UGI ENERGY SERVICES, LLC
AND SUBSIDIARIES

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
and MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
for the three months ended December 31, 2022 and 2021
(Unaudited)

UGI ENERGY SERVICES, LLC AND SUBSIDIARIES

TABLE OF CONTENTS

UGI ENERGY SERVICES, LLC AND SUBSIDIARIES

GLOSSARY OF TERMS AND ABBREVIATIONS

Terms and abbreviations used in this document are defined below:

UGI Energy Services and Related Entities

AmeriGas - AmeriGas Propane, L.P., an indirect wholly-owned subsidiary of UGI

Company - UGI Energy Services, LLC and its consolidated subsidiaries collectively

Energy Services - UGI Energy Services, LLC, a wholly-owned subsidiary of Enterprises, or collectively, UGI Energy Services, LLC and its consolidated subsidiaries

Enterprises - UGI Enterprises, LLC, a wholly-owned subsidiary of UGI

GHI - GHI Energy, LLC, a Houston-based RNG company and indirect wholly owned subsidiary of Energy Services

Pennant - Pennant Midstream, LLC, an indirect wholly owned subsidiary of Energy Services

Pine Run - Pine Run Gathering, LLC

Stonehenge - Stonehenge Appalachia, LLC, a midstream natural gas gathering business

UGI - UGI Corporation

UGI Moraine East - UGI Moraine East Gathering LLC, a wholly owned subsidiary comprising the assets acquired in the Stonehenge Acquisition

UGI Utilities - UGI Utilities, Inc., a wholly-owned subsidiary of UGI comprising PA Gas Utility and Electric Utility

UGID - UGI Development Company, a wholly-owned subsidiary of Energy Services

Other Terms and Abbreviations

2022 Annual Report - Energy Services' Annual Report for the fiscal year ended September 30, 2022

2021 three-month period - Three months ended December 31, 2021

2022 three-month period - Three months ended December 31, 2022

AOCI - Accumulated Other Comprehensive Income (Loss)

ASC - Accounting Standards Codification

ASC 606 - ASC 606, “Revenue from Contracts with Customers”

COVID-19 - A novel strain of coronavirus disease discovered in 2019

Energy Services Credit Agreement - Third Amended and Restated Credit Agreement entered into by Energy Services, as borrower, providing for borrowings up to $260 million, including a letter of credit subfacility of up to $50 million, scheduled to expire in March 2025

FERC - Federal Energy Regulatory Commission

Fiscal 2021 - The fiscal year ended September 30, 2021

Fiscal 2022 - The fiscal year ended September 30, 2022

Fiscal 2023 - The fiscal year ending September 30, 2023

GAAP - U.S. generally accepted accounting principles

ICE - Intercontinental Exchange

LNG - Liquefied natural gas

NPNS - Normal purchase and normal sale

NYMEX - New York Mercantile Exchange

Pennant Acquisition - The August 2022 acquisition by Energy Services of the remaining 53% equity interest in Pennant

Receivables Facility - A receivables purchase facility of Energy Services with an issuer of receivables-backed commercial paper

RNG - Renewable natural gas

SCAA - Storage Contract Administrative Agreements

Stonehenge Acquisition - Acquisition of Stonehenge Appalachia, LLC, which closed January 27, 2022

U.S. - United States of America

USD - U.S. dollar

UGI ENERGY SERVICES, LLC AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)
(Millions of dollars)

	December 31, 2022	September 30, 2022	December 31, 2021
ASSETS			
Current assets:			
Cash and cash equivalents	$ 38	$ 62	$ 109
Restricted cash	43	43	19
Accounts receivable (less allowances for doubtful accounts of $2, $2 and $5, respectively)	321	243	201
Accounts receivable - related parties	61	27	47
Inventories	54	59	43
Derivative instruments	27	61	35
Prepaid expenses and other current assets	43	61	37
Total current assets	587	556	491
Property, plant and equipment (less accumulated depreciation of $396, $377 and $327, respectively)	1,926	1,934	1,668
Goodwill	337	337	337
Intangible assets, net	247	250	259
Derivative instruments	25	49	20
Investments in equity method investees	145	110	172
Other assets	41	45	42
Total assets	$ 3,308	$ 3,281	$ 2,989
LIABILITIES AND MEMBER'S EQUITY			
Current liabilities:			
Current maturities of long-term debt	$ 10	$ 10	$ 10
Short-term borrowings	121	—	—
Accounts payable	266	211	186
Accounts payable - related parties	23	12	21
Derivative instruments	34	29	20
Other current liabilities	45	51	44
Total current liabilities	499	313	281
Long-term debt	699	700	704
Deferred income taxes	244	301	257
Derivative instruments	18	16	10
Other noncurrent liabilities	39	14	11
Total liabilities	1,499	1,344	1,263
Member's equity	1,809	1,937	1,726
Total liabilities and member's equity	$ 3,308	$ 3,281	$ 2,989

See accompanying notes to condensed consolidated financial statements.

