**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, 2019 and 2018
(Unaudited)

**UGI ENERGY SERVICES, LLC AND SUBSIDIARIES**

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**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., a wholly-owned subsidiary of UGI

***CMG -*** Columbia Midstream Group, LLC

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

***Energy Services -*** UGI Energy Services, LLC, a wholly owned subsidiary of Enterprises

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

***ESFC -*** Energy Services Funding Corporation, a wholly owned subsidiary of Energy Services

***Pennant -*** Pennant Midstream, LLC, a Delaware limited liability company

***PennEast -*** PennEast Pipeline Company, LLC

***UGI*** - UGI Corporation

***UGI PennEast, LLC -*** A wholly owned subsidiary of Energy Services that holds a 20% membership interest in PennEast

***UGI Utilities -*** UGI Utilities, Inc., a wholly owned subsidiary of UGI

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

***Other Terms and Abbreviations***

***Adjusted LIBOR*** - A rate derived from LIBOR

***2018 three-month period -*** Three-month period ended December 31, 2018

***2019 Annual Report -*** Energy Services' Annual Report for the fiscal year ended September 30, 2019

***2019 three-month period -*** Three-month period ended December 31, 2019

***AFUDC -*** Allowance for Funds Used During Construction

***AOCI -*** Accumulated Other Comprehensive Income (loss)

***ARO -*** Asset Retirement Obligations

***ASC -*** Accounting Standards Codification

***ASC 605 -*** ASC 605, “Revenue Recognition”

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

***ASC 840*** - ASC 840, “Leases”

***ASC 842*** - ASC 842, “Leases” (effective October 1, 2019)

***ASU -*** Accounting Standards Update

***ASU 2014-09 -*** Accounting Standards Update No. 2014-09, “Revenue from Contracts with Customers”

***CMG -*** Columbia Midstream Group, LLC

***CMG Acquisition*** **-** Acquisition of CMG and Columbia Pennant, LLC on August 1, 2019 pursuant to the CMG Acquisition Agreements

***CMG Acquisition Agreements*** - Agreements related to the CMG Acquisition comprising (1) a purchase and sale agreement related to the CMG acquisition, dated July 2, 2019, by and among Columbia Midstream & Minerals Group, LLC, Energy Services, UGI and TransCanada PipeLine USA Ltd., and (2) a purchase and sale agreement related to the Colombia Pennant, LLC acquisition, dated July 2, 2019, by and among Columbia Midstream & Minerals Group, LLC, Energy Services, and TransCanada PipeLine USA Ltd.

***EBITDA -*** Earnings before interest expense, income taxes, depreciation, and amortization

***Energy Services Credit Agreement -*** An unsecured revolving credit agreement entered into by Energy Services providing for borrowings up to $200 million, including a letter of credit subfacility of up to $50 million expiring March 2021

***Energy Services Term Loan -*** A seven-year $700 million senior secured term loan agreement entered into by Energy Services on August 13, 2019, with a group of lenders

***FASB -*** Financial Accounting Standards Board

***FERC -*** Federal Energy Regulatory Commission

***Fiscal 2018*** - The fiscal year ended September 30, 2018

***Fiscal 2019*** - The fiscal year ended September 30, 2019

***Fiscal 2020*** - The fiscal year ending September 30, 2020

***Fiscal 2021*** - The fiscal year ending September 30, 2021

***Fiscal 2022*** - The fiscal year ending September 30, 2022

***Fiscal 2023*** - The fiscal year ending September 30, 2023

***Fiscal 2024*** - The fiscal year ending September 30, 2024

***GAAP -*** U.S. generally accepted accounting principles

***Hunlock -*** Hunlock Station, a 130-megawatt natural gas-fueled electricity generating station located near Wilkes-Barre, Pennsylvania

***ICE*** - Intercontinental Exchange

***LIBOR*** - London Inter-bank Offered Rate

***LNG*** - Liquefied natural gas

***MD&A -*** Management's Discussion and Analysis of Financial Condition and Results of Operations

***NPNS -*** Normal purchase and normal sale

***NYMEX -*** New York Mercantile Exchange

***PADEP -*** Pennsylvania Department of Environmental Protection

***PJM*** - PJM Interconnection, LLC

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

***ROU*** - Right-of-use

***SAR -*** Stock Appreciation Rights

***SCAA -*** Storage Contract Administrative Agreements

***Stock Unit -*** Unit awards that entitle the grantee to shares of UGI Common Stock or cash subject to service conditions

