. With the completion of the merger, Atmos serves over 1,000,000 customers in 13 states.

UCGC was merged with and into Atmos by means of a tax-free reorganization. The transaction was accounted for as a pooling of interests; therefore, all historical financial statements and notes thereto have been restated. UCGC prepared its financial statements on a December 31 fiscal year end. UCGC's fiscal year has been changed to September 30 to conform to the Company's year end. The restated September 30, 1996 balance sheet, as presented, is the combined balance sheets of Atmos as of September 30, 1996 and UCGC as of December 31, 1996. The restated consolidated statements of income and cash flows for the years ended September 30, 1996 and 1995 include Atmos operations for the years then ended and UCGC operations for the years ended December 31, 1996 and 1995. The consolidated statement of income for the year ended September 30, 1997 includes Atmos and UCGC operations for the twelve months then ended. As a result, UCGC's operations for the three months ended December 31, 1996 (operating revenues of $122,971,000 and net income of $9,263,000) are included in both the 1997 and 1996 consolidated statements of income, the UCGC net income for this period has been deducted in calculating the shareholders' equity balances at September 30, 1997 and cash flows for the year then ended. Certain account reclassifications were made to conform UCGC's classifications to Atmos' presentation.

Following the merger, UCGC's business has been operated as United Cities Gas Company, a division of Atmos ("United Cities Division") and integration of the companies has begun. The United Cities Division will be structured like other divisions of Atmos. To achieve this structure, approximately 560 utility positions in the United Cities Division will be eliminated by September 1998. An additional 75 Atmos positions will be eliminated as part of the integration, resulting in approximately 635 total position reductions in the combined company by September 1998. Atmos also has initiated plans to enhance its customer service in Texas, Louisiana, Kentucky, Colorado, Kansas and Missouri through business process changes which will result in a net reduction of approximately 240 positions. These changes include restructuring business office operations, establishing a network of payment centers and creating a customer support call center.

Atmos estimates the cost of the merger and integration will total approximately $17,000,000 for the transaction costs and $32,000,000 for the separation and other costs. The Company believes there are substantial longer term benefits to its customers and shareholders from the merger of the two companies, which are expected to result in operating cost savings over the next 10 years totaling approximately $375,000,000. The Company believes a significant amount of the costs to achieve these benefits will be recovered through rates and future operating efficiencies of the combined operations.

The Company recorded as regulatory assets the costs of the merger and integration of the United Cities Division as discussed above, along with the costs of the customer service initiative, which are primarily separation costs and are estimated to be approximately $12,000,000 through September 30, 1997. However, the Company established a general reserve of approximately $20,340,000 ($12,630,000 after-tax), to account for costs that may not be recovered through rates. Since the substantial portion of the costs are related to position eliminations between July 31, 1997 and July 31, 1998 and fees payable at the close of the merger, the Company recorded these costs in the fourth quarter of fiscal year 1997 when the merger was completed, separation plans were approved by the Board of Directors, and announcements were made to employees.

Results of operations and net income for the previously separate companies for the periods prior to the merger are as follows:

(In thousands)	10 months ended July 31, 1997	Year ended September 30, 1996	1995
Operating revenues:	(Unaudited)		
Atmos	$ 474,069	$483,744	$435,820
UCGC	356,325	402,947	313,735
	$ 830,394	$886,691	$749,555
Net income:			
Atmos	$ 23,079	$ 23,949	$ 18,873
UCGC	19,434	17,202	9,935
	$ 42,513	$ 41,151	$ 28,808
Dividends per share:			
Atmos	$ .75	$ .96	$ .92
UCGC	$ .76	$ 1.02	$ 1.02

THREE Rates

As of September 30, 1997, the Company did not have any rate cases currently pending except for a "show cause" hearing scheduled to review rates in Colorado before the Colorado Public Utility Commission in December 1997. Rate cases completed during the three years ended September 30, 1997 are summarized below.

In November 1996, UCGC filed to increase rates on an annual basis by $1,234,000 to approximately 23,000 customers in the state of Illinois. Effective July 9, 1997, the Illinois Commerce Commission granted a rate increase of $428,000 in annual revenues. The increase will be followed by a rate moratorium until June 2000. Effective December 2, 1996, UCGC received an annual rate increase of $3,160,000 for approximately 70,000 customers in the state of Georgia. UCGC had filed in May 1996 to increase rates by $5,003,000 on an annual basis. Effective May 17, 1996, UCGC received an annual rate increase of $410,000 in the state of Iowa. UCGC had filed to increase rates by $750,000 on an annual basis. Included in the rate increase in Iowa was the recovery of $1,787,000 over a ten-year period related to UCGC's agreement with Union Electric Company ("Union Electric") whereby Union Electric agreed to assume responsibility for UCGC's continuing investigation and environmental response action obligations as outlined in the feasibility study pertaining to a manufactured gas plant site in Keokuk, Iowa.

Effective November 15, 1995, UCGC received an annual rate increase of $2,227,000 in the state of Tennessee. UCGC had filed to increase rates by $3,951,000 on an annual basis. Effective October 14, 1995, UCGC received an annual rate increase of $903,000 in the state of Missouri. UCGC had filed to increase rates by $1,100,000 on an annual basis. Effective September 1, 1995, UCGC received an annual rate increase of $2,700,000 in the state of Kansas. UCGC had filed to increase rates by $4,230,000 on an annual basis. Effective February 7, 1995, UCGC received an annual rate increase of $253,000 in the state of South Carolina. UCGC had filed to increase rates by $341,000 on an annual basis.

The Georgia Public Service Commission and the Tennessee Regulatory Authority have approved Weather Normalization Adjustments ("WNAs"). The WNAs, effective October through May each year in Georgia and November through April each year in Tennessee, allow the United Cities Division 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. The net effect of the WNAs was an increase/(decrease) in revenues of $2,643,000, ($2,612,000) and $1,030,000 in 1997, 1996 and 1995, respectively.

In April 1995, UCGC filed to increase rates on an annual basis by $810,000 to approximately 18,000 customers in the state of Virginia. UCGC was granted permission by the Virginia State Corporation Commission ("Virginia Commission") to implement the proposed 3% rate increase, subject to refund, effective September 29, 1995. In May 1997, the Virginia Commission issued an order approving a rate increase of .4%, effective September 29, 1995, which is expected to generate additional annual revenues of $103,000. Money over-collected from customers under the interim rates was credited to customer accounts with interest.

Effective April 1, 1995, and for an experimental two-year period, the PGA clause in Tennessee was modified by an incentive rate program which compares UCGC purchased gas prices to market prices. The gains or losses recognized by UCGC as a result of the incentive program were limited to a maximum of $25,000 per month in the plan year ended March 31, 1996, and limited to a maximum of $600,000 per year in the plan year ended March 31, 1997. UCGC recognized gains related to the incentive programs in Tennessee of $675,000 and $213,000 for fiscal 1996 and 1995, respectively. On March 5, 1997, the Tennessee Court of Appeals (the "Court") issued a decision reversing and remanding the Tennessee Regulatory Authority's order which approved the incentive rate program for the plan year ending March 31, 1997. UCGC has filed to make the program permanent, effective April 1, 1997 and a hearing has not been held as of this date. An experimental incentive rate program similar to the Tennessee program has also been approved in Georgia for a two-year period that began April 1, 1997.

In May 1996, the Company filed to increase revenues by approximately $7.7 million for a portion of its Energas Division service area, which includes approximately 200,000 customers inside the city limits of 67 cities in West Texas. All cities either approved, or took no action to reject, a settlement allowing a $5.3 million increase in annual revenues to be effective for bills rendered on or after November 1, 1996. In October 1996, the Company filed a rate request with the Railroad Commission of Texas to increase revenues by approximately $.5 million for the remaining 22,000 rural customers in West Texas. The rate request was approved and became effective in April 1997.

In February 1995, the Company filed with the Kentucky Public Service Commission (the "Kentucky Commission") for a rate increase for its Western Kentucky Division, which includes approximately 171,000 customers. In October 1995, the Kentucky Commission issued an order authorizing the Company to increase its rates by $2.3 million annually effective November 1, 1995, and by an additional $1.0 million annually beginning in March 1996. The settlement included a decrease in depreciation rates, recovery of expenses related to adoption of Statement of Financial Accounting Standards No. 106 and included a provision for the Company to begin a three-year demand-side management pilot program for the 1996-97 heating season, which could cost up to $450,000 annually, resulting in a total annual operating income increase of approximately $4.0 million. In fiscal 1997 the Company incurred costs of approximately $218,000 on the demand-side management pilot program.

FOUR Income taxes

The components of income tax expense for 1997, 1996 and 1995 are as follows:

(In thousands)	1997	1996	1995
Current	$ 8,917	$16,156	$12,319
Deferred	5,807	7,585	4,652
Investment tax credits	(426)	(425)	(427)
	$14,298	$23,316	$16,544

Included in the provision for income taxes are state income taxes of $2,000,000, $2,801,000, and $1,552,000 for 1997, 1996, and 1995, respectively.

Deferred income taxes reflect the tax effect of differences between the basis of assets and liabilities for book and tax purposes. The tax effect of temporary differences that give rise to significant components of the deferred tax liabilities and deferred tax assets at September 30, 1997 and 1996 are presented below:

(In thousands)	1997	1996
Deferred tax assets		
Costs expensed for book purposes and capitalized for tax purposes	$ 641	$ 1,087
Accruals not currently deductible for tax purposes	12,398	3,460
Customer advances	3,160	2,629
Nonqualified benefit plans	9,118	8,238
Postretirement benefits	5,757	3,819
Unamortized investment tax credit	1,723	1,593
Regulatory liabilities	3,117	3,035
Other, net	3,758	1,776
Total deferred tax assets	39,672	25,637
Deferred tax liabilities		
Difference in net book value and net tax value of assets	(102,038)	(87,604)
Pension funding	(4,190)	(4,734)
Gas cost adjustment	(6,568)	(655)
Regulatory assets	(8,673)	(1,529)
Other, net	(6,031)	(3,188)
Total deferred tax liabilities	(127,500)	(97,710)
Net deferred tax liabilities	$ (87,828)	$(72,073)
SFAS No. 109 deferred accounts for rate regulated entities (included in other deferred credits)	$ 15,072	$ (3,904)

Reconciliations of the provisions for income taxes computed at the statutory rate to the reported provisions for income taxes for 1997, 1996 and 1995 are set forth below:

(In thousands)	Liability Method		
	1997	1996	1995
Tax at statutory rate of 35%	$13,348	$22,564	$15,873
Common stock dividends deductible for tax reporting	(706)	(684)	(619)
State taxes	1,300	2,000	951
Other, net	356	(564)	339
Provision for income taxes	$14,298	$23,316	$16,544

FIVE Contingencies

Litigation On March 15, 1991, suit was filed in the 15th Judicial District Court of Lafayette Parish, Louisiana, by the "Lafayette Daily Advertiser" and others against the Trans Louisiana Gas Company ("Trans La Division"), Trans Louisiana Industrial Gas Company, Inc. ("TLIG"), a wholly owned subsidiary of the Company, and Louisiana Intrastate Gas Corporation and certain of its affiliates ("LIG"). LIG is the Company's primary supplier of natural gas in Louisiana and is not otherwise affiliated with the Company.