UGI ENERGY SERVICES, LLC AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(Millions of dollars)

	Three Months Ended December 31,	
	2022	2021
Revenues	$ 671	$ 542
Costs and expenses:		
Cost of sales (excluding depreciation and amortization shown below)	697	545
Operating and administrative expenses	29	28
Depreciation and amortization	21	19
Other operating (income) expense, net	(1)	1
	746	593
Operating loss	(75)	(51)
Income from equity method investees	1	8
Interest expense	(11)	(10)
Loss before income taxes	(85)	(53)
Income tax benefit	7	15
Net loss	$ (78)	$ (38)
Other comprehensive income:		
Net gains on derivative instruments (net of tax of $(1) and $(1), respectively)	$ 2	$ 6
Reclassifications of net (gains) losses on derivative instruments (net of tax of $1 and $(1), respectively)	(2)	1
Other comprehensive income	—	7
Comprehensive loss	$ (78)	$ (31)

See accompanying notes to condensed consolidated financial statements.

UGI ENERGY SERVICES, LLC AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Millions of dollars)

	Three Months Ended December 31, 2022	Three Months Ended December 31, 2021
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (78)	$ (38)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	21	19
Deferred income tax benefit, net	(27)	(35)
Changes in unrealized gains and losses on derivative instruments	181	125
Income from equity method investees	(1)	(8)
Other, net	(1)	1
Net change in:		
Accounts receivable	(147)	(146)
Inventories	5	(7)
Accounts payable	66	69
Derivative instruments collateral deposits paid	(83)	(76)
Other current assets	20	(21)
Other current liabilities	(5)	37
Net cash used by operating activities	(49)	(80)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Expenditures for property, plant and equipment	(12)	(8)
Investments in equity method investees	(33)	—
Net cash used by investing activities	(45)	(8)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Distributions paid	(50)	—
Receivables Facility net borrowings	121	—
Repayments of long-term debt and finance leases	(1)	(2)
Net cash provided (used) by financing activities	70	(2)
Cash, cash equivalents and restricted cash decrease	$ (24)	$ (90)
CASH, CASH EQUIVALENTS AND RESTRICTED CASH:		
End of period	$ 81	$ 128
Beginning of period	105	218
Cash, cash equivalents and restricted cash decrease	$ (24)	$ (90)

See accompanying notes to condensed consolidated financial statements.

UGI ENERGY SERVICES, LLC AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN MEMBER'S EQUITY

(Unaudited)
(Millions of dollars)

	Member's Equity
Balance at September 30, 2022	$ 1,937
Net loss	(78)
Cash distributions	(50)
Balance at December 31, 2022	$ 1,809

	Member's Equity
Balance at September 30, 2021	$ 1,757
Net loss	(38)
Other comprehensive income	7
Balance at December 31, 2021	$ 1,726

See accompanying notes to condensed consolidated financial statements.

(Millions of dollars, except where indicated otherwise)

Note 1 — Nature of Operations

Energy Services is a Pennsylvania limited liability company and a wholly-owned subsidiary of Enterprises. Enterprises is a wholly-owned subsidiary of UGI.

Energy Services conducts, directly and through subsidiaries and affiliates, energy marketing (including RNG), midstream transmission, LNG storage, natural gas gathering and processing, natural gas and RNG production, electricity generation and energy services businesses primarily in the eastern region of the U.S., eastern Ohio, the panhandle of West Virginia and California. UGID owns electricity generation facilities principally located in Pennsylvania. Energy Services and its subsidiaries' storage, LNG and portions of its midstream transmission operations are subject to regulation by the FERC.

Note 2 — Summary of Significant Accounting Policies

The accompanying condensed consolidated financial statements are unaudited and have been prepared in accordance with GAAP. They include all adjustments that we consider necessary for a fair statement of the results for the interim periods presented. Such adjustments consisted only of normal recurring items unless otherwise disclosed. The September 30, 2022, Condensed Consolidated Balance Sheet was derived from audited financial statements but does not include all footnote disclosures from the annual financial statements.

These financial statements should be read in conjunction with the financial statements and related notes included in the Company's 2022 Annual Report. Due to the seasonal nature of our businesses, the results of operations for interim periods are not necessarily indicative of the results to be expected for a full year.

Restricted Cash. Restricted cash principally represents those cash balances in our commodity futures brokerage accounts that are restricted from withdrawal. The following table provides a reconciliation of the total cash, cash equivalents and restricted cash reported on the Condensed Consolidated Balance Sheets to the corresponding amounts reported on the Condensed Consolidated Statements of Cash Flows.

	December 31, 2022	December 31, 2021
Cash and cash equivalents	$ 38	$ 109
Restricted cash	43	19
Cash, cash equivalents and restricted cash	$ 81	$ 128

Equity Method Investments. We account for privately held equity securities of entities without readily determinable fair values in which we do not have control, but have significant influence over operating and financial policies, under the equity method. These are included in "Investments in equity method investees" on the Condensed Consolidated Balance Sheets. Equity method earnings are included in "Income from equity method investees" on the Condensed Consolidated Statements of Comprehensive Income. At December 31, 2022, our equity method investments primarily comprise Pine Run and equity method investments in biomass and other renewable energy projects. At December 31, 2021, our equity method investments also included Pennant (prior to the Pennant Acquisition as further described below).