***TCJA*** - The Tax Cuts and Jobs Act

***TSR*** - Total Shareholder Return

***UGI Performance Units -*** Unit awards that entitle the grantee to shares of UGI Common Stock or cash subject to service and market performance conditions

***VIE*** - Variable Interest Entity

**UGI ENERGY SERVICES, LLC AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**
(Unaudited)
(Thousands of dollars)

| | December 31, 2019 | September 30, 2019 | December 31, 2018 |
|---|---|---|---|
| **ASSETS** | | | |
| Current assets: | | | |
| Cash and cash equivalents | $ 24,076 | $ 25,893 | $ 66,954 |
| Restricted cash | 43,733 | 33,922 | 13,019 |
| Accounts receivable (less allowances for doubtful accounts of $1,082, $1,173 and $1,332, respectively) | 154,799 | 88,969 | 194,659 |
| Accounts receivable - related parties | 8,462 | 4,545 | 19,394 |
| Inventories | 22,063 | 22,668 | 22,714 |
| Derivative instruments | 4,325 | 3,583 | 9,256 |
| Prepaid expenses and other current assets | 13,094 | 12,842 | 13,208 |
| Total current assets | 270,552 | 192,422 | 339,204 |
| Property, plant and equipment: | | | |
| Gross property, plant and equipment | 2,004,572 | 1,971,495 | 1,218,168 |
| Accumulated depreciation | (271,216) | (255,992) | (219,324) |
| Net property, plant and equipment | 1,733,356 | 1,715,503 | 998,844 |
| Goodwill | 335,162 | 335,554 | 11,919 |
| Intangible assets, net | 270,647 | 268,540 | 21,156 |
| Derivative instruments | 4,867 | 1,903 | 6,173 |
| Investments in equity method investees | 184,934 | 178,897 | 76,641 |
| Other assets | 35,256 | 25,677 | 26,140 |
| Total assets | $ 2,834,774 | $ 2,718,496 | $ 1,480,077 |
| **LIABILITIES AND MEMBER'S EQUITY** | | | |
| Current liabilities: | | | |
| Current maturities of long-term debt | $ 9,809 | $ 7,135 | $ 130 |
| Short-term borrowings | 88,400 | 91,400 | 10,000 |
| Accounts payable | 104,090 | 67,775 | 199,583 |
| Accounts payable - related parties | 14,533 | 13,729 | 1,958 |
| Derivative instruments | 32,438 | 30,148 | 12,423 |
| Other current liabilities | 63,155 | 38,000 | 55,615 |
| Total current liabilities | 312,425 | 248,187 | 279,709 |
| Long-term debt | 716,546 | 679,473 | 303 |
| Deferred income taxes | 145,134 | 145,197 | 146,704 |
| Derivative instruments | 13,908 | 17,185 | 10,907 |
| Other noncurrent liabilities | 19,875 | 36,217 | 8,594 |
| Total liabilities | 1,207,888 | 1,126,259 | 446,217 |
| Commitments and contingencies (Note 8) | | | |
| Member's equity | 1,626,886 | 1,592,237 | 1,033,860 |
| Total liabilities and member's equity | $ 2,834,774 | $ 2,718,496 | $ 1,480,077 |

See accompanying notes to condensed consolidated financial statements.

**UGI ENERGY SERVICES, LLC AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**

(Unaudited)

(Thousands of dollars)

| | Three Months Ended December 31, | |
|---|---|---|
| | 2019 | 2018 |
| Revenues | $ 364,159 | $ 445,360 |
| Costs and expenses: | | |
| Cost of sales | 268,352 | 366,772 |
| Operating and administrative expenses | 29,688 | 23,781 |
| Depreciation and amortization | 18,177 | 11,239 |
| Other operating income, net | (75) | (483) |
| | 316,142 | 401,309 |
| Operating income | 48,017 | 44,051 |
| Income from equity method investees | 6,502 | 1,471 |
| Other non-operating (loss) income | (1) | 8 |
| Interest expense | (11,491) | (453) |
| Income before income taxes | 43,027 | 45,077 |
| Income tax expense | (12,146) | (12,039) |
| Net income | $ 30,881 | $ 33,038 |
| Other comprehensive income, net of tax: | | |
| Net gain on derivative instruments (net of tax of $(1,231) and $0, respectively) | $ 3,151 | $ — |
| Reclassifications of net losses on derivative instruments (net of tax of $(245) and $0, respectively) | 617 | — |
| Other comprehensive income, net of tax | 3,768 | — |
| Comprehensive income | $ 34,649 | $ 33,038 |

See accompanying notes to condensed consolidated financial statements.