The plaintiffs purported to represent a class consisting of all residential and commercial gas customers in the Trans La Division's service area. Among other things, the lawsuit alleged that the defendants violated antitrust laws of the state of Louisiana by manipulating the cost-of-gas component of the Trans La Division's gas rate to the purported customer class, thereby causing such purported class members to pay a higher rate. The plaintiffs made no specific allegation of an amount of damages.

On July 14, 1995, the Louisiana Commission entered an order approving a settlement with the Company and TLIG in connection with its investigation of the costs included in the Trans La Division's purchased gas adjustment component in its rates. The order exonerated the Company of any wrongdoing with respect to the manipulation of the cost of gas component of its gas rate to residential and commercial customers. In the settlement, the Company agreed to refund approximately $541,000 plus interest to the Trans La Division's customers over a two-year period due to certain issues related to the calculation of the weighted average cost of gas. The refund totaling approximately $1,016,000, which includes interest calculated through October 1, 1995, began in September 1995 and was credited to customer bills along with interest that accrued after October 1, 1995. The Company completed the refunds, refunding $533,000 under the settlement for the twelve months ended September 30, 1997. Most of the issues that generated the refunds arose before Trans Louisiana Gas Company was acquired by the Company in 1986.

On April 18, 1997, the Louisiana Commission entered its Order approving a settlement between LIG and the Louisiana Commission pursuant to which LIG will make a payment of $10,275,000 to the Trans La Division for the benefit of its ratepayers. This settlement resolves all remaining issues in the Louisiana proceeding discussed above. Pursuant to the Order, the Trans La Division has been ordered to flow through a total of $9,725,000 of

the LIG settlement, plus accrued interest, to its customers in the form of credits to customers bills for the months November 1997 through March 1998. The remaining $550,000 will be credited one half to TLIG with the other half credited to the Trans La Division for legal fees. The Order became final on June 2, 1997 when no appeals had been filed during the appeal period which ended June 1, 1997.

As a result of the settlements reached in the Louisiana proceedings, a Joint Motion was filed in the Court on July 29, 1997, requesting the Court to lift the stay of the proceedings entered by the Court on January 19, 1993 to permit the consummation of the proposed settlement, certify a class for purposes of settlement and to preliminarily approve the settlement between the plaintiff class and all defendants. On July 30, 1997, the Court entered its order lifting the stay of the proceedings, certifying a class of current Trans La Division ratepayers for purposes of settlement and receipt of proceeds of settlement, preliminarily approving the proposed settlement between the plaintiff class and the defendants, approving the form of notice to potential class members, and setting a fairness hearing regarding the proposed settlement and disbursement of proceeds. At the fairness hearing, which is set for December 15, 1997, final approval of the settlement by the Court will be sought. If final approval of the Court is granted, the suit will be dismissed.

In Colorado, Greeley Gas Company ("Greeley Gas Division") is a defendant in several lawsuits filed as a result of a fire in a building in Steamboat Springs, Colorado on February 3, 1994. The plaintiffs claim that the fire resulted from a leak in a severed gas service line owned by the Greeley Gas Division. On January 12, 1996, the jury awarded the plaintiffs approximately $2.5 million in compensatory damages and approximately $2.5 million in punitive damages. The jury assessed the Company with liability for all of the damages awarded. The Company has appealed the judgement to the Colorado Court of Appeals. The Company believes it has meritorious issues for such appeal but cannot assess, at this time, the likelihood of success in the appeal. The Company has adequate insurance to cover the compensatory damages awarded. The Company's insurance carrier has also recently informed the Company that any punitive damages which may be awarded against the Company would be covered by the Company's insurance policy.

In March 1997, Western Kentucky Gas Company ("Western Kentucky Division") was named as a defendant in a lawsuit in the District Court in Danville, Kentucky, as a result of an explosion and fire at a residence in Danville, Kentucky on March 4, 1997. The plaintiffs, Lisa Benedict, et al, who were leasing the residence, suffered serious burns in the accident and have alleged that Western Kentucky Division was negligent in installing and servicing gas lines at the residence. The plaintiffs, who are also suing the landlord/owner of the house, have asked for punitive damages and compensatory damages in the case. Discovery has just begun; accordingly, the Company cannot assess, at this time, the likelihood of success in this case. However, the Company has adequate insurance and reserves to cover any damages that may be awarded.

In November 1997, a jury in Plaquemine, Louisiana awarded Brian L. Heard General Contractor, Inc., ("Heard") a total of $177,929 in actual damages and $15 million in punitive damages resulting from a lawsuit by Heard against the Trans La Division, the successor in interest to Oceana Heights Gas Company, which the Company acquired in November 1995. The trial judge also awarded interest on the total judgment amount. The claims are for events that occurred prior to the time Atmos acquired Oceana Heights Gas Company. Heard claimed damages associated with delays he allegedly incurred in constructing a sewer system in Iberville Parish, Louisiana. Heard filed the suit against the Trans La Division and two other defendants, alleging that gas leaks had caused delays in Heard's completion of a sewer project, resulting in lost business opportunities for the contractor during 1994. The Company believes that the gas leaks claimed in the lawsuit were minor leaks, common in normal operations of gas systems, and were repaired in accordance with standard industry practices and did not cause the damages claimed.

The jury awarded punitive damages under a prior Louisiana statute that allowed punitive damages to be awarded in cases involving hazardous substances, which, as defined in the statute, included natural gas. Although not retroactive, the Louisiana legislature repealed the statute in 1996. The Company does not believe that punitive damages are applicable in the case and should not be awarded because there were no direct damages caused by natural gas. The Company plans to immediately appeal the verdict and to aggressively pursue obtaining reversal of the judgment. However, the Company cannot assess, at this time, the likelihood of the judgment being reversed on appeal. The Company is in the process of reviewing its insurance coverage with respect to this case. Although Oceana Heights Gas Company was insured, it appears that a claim of this nature will not be covered by such insurance. However, the Company does not expect the final outcome of this case to have a material adverse effect on the financial condition, the results of operations or the net cash flows of the Company.

From time to time, other claims are made and lawsuits are filed against the Company arising out of the ordinary business of the Company. In the opinion of the Company's management, liabilities, if any, arising from these other claims and lawsuits are either covered by insurance, adequately reserved for by the Company or would not have a material adverse effect on the financial condition, results of operations, or cash flows of the Company.

Environmental matters UCGC is the owner or previous owner of manufactured gas plant sites which were used to supply gas prior to the availability of natural gas. Manufactured gas was an inexpensive source of fuel for lighting and heating nationwide. As a result of the gas manufacturing process, certain by-products and residual materials, including coal-tar, were produced and may have been accumulated at the plant sites. This was an acceptable and satisfactory process at the time such operations were being conducted. Under current environmental protection laws and regulations, the Company may be responsible for response actions with respect to such materials, if response actions are necessary.

In June 1995, UCGC entered into an agreement to pay $1,787,000 to Union Electric whereby Union Electric agreed to assume responsibility for UCGC's continuing investigation and environmental response action obligations as outlined in the feasibility study related to a former manufactured gas plant site in Keokuk, Iowa. At September 30, 1997, the Company had $714,600 accrued for its remaining liability related to the agreement. This amount is to be paid in equal annual payments over each of the next two years. UCGC deferred the agreement amount of $1,787,000 and was granted recovery over a ten-year period in the May 1996 Iowa rate increase.

The United Cities Division owns or owned former manufactured gas plant sites in Johnson City and Bristol, Tennessee; Hannibal, Missouri; and Americus, Georgia. UCGC and the Tennessee Department of Environment and Conservation entered into a consent order effective January 23, 1997, for the purpose of facilitating the investigation, removal and remediation of the Johnson City site. UCGC began the implementation of the consent order in the first quarter of 1997. The Company is unaware of any information which suggests that the Bristol site gives rise to a present health or environmental risk as a result of the manufactured gas process or that any response action will be necessary. The Missouri Department of Natural Resources ("MDNR") conducted a site reconnaissance and sampling at the Hannibal site. In its most recent report the MDNR concludes that hazardous substances and hazardous wastes are present on site, and that a release of hazardous substances to soils has occurred; however, the risk of human exposure appears to be minimal. Additional site work is likely. As of September 30, 1997, the Company had incurred and deferred for recovery $352,000, including $258,000 related to an insurance recoverability study, and accrued and deferred for recovery an additional $750,000 associated with the preliminary survey and invasive study of these three sites. The Tennessee Regulatory Authority granted UCGC permission to defer, until its next rate case, all costs incurred in Tennessee in connection with state and federally mandated environmental control requirements. On May 14, 1997, the Georgia Environmental Protection Division requested that UCGC enter into a proposed voluntary consent order for the remediation of the Americus site. Subsequently, the other responsible parties at the site advised UCGC that they would be willing to enter into a "cashout" settlement for a one-time payment by the Company of $250,000. The Company is willing to pay $250,000 for a "cashout" settlement. The Company has provided its comments to the proposed settlement agreement and expects to conclude those discussions shortly. As of September 30, 1997, the Company had accrued and deferred for recovery amounts related to this site.

Pursuant to the Tennessee Petroleum Underground Storage Tank Act, the Company is required to upgrade or remove certain underground storage tanks ("USTs") situated in Tennessee. As of September 30, 1997, the Company had identified a small number of USTs in this category in Tennessee and had incurred and deferred for recovery $98,000 and, based on available current information, accrued and deferred for recovery an additional $70,000 for the upgrade or removal of these USTs. The Tennessee Regulatory Authority granted UCGC permission to defer, until its next rate case, all costs incurred in connection with state and federally mandated environmental control requirements. In addition, the Company may be able to recover a portion of any corrective action costs from the Tennessee Underground Storage Tank Fund for certain of the UST sites in Tennessee.

In October 1995, UCGC received two Notices of Violation ("NOVs") from the Tennessee Department of Environment and Conservation ("TDEC") concerning historic releases from a UST in Kingsport, Tennessee. This UST was formerly owned by Holston Oil Co., Inc. ("Holston"), which at one time was a wholly-owned subsidiary of Tennessee-Virginia Energy Corporation ("TVEC"). Prior to TVEC's merger with UCGC in 1986, TVEC sold the common stock of Holston to an unrelated party. UCGC responded to the NOVs advising the TDEC that UCGC was not a responsible party for any environmental contamination at the site. The Company does not anticipate incurring any response action costs at this site.