Pine Run. The Company has an approximately 49% interest in Pine Run, a company jointly owned by Stonehenge Energy Resources and UGI Pine Run LLC. Pine Run owns Pine Run Midstream which operates dry gas gathering pipelines and compression assets in western Pennsylvania. Pine Run is accounted for as an equity method investment as we have the ability to exercise significant influence, but not control, over the entity. The carrying value of our investment in Pine Run at December 31, 2022 and 2021 was $71 and $62, respectively.

Other Investments. Our other equity method investments totaled $74 and $11 at December 31, 2022 and 2021, respectively, and principally comprise of a number of investments in biomass and other renewable energy projects. Our maximum exposure to loss related to these investments is limited to the amount invested.

Pennant. At December 31, 2021, the carrying value of our investment in Pennant was $99. In August 2022, the Company completed the Pennant Acquisition in which the Company acquired the remaining 53% of the equity interests in Pennant. The acquisition of the remaining interests was accounted for as an acquisition of assets, and the purchase price of approximately $61 was primarily allocated to property, plant and equipment.

On January 31, 2023, the Company, entered into a joint venture agreement with a third party. The primary purpose of the joint venture will be to upgrade landfill gas from the Commonwealth Environmental Systems landfill located in Hegins, Pennsylvania to pipeline-quality RNG. Pursuant to this agreement, the Company will contribute its existing 11 megawatt landfill gas-to-electricity facility in return for a 40% equity interest in the joint venture.

Derivative Instruments. Derivative instruments are reported on the Condensed Consolidated Balance Sheets at their fair values, unless the NPNS exception is elected. The accounting for changes in fair value depends upon the purpose of the derivative instrument or if it qualifies and is designated as a hedge for accounting purposes.

Certain of our derivative instruments qualify and are designated as cash flow hedges. For cash flow hedges, changes in the fair values of the derivative instruments are recorded in AOCI, to the extent effective at offsetting changes in the hedged item, until earnings are affected by the hedged item. We discontinue cash flow hedge accounting if occurrence of the forecasted transaction is determined to be no longer probable. Hedge accounting is also discontinued for derivatives that cease to be highly effective. We do not designate our commodity derivative instruments as hedges under GAAP. Changes in the fair values of these derivative instruments are reflected in net income. Cash flows from derivative instruments are included in cash flows from operating activities on the Condensed Consolidated Statements of Cash Flows.

For a more detailed description of the derivative instruments we use, our accounting for derivatives, our objectives for using them and other information see Note 6.

Use of Estimates. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and costs. These estimates are based on management's knowledge of current events, historical experience and various other assumptions that are believed to be reasonable under the circumstances. Accordingly, actual results may be different from these estimates and assumptions.

Subsequent Events. Management has evaluated the impact of subsequent events through February 9, 2023, the date these condensed consolidated financial statements were issued, and the effects, if any, of such evaluation have been reflected in the condensed consolidated financial statements and related disclosures.

Note 3 — Revenue from Contracts with Customers

The Company recognizes revenue when control of promised goods or services is transferred to customers in an amount that reflects the consideration to which we expect to be entitled in exchange for those goods or services. See Note 4 in the Company's 2022 Annual Report for additional information on our revenues from contracts with customers.

(Millions of dollars, except where indicated otherwise)

Revenue Disaggregation

The following table presents our disaggregated revenues:

	Three Months Ended December 31, 2022	Three Months Ended December 31, 2021
Revenues from contracts with customers:		
Energy Marketing	$ 537	$ 436
Midstream:		
Pipeline	65	46
Peaking	56	45
Other	3	2
Electricity Generation	8	5
Total revenues from contracts with customers	669	534
Other revenues (a)	2	8
Total revenues	$ 671	$ 542

(a) Represents revenues from certain gathering assets and gains and losses on commodity derivative instruments not associated with current-period transactions that are not within the scope of ASC 606 and are accounted for in accordance with other GAAP.

Contract Balances

The timing of revenue recognition may differ from the timing of invoicing to customers or cash receipts. Contract assets represent our right to consideration after the performance obligations have been satisfied when such right is conditioned on something other than the passage of time. There were no contract assets for all periods presented. Substantially all of our receivables are unconditional rights to consideration and are included in "Accounts receivable" on the Condensed Consolidated Balance Sheets. Amounts billed are generally due within the following month.

Contract liabilities arise when payment from a customer is received before the performance obligations have been satisfied and represent the Company's obligations to transfer goods or services to a customer for which we have received consideration. The balances of contract liabilities were $7, $9 and $7 at December 31, 2022, September 30, 2022 and December 31, 2021, respectively, and are included in "Other current liabilities" on the Condensed Consolidated Balance Sheets.

Note 4 — Commitments and Contingencies

There are currently no pending claims or legal actions that could have a material adverse effect on our financial statements.