## UGI ENERGY SERVICES, LLC AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)
(Thousands of dollars)

| | Three Months Ended December 31, 2019 | Three Months Ended December 31, 2018 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | |
| Net income | $ 30,881 | $ 33,038 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 18,177 | 11,239 |
| Deferred income taxes, net | (1,960) | 738 |
| Changes in unrealized gains and losses on derivative instruments | 7,443 | (1,818) |
| Income from equity method investees | (6,502) | (1,471) |
| Other, net | (5,728) | 2,274 |
| Net change in: | | |
| Accounts receivable | (69,617) | (111,115) |
| Inventories | 605 | 2,126 |
| Accounts payable | 42,947 | 111,497 |
| Other current assets | (391) | 2,465 |
| Other current liabilities | 25,140 | 14,446 |
| Net cash provided by operating activities | 40,995 | 63,419 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | |
| Expenditures for property, plant and equipment | (27,685) | (23,870) |
| Acquisitions of businesses, net of cash acquired | — | (15,000) |
| Other | (343) | (332) |
| Net cash used by investing activities | (28,028) | (39,202) |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | |
| Receivables Facility net borrowings (repayments) | 22,000 | (2,000) |
| (Decrease) increase in short-term borrowings | (25,000) | 10,000 |
| Repayments of long-term debt | (1,973) | (33) |
| Net cash (used) provided by financing activities | (4,973) | 7,967 |
| Cash, cash equivalents and restricted cash increase | $ 7,994 | $ 32,184 |
| **CASH, CASH EQUIVALENTS AND RESTRICTED CASH:** | | |
| End of year | $ 67,809 | $ 79,973 |
| Beginning of year | 59,815 | 47,789 |
| Cash, cash equivalents, and restricted cash increase | $ 7,994 | $ 32,184 |

See accompanying notes to condensed consolidated financial statements.

## UGI ENERGY SERVICES, LLC AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN MEMBER'S EQUITY

(Unaudited)
(Thousands of dollars)

| | Member's Equity |
|---|---|
| **Balance at September 30, 2018** | $ 1,003,986 |
| Net income | 33,038 |
| Cumulative effect of change in accounting principle - ASC 606 | (3,178) |
| Other | 14 |
| **Balance at December 31, 2018** | $ 1,033,860 |

| | Member's Equity |
|---|---|
| **Balance at September 30, 2019** | $ 1,592,237 |
| Net income | 30,881 |
| Changes in AOCI balance (Note 11) | 3,768 |
| **Balance at December 31, 2019** | $ 1,626,886 |

See accompanying notes to condensed consolidated financial statements.

**Note 1 — Nature of Operations**

The consolidated financial statements reflect the consolidated financial position and results of operations of Energy Services and its subsidiaries. Energy Services is a Pennsylvania limited liability company and a wholly owned subsidiary of UGI Enterprises. Enterprises is a wholly owned subsidiary of UGI. Energy Services is a sole member limited liability company with Enterprises owning 100% of the membership interest.

Energy Services , directly and through subsidiaries, (i) conducts an energy marketing business principally in the Mid-Atlantic region of the United States, (ii) owns and operates natural gas liquefaction, storage and vaporization facilities and propane-air mixing assets, (iii) manages natural gas pipeline and storage contracts, (iv) develops, owns and operates pipelines, gathering infrastructure and gas storage facilities in the Marcellus and Utica Shale regions of Pennsylvania, eastern Ohio and the panhandle of West Virginia, and (v) owns all or portions of electricity generation facilities.

**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, 2019, 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 Company's 2019 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.

***Leases.*** Effective October 1, 2019, the Company adopted ASU No. 2016-02, "Leases," which, as amended, is included in ASC 842. This new accounting guidance supersedes previous lease accounting guidance in ASC 840 and requires entities that lease assets to recognize the assets and liabilities for the rights and obligations created by those leases on its balance sheet. The new guidance also requires additional disclosures about the amount, timing and uncertainty of cash flows from leases.