The Kansas Department of Health and Environment ("KDHE") identified the need to investigate gas industry activities which utilize mercury equipment in Kansas. The Company and KDHE have signed a Consent Order for the investigation and possible response action for mercury contamination at any gas pipeline site which is identified as exceeding the KDHE's established acceptable concentration levels. As of September 30, 1997, the Company had identified approximately 720 meter sites where mercury may have been used and had incurred and deferred for recovery $100,000 and, based on available current information, accrued and deferred for recovery an additional $280,000 for the investigation of these sites. UCGC has received an order from the Kansas Corporation Commission ("KCC") allowing UCGC to defer and seek recovery in future rate proceedings the reasonable and prudent costs and expenses associated with the Consent Order. In the order, the Commission approved a Stipulation and Agreement which provides a cap of $1,500,000 on amounts deferred with the ability to exceed this cap if reasonable costs of response action are incurred. Based on a decision by the KCC concerning the recovery of environmental response action costs incurred by another company, the Company expects recovery of the costs involved in the investigation and response action associated with the mercury meter sites in Kansas.

The Company addresses other environmental matters from time to time in the regular and ordinary course of its business. Management expects that future expenditures related to response action at any site will be recovered through rates or insurance, or shared among other potentially responsible parties. Therefore, the costs of responding to these sites are not expected to materially affect the results of operations, financial condition or cash flows of the Company.

SIX Leases

The Company has entered into noncancelable leases involving office space and warehouse space. The remaining lease terms range from one to 20 years and generally provide for the payment of taxes, insurance and maintenance by the lessee. Net property, plant and equipment included amounts for capital leases of $2,327,000 and $2,511,000 at September 30, 1997 and 1996, respectively.

The related future minimum lease payments at September 30, 1997 were as follows:

(In thousands)	Capital leases	Operating leases
1998	$ 699	$ 9,841
1999	699	9,583
2000	760	9,187
2001	568	8,607
2002	568	8,344
Thereafter	2,279	61,044
Total minimum lease payments	5,573	$106,606
Less amount representing interest	(2,526)	
Present value of net minimum lease payments	$ 3,047	

Consolidated rent expense amounted to $10,522,000, $9,710,000 and $9,175,000 for fiscal 1997, 1996 and 1995, respectively. Rents for the regulated business are expensed and the Company receives rate treatment as a cost of service on a pay-as-you-go basis.

SEVEN Long-term debt and notes payable

Long-term debt at September 30, 1997 and 1996 consisted of the following:

(In thousands)	1997	1996
Unsecured 7.95% Senior Notes, due 2006, payable in annual installments of $1,000	$ 9,000	$ 10,000
Unsecured 9.57% Senior Notes, due 2006, payable in annual installments of $2,000	18,000	20,000
Unsecured 9.76% Senior Notes, due 2004, payable in annual installments of $3,000	24,000	27,000
Unsecured 11.2% Senior Notes, due 2002, payable in annual installments of $2,000	12,000	14,000
Unsecured 10% Notes, due 2011	2,303	2,303
Unsecured 6.09% Note, due 1998	40,000	-
Unsecured 8.07% Senior Notes, due 2006, payable in annual installments of $4,000 beginning 2002	20,000	20,000
Unsecured 8.26% Senior Notes, due 2014, payable in annual installments of $1,818 beginning 2004	20,000	20,000
Unsecured 9.75% Senior Notes, due 1996	-	1,000
First Mortgage Bonds		
Series J, 9.40% due 2021	17,000	17,000
Series N, 8.69% due 2002	5,000	7,000
Series P, 10.43% due 2017	25,000	25,000
Series Q, 9.75% due 2020	20,000	20,000
Series R, 11.32% due 2004	15,000	15,000
Series T, 9.32% due 2021	18,000	18,000
Series U, 8.77% due 2022	20,000	20,000
Series V, 7.50% due 2007	10,000	10,000
Medium term notes		
Series A, 1995-1, 6.67%, due 2025	10,000	10,000
Series A, 1995-2, 6.27%, due 2020	10,000	10,000
Series A, 1995-3, 6.20%, due 2000	2,000	2,000
Rental property, propane and other term notes due in installments through 2013	20,879	24,538
Total long-term debt	318,182	292,841
Less current maturities	(15,201)	(16,679)
	$302,981	$ 276,162

The Company may prepay most of the Senior Notes or First Mortgage Bonds in whole at any time, subject to a prepayment premium. The note agreements provide for certain cash flow requirements and restrictions on additional indebtedness, sale of assets and payment of dividends. Under the most restrictive of such covenants, cumulative cash dividends paid after December 31, 1988 may not exceed the sum of accumulated net income for periods after December 31, 1988 plus $15,038,000. At September 30, 1997, approximately $37,489,000 of retained earnings was not so restricted.

As of September 30, 1997, all of the Greeley Gas Division utility plant assets with a net book value of approximately $83,371,000 are subject to a lien under the 9.4% Series J First Mortgage Bonds assumed by the Company in the acquisition of Greeley Gas Company. Also, substantially all of the United Cities Division utility plant assets, totaling approximately $314,591,000 are subject to a lien under the Indenture of Mortgage of the Series N through V First Mortgage Bonds.

UCG Energy and Woodward Marketing, Inc. ("WMI"), sole shareholders of Woodward Marketing, L.L.C. ("WMLLC"), act as guarantors of a $12,500,000 credit facility for WMLLC with a bank. No balance was outstanding on this credit facility at September 30, 1997. UCG Energy and WMI also act as joint and several guarantors on certain purchases of natural gas and transportation services from suppliers by WMLLC. These outstanding obligations amounted to $12,200,000 at September 30, 1997.

Based on the borrowing rates currently available to the Company for debt with similar terms and remaining average maturities, the fair value of long-term debt at September 30, 1997 and 1996 is estimated using discounted cash flow analysis to be $348,261,000 and $329,811,000, respectively. It is not currently advantageous for the Company to refinance its long-term debt because of prepayment costs set forth in the various debt agreements.

Maturities of long-term debt are as follows (in thousands):

1998	$ 15,201
1999	56,578
2000	14,790
2001	14,141
2002	14,205
Thereafter	203,267
	$318,182

Notes payable to banks The Company has committed short-term, unsecured bank credit facilities totaling $187,000,000, $35,000,000 of which was unused at September 30, 1997. One facility of $175,000,000 requires a commitment fee of .06% on the unused portion. A second facility for $12,000,000 requires a commitment fee of 5/32 of 1% on the unused portion. The committed lines are renewed or renegotiated at least annually.

The Company also had aggregate uncommitted credit lines of $170,000,000, of which $159,900,000 was unused as of September 30, 1997. The uncommitted lines have varying terms and the Company pays no fee for the availability of the lines. Borrowings under these lines are made on a when and as-available basis at the discretion of the banks.

The weighted average interest rates on short-term borrowings outstanding at September 30, 1997 and 1996 were 6.1% and 6.3%, respectively.

EIGHT Statement of cash flows supplemental disclosures

Supplemental disclosures of cash flow information for 1997, 1996 and 1995 are presented below:

(In thousands)	1997	1996	1995
Cash paid for			
Interest	$25,216	$32,778	$27,667
Income taxes	$ 9,736	14,562	18,746

NINE Common stock and stock options

The Company issued 100,000 shares of its common stock in fiscal 1997 in connection with its Restricted Stock Grant Plan.

Atmos has an Employee Stock Ownership Plan ("ESOP") and the United Cities Division has a 401(k) savings plan, as discussed in Note 10. Atmos issued 200,482 shares under its ESOP in 1997. The Company has registered 1,600,000 shares for issuance under the ESOP, of which 512,871 shares were available for future issuance on September 30, 1997.

The Company also has a Direct Stock Purchase Plan ("DSPP"). Participants in the DSPP may have all or part of their dividends reinvested at a 3% discount from market prices. DSPP participants may purchase additional shares of Company common stock as often as weekly with voluntary cash payments of at least $25, up to an annual maximum of $100,000. At September 30, 1997, 712,596 shares were available for future issuance under the plan.

On April 27, 1988, the Company adopted a Shareholders' Rights Plan and declared a dividend of one right (a "Right") for each outstanding pre-split share of common stock of the Company, payable to shareholders of record as of May 10, 1988. Each Right will entitle the holder thereof, until the earlier of May 10, 1998 or the date of redemption of the Rights, to buy one share of common stock of the Company at an exercise price of $30 per share, subject to adjustment by the Board of Directors upon the occurrence of certain events. The Rights will be represented by the common stock certificates and are not exercisable or transferable apart from the common stock until a "Distribution Date" (which is defined in the Rights Agreement between the Company and the Rights Agent as the date upon which the Rights become separate from the common stock).

At no time will the Rights have any voting rights. The exercise price payable and the number of shares of common stock or other securities or property issuable upon exercise of the Rights are subject to adjustment from time to time to prevent dilution. Until the Distribution Date, the Company will issue one Right with each share of common stock that becomes outstanding so that all shares of common stock will have attached Rights. After a Distribution Date, the Company may issue Rights when it issues common stock if the Board deems such issuance to be necessary or appropriate.

The Rights have certain anti-takeover effects and may cause substantial dilution to a person or entity that attempts to acquire the Company on terms not approved by the Board of Directors except pursuant to an offer conditioned upon a substantial number of Rights being acquired. The Rights should not interfere with any merger or other business combination approved by the Board of Directors because, prior to the time the Rights become exercisable or transferable, the Rights may be redeemed by the Company at $.05 per Right.

In November 1997, the Board of Directors approved the adoption of a new shareholders' rights plan that will go into effect upon the expiration of the existing shareholders' rights plan on May 10, 1998. The provisions of the new rights plan are similar to those of the existing rights plan. However, the new rights plan does differ from the existing plan in certain respects, including, but not limited to the following: (i) the exercise price under the new plan will be $80 per share vs. $30 per share under the existing plan; (ii) the rights under the new plan may be redeemed by the Company prior to the time they become exercisable or transferable at $.01 per right vs. $.05 per right under the existing plan; and (iii) the nature of the events that will make the rights exercisable has been modified to reflect new developments in the securities markets since 1988.

The Company's Restricted Stock Grant Plan for management and key employees of the Company, which became effective October 1, 1987 and was amended and restated in November 1997, provides for awards of common stock that are subject to certain restrictions. The plan is administered by the Board of Directors. The members of the Board who are not employees of the Company make the final determinations regarding participation in the plan, awards under the plan, and restrictions on the restricted stock awarded. The restricted stock may consist of previously issued shares purchased on the open market or shares issued directly from the Company. The Company has registered 900,000 shares for issuance under the plan. Compensation expense of $437,000, $795,000 and $1,015,000 was recognized in 1997, 1996 and 1995, respectively, in connection with the issuance of shares under the plan. At September 30, 1997, 252,500 shares were available for future award under the plan.