(Millions of dollars, except where indicated otherwise)

Note 5 — Fair Value Measurements

Derivative Instruments

The following table presents on a gross basis, our financial assets and liabilities, including both current and noncurrent portions, that are measured at fair value on a recurring basis within the fair value hierarchy:

	Asset (Liability)			
	Level 1	Level 2	Level 3	Total
December 31, 2022:				
Assets:				
Commodity contracts	$ 193	$ 21	$ —	$ 214
Interest rate contracts	$ —	$ 31	$ —	$ 31
Liabilities:				
Commodity contracts	$ (224)	$ (17)	$ —	$ (241)
September 30, 2022:				
Assets:				
Commodity contracts	$ 368	$ 30	$ —	$ 398
Interest rate contracts	$ —	31	$ —	$ 31
Liabilities:				
Commodity contracts	$ (263)	$ (14)	$ —	$ (277)
December 31, 2021:				
Assets:				
Commodity contracts	$ 136	$ 17	$ —	$ 153
Liabilities:				
Commodity contracts	$ (107)	$ (9)	$ —	$ (116)
Interest rate contracts	$ —	$ (9)	$ —	$ (9)

The fair values of our Level 1 exchange-traded commodity futures and non-exchange-traded commodity futures and forward contracts are based upon actively quoted market prices for identical assets and liabilities. The remainder of our derivative instruments are designated as Level 2. The fair values of certain non-exchange traded commodity derivatives designated as Level 2 are based upon indicative price quotations available through brokers, industry price publications or recent market transactions and related market indicators. The fair values of our Level 2 interest rate contracts are based upon third-party quotes or indicative values based on recent market transactions.

Note 6 — Derivative Instruments and Hedging Activities

We are exposed to certain market risks related to our ongoing business operations. Management uses derivative financial and commodity instruments, among other things, to manage: (1) commodity price risk; and (2) interest rate risk. Although we use derivative financial and commodity instruments to reduce market risk associated with forecasted transactions, we do not use derivative financial and commodity instruments for speculative or trading purposes. The use of derivative instruments is controlled by our risk management and credit policies, which govern, among other things, the derivative instruments we can use, counterparty credit limits and contract authorization limits. Although our commodity derivative instruments extend over a number of years, a significant portion of our commodity derivative instruments economically hedge commodity price risk during the next twelve months. For information on the accounting for our derivative instruments, see Note 2.

The following summarizes the types of derivative instruments used by the Company to manage certain market risks:

Commodity Price Risk

In order to manage market price risk relating to fixed-price sales contracts for natural gas and electricity, the Company enters into NYMEX and over-the-counter natural gas futures, forward and options contracts, ICE natural gas basis swap contracts, and electricity futures and forward physical contracts. The Company also uses NYMEX and over the counter electricity futures contracts to economically hedge the price of a portion of its anticipated future sales of electricity from its electric generation facilities. Also, Energy Services, from time to time, uses NYMEX futures contracts to economically hedge the gross margin associated with the purchase and anticipated later near-term sale of propane. For all periods presented, volumes associated with these propane contracts were not material.

Interest Rate Risk

Energy Services has a variable-rate term loan that is indexed to a short-term market interest rate. In order to fix the underlying short-term market interest rate, Energy Services has entered into a pay-fixed, receive-variable interest rate swap to effectively fix the underlying variable rate on a significant portion of the loan's tenor through July 2024. We have designated this interest rate swap as a cash flow hedge. At December 31, 2022, the amount of pre-tax net gains associated with this interest rate swap expected to be reclassified into earnings during the next twelve months based upon current fair values is approximately $21.

Quantitative Disclosures Related to Derivative Instruments

The following table summarizes by derivative type the gross notional amounts related to open derivative contracts at December 31, 2022, September 30, 2022, and December 31, 2021, and the final settlement dates of the Company's open derivative contracts as of December 31, 2022, excluding those derivatives that qualified for the NPNS exception:

			Notional Amounts (in millions)		
Type	Units	Settlements Extending Through	December 31, 2022	September 30, 2022	December 31, 2021
Commodity Price Risk:					
Natural gas futures, forward, basis swap, options and pipeline contracts	Dekatherms	October 2027	356	335	339
Electricity forward and futures contracts	Kilowatt hours	December 2026	864	816	997
Interest Rate Risk:					
Interest rate swaps	USD	July 2024	$ 641	$ 642	$ 648

Derivative Instrument Credit Risk

We are exposed to risk of loss in the event of nonperformance by our derivative instrument counterparties. Our derivative instrument counterparties principally comprise large energy companies and major U.S. and international financial institutions. We maintain credit policies with regard to our counterparties that we believe reduce overall credit risk. These policies include evaluating and monitoring our counterparties' financial condition, including their credit ratings, and entering into agreements with counterparties that govern credit limits or entering into netting agreements that allow for offsetting counterparty receivable and payable balances for certain financial transactions, as deemed appropriate.

We have concentrations of credit risk associated with derivative instruments and we evaluate the creditworthiness of our derivative counterparties on an ongoing basis. As of December 31, 2022, the maximum amount of loss, based upon the gross fair values of the derivative instruments, we would incur if these counterparties failed to perform according to the terms of their contracts was $245. In general, many of our over-the-counter derivative instruments and all exchange contracts call for the posting of collateral by the counterparty or by the Company in the forms of letters of credit, parental guarantees or cash. At December 31, 2022, we had received cash collateral from derivative instrument counterparties totaling $6. In addition, we may have offsetting derivative liabilities and certain accounts payable balances with certain of these counterparties, which further mitigates the previously mentioned maximum amount of loss.