We adopted this new guidance using the modified retrospective transition method. Amounts and disclosures related to periods prior to October 1, 2019 have not been restated and continue to be reported in accordance with ASC 840. We elected to apply the following practical expedients in accordance with the guidance upon adoption:

- Short-term leases: We did not recognize short-term leases (term of 12 months or less) on the balance sheet;
- Easements: We did not re-evaluate existing land easements that were not previously accounted for as leases; and
- Other: We did not reassess the classification of expired or existing contracts or determine whether they are or contain a lease. We also did not reassess whether initial direct costs qualify for capitalization under ASC 842.

Upon adoption, we recorded ROU assets and lease liabilities of $9,317 related to our operating leases. Our accounting for finance leases remained substantially unchanged. There were no cumulative effect adjustments made to opening retained earnings as of October 1, 2019. The adoption did not, and is not expected to, have a significant impact on our condensed consolidated statements of income or cash flows. See Note 6 for additional disclosures regarding our leases.

***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. Our equity method investments are primarily comprised of PennEast and Pennant.

UGI PennEast, LLC and four other members comprising wholly owned subsidiaries of Southern Company, New Jersey Resources, South Jersey Industries, and Enbridge, Inc., each hold a 20% membership interest in PennEast. In September 2019, a panel of the U.S. Court of Appeals for the Third Circuit ruled that New Jersey's Eleventh Amendment immunity barred PennEast from bringing an eminent domain lawsuit in federal court, under the Natural Gas Act, against New Jersey or its agencies. The Third Circuit subsequently denied PennEast's petition for rehearing en banc. In addition, in October 2019, in reliance on the Third Circuit ruling, the New Jersey Department of Environmental Protection rejected PennEast's application for certain project permits. Following the Third Circuit denial of petition for rehearing, PennEast filed a petition for declaratory order with the FERC regarding interpretation of the Natural Gas Act; the FERC issued an order favorable to PennEast's position on January 30, 2020. PennEast also expects to file a petition for a writ of certiorari to seek U.S. Supreme Court review of the Third Circuit decision. The ultimate outcome of these matters cannot be determined at this time, and could result in delays, additional costs, or the inability to move forward with the project, resulting in an impairment of all or a portion of our investment in PennEast.

(Thousands of dollars, except where indicated otherwise)

**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.

| | Cash, Cash Equivalents and Restricted Cash | | | |
|---|---|---|---|---|
| | December 31, 2019 | December 31, 2018 | September 30, 2019 | September 30, 2018 |
| Cash and cash equivalents | $ 24,076 | $ 66,954 | $ 25,893 | $ 39,989 |
| Restricted cash | 43,733 | 13,019 | 33,922 | 7,800 |
| Cash, cash equivalents and restricted cash | $ 67,809 | $ 79,973 | $ 59,815 | $ 47,789 |

**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 10.

**Business Combination Purchase Price Allocations**. From time to time, the Company enters into material business combinations. In accordance with accounting guidance associated with business combinations, the purchase price is allocated to the various assets acquired and liabilities assumed at their estimated fair value as of the acquisition date. Fair values of assets acquired and liabilities assumed are based upon available information. Estimating fair values is generally subject to significant judgment and assumptions and most commonly impacts property, plant and equipment and intangible assets, including those with indefinite lives. Generally, we have, under certain circumstances, up to one year from the acquisition date to obtain information and finalize the purchase price allocation.

***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.

***Reclassifications.*** Certain prior-period amounts have been reclassified to conform to the current-period presentation.

**Subsequent Events.** Management has evaluated the impact of subsequent events through February 14, 2020, the date these financial statements were issued, and the effects of such evaluation have been reflected in the financial statements and related disclosures.

## Note 3 — Accounting Changes

### New Accounting Standards Adopted in Fiscal 2020

***Derivatives and Hedging.*** In August 2017, the FASB issued ASU No. 2017-12, "Targeted Improvements to Accounting for Hedging Activities." This ASU amends and simplifies existing guidance to allow companies to more accurately present the economic effects of risk management activities in the financial statements. For cash flow and net investment hedges as of the adoption date, the guidance required a modified retrospective approach. The amended presentation and disclosure guidance was required prospectively. The Company adopted the new guidance effective October 1, 2019. The adoption did not have a material impact on our consolidated financial statements.