In November 1994, the Board adopted the Outside Directors Stock-for-Fee Plan, which plan was approved by the shareholders of the Company in February 1995 and was amended and restated in November 1997. The plan permits non-employee directors to receive all or part of their annual retainer and meeting fees in stock rather than in cash. The Company has registered 50,000 shares, 44,685 of which were available for future issuance under the plan as of September 30, 1997.

In October 1995, the Financial Accounting Standards Board issued Statement No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation." This statement establishes 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 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 Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." The Company has elected to remain with this method. Because of the limited nature of the Company's stock-based compensation plans, the adoption of SFAS 123 was immaterial.

TEN Employee retirement and stock ownership plans

At September 30, 1997, the Company had four defined benefit pension plans, covering the Western Kentucky Division employees, the Greeley Gas Division employees, and the United Cities Division employees, while the fourth covers all other Atmos employees. The plans provide essentially the same benefits to all employees. Except for the United Cities Division, the plans' benefits are based on years of service and the employee's compensation during the highest paid five consecutive calendar years within the last 10 years of employment. The United Cities Division plan provides benefits based on years of service and final average salary. The Company's funding policy is to contribute annually an amount in accordance with the requirements of the Employee Retirement Income Security Act of 1974. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future.

The following table sets forth the Atmos plan's funded status at September 30, 1997 and 1996:

(In thousands)	1997	1996
Actuarial present value of benefit obligations:		
Accumulated benefit obligation, including vested benefits of $75,027 and $77,089 in 1997 and 1996, respectively	$(78,591)	$(77,513)
Projected benefit obligation	$(87,999)	$(86,571)
Plan assets at fair value	102,865	90,157
Funded status	14,866	3,586
Unrecognized net asset being recognized over 15 years	-	(198)
Unrecognized prior service cost	(1,217)	(1,359)
Unrecognized net (gain) loss	(15,273)	(3,086)
Accrued pension cost	$ (1,624)	$ (1,057)

Net periodic pension cost for the Atmos plan for 1997, 1996 and 1995 included the following components:

(In thousands)	1997	1996	1995
Service cost	$ 2,263	$ 2,235	$ 1,862
Interest cost on projected benefit obligation	6,356	6,434	6,060
Actual return on plan assets	(16,588)	(11,342)	(12,200)
Net amortization and deferral	8,322	3,298	5,007
Net periodic pension cost	$ 353	$ 625	$ 729

The following table sets forth the Western Kentucky Division plan's funded status at September 30, 1997 and 1996:

(In thousands)	1997	1996
Actuarial present value of benefit obligations:		
Accumulated benefit obligation, including vested benefits of $31,877 and $30,984 in 1997 and 1996, respectively	$(32,752)	$(30,983)
Projected benefit obligation	$(36,293)	$(35,673)
Plan assets at fair value	53,289	46,478
Funded status	16,996	10,805
Unrecognized prior service cost	3,976	4,829
Unrecognized net (gain) loss	(10,065)	(4,361)
Prepaid pension cost	$ 10,907	$ 11,273

Net periodic pension cost for 1997, 1996 and 1995 included the following components:

(In thousands)	1997	1996	1995
Service cost	$ 734	$ 672	$ 706
Interest cost	2,619	2,431	2,306
Actual return on plan assets	(8,456)	(5,771)	(6,355)
Net amortization and deferral	5,081	2,356	3,399
Net periodic pension cost (benefit)	$ (22)	$ (312)	$ 56

The weighted-average discount rates used in determining the actuarial present value of the projected benefit obligations of the Atmos and Western Kentucky Division retirement plans was 7.5% at June 30, 1997 and 1996. The rate of increase in future compensation levels reflected in such determination was 4.0% for the years ended September 30, 1997 and 1996. The expected long-term rate of return on plan assets was 9.0%, 9.5% and 10.0% for the years ended September 30, 1997, 1996 and 1995, respectively. The plan assets consist primarily of investments in common stocks, interest bearing securities and interests in commingled pension trust funds. Prepaid pension cost is included in deferred charges and other assets.

The following table sets forth the Greeley Gas Division plan's funded status at September 30, 1997 and 1996:

(In thousands)	1997	1996
Actuarial present value of benefit obligations:		
Accumulated benefit obligation, including vested benefits of $15,361 and $15,110 in 1997 and 1996, respectively	$(16,033)	$(15,252)
Projected benefit obligation	$(17,700)	$(17,666)
Plan assets at fair value	17,535	16,086
Funded status	(165)	(1,580)
Unrecognized net asset being recognized over 15 years	(1,231)	(1,521)
Unrecognized prior service cost	1,344	1,480
Unrecognized net (gain) loss	(372)	1,375
Accrued pension cost	$ (424)	$ (246)

Net periodic pension cost (credit) for the Greeley Gas Division plan for 1997, 1996 and 1995 included the following components:

(In thousands)	1997	1996	1995
Service cost	$ 485	$ 453	$ 328
Interest cost on projected benefit obligation	1,277	1,185	1,208
Actual return on plan assets	(2,724)	(2,390)	(2,530)
Net amortization and deferral	1,167	810	1,217
Net periodic pension cost	$ 205	$ 58	$ 223

Accumulated plan benefits were computed using the Projected Unit Credit funding method. The discount rate and rate of increase in future compensation levels used in determining the actuarial present value of the projected benefit obligations were 7.5% and 4.0% in both 1997 and 1996. The expected long-term rate of return on plan assets was 9.0%, 9.5% and 10.0% in 1997, 1996 and 1995, respectively. Plan assets consist primarily of corporate bonds, equity securities, mutual funds, partnership interests, and other miscellaneous investments.

The following table sets forth the United Cities Division plan's funded status at September 30, 1997 and 1996:

(In thousands)	1997	1996
Actuarial present value of benefit obligations:		
Accumulated benefit obligation, including vested benefits of $60,086 and $45,528 in 1997 and 1996, respectively	$(66,873)	$(54,130)
Projected benefit obligation	(75,159)	(69,652)
Plan assets at fair value	86,162	71,978
Funded status	11,003	2,326
Unrecognized net asset being recognized over 15 years	142	191
Unrecognized prior service cost	1,750	1,143
Unrecognized net (gain) loss	(15,785)	(1,819)
Prepaid (accrued) pension cost	$ (2,890)	$ 1,841

Net periodic pension cost (credit) for the United Cities Division plan for 1997, 1996 and 1995 included the following components:

(In thousands)	1997	1996	1995
Service cost	$ 3,157	$ 3,116	$ 3,451
Interest cost on projected benefit obligation	5,050	4,720	4,296
Actual return on plan assets	(17,461)	(7,936)	(10,365)
Net amortization and deferral	11,420	2,372	5,772
Net periodic pension cost	$ 2,166	$ 2,272	$ 3,154

The weighted-average discount rates used in determining the actuarial present value of the projected benefit obligations of the United Cities Division retirement plan was 7.5% at September 30, 1997 and December 31, 1996. The rate of increase in future compensation levels reflected in such determination was 5.5% for the years ended September 30, 1997 and December 31, 1996. The expected long-term rate of return on plan assets was 9.0% for the years ended September 30, 1997, and December 31, 1996 and 1995. The plan assets consist primarily of marketable equity securities, corporate and government debt securities, and deposits with insurance companies. Prepaid pension cost is included in deferred charges and other assets.

Effective October 1, 1987, the Company adopted a nonqualified Supplemental Executive Benefits Plan ("Supplemental Plan") which provides additional pension, disability and death benefits to the officers and certain other employees of the Company. Expense recognized in connection with the Supplemental Plan during fiscal 1997, 1996, and 1995 was $3,491,000, $2,708,000 and $2,158,000, respectively. The Supplemental Plan was amended and restated in May 1997 and amended again in August 1997 and November 1997.

Atmos sponsors an Employee Stock Ownership Plan ("ESOP") for employees other than those in the United Cities Division. Full time employees who have completed one year of service, as defined in the plan, are eligible to participate. Each participant enters into a salary reduction agreement with the Company pursuant to which the participant's salary is reduced by an amount not less than 2% nor more than 10%. Taxes on the amount by which the participant's salary is reduced are deferred pursuant to Section 401(k) of the Internal Revenue Code. The amount of the salary reduction is contributed by the Company to the ESOP for the account of the participant. The Company may make a matching contribution for the account of the participant in an amount determined each year by the Board of Directors, which amount must be at least equal to 25% of all or a portion of the participant's salary reduction. For the 1997 plan year, the Board of Directors elected to match 100% of each participant's salary reduction contribution up to 4% of the participant's salary. Matching contributions to the ESOP amounted to $2,077,000, $1,944,000, and $1,977,000 for 1997, 1996 and 1995, respectively. The Directors may also approve discretionary contributions, subject to the provisions of the Internal Revenue Code of 1986 and applicable regulations of the Internal Revenue Service. The Company recorded a charge of $1,500,000 for a discretionary contribution in the year ended September 30, 1996. Company contributions to the plan are expensed as incurred.

The Company sponsors a 401(k) savings plan for the United Cities Division employees. The plan allows participants to make contributions toward retirement savings. Each participant may contribute up to 15% of qualified compensation. For employee contributions up to 6% of the participant's qualified compensation, the Company will contribute 30% of the employee's contribution. The Company may also contribute up to an additional 20% of the employee's contribution based on certain criteria specified in the plan. Effective January 1, 1995, any additional contribution made by the Company will be through the issuance of the Company's common stock. The Company contributed $694,000 for the nine months ended September 30, 1997, and $826,000 and $478,000 for the years ended December 31, 1996 and 1995, respectively.

ELEVEN Other postretirement benefits

Atmos sponsors two defined benefit postretirement plans other than pensions. Each provides health care benefits to retired employees. One provides benefits to the United Cities Division. The other Atmos plan offers medical benefits to all other retired Atmos employees.

Effective October 1, 1993, the Company adopted Statement of Financial Accounting Standards No. 106 ("SFAS No. 106"), "Employers' Accounting for Postretirement Benefits Other Than Pensions." SFAS No. 106 focuses principally on postretirement health care benefits and significantly changed the practice of accounting for postretirement benefits on a pay-as-you-go basis by requiring accrual of such benefit costs on an actuarial basis from the date each employee reaches age 45 until the date of full eligibility for such benefits. The Company is amortizing on a straight line basis its initial transition obligations over 20 years. The initial transition obligation of the United Cities Division was $8,894,000. The initial transition obligation for all other Divisions was $33,354,000.

Substantially all of the Company's employees other than the United Cities Division become eligible for these benefits if they reach retirement age while working for the Company and attain 10 consecutive years of service after age 45. Participant contributions are required under these plans. Prior to June 1994, the plans were not funded. In June 1994, the Company made its first quarterly payment to the external trust set up to fund SFAS No. 106 costs in excess of the pay-as-you-go cost in Kansas in accordance with an order of the Kansas Corporation Commission. In April, 1995 it began external funding in Colorado in accordance with an order of the Colorado Public Utility Commission. The amount of funding will ultimately depend upon the ratemaking treatment allowed in the Company's various rate jurisdictions.