(Millions of dollars, except where indicated otherwise)

Offsetting Derivative Assets and Liabilities

Derivative assets and liabilities are presented net by counterparty on the Condensed Consolidated Balance Sheets if the right of offset exists. We offset amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral against amounts recognized for derivative instruments executed with the same counterparty. Our derivative instruments include both those that are executed on an exchange through brokers and centrally cleared and over-the-counter transactions. Exchange contracts utilize a financial intermediary, exchange, or clearinghouse to enter, execute, or clear the transactions. Over-the-counter contracts are bilateral contracts that are transacted directly with a third party. Certain over-the-counter and exchange contracts contain contractual rights of offset through master netting arrangements, derivative clearing agreements, and contract default provisions. In addition, the contracts are subject to conditional rights of offset through counterparty nonperformance, insolvency or other conditions.

In general, many of our over-the-counter transactions and all exchange contracts are subject to collateral requirements. Types of collateral generally include cash or letters of credit. Cash collateral paid by us to our over-the-counter derivative counterparties, if any, is reflected in the table below to offset derivative liabilities. Cash collateral received by us from our over-the-counter derivative counterparties, if any, is reflected in the table below to offset derivative assets. Certain other accounts receivable and accounts payable balances recognized on the Condensed Consolidated Balance Sheets with our derivative counterparties are not included in the table below but could reduce our net exposure to such counterparties because such balances are subject to master netting or similar arrangements.

Fair Value of Derivative Instruments

The following table presents the Company's derivative assets and liabilities by type, as well as the effects of offsetting:

	December 31, 2022	September 30, 2022	December 31, 2021
Derivative assets:			
Derivatives designated as hedging instruments:			
Interest rate contracts	$ 31	$ 31	$ —
Derivatives not designated as hedging instruments:			
Commodity contracts	214	398	153
Total derivative assets - gross	245	429	153
Gross amounts offset in balance sheet	(187)	(230)	(95)
Cash collateral received	(6)	(89)	(3)
Total derivative assets - net	$ 52	$ 110	$ 55
Derivative liabilities:			
Derivatives designated as hedging instruments:			
Interest rate contracts	$ —	$ —	$ (9)
Derivatives not designated as hedging instruments:			
Commodity contracts	(241)	(277)	(116)
Total derivative liabilities - gross	(241)	(277)	(125)
Gross amounts offset in balance sheet	187	230	95
Cash collateral pledged	2	2	—
Total derivative liabilities - net	$ (52)	$ (45)	$ (30)

(Millions of dollars, except where indicated otherwise)

Effects of Derivative Instruments

The following tables provide information on the effects of derivative instruments on the Condensed Consolidated Statements of Comprehensive Income:

Three Months Ended December 31,	Gain Recognized in AOCI		Gain (Loss) Reclassified from AOCI into Income		Location of Gain (Loss) Reclassified from AOCI into Income
	2022	2021	2022	2021	
Cash Flow Hedges:					
Interest rate contracts	$ 3	$ 7	$ 3	$ (2)	Interest expense

	Gain (Loss) Recognized in Income		Location of Gain (Loss) Recognized in Income
	2022	2021	
Derivatives Not Designated As Hedging Instruments:			
Commodity contracts	$ 2	$ 5	Revenues
Commodity contracts	(145)	(69)	Cost of sales
Total	$ (143)	$ (64)	

We are also a party to a number of other contracts that have elements of a derivative instrument. However, these contracts qualify for NPNS exception accounting under GAAP because they provide for the delivery of products or services in quantities that are expected to be used in the normal course of operating our business and the price in the contract is based on an underlying that is directly associated with the price of the product or service being purchased or sold. These contracts include, among others, binding purchase orders, contracts that provide for the purchase and delivery, or sale, of energy products, and service contracts that require the counterparty to provide commodity storage, transportation or capacity service to meet our normal sales commitments.

Note 7 — Accumulated Other Comprehensive Income (Loss)

The tables below present changes in AOCI, net of tax:

Three Months Ended December 31, 2022	Derivative Instruments
AOCI — September 30, 2022	$ 24
Other comprehensive income before reclassification adjustments	2
Amounts reclassified from AOCI	(2)
AOCI — December 31, 2022	$ 24

Three Months Ended December 31, 2021	Derivative Instruments
AOCI — September 30, 2021	$ (12)
Other comprehensive income before reclassification adjustments	6
Amounts reclassified from AOCI	1
AOCI — December 31, 2021	$ (5)

(Millions of dollars, except where indicated otherwise)

Note 8 — Related Party Transactions

SCAA Activities. From time to time, Energy Services is a party to SCAAs with UGI Utilities which have terms of up to three years. Under the SCAAs, UGI Utilities has, among other things, released certain natural gas storage and transportation contracts (subject to recall for operational purposes) to Energy Services for the terms of the SCAAs. UGI Utilities also transferred certain associated natural gas storage inventories upon the commencement of the SCAAs, receives a transfer of storage inventories at the end of the SCAAs, and makes payments associated with refilling storage inventories during the term of the SCAAs. Energy Services receives payments from UGI Utilities for storage inventories and pipeline transportation and storage capacity charges associated with SCAAs. Energy Services, in turn, provides a firm delivery service and makes certain payments to UGI Utilities for its various obligations under the SCAAs. In conjunction with the SCAAs, Energy Services pays UGI Utilities security deposits.