***Leases.*** Effective October 1, 2019, the Company adopted new accounting guidance for leases in accordance with ASC 842. See Notes 2 and 6 for a detailed description of the impact of the new guidance and related disclosures.

### Accounting Standards Not Yet Adopted

***Credit Losses.*** In June 2016, the FASB issued ASU 2016-13, "Measurement of Credit Losses on Financial Instruments." This ASU, as subsequently amended, requires entities to estimate lifetime expected credit losses for financial instruments not measured at fair value through net income, including trade and other receivables, net investments in leases, financial receivables, debt securities, and other financial instruments, which may result in earlier recognition of credit losses. Further, the new current expected credit loss model may affect how entities estimate their allowance for loss for receivables that are current with respect to their payment terms. ASU 2016-13 is effective for the Company for interim and annual periods beginning October 1, 2020 (Fiscal 2021). Early adoption is permitted. The Company is in the process of assessing the impact on its financial statements from the adoption of the new guidance.

***Income Taxes.*** In December 2019, The FASB issued ASU 2019-12, "Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes." This ASU simplifies the accounting for income taxes by eliminating certain exceptions within the existing guidance for recognizing deferred taxes for equity method investments, performing intraperiod allocations and calculating income taxes in interim periods. Further, this ASU clarifies existing guidance related to, among other things, recognizing deferred taxes for goodwill and allocated taxes to members of a consolidated group. ASU 2019-12 is effective for the Company for interim and annual periods beginning October 1, 2021 (Fiscal 2022). Early adoption is permitted. The Company is in the process of assessing the impact on its financial statements from the adoption of the new guidance and determining the period in which the new guidance will be adopted.

## Note 4 — Revenue from Contracts with Customers

Energy Services recognizes revenue when control of promised goods or services is transferred to its 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 2019 Annual Report for information on our revenues from contracts with customers.

(Thousands of dollars, except where indicated otherwise)

**Revenue Disaggregation**

The following table presents our disaggregated revenues for the three months ended December 31, 2019 and 2018:

| | Three Months Ended December 31, | |
|---|---|---|
| | 2019 | 2018 |
| **Revenues from contracts with customers:** | | |
| Energy Marketing | $ 264,585 | $ 373,333 |
| Midstream: | | |
| Pipeline | 43,188 | 17,730 |
| Peaking | 41,580 | 40,680 |
| Other | 1,784 | 2,618 |
| Electricity Generation | 8,798 | 11,690 |
| **Total revenues from contracts with customers** | 359,935 | 446,051 |
| Other revenues (a) | 4,224 | (691) |
| **Total revenues** | $ 364,159 | $ 445,360 |

(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." 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 $8,518, $4,879 and $8,769 at December 31, 2019, September 30, 2019 and December 31, 2018, respectively, and are included in "Other current liabilities" on the Condensed Consolidated Balance Sheets. Revenue recognized for the three months ended December 31, 2019 and 2018 from the amount included in contract liabilities at September 30, 2019 and 2018 was $4,879 and $5,003, respectively.

**Remaining Performance Obligations**

Energy Services has elected to use practical expedients as allowed in ASC 606 to exclude disclosures related to the aggregate amount of the transaction price allocated to certain performance obligations that are unsatisfied as of the end of the reporting period because these contracts have an initial expected term of one year or less, or we have a right to bill the customer in an amount that corresponds directly with the value of services provided to the customer to date. Certain contracts with customers at Energy Services contain minimum future performance obligations through 2047. At December 31, 2019, Energy Services expects to record approximately $2.0 billion of revenues, related to the minimum future performance obligations over the remaining terms of the related contracts.

## Note 5 — Acquisitions

**CMG Acquisition**

On August 1, 2019, Energy Services completed the CMG Acquisition in which Energy Services acquired all of the equity interests in CMG and CMG's approximate 47% interest in Pennant, for total cash consideration of $1,284,391, subject to final working capital and other adjustments. The CMG Acquisition was consummated pursuant to the CMG Acquisition Agreements. CMG and Pennant provide natural gas gathering and processing services through five discrete systems located in western Pennsylvania, eastern Ohio and the panhandle of West Virginia. The CMG Acquisition is consistent with our growth strategies, including expanding our midstream natural gas gathering and processing assets within the Marcellus and Utica production regions. The CMG Acquisition was funded with cash from borrowings under the Energy Services Term Loan, capital contributions and cash on hand. We refer to CMG and its equity interest in Pennant as "UGI Appalachia".