The components of net periodic postretirement benefits cost for the Atmos plans for each of the years ended September 30, 1997, 1996 and 1995 are as follows:

(In thousands)	1997	1996	1995
Service cost	$1,599	$1,469	$1,497
Interest cost	2,371	2,224	2,322
Actual return on plan assets	(28)	(39)	(18)
Amortization of transition obligation	1,550	1,550	1,549
Prior service cost	202	-	-
Net amortization and deferral	(217)	(80)	(150)
Net periodic postretirement benefits cost	$5,477	$5,124	$5,200

The following is a reconciliation of the funded status of the Atmos plans to the net postretirement benefits liability on the balance sheet as of September 30, 1997 and 1996:

(In thousands)	1997	1996
Accumulated postretirement benefits obligation		
Retirees	$(22,575)	$(19,849)
Fully eligible employees	(721)	(6,426)
Other employees	(10,328)	(4,644)
	(33,624)	(30,919)
Plan assets	1,278	927
Accumulated postretirement benefits obligation in excess of plan assets	(32,346)	(29,992)
Unrecognized net gain	(6,602)	(4,775)
Unrecognized transition obligation	25,802	26,342
Accrued postretirement benefits liability	$(13,146)	$ (8,425)

In the latest actuarial calculation of the accrued postretirement benefits liability, the assumed health care cost trend rate used to estimate the cost of postretirement benefits was 7.5% for 1997 and 1998 and is assumed to decrease gradually to 5.0% by 2001 and remain at that level thereafter. The trend for vision benefits is assumed to remain level for all years at 4.5%. The effect of a 1% increase in the assumed health care cost trend rate for each future year is $376,000 and $344,000 on the annual aggregate of the service and interest cost components of net periodic postretirement benefit costs and $2,760,000 and $2,377,000 on the accumulated postretirement benefits obligation as of September 30, 1998 and 1997, respectively. The assumed discount rate, the rate at which liabilities could be settled, was 7.5% as of September 30, 1997 and 1996. The expected long-term rate of return on plan assets was 5.3% for 1997 and 1996.

The Company maintains a separate postretirement health care benefits plan for the United Cities Division. Substantially all of its employees will become eligible for these benefits if they reach the normal retirement age while working for the Company.

The components of net periodic postretirement benefits cost for the United Cities Division for each of the years ended September 30, 1997, 1996 and 1995 are as follows:

(In thousands)	1997	1996	1995
Service cost	$ 86	$ 89	$ 120
Interest cost	926	897	1,051
Actual return on plan assets	(274)	(212)	(107)
Amortization of transition obligation	364	364	445
Net amortization and deferral	298	232	182
Net periodic postretirement benefits cost	$1,400	$1,370	$1,691

The following is a reconciliation of the funded status of the United Cities Division plan to the net postretirement benefits liability on the balance sheet as of September 30, 1997 and 1996:

(In thousands)	1997	1996
Accumulated postretirement benefits obligation		
Retirees	$(16,331)	$(11,546)
Fully eligible employees	(213)	(1,007)
Other employees	(750)	(816)
	(17,294)	(13,369)
Plan assets	4,336	3,715
Accumulated postretirement benefits obligation in excess of plan assets	(12,958)	(9,654)
Unrecognized net gain	7,837	5,186
Unrecognized transition obligation	5,280	5,821
Accrued postretirement benefits liability	$ 159	$ 1,353

In the latest actuarial calculation of the accrued postretirement benefits liability for the United Cities Division, the assumed health care cost trend rate used to estimate the cost of postretirement benefits was 7.5% for 1997 and 1998, and is assumed to decrease gradually to 5.0% by 2001 and remain at that level thereafter. The effect of a 1% increase in the assumed health care cost trend rate for each future year is $88,000 and $79,000 on the annual aggregate of the service and interest cost components of net periodic postre-

tirement benefit costs and $1,732,000 and $1,099,000 on the accumulated postretirement benefits obligation as of September 30, 1997 and December 31, 1996, respectively. The assumed discount rate, the rate at which liabilities could be settled, was 7.5% as of September 30, 1997 and December 31, 1996, respectively. The expected long-term rate of return on plan assets was 4.3% for 1997 and 1996.

The Company is currently recovering other postretirement benefits ("OPEB") costs through its regulated rates under SFAS No. 106 accrual accounting in Colorado, Kansas, the majority of its Texas service area and in Kentucky (effective November 1, 1995). It receives rate treatment as a cost of service item for OPEB costs on the pay-as-you-go basis in Louisiana. OPEB costs have been specifically addressed in rate orders in each jurisdiction served by the United Cities Division or have been included in a rate case and not disallowed. However, the Company was required to recover the portion of the UCGC transition obligation applicable to Virginia operations over 40 years, rather than 20 years, as in other states. Management believes that accrual accounting in accordance with SFAS No. 106 is appropriate and will continue to seek rate recovery of accrual based expenses in its ratemaking jurisdictions that have not yet approved the recovery of these expenses.

Management's Responsibility for Financial Statements

Management is responsible for the preparation, presentation and integrity of the financial statements and other financial information in this report. The accompanying financial statements have been prepared in accordance with generally accepted accounting principles, and include estimates and judgments made by management that were necessary to prepare the statements in accordance with such accounting principles.

The Company maintains a system of internal accounting controls designed to provide reasonable assurance that assets are safeguarded from loss and that transactions are executed and recorded in accordance with established procedures. The concept of reasonable assurance is based on the recognition that the cost of maintaining a system of internal accounting controls should not exceed related benefits. The system of internal accounting controls is supported by written policies and guidelines, internal auditing and the careful selection and training of qualified personnel.

The financial statements have been audited by the Company's independent auditors. Their audit was made in accordance with generally accepted auditing standards, as indicated in the Report of Independent Auditors, and included a review of the system of internal accounting controls and tests of transactions to the extent they considered necessary to carry out their responsibilities for the audit.

Management has considered the internal auditors' and the independent auditors' recommendations concerning the Company's system of internal control and has taken actions that we believe are cost-effective in the circumstances to respond appropriately to these recommendations. The Audit Committee of the Board of Directors meets periodically with the internal auditors and the independent auditors to discuss the Company's internal accounting controls, auditing and financial reporting matters.

Report of Ernst & Young LLP, Independent Auditors

Board of Directors
Atmos Energy Corporation

We have audited the accompanying consolidated balance sheets of Atmos Energy Corporation at September 30, 1997 and 1996, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended September 30, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of United Cities Gas Company, wholly owned by Atmos Energy Corporation (see Note 2), which statements reflect total assets of $513,649,000 as of December 31, 1996, and total revenues of $402,947,000 and $313,735,000 for the years ended December 31, 1996 and 1995. Those statements were audited by other auditors whose report has been furnished to us and our opinion, insofar as it relates to data included for United Cities Gas Company is based solely on the report of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Atmos Energy Corporation at September 30, 1997 and 1996, and its consolidated results of operations and its cash flows for each of the three years in the period ended September 30, 1997 in conformity with generally accepted accounting principles.

Dallas, Texas
November 11, 1997

Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

This section provides management's discussion of Atmos Energy Corporation's ("the Company" or "Atmos") financial condition, cash flows and results of operations with specific information on liquidity, capital resources and results of operations. It includes management's interpretation of such financial results, the major factors expected to affect future operating results, and future investment and financing plans. This discussion should be read in conjunction with the Company's consolidated financial statements and notes thereto. For financial and operating statistics, please see the tables of restated and pooled data included herein.

Cautionary Statement under the Private Securities Litigation Reform Act of 1995

The matters discussed or incorporated by reference in this Annual Report contain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 or Section 21E of the Securities Exchange Act of 1934. All statements other than statements of historical facts included in this Report including, but not limited to, those contained in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" regarding the Company's financial position, business strategy and plans and objectives of management of the Company for future operations, are forward-looking statements made in good faith by the Company. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. 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 operations, markets, services, rates, recovery of costs, availability of gas supply and other factors. These risks and uncertainties include, but are not limited to, economic, competitive, governmental, weather, technological and other factors.

Organization

The Company distributes, sells and transports natural gas and propane to residential, commercial, industrial and agricultural customers in thirteen states. The natural gas distribution business is operated through its five utility divisions, rather than as a holding company. Such utility business is subject to regulation by state and/or local authorities in each of the states in which the Company operates. In addition, the Company's business is affected by seasonal weather patterns, competition within the energy industry, and economic conditions in the areas that the Company serves.

With the completion of the merger with United Cities Gas Company this year, Atmos is the 12th largest natural gas distribution utility company in terms of total customers in the country, and the fifth largest pure natural gas utility. Since its organization in 1983, the Company has sought to expand its customer base and to diversify the weather patterns, local economic conditions, and regulatory environments in which it operates. As part of this strategy, the Company has completed major acquisitions in 1986, 1987, 1993 and 1997. In addition to growing through acquisitions, the Company's strategy includes building the Atmos team, running the utility operations exceptionally well, increasing the size and market share of the non-utility operations (gas marketing and propane), and developing plans to participate in retail energy services behind the meter.

In connection with its merger with United Cities Gas Company, as discussed in Note 2 of notes to consolidated financial statements, the Company acquired certain non-utility subsidiaries which contributed approximately 14% of 1997 net income and offer potential growth opportunities.

One non-utility subsidiary, UCG Storage, was formed in 1989 to provide natural gas storage services. In 1989, a natural gas storage field was purchased in Kentucky to supplement natural gas used by customers in Tennessee. In addition, natural gas storage fields located in Kansas were sold to UCG Storage and are used to supplement natural gas requirements of Kansas customers.

The other non-utility subsidiary, UCG Energy, incorporated in 1965, leases appliances, real estate and equipment, and vehicles to the United Cities Division and others. UCG Energy also owns a 45% interest in WMLLC of Houston, Texas, which provides natural gas services to industrial customers, municipalities and local distribution companies in the Southeast and Midwest, including the United Cities Division. Management services include contract negotiation and administration, load forecasting, nominations and scheduling, storage acquisition, capacity utilization and pricing/risk management. WMLLC was formed in 1995.

UCG Energy has two wholly-owned subsidiaries, United Cities Propane Gas of Tennessee, Inc. and UCG Leasing, Inc. United Cities Propane Gas of Tennessee, Inc. is engaged in the retail and wholesale distribution and transportation of propane (LP) gas. As of September 30, 1997, the propane operation served 29,097 customers in Kentucky, North Carolina, Tennessee and Virginia. UCG Leasing, Inc. was incorporated under the laws of Georgia in 1987 and leases vehicles, equipment and real estate to the United Cities Division.