Gas Supply and Delivery Services. UGI Utilities purchases natural gas and pipeline capacity from Energy Services. Additionally, UGI Utilities has gas supply and delivery service agreements with Energy Services pursuant to which Energy Services provides certain gas supply and related delivery service to UGI Utilities.

From time to time, Energy Services purchases natural gas or pipeline capacity from UGI Utilities. Also from time to time, Energy Services sells natural gas and pipeline capacity to UGI Utilities (in addition to those transactions already described above) and sells a firm storage service from a subsidiary of Energy Services, under one-year agreements.

Administrative Services. UGI provides certain financial and administrative services to the Company. UGI bills the Company monthly for all direct expenses and for an allocated share of indirect corporate expenses incurred or paid on behalf of the Company. The allocation of indirect UGI corporate expenses to the Company utilizes a weighted, three-component formula comprising revenues, operating expenses and net assets employed and considers the Company's relative percentage of such items to the total of such items for all UGI operating subsidiaries for which general and administrative services are provided. Management believes that this allocation method is reasonable and equitable to the Company.

Propane Sales. From time to time, Energy Services sells propane to AmeriGas on an as needed basis. The sales price is generally based on market prices at the time of sale. There were no sales of propane by Energy Services to AmeriGas during the three months ended December 31, 2022 and 2021.

The following related party amounts and balances are included in our condensed consolidated financial statements:

	Three Months Ended December 31, 2022	Three Months Ended December 31, 2021	Classification on Condensed Consolidated Statements of Comprehensive Income
SCAA Activities:			
SCAA revenues	$ 5	$ 5	Revenues
Gas Supply and Delivery Service:			
Gas supply and delivery service revenues	$ 110	$ 89	Revenues
Costs of natural gas and pipeline capacity purchases	$ 33	$ 22	Cost of sales
Administrative Services:			
Administrative services provided by UGI	$ 4	$ 4	Operating and administrative expenses

	December 31, 2022	September 30, 2022	December 31, 2021	Classification on Condensed Consolidated Balance Sheets
SCAA security deposits	$ 9	$ 8	$ 7	Prepaid expenses and other current assets

Forward-Looking Statements

Information contained in this Quarterly Report contains forward-looking statements. Such statements use forward-looking words such as “believe,” “plan,” “anticipate,” “continue,” “estimate,” “expect,” “may,” or other similar words and terms of similar meaning, although not all forward-looking statements contain such words. These statements discuss plans, strategies, events or developments that we expect or anticipate will or may occur in the future. Management believes that these are reasonable as of today’s date only. Actual results may differ significantly because of risks and uncertainties that are difficult to predict and many of which are beyond management’s control; accordingly, there is no assurance that results will be realized. We undertake no obligation (and expressly disclaim any obligation) to update publicly any forward-looking statement whether as a result of new information or future events.

EXECUTIVE OVERVIEW

Recent Developments

Macroeconomic Conditions. Beginning in Fiscal 2021 and continuing into Fiscal 2023, commodity and labor markets have experienced significant inflationary pressures attributable to various economic and political factors, including, among others: the economic recovery and evolving consumer patterns associated with the COVID-19 pandemic; supply chain issues including those associated with labor shortages; and significant increases and volatility in energy commodity prices. These factors have contributed to inflationary pressures as evidenced by recent increases in various consumer price indices. In response to these inflationary pressures, the Federal Reserve began increasing interest rates during Fiscal 2022. In addition, during the last several years, we have experienced significant volatility in energy commodity prices, particularly in natural gas and electricity prices, which have resulted in substantial fluctuations in the fair values of our commodity derivative instruments. These inflationary pressures and commodity price fluctuations have resulted in increases in inventory and certain operating and distribution expenses . The commodity prices fluctuations have also significantly affected the cash collateral deposit requirements of our derivative instrument counterparties and the restricted cash required to be held in our derivative broker accounts. We cannot predict the duration or total magnitude of these conditions and the effects such conditions may have on our future business, financial results, financial position, and liquidity and cash flows. However, we continue to monitor and respond to these global economic and political conditions and remain focused on managing our financial condition and liquidity as these conditions continue to evolve.

2022 three-month period compared with 2021 three-month period

Energy Services' net loss was $78 million in the 2022 three-month period compared to a net loss of $38 million in the prior-year period. These results reflect losses on commodity derivative instruments not associated with current-period transactions of $155 million and $89 million, respectively. Although these net losses are reflected in our GAAP results, they are excluded from our non-GAAP measures. See "Non-GAAP Financial Measures" below.

Excluding the impacts of commodity derivative instruments not associated with current-period transactions, adjusted net income increased $26 million in the 2022 three-month period. The increase in adjusted net income is primarily attributable to higher margins related to natural gas marketing activities and incremental contributions from UGI Moraine East and Pennant.