(Thousands of dollars, except where indicated otherwise)

The Company has accounted for the CMG Acquisition using the acquisition method. At December 31, 2019, the allocation of the purchase price is substantially complete but remains preliminary pending the completion of our third-party valuation report and with regard to the identification and resolution of certain pre-acquisition contingencies and disputes. These amounts are preliminary pending the receipt of additional information. The purchase price allocation will be finalized once these items have been resolved. Accordingly, the fair value estimates presented below relating to these items are subject to change within the measurement period not to exceed one year from the date of acquisition.

The components of the preliminary CMG purchase price allocations are as follows:

| | | |
|---|---|---|
| Assets acquired: | | |
| Cash | $ | 258 |
| Accounts receivable | | 11,314 |
| Prepaid expenses and other current assets | | 1,095 |
| Property, plant and equipment | | 613,212 |
| Investment in Pennant | | 88,000 |
| Intangible assets (a) | | 250,000 |
| Total assets acquired | $ | 963,879 |
| | | |
| Liabilities assumed: | | |
| Accounts payable | $ | 3,275 |
| Other noncurrent liabilities | | 133 |
| Total liabilities assumed | $ | 3,408 |
| Goodwill | | 323,920 |
| Net consideration transferred (including preliminary working capital adjustments) | $ | 1,284,391 |

(a) Represents customer relationships having an average amortization period of 35 years.

We allocated the purchase price of the acquisition to identifiable intangible assets and property, plant and equipment based on estimated fair values as follows:

- Customer relationships were valued using a multi-period, excess earnings method. Key assumptions used in this method include discount rates, growth rates and cash flow projections. These assumptions are most sensitive and susceptible to change as they require significant management judgment; and

- Property, plant and equipment were valued based on estimated fair values primarily using depreciated replacement cost and market value methods.

The excess of the purchase price for the CMG Acquisition over the preliminary fair values of the assets acquired and liabilities assumed has been reflected as goodwill and results principally from anticipated future capital investment opportunities and value creation resulting from new natural gas processing assets in the Marcellus and Utica production regions. The goodwill recognized from the CMG Acquisition is deductible for income tax purposes.

## Note 6 — Leases

### Lessee

We lease various buildings and other facilities, real estate, and other equipment, the majority of which are operating leases. The lease of our corporate office building is a finance lease. We determine if a contract is or contains a lease by evaluating whether the contract explicitly or implicitly identifies an asset, whether we have the right to obtain substantially all of the economic benefits of the identified leased asset and to direct its use.

(Thousands of dollars, except where indicated otherwise)

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. We recognize ROU assets at the lease commencement date at the value of the lease liability adjusted for any prepayments, lease incentives received, and initial direct costs incurred. Lease liabilities are recognized at the lease commencement date based on the present value of lease payments over the lease term. These payments are discounted using the discount rate implicit in the lease, when available. We apply an incremental borrowing rate, which is developed utilizing a credit notching approach based on information available at the lease commencement date, to substantially all of our leases as the implicit rate is often not available.

Lease expense is recognized on a straight-line basis over the expected lease term. Renewal and termination options are not included in the lease term unless we are reasonably certain that such options will be exercised. Leases with an original lease term of one year or less, including consideration of any renewal options assumed to be exercised, are not included in the Condensed Consolidated Balance Sheets.

Certain leasing arrangements require variable payments that are dependent on asset usage or are based on changes in index rates, such as the Consumer Price Index. The variable payments component of such leases cannot be determined at lease commencement and is not recognized in the measurement of ROU assets or lease liabilities, but is recognized in earnings in the period in which the obligation occurs.

ROU assets and lease liabilities recorded in the Condensed Consolidated Balance Sheet are as follows:

| | December 31, 2019 | Location on the Balance Sheet |
|---|---|---|
| ROU assets: | | |
| Operating lease ROU assets | $ 8,590 | Other assets |
| Finance lease ROU assets | 48,105 | Property, plant and equipment |
| Total ROU assets | $ 56,695 | |
| | | |
| Lease liabilities: | | |
| Operating lease liabilities - current | $ 2,705 | Other current liabilities |
| Operating lease liabilities - noncurrent | 5,879 | Other noncurrent liabilities |
| Finance lease liabilities - current | 2,809 | Current maturities of long-term debt |
| Finance lease liabilities - noncurrent | 38,582 | Long-term debt |
| Total lease liabilities | $ 49,975 | |

The components of lease cost are as follows:

| | Three Months Ended December 31, 2019 |
|---|---|
| Operating lease cost | $ 834 |
| Finance lease cost: | |
| Amortization of ROU assets | 408 |
| Interest on lease liabilities | 441 |
| Short-term lease cost | 211 |
| Total lease cost | $ 1,894 |

Lease cost associated with variable lease components was not material for the three months ended December 31, 2019.