Acquisitions and Mergers

The Company has expanded its customer base and sought to diversify the regulations, weather patterns and local economic conditions to which it is subject through acquisitions in fiscal years 1997, 1994, 1987, and 1986. The Company plans to continue its acquisition strategy to add new customers and service areas for both natural gas and propane. It

has an excellent track record of acquiring LDC operations that provide diversity in weather, regulatory patterns, economies and markets. It has achieved synergies and benefits quickly, while preserving brand equity.

Ratemaking Activity

Rates and regulatory initiatives are at the heart of Atmos' utility operations and are important to both shareholders and customers. Atmos' objective is to achieve rates that provide fair returns for its shareholders while having these rates at low, competitive levels for its customers. As the energy environment and industry change, the process for setting rates in the future may also need to change. In that regard, the Company is participating in a performance-based rates experimental program in Tennessee, which is designed to reward the Company for performing better than certain benchmarks relating to purchased gas cost. A similar program is under way in Georgia. Atmos believes that performance-based rate programs benefit customers and reward efficient service providers like Atmos, and Atmos intends to seek gas cost incentive arrangements and incentive rates in every jurisdiction possible.

The Company received rate increases totaling $9.4 million, $6.8 million, and $5.8 million effective in fiscal 1997, 1996 and 1995, respectively. For further information regarding these rate increases please see Note 3 "Rates" in notes to consolidated financial statements.

Weather and Seasonality

The Company's natural gas and propane distribution businesses are seasonal due to weather conditions in the Company's service areas. Sales are affected by winter heating season requirements. Sales to agricultural customers (who use natural gas as fuel in the operation of irrigation pumps) during the period from April through September are affected by rainfall amounts. These factors generally result in higher operating revenues and net income during the period from October through March of each year and lower operating revenues and either net losses or lower net income during the period from April through September of each year. For further seasonality information, please see the Supplementary Quarterly Financial Data following the notes to consolidated financial statements herein.

The Georgia Public Service Commission and the Tennessee Regulatory Authority have approved Weather Normalization Adjustments ("WNAs"). The WNAs, effective October through May each year in Georgia and November through April each year in Tennessee, allow the United Cities Division 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. The net effect of the WNAs was an increase/(decrease) in revenues of $2,643,000, ($2,612,000) and $1,030,000 in 1997, 1996 and 1995, respectively.

The Company has not sought weather normalization clauses in its other rate jurisdictions because of the effect of its geographical diversification strategy and the potential for increased profits in unusually cold years.

Environmental Matters

The Company is involved in certain environmental matters as discussed in Note 5 "Contingencies" of notes to consolidated financial statements.

Results of Operations

Year ended September 30, 1997 compared with year ended September 30, 1996

To assist in management's discussion of results of operations, the following table presents the effects for fiscal years 1997, 1996 and 1995 of certain non-recurring charges as well as weather which affected reported results.

(In thousands, except per share data)	1997		1996		1995	
	Amount	Per Share	Amount	Per Share	Amount	Per Share
Net income as reported	$23,838	$ .81	$41,151	$1.42	$28,808	$1.06
Non-recurring charges:						
Management reorganization	2,800	.10	-	-	-	-
Reserve for potential sharing of merger and integration costs	12,630	.43	-	-	-	-
Normalized net income except for effects of weather	39,268	1.34	41,151	1.42	28,808	1.06
Effects of weather	3,571	.12	(1,838)	(.06)	5,000	.18
Normalized net income	$42,839	$1.46	$39,313	$1.36	$33,808	$1.24

Net Income As Reported

The Company reported net income of $23.8 million, or $.81 per share, on operating revenues of $906.8 million for the fiscal year ended September 30, 1997. The 1997 net income includes the effects of non-recurring after-tax charges related to management reorganization ($2.8 million or $.10 per share) and reserves related to the UCGC merger and integration ($12.6 million or $.43 per share). Excluding the effect of these charges, the Company's net income would have been $39.3 million or $1.34 per share in 1997, compared with $41.2 million, or $1.42 per share for 1996. The 1997 results include United Cities Gas Company, which merged with Atmos effective July 31, 1997, and prior year operating results have been restated to reflect the pooling of interests accounting which was used for the merger.

Non-recurring Charges

The Company completed a management reorganization in 1997 and recorded a charge of $4.4 million ($2.8 million after-tax) in related costs.

The cost of the UCGC merger and integration totaled approximately $17 million for the transaction costs and $32 million for the separation and other costs. There are substantial longer term benefits to the Company's customers and shareholders from the merger of the two companies, which the Company expects to result in cost savings over the next 10 years totaling about $375 million. The Company believes a significant amount of the costs to achieve these benefits will be recovered through rates and future operating effi-

ciencies of the combined operations. Therefore, the Company recorded as regulatory assets the costs of the merger and integration of UCGC. However, the Company has established a reserve of approximately $20 million ($12.6 million after-tax), to account for costs that may not be recovered. The Company recorded these costs in the fourth quarter of fiscal year 1997 when the merger was completed, separation plans were approved by the Board of Directors and announcements were made to employees. For further information regarding the merger please see Note 2 of notes to consolidated financial statements.

Effects of Weather

Annual sales volumes and revenues vary in relation to winter heating degree days and summer irrigation demand. The Company has weather normalization adjustments in its rates in Georgia and Tennessee, but not in the other 10 states in which it has natural gas distribution operations. The estimated effect on net income of weather different from 30-year normals is included in the previous table. The decline in net income, excluding the charges and reserves, was the result of the effects of warmer than normal weather during the winter months, which negatively impacted gas throughput and sales as well as propane sales. In addition, the spring months were wetter than normal, which adversely impacted irrigation gas utilization. Normal weather conditions would have added $.12 per share to net income.

Rates

The negative effects of weather were partially offset by rate increases implemented in fiscal 1996 and 1997 in jurisdictions in Texas, Kentucky, Illinois, Georgia, Iowa, Tennessee, Missouri and Virginia. Rate increases contributed approximately $8 million to gross profit in 1997.

The following table summarizes heating degree days and volumes delivered for 1997, 1996 and 1995.

	YEAR ENDED SEPTEMBER 30,		
	1997	1996	1995
Heating degree days,			
Actual	3,909	4,043	3,706
Percent of normal	98%	101%	93%
Sales volumes – MMcf			
Residential	75,214	77,001	69,666
Commercial	37,382	38,247	34,921
Industrial (including agricultural)	46,417	57,863	57,290
Public authority and other	5,195	5,182	4,779
Total	164,208	178,293	166,656
Transportation volumes – MMcf	48,800	44,146	47,647
Total volumes delivered – MMcf	213,008	222,439	214,303
Propane – Gallons (000's)	32,975	40,723	28,854
Total operating revenues (000's)	$906,835	$886,691	$749,555

Operating revenues increased approximately 2% to $906.8 million in 1997 from $886.7 million in 1996 due to an increase of 13% in the average sales price per thousand cubic feet ("Mcf") of gas sold, which more than offset a 4% decrease in total volumes delivered. The increase in sales price reflects an increase in the commodity cost of gas which is passed through to end users and rate increases implemented in 1996 and 1997. Average gas sales revenues per Mcf increased by $.60 to $5.11 in 1997, while the average cost of gas per Mcf sold increased $.36 to $3.51 in 1997. The number of meters in service increased to 985,448 at September 30, 1997 compared with 976,308 at September 30, 1996. Sales to weather sensitive residential, commercial and public authority customers decreased approximately 2.6 billion cubic feet ("Bcf") in 1997 while sales and transportation volumes delivered to industrial and agricultural customers decreased approximately 6.8 Bcf. Total sales and transportation volumes delivered decreased 4.2% to 213.0 Bcf in 1997, as compared with 222.4 Bcf in 1996. The decrease was primarily due to lower irrigation demand as a result of cooler, wetter summer weather in West Texas.

Gross profit increased by approximately 2% to $329.7 million in 1997 from $324.4 million in 1996. The primary factor contributing to the higher gross profit was annual rate increases totalling approximately $16.3 million implemented in fiscal 1997 and 1996 in Texas, Kentucky, Tennessee, Iowa, Missouri, Georgia, and Illinois. This was partially offset by a decrease of 9.4 Bcf or 4.2% due to the effect of warmer than normal weather and decreased irrigation demand as a result of cooler, wetter summer weather in 1997. Operating expenses, excluding income taxes, increased $31.2 million or 13% to $263.0 million in 1997. The $25.5 million increase in operation expense was due primarily to the non-recurring $20.0 million reserve for potential sharing of merger and integration costs, and the $4.4 million charge for management reorganization. The $3.6 million increase in depreciation was due to utility plant additions placed in service in 1996 and 1997. Income taxes decreased to $14.3 million for 1997 from $23.3 million for 1996. The primary reason for the decrease was lower pre-tax profits. The effective tax rate increased slightly to 37.5% in 1997 from 36.2% in 1996. This was primarily due to increased state income tax rates in 1997. Also, prior to the merger in 1997, UCGC's income was subject to a slightly lower federal tax rate because of the graduated rate structure. Operating income decreased in 1997 by approximately $17.0 million or 24% to $52.3 million. The decrease in operating income resulted primarily from the non-recurring charges included in 1997 operating expenses as discussed above.

Net income decreased in 1997 by approximately 42% to $23.8 million from $41.2 million in the prior year. This $17.3 million decrease in net income resulted from the $17.0 million decrease in operating income and a $1.9 million increase in interest expense, which were partially offset by a $1.6 million increase in other income. The increase in interest expense was due to higher average debt outstanding in 1997 than in 1996. The $1.6 million increase in other income for 1997 was primarily due to a $1.1 million increase in income from the Company's investment in Woodward Marketing L.L.C., a Houston gas marketing company. Net income per share decreased to $.81 for 1997 from $1.42 for 1996. Average shares outstanding increased 1% to 29,409,000 shares in 1997 from 1996.

Year ended September 30, 1996 compared with year ended September 30, 1995

Operating revenues increased 18% to $886.7 million in 1996 from $749.6 million in 1995 due to weather that was 9% colder than in 1995 and an 11% increase in the aver-

age sales price per Mcf sold. Average gas sales revenues per Mcf increased from 1995 by $.44 to $4.51 in 1996, while the average cost of gas per Mcf sold increased $.45 to $3.15 in 1996. The total number of natural gas and propane customers increased to 1,002,416 at September 30, 1996 compared with 972,572 at September 30, 1995. Sales to weather sensitive residential, commercial and public authority customers increased approximately 11.0 Bcf in 1996 while sales and transportation volumes delivered to industrial and agricultural customers decreased 2.9 Bcf. Total volumes delivered increased 4% to 222.4 Bcf in 1996, as compared with 214.3 Bcf in 1995. Revenues from gas sales to weather sensitive customers increased $109.9 million to $616.8 million in fiscal 1996 due to an 11% increase in average sales price and a 10% increase in volumes sold in 1996. The increase in volumes sold was due to weather 1% colder than normal in 1996, as compared with 7% warmer than normal weather in 1995. Revenues from gas sold and transported to industrial and agricultural customers increased $15.2 million due to a $.24 per Mcf or 8% increase in sales price, despite a slight decrease in volumes delivered.