Non-GAAP Financial Measures

We present the non-GAAP measures adjusted total margin, adjusted operating income, adjusted income before income taxes and adjusted net income, in order to assist in the evaluation of our overall performance. We believe that these non-GAAP measures provide meaningful information to investors about our performance because they eliminate the impact of (1) gains and losses on commodity derivative instruments not associated with current-period transactions, principally comprising unrealized gains and losses on such derivative instruments, and (2) other significant discrete items that can affect the comparisons of period-over-period results. These financial measures are not in accordance with, or an alternative to, GAAP and should be considered in addition to, and not as a substitute for, the comparable GAAP measures.

The following table includes reconciliations of adjusted total margin, adjusted operating income, adjusted income before income taxes and adjusted net income to the most directly comparable financial measures calculated and presented in accordance with GAAP for the periods presented.

(Millions of dollars)	Three Months Ended December 31, 2022	2021
Adjusted total margin:		
Total revenues	$ 671	$ 542
Cost of sales	(697)	(545)
Total margin	(26)	(3)
Add net losses on commodity derivative instruments not associated with current-period transactions	181	125
Adjusted total margin	$ 155	$ 122
Adjusted operating income:		
Operating loss	$ (75)	$ (51)
Add net losses on commodity derivative instruments not associated with current-period transactions	181	125
Adjusted operating income	$ 106	$ 74
Adjusted income before income taxes:		
Loss before income taxes	$ (85)	$ (53)
Add net losses on commodity derivative instruments not associated with current-period transactions	181	125
Adjusted income before income taxes	$ 96	$ 72
Adjusted net income:		
Net loss	$ (78)	$ (38)
Add net losses on commodity derivative instruments not associated with current-period transactions	155	89
Adjusted net income	$ 77	$ 51

Analysis of Results of Operations

2022 three-month period compared with the 2021 three-month period

Three Months Ended December 31,	2022	2021	Increase (Decrease)	
(Dollars in millions)				
Revenues	$ 671	$ 542	$ 129	24 %
Total margin (a)	$ (26)	$ (3)	$ (23)	767 %
Operating and administrative expenses	$ 29	$ 28	$ 1	4 %
Operating loss	$ (75)	$ (51)	$ (24)	47 %
Loss before income taxes	$ (85)	$ (53)	$ (32)	60 %
Non-GAAP financial measures (b):				
Adjusted total margin	$ 155	$ 122	$ 33	27 %
Adjusted operating income	$ 106	$ 74	$ 32	43 %
Adjusted income before income taxes	$ 96	$ 72	$ 24	33 %
Adjusted net income	$ 77	$ 51	$ 26	51 %

(a) Total margin represents total revenues less total cost of sales and includes the impact of net unrealized losses of $181 million and $125 million, on commodity derivative instruments not associated with current-period transactions for the 2022 and 2021 three-month periods, respectively.

(b) These financial measures are non-GAAP financial measures and are not in accordance with, or an alternative to, GAAP and should be considered in addition to, and not a substitute for, the comparable GAAP measures. See “Non-GAAP Financial Measures” above.

Average temperatures across Energy Services’ energy marketing territory during the 2022 three-month period were 1% warmer than normal and 13% colder than the prior-year period.

Revenues and cost of sales for the 2022 three-month period increased $129 million and $152 million, respectively, compared to the prior-year period. Excluding the effects of net losses on commodity derivative instruments not associated with current-period transactions, revenues and cost of sales increased $134 million and $101 million, respectively, compared to the prior-year period. The increase in revenues principally reflects higher revenues from natural gas and power marketing activities ($119 million), including the effects of peaking and capacity management activities, that were impacted by higher natural gas prices. The increase in revenues also includes higher natural gas gathering activities ($14 million), primarily due to the prior-year acquisitions of UGI Moraine East and Pennant, and power generation, partially offset by reduced RNG credit sales. The increase in cost of sales primarily reflects the higher natural gas costs related to the previously mentioned natural gas and power marketing activities ($97 million).

Total margin decreased $23 million in the 2022 three-month period. Adjusted total margin increased $33 million in the 2022 three-month period reflecting higher margins from natural gas marketing activities ($18 million), including the effects of peaking and capacity management activities from particularly cold weather at the end of December. The increase in adjusted total margin also includes incremental natural gas gathering activities ($14 million), primarily from the prior-year acquisitions of UGI Moraine East and Pennant.

Operating loss increased $24 million and loss before income taxes increased $32 million, respectively, during the 2022 three-month period. Adjusted operating income and adjusted income before income taxes increased $32 million and $24 million, respectively, compared to the prior-year period. The increase in adjusted operating income is largely attributable to the previously mentioned increase in adjusted total margin. The increase in adjusted income before income taxes principally reflects the increase in adjusted operating income partially offset by lower income from equity-method investments following the acquisition of the remaining 53% ownership interest in Pennant during the fourth quarter of Fiscal 2022.

Interest Expense and Income Taxes

Interest expense in the 2022 three-month period was slightly higher compared to the prior-year period, reflecting higher average short-term borrowings during the 2022 three-month period associated with the Receivables Facility.

The decrease in the Company's effective income tax rate for the 2022 three-month period was principally related to the impact of significantly higher losses on commodity derivative instruments compared to the prior-year period and the availability of investment tax credits in Fiscal 2023 following enactment of the Inflation Reduction Act. The Company continues to evaluate the elections available under current regulations and pending legislation. Accordingly, the impacts on the Company’s income tax provisions and taxes payable or refundable related to these items are subject to change.