(Thousands of dollars, except where indicated otherwise)

The following table presents the cash and non-cash activity related to lease liabilities included in the Condensed Consolidated Statement of Cash Flows occurring during the period:

| | Three Months Ended December 31, 2019 | |
|---|---|---|
| Cash paid related to lease liabilities: | | |
| Operating cash flows from operating leases | $ | 840 |
| Operating cash flows from finance leases | $ | 441 |
| Financing cash flows from finance leases | $ | 223 |
| | | |
| Non-cash lease liability activities: | | |
| ROU assets obtained in exchange for operating lease liabilities | $ | 9,317 |
| ROU assets obtained in exchange for finance lease liabilities | $ | 18,605 |

The following table presents the weighted-average remaining lease term and weighted-average discount rate as of December 31, 2019:

| Weighted-average remaining lease term | In years |
|---|---|
| Operating leases | 5.7 |
| Finance leases | 30.5 |
| | |
| Weighted-average discount rate | % |
| Operating leases | 5.0% |
| Finance leases | 6.4% |

Expected annual lease payments based on maturities of operating and finance leases, as well as a reconciliation to the lease liabilities on the Condensed Consolidated Balance Sheet, as of December 31, 2019, were as follows:

| | Remainder of Fiscal 2020 | Fiscal 2021 | Fiscal 2022 | Fiscal 2023 | Fiscal 2024 | After Fiscal 2024 | Total Lease Payments | Imputed Interest | Lease Liabilities |
|---|---|---|---|---|---|---|---|---|---|
| Operating leases: | $ 2,321 | $ 2,600 | $ 1,137 | $ 1,091 | $ 945 | $ 1,929 | $ 10,023 | $ (1,439) | $ 8,584 |
| Finance leases: | $ 2,000 | $ 2,703 | $ 2,744 | $ 2,785 | $ 2,827 | $ 85,744 | $ 98,803 | $(57,412) | $ 41,391 |

At December 31, 2019, operating and finance leases that had not yet commenced were insignificant.

***Disclosures related to periods prior to adoption of ASC 842***

As discussed above, the Company adopted ASC 842 effective October 1, 2019, using a modified retrospective approach. As required, the following disclosure is provided for periods prior to adoption. The Company's future minimum payments under non-cancelable operating leases at September 30, 2019, which were accounted for under ASC 840, were as follows:

| | Fiscal 2020 | Fiscal 2021 | Fiscal 2022 | Fiscal 2023 | Fiscal 2024 | After Fiscal 2024 |
|---|---|---|---|---|---|---|
| Total | $ 3,249 | $ 3,150 | $ 3,005 | $ 2,987 | $ 2,954 | $ 37,905 |

**Lessor**

We enter into lessor arrangements for the purposes of storing, gathering or distributing natural gas to customers, which we classify as operating leases. Lease income is generally recognized on a straight-line basis over the lease term and included in "Revenues" on the Condensed Consolidated Statement of Income (see Note 4).

(Thousands of dollars, except where indicated otherwise)

## Note 7 — Goodwill and Intangible Assets

Goodwill and intangible assets comprise the following:

| | December 31, 2019 | September 30, 2019 | December 31, 2018 |
|---|---|---|---|
| Goodwill | $ 335,162 | $ 335,554 | $ 11,919 |
| Intangible assets: | | | |
| Customer relationships | 277,138 | 269,867 | 19,867 |
| Land development rights and other | 21,435 | 13,401 | 13,401 |
| Accumulated amortization | (27,926) | (14,744) | (12,179) |
| | 270,647 | 268,524 | 21,089 |
| Customer contracts | — | 16 | 67 |
| Intangible assets, net | $ 270,647 | $ 268,540 | $ 21,156 |

Amortization expense of intangible assets was $2,578 and $487 for the three months ended December 31, 2019 and 2018, respectively. The estimated aggregate amortization expense of these intangible assets for the remainder of Fiscal 2020 is and for the next four fiscal years is as follows: remainder of Fiscal 2020 — $6,982; Fiscal 2021 — $9,309; Fiscal 2022 — $9,309; Fiscal 2023 — $9,309; Fiscal 2024 — $9,309.