Gross profit increased by approximately 8% to $324.4 million in 1996 from $300.2 million in 1995. The primary factor contributing to the higher gross profit in 1996 was higher volumes sold to weather-sensitive customers due to colder weather. The companywide average margin (sales price per Mcf less cost of gas per Mcf) did not change significantly in 1996. Operating expenses, excluding income taxes, increased only slightly to $231.8 million in 1996 from $228.2 million in 1995. Income taxes increased to $23.3 million in 1996 from $16.5 million in 1995. The primary reason for the increase was higher pre-tax profits. The effective tax rate decreased slightly to 36.2% in 1996 from 36.5% in 1995. Operating income increased in 1996 by approximately 25% to $69.3 million from $55.4 million in 1995. The increase in operating income resulted primarily from the increase in 1996 gross profit, partially offset by increases in operating expenses, primarily income taxes, as discussed above.

Net income increased in 1996 from 1995 by approximately 43% to $41.2 million from $28.8 million in the prior year. This increase in net income resulted primarily from the increase in operating income, which was partially offset by a $1.5 million increase in interest expense. This increase in interest expense was caused by an increase in weighted average short-term debt outstanding in 1996. Net income per share increased to $1.42 for 1996 from $1.06 for 1995. Average shares outstanding increased 7% to 28,978,000 in 1996.

Capital Resources and Liquidity (See "Consolidated Statements of Cash Flows")

Because of the pooling of interests of Atmos, which has a September 30 fiscal year end, with UCGC, which had a December 31 year end, the activities of UCGC for the quarter ended December 31, 1996 are included in the restated 1996 consolidated statement of cash flows and not the 1997 consolidated statement of cash flows. As a result, amounts in the 1997 consolidated statement of cash flows as reported are different than they would have been, had they included a full 12 month's activity for UCGC.

The following pro forma condensed consolidated statement of cash flows reflects activities of both Atmos and UCGC for the full 12 months ended September 30, 1997.

(In thousands)	
Cash flows from operating activities:	
Net income	$ 23,838
Depreciation	47,494
Other	(11,054)
Net cash provided by operating activities	60,278
Net cash used in investing activities	(131,286)
Cash flows from financing activities:	
Increase in notes payable, net	63,600
Issuance of long-term debt	40,000
Repayment of long-term debt	(16,037)
Issuance of common stock	10,482
Cash dividends paid	(29,778)
Net cash provided by financing activities	68,267
Decrease in cash	(2,741)
Cash at beginning of year	8,757
Cash at end of year	$ 6,016

Cash Flows from Operating Activities

Cash flows from operating activities as reported in the consolidated statement of cash flows totaled $68.7 million for 1997 compared with $91.7 million for 1996 and $79.1 million for 1995. Due to non-recurring charges recorded in 1997 and deducting UCGC's net income for the quarter ended December 31, 1996, the Company reported lower net income for the 1997 Statement of Cash Flows as compared with 1996 and 1995. Depreciation for the full 12 months of fiscal 1997 was $2.2 million higher than for 1996 because of increasing utility plant in service. Using 1997 beginning balances for UCGC as of December 31, 1996 resulted in large swings in certain seasonal asset and liability accounts like accounts receivable and accounts payable. Gas stored underground increased in 1996 because of higher gas cost, but was lower in 1997 and 1995 because of substantially lower gas prices during the summers of 1997 and 1995 when the storage reservoirs were being refilled. The changes in deferred charges and other assets and other current liabilities in 1997 were related to merger and integration costs accrued and the related regulatory assets recorded in the fourth quarter of 1997. See "Consolidated Statements of Cash Flows" for other changes in assets and liabilities.

Cash Flows from Investing Activities

A substantial portion of the Company's cash resources is used to fund its ongoing construction program in order to provide natural gas services to a growing customer base. Net cash used in investing activities totaled $121.1 million in 1997 compared with $111.9 million in 1996 and $101.4 million in 1995. During 1995, UCGC completed construction of a twenty-eight mile main which connects two of its fastest growing distribution systems

located in Middle Tennessee and is designed to provide the Company's current customers with the lowest possible priced gas through increased gas supply flexibility. Included in the 1995 capital expenditures stated above is $5.7 million related to this project. Capital expenditures in fiscal 1997 amounted to $122.3 million (including $26.0 million for the Customer Service Initiative ("CSI")) compared with $117.6 million in 1996 and $103.9 million in 1995. Currently budgeted capital expenditures for 1998 total $109.1 million and include approximately $41.5 million for completing the CSI, as well as funds for additional mains, services, meters, and vehicles. The CSI project includes application software, related technology infrastructure and business process changes. Benefits related to the CSI project include enabling the Company's ability to deliver its vision by positioning for the future, using best practices in the industry, timely integration of new acquisitions and resolution of Year 2000 issues. Capital expenditures for fiscal 1998 are planned to be financed from internally generated funds and financing activities, as discussed below.

The following table reflects the Company's capitalization, including short-term debt except for the portion related to current storage gas.

(In thousands)	1997		1996	
Working capital				
Short-term debt(1)	$ 48,122		$ 43,350	
Short-term debt	119,178	15.6%	85,138	12.0%
Long-term debt	318,182	41.6%	292,841	41.4%
Shareholders' equity	327,260	42.8%	329,582	46.6%
Total capitalization	$764,620	100%	$707,561	100%

(1) Includes short-term borrowings associated with working gas inventories.

As of the end of fiscal 1997, the debt to capitalization ratio had increased to 57.2% from 53.4% in 1996. The increase was primarily due to increased cash requirements related to merger and integration costs and CSI investments in 1997, as well as the effects of the charges and reserves previously discussed. The Company plans to decrease the debt to capitalization ratio to nearer its target of 50% over the next three years through cash flow generated from operations, issuance of new common stock under its Direct Stock Purchase Plan and ESOP, recovery of CSI and merger/integration costs and possibly from the sale of certain real estate assets.

Future Capital Requirements

Short-term borrowings are expected to continue to increase somewhat in fiscal 1998 due to budgeted capital expenditures discussed above and scheduled maturities of long-term debt of $15.2 million. The Company has access to $35.0 million available under its committed lines of credit and $159.9 million available under its uncommitted lines.

Forward looking cash requirements beyond fiscal 1998 include capital expenditures and possible contingencies and environmental matters as discussed in the notes to consolidated financial statements. The Company plans to fund future requirements through internally generated cash flows, credit facilities and its access to the public debt and equity capital markets.

Cash Flows from Financing Activities

Net cash provided by financing activities totaled $47.3 million for 1997 compared with $22.0 million for 1996 and $26.1 million for 1995. Financing activities during these periods included issuance of common stock, dividend payments, short-term borrowings from banks under the Company's credit lines, and issuance and repayments of long-term debt.

Cash dividends paid The Company paid $26.4 million in cash dividends during 1997 (excluding dividends of $3.4 million paid by UCGC in the quarter ended December 31, 1996) compared with $28.5 million in 1996 and $26.2 million in 1995. Prior to the UCGC merger in July 1997, Atmos increased its actual annual dividend rate by $.04 in each of the three years presented. Including fiscal 1998, the Company has increased its dividend rate for ten consecutive years.

Short-term financing activities At September 30, 1997, the Company had committed lines of credit totaling $187.0 million, $35.0 million of which was unused, in order to provide for short-term cash requirements. These credit facilities are negotiated at least annually. At September 30, 1997, the Company also had uncommitted short-term credit lines of $170.0 million, of which $159.9 million was unused. During 1997, notes payable increased $38.8 million after the application of $40.0 million proceeds from the issuance of long-term debt to reduce notes payable, compared with an increase of $62.7 million during 1996 and a decrease of $38.5 million in 1995. The decrease in fiscal 1995 was primarily due to repayment of short-term debt with most of the proceeds from the issuance of $67.0 million of long-term debt.

Long-term financing activities In November 1996, the Company issued $40.0 million of 6.09% unsecured notes due in November 1998 to a bank. The proceeds were used to refinance short-term debt. Long-term debt payments totaled $14.7 million, $20.7 million, and $10.3 million for the years ended September 30, 1997, 1996 and 1995, respectively. The amount for 1997 excludes repayments of $1.4 million by UCGC in the quarter ended December 31, 1996. Payments of long-term debt in 1997 consisted of $9.0 million of installments on the Company's various unsecured Senior Notes, a $2.0 million installment on the 8.69% Series N First Mortgage Bonds, and installments on various term notes and other long-term obligations totaling $3.7 million. Payments of long-term debt in 1996 and 1995 likewise consisted of annual installments under the various loan documents. No long-term debt was issued in 1996. In the first quarter of 1995, the Company entered into note purchase agreements totaling $40.0 million with two insurance companies and issued $20.0 million of unsecured Senior Notes at 8.07% payable in annual installments of $4.0 million beginning October 31, 2002 through October 31, 2006 with semiannual interest payments and $20.0 million of unsecured Senior Notes at 8.26% payable in annual installments of $1,818,182 beginning October 31, 2004 through October 31, 2014 with semiannual interest payments. In 1995 UCGC issued $22.0 million of medium-term notes under a shelf registration statement and a $5.0 million term note for its propane company. The $27.0 million proceeds of these notes were used by UCGC to repay short-term borrowings, retire long-term debt, finance the Company's construction program and for other corporate purposes.

The loan agreements pursuant to which the Company's Senior Notes and First Mortgage Bonds have been issued contain covenants by the Company with respect to the maintenance of certain debt-to-equity ratios and cash flows, and restrictions on the payment of dividends. Also see Note 7 of the accompanying notes to consolidated financial statements.

UCG Energy and Woodward Marketing, Inc. ("WMI"), sole shareholders of WMLLC, act as guarantors of a $12,500,000 credit facility for WMLLC with a bank. No balance was outstanding on this credit facility at September 30, 1997. UCG Energy and WMI also act as joint and several guarantors on certain purchases of natural gas and transportation services from suppliers by WMLLC. These outstanding obligations amounted to $12.2 million at September 30, 1997.

Issuance of common stock The Company issued 400,578, 995,467 and 2,335,785 shares of common stock in 1997, 1996 and 1995, respectively, for its Direct Stock Purchase Plan, Employee Stock Ownership Plans, Restricted Stock Grant Plan, Outside Directors Stock-for-Fee Plan, a public offering in 1995, acquisitions of Oceana Heights and Monarch Gas Company and an interest in Woodward Marketing L.L.C. See the Consolidated Statements of Shareholders' Equity for the number of shares issued under each of the plans and for other transactions. Please see Note 9 of the accompanying notes to consolidated financial statements for the number of shares registered and available for future issuance under each of the Company's plans.