Financial Condition and Liquidity

The Company expects to have sufficient liquidity including cash on hand and available borrowing capacity to continue to support long-term commitments and ongoing operations despite uncertainties associated with ongoing global macroeconomic conditions including, among others, changes in consumer behavior resulting from the COVID-19 pandemic, the inflationary cost environment and ongoing commodity price volatility. The Company does not have any near-term term loan maturities. The Company cannot predict the duration or total magnitude of the uncertain economic factors mentioned above and the total effects they will have on its liquidity, debt covenants, financial condition or the timing of capital expenditures. Energy Services was in compliance with all debt covenants as of December 31, 2022.

We depend on both internal and external sources of liquidity to provide funds for working capital and to fund capital requirements. Our short-term cash requirements not met by cash from operations are generally satisfied with borrowings under our Receivables Facility and the Energy Services Credit Agreement. Long-term cash requirements are generally met through the issuance of long-term debt and capital contributions. We believe that we have sufficient liquidity in the forms of cash and cash equivalents on hand; cash expected to be generated from operations; credit facility and Receivables Facility borrowing capacity; and the ability to obtain long-term financing to meet anticipated contractual and projected cash commitments.

Issuances of debt securities in the capital markets and additional credit facilities may not, however, be available to us on acceptable terms.

Our cash and cash equivalents totaled $38 million at December 31, 2022 compared to $62 million at September 30, 2022. Our restricted cash balances was $43 million at December 31, 2022 and $43 million at September 30, 2022, principally comprising cash in brokerage accounts that are restricted from withdrawal. The decrease in cash and cash equivalents since September 30, 2022 is primarily attributable to commodity price volatility experienced in the 2022 three-month period and the seasonality of our business as further described in “Cash Flows” below. Our debt outstanding at December 31, 2022, totaled $830 million (including current maturities of long-term debt of $10 million and short-term borrowings of $121 million). Our debt outstanding at September 30, 2022, totaled $710 million (including current maturities of long-term debt of $10 million and no short-term borrowings). Total long-term debt outstanding at December 31, 2022, including current maturities, comprises $676 million of term loan borrowings and $40 million of other long-term debt comprising a finance lease liability, and is net of $7 million of unamortized debt issuance costs.

Credit Facilities

At December 31, 2022, there were no borrowings outstanding under the Energy Services Credit Agreement and the available borrowing capacity was $260 million. The average daily and peak short-term borrowings outstanding under the Energy Services Credit Agreement during the 2022 three-month period were $1 million and $25 million, respectively. During the 2021 three-month period there were no borrowings under the Energy Services Credit Agreement.

Energy Services also has a Receivables Facility with an issuer of receivables-backed commercial paper currently scheduled to expire in October 2023. At December 31, 2022, the outstanding balance of trade receivables was $128 million, $121 million of which was sold to the bank. At December 31, 2021, the outstanding balance of trade receivables was $115 million, none of which was sold to the bank. Amounts sold to the bank are reflected as “Short-term borrowings” on the Condensed Consolidated Balance Sheets. During the three months ended December 31, 2022 peak sales of receivables and average daily amounts sold were $121 million and $30 million, respectively. There were no sales of receivables under the Receivables Facility during the three months ended December 31, 2021.

Cash Flows

Due to the seasonal nature of the Company’s businesses, cash flows from operating activities are generally strongest during the first and second fiscal quarters when customers pay for natural gas, electricity and other energy products consumed during the peak heating season months. In addition, cash flows from operating activities can be significantly affected by year-to-year variations in changes in operating working capital reflecting changes in energy commodity prices, principally changes in prices for natural gas. Cash flow from investing activities is principally affected by cash expenditures for property, plant and equipment, cash paid for acquisitions of businesses and assets and investments in equity method investees. Changes in cash flow from financing activities are primarily due to issuances and repayments of long-term debt, short-term borrowings and capital contributions from, and cash distributions to Enterprises.

<u>Operating Activities:</u> Cash flow used by operating activities was $49 million in the 2022 three-month period compared to cash flow used of $80 million in the prior-year period. Cash flow from operating activities before changes in operating working capital was $95 million in the 2022 three-month period compared to $64 million in the prior-year period principally reflecting the improvement in operating results after excluding the losses on commodity derivative instruments not associated with current-period transactions. Cash flow used to fund changes in operating working capital totaled $144 million in both the 2022 three-month period and 2021 three-month period.

<u>Investing Activities:</u> Cash flow used by investing activities was $45 million in the 2022 three-month period compared to $8 million in the prior-year period. Capital expenditures for property, plant and equipment were $12 million in the 2022 three-month period compared to $8 million in the prior-year period. Cash used for investments in equity method investees in the 2022 three-month period reflects our continued investments in renewable energy businesses.

<u>Financing Activities:</u> Cash flow provided by financing activities was $70 million in the 2022 three-month period compared to cash flow used by financing activities of $2 million in the prior-year period. The cash provided by financing activities in the 2022 three-month period reflects $121 million of borrowings under the Receivables Facility. During the three months ended December 31, 2022, we paid cash distributions of $50 million to Enterprises.