In November 1995 the Company exchanged 313,411 shares of its common stock valued at approximately $6.4 million in exchange for privately held Oceana Heights Gas Company of Thibodaux, Louisiana.

In June 1996, in connection with the acquisition of Monarch Gas Company ("Monarch"), 207,366 shares of UCGC's common stock were exchanged for the common stock of Monarch. The merger added approximately 2,900 natural gas customers in the Vandalia, Illinois area. In May 1995, 320,512 shares of UCGC's common stock valued at $5,000,000 were issued in connection with the purchase of a 45% interest in Woodward Marketing, L.L.C. ("WMLLC") by UCG Energy. In June 1995 UCGC issued 1,380,000 shares of common stock under a shelf registration statement in an underwritten public offering with net proceeds from the sale amounting to approximately $18.9 million.

The Company believes that internally generated funds, its credit facilities 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 1998.

Inflation

The Company believes that inflation has caused and will continue to cause increases in certain operating expenses and has required and will continue to require assets to be replaced at higher costs. The Company continually reviews the adequacy of its gas rates in relation to the increasing cost of providing service and the inherent regulatory lag in adjusting those gas rates.

Quarterly Financial Data (Unaudited)

Summarized unaudited quarterly financial data are presented below. The sum of net income per share by quarter may not equal the net income per share for the year due to variations in the weighted average shares outstanding used in computing such amounts. The Company's natural gas and propane distribution businesses are seasonal due to weather conditions in the Company's service areas. For further information on its effects on quarterly results, please see the "Seasonality" discussion included in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section herein.

	QUARTER ENDED							
	DECEMBER 31,		MARCH 31,		JUNE 30,		SEPTEMBER 30,	
(In thousands, except per share data)	1996	1995	1997	1996	1997	1996	1997	1996
Operating revenues	$280,624	$253,439	$362,636	$341,867	$143,714	$175,240	$119,861	$116,145
Gross profit	97,269	89,707	124,249	120,231	59,546	68,220	48,590	46,254
Operating income (loss)	25,968	24,365	37,075	41,216	4,599	6,853	(15,331)	(3,173)
Net income (loss)	18,155	18,496	30,625	35,906	(3,018)	(2,795)	(21,924)	(10,456)
Net income (loss) per share	.62	.64	1.04	1.26	(.10)	(.10)	(.74)	(.36)

Market Information

The Company's stock trades on the New York Stock Exchange under the trading symbol "ATO." The high and low sale prices and dividends paid per share of the Company's common stock for fiscal 1997 and 1996 are listed below. Dividends paid for 1997 and 1996 have been restated to reflect the merger of Atmos and UCGC accounted for as a pooling of interests. Atmos' actual dividends paid in fiscal 1997 were $.25 for each of the first three quarters and $.255 for the fourth quarter, and $.24 per quarter for each quarter of fiscal 1996. The high and low prices listed are the actual closing NYSE quotes for Atmos shares.

	1997			1996		
	High	Low	Dividends paid	High	Low	Dividends paid
Quarter ended						
December 31	$24 ¾	$22 ⅝	$ .251	$ 23	$ 18	$.245
March 31	26 ¼	22 ⅛	.252	23	21	.245
June 30	25 ½	22 ½	.252	31	22 ¾	.245
September 30	27 ⅞	24 ½	.255	30 ⅝	20 ⅞	.245
			$1.01			$ .98

See Note 7 of notes to consolidated financial statements for restriction on payment of dividends. The number of record holders of the Company's common stock on September 30, 1997 was 29,867.

Selected Financial Data

The following table sets forth selected financial data of the Company and should be read in conjunction with the consolidated financial statements included herein. Amounts for 1997 reflect the pooled operations of Atmos and the United Cities Division. Prior year amounts have been restated for the pooling.

(In thousands, except per share data)	YEAR ENDED SEPTEMBER 30,				
	1997	1996	1995	1994	1993
Operating revenues	$ 906,835	$ 886,691	$749,555	$ 826,302	$794,893
Net income	$ 23,838	$ 41,151	$ 28,808	$ 26,772	$ 29,694
Net income per share	$ .81	$ 1.42	$ 1.06	$ 1.05	$ 1.21
Cash dividends per share	$ 1.01	$ .98	$ .96	$ .91	$ .82
Total assets at end of year	$1,088,311	$1,010,610	$900,948	$ 829,385	$786,739
Long-term debt at end of year	$ 302,981	$ 276,162	$294,463	$ 282,647	$257,696

Consolidated Five-Year Financial and Statistical Summary (1)

	YEAR ENDED SEPTEMBER 30,				
	1997	1996	1995	1994	1993
BALANCE SHEET DATA AT SEPTEMBER 30 (In thousands)					
Capital expenditures	$ 122,312	$117,589	$103,904	$ 85,471	$ 74,110
Net property, plant and equipment	849,127	770,211	697,287	638,787	592,886
Working capital	(169,518)	(102,764)	(41,980)	(32,340)	(31,830)
Total assets	1,088,311	1,010,610	900,948	829,385	786,739
Shareholders' equity	327,260	329,582	304,349	267,584	251,317
Long-term debt, excluding current maturities	302,981	276,162	294,463	282,647	257,696
Total capitalization	630,241	605,744	598,812	550,231	509,013
INCOME STATEMENT DATA (In thousands, except per share data)					
Operating revenues	$ 906,835	$886,691	$749,555	$826,302	$794,893
Gross profit	329,654	324,412	300,158	297,020	289,393
Net income	23,838	41,151	28,808	26,772	29,694
Net income per share	0.81	1.42	1.06	1.05	1.21
COMMON STOCK DATA					
Shares outstanding (In thousands)					
End of year	29,642	29,242	28,246	25,911	25,183
Average	29,409	28,978	27,208	25,604	24,535
Cash dividends per share	$ 1.01	$ 0.98	$ 0.96	$ 0.91	$ 0.82
Shareholders of record	29,867	36,472	31,782	27,005	24,649
Market price – high	$ 27 7/8	$ 31	$ 20 5/8	$ 21 1/8	$ 20 5/8
low	$ 22 1/8	$ 18	$ 15 7/8	$ 16 3/8	$ 13 1/2
end of year	$ 24 7/8	$ 23 3/8	$ 19 3/8	$ 17 3/4	$ 20 1/4
Book value per share at end of year	$ 11.04	$ 11.27	$ 10.77	$ 10.33	$ 9.98
Price/Earnings ratio at end of year	30.71	16.46	18.28	16.90	16.74
Market/Book ratio at end of year	2.25	2.07	1.80	1.72	2.03
Annualized dividend yield at end of year	4.1%	4.2%	5.0%	5.1%	4.1%
CUSTOMERS AND VOLUMES (as metered)					
Gas sales volumes (MMcf)	164,208	178,293	166,656	170,691	166,065
Gas transportation volumes (MMcf)	48,800	44,146	47,647	47,882	51,665
Total volumes handled (MMcf)	213,008	222,439	214,303	218,573	217,730
Meters in service at end of year	985,448	976,308	949,213	943,728	888,315
Average meters in service	984,835	974,767	947,358	940,574	917,614
Heating degree days (Atmos only before '96)	3,909	3,925	3,579	3,953	4,046
Degree days as a % of normal	98%	99%	90%	99%	102%
Average gas sales price per Mcf sold	$ 5.11	$ 4.51	$ 4.07	$ 4.41	$ 4.32
Average purchased gas cost per Mcf sold	$ 3.51	$ 3.15	$ 2.70	$ 3.10	$ 3.04
Average transportation fee per Mcf	$ 0.41	$ 0.43	$ 0.42	$ 0.45	$ 0.42
STATISTICS					
Return on average shareholders' equity	7.3%	13.0%	10.1%	10.3%	12.5%
Number of employees	2,679	2,863	2,944	3,052	3,105
Net plant per meter	$ 862	$ 789	$ 735	$ 677	$ 645
Utility operating, maintenance and administrative expense per meter	$ 147	$ 194	$ 201	$ 214	$ 201
Utility customers per employee	392	341	322	309	296
Times interest earned before income taxes	2.04	3.00	2.44	2.45	2.47

(1) Amounts have been restated for pooling of interests with UCGC in July 1997 and Greeley Gas Company in December 1993, and share data have been adjusted for a 3-for-2 stock split in May 1994.

Board of Directors

FRONT, FROM LEFT
Travis Bain, Phillip Nichol
REAR, FROM LEFT
Gene Koonce, Charles Vaughan, Dan Busbee, Robert Best

FRONT, FROM LEFT
Thomas Meredith, Lee Schlessman
REAR, FROM LEFT
Thomas Garland, Richard Cardin, Vincent Lewis, Richard Ware, Carl Quinn

Travis W. Bain
President, Bain Enterprises Inc.
Plano, Texas
Board member since 1988
Committees: Work Session/Annual Meeting (Chairman), Audit, Human Resources

Robert W. Best
Chairman of the Board, President and Chief Executive Officer,
Atmos Energy Corporation
Dallas, Texas
Board member since 1997
Committees: Executive

Dan Busbee
Attorney and Shareholder, Locke Purnell Rain Harrell (A Professional Corporation)
Dallas, Texas
Board member since 1988
Committees: Audit (Chairman),
Human Resources

Richard W. Cardin
Consultant and Private Investor
Nashville, Tenn.
Board member since 1997
Committees: Audit

Thomas J. Garland
Executive in Residence and a Distinguished Service Professor of the Civic Arts,
Tusculum College
Greeneville, Tenn.
Board member since 1997
Committees: Human Resources

Gene C. Koonce
Vice Chairman of the Board,
Atmos Energy Corporation
Brentwood, Tenn.
Board member since 1997
Committees: Executive,
Work Session/Annual Meeting

Vincent J. Lewis
Senior Vice President,
Legg Mason Wood Walker Inc.
Rutherford, N.J.
Board member since 1997
Committees: Nominating

Dr. Thomas C. Meredith
Chancellor of the University of Alabama System
Tuscaloosa, Ala.
Board member since 1995
Committees: Audit, Nominating

Phillip E. Nichol
Senior Vice President and Branch Manager
PaineWebber Incorporated
Fort Worth, Texas
Board member since 1985
Committees: Nominating (Chairman),
Human Resources, Work Session/Annual Meeting

Carl S. Quinn
General Partner, Quinn Oil Company, Ltd.
New York, New York
Board member since 1994
Committees: Human Resources (Chairman)

Lee E. Schlessman
President, Dolo Investment Company
Denver, Colo.
Board member since 1994
Committees: Nominating, Executive

Charles K. Vaughan
Formerly Chairman of the Board,
Atmos Energy Corporation
Dallas, Texas
Board member since 1983
Committees: Executive (Chairman)

Richard Ware II
President, Amarillo National Bank
Amarillo, Texas
Board member since 1994
Committees: Audit, Work Session/Annual Meeting