## Note 8 — Commitments and Contingencies

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

(Thousands of dollars, except where indicated otherwise)

## Note 9 — 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 as described in Note 2, as of December 31, 2019, September 30, 2019 and December 31, 2018:

| | Asset (Liability) | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| **December 31, 2019** | | | | |
| Derivative instruments: | | | | |
| Assets: | | | | |
| Commodity contracts | $ 16,673 | $ 7,725 | $ — | $ 24,398 |
| Interest rate contracts | $ — | $ 2,172 | $ — | $ 2,172 |
| Liabilities: | | | | |
| Commodity contracts | $ (57,117) | $ (6,607) | $ — | $ (63,724) |
| Interest rate contracts | $ — | $ — | $ — | $ — |
| **September 30, 2019** | | | | |
| Derivative instruments: | | | | |
| Assets: | | | | |
| Commodity contracts | $ 20,007 | $ 9,958 | $ — | $ 29,965 |
| Liabilities: | | | | |
| Commodity contracts | $ (56,725) | $ (11,957) | $ — | $ (68,682) |
| Interest rate contracts | $ — | $ (3,130) | $ — | $ (3,130) |
| **December 31, 2018** | | | | |
| Derivative instruments: | | | | |
| Assets: | | | | |
| Commodity contracts | $ 22,371 | $ 18,481 | $ — | $ 40,852 |
| Liabilities: | | | | |
| Commodity contracts | $ (32,511) | $ (16,242) | $ — | $ (48,753) |

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.

## Note 10 — Derivative Instruments & 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 these risks. The primary risks managed by derivative instruments are (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.

**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 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. In addition, the Company uses NYMEX futures and options contracts to economically hedge the gross margin associated with the purchase and anticipated later near-term sale of natural gas or propane.

**Interest Rate Risk**

During Fiscal 2019 Energy Services entered into Energy Services Term Loan. In order to fix the underlying short-term market interest rates, we entered into associated pay-fixed, receive-variable interest rate swap agreement for all of Energy Services Term Loan's outstanding principal balance, and a significant portion of the loan’s tenor and designated such swaps as cash flow hedges.

**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, 2019, September 30, 2019, and December 31, 2018 and the final settlement date of the Company's open derivative transactions as of December 31, 2019, excluding those derivatives that qualified for the NPNS exception:

| | | | Notional Amounts (in millions) | | |
|---|---|---|---|---|---|
| Type | Units | Settlements Extending Through | December 31, 2019 | September 30, 2019 | December 31, 2018 |
| **Commodity Price Risk:** | | | | | |
| Natural gas futures, forward and pipeline contracts | Dekatherms | December 2024 | 173.5 | 189.9 | 177.1 |
| Natural gas basis swap contracts | Dekatherms | December 2024 | 154.7 | 131.1 | 81.2 |
| NYMEX natural gas storage futures contracts | Dekatherms | March 2020 | 0.4 | 0.3 | 0.7 |
| NYMEX natural gas option contracts | Dekatherms | March 2020 | 2.0 | 2.4 | — |
| NYMEX propane storage futures contracts | Gallons | April 2020 | 0.1 | 0.5 | 0.3 |
| Electricity long forward and futures contracts | Kilowatt hours | June 2022 | 812.8 | 883.3 | 800.1 |
| Electricity short forward and futures contracts | Kilowatt hours | April 2024 | 555.8 | 628.6 | 366.7 |
| **Interest Rate Risk:** | | | | | |
| Interest rate swaps | USD | July 2024 | $ 696.5 | $ 698.3 | $ — |

**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 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. Certain of these agreements call for the posting of collateral by the counterparty or by the Company in the forms of letters of credit, parental guarantees or cash. Additionally, our natural gas and electricity exchange-traded futures contracts generally require cash deposits in margin accounts. At December 31, 2019, September 30, 2019 and December 31, 2018, restricted cash in brokerage accounts totaled $43,733, $33,922 and $13,019 respectively. Although we have concentrations of credit risk associated with derivative instruments, the maximum amount of loss we would incur if these counterparties failed to perform according to the terms of their contracts, based upon the gross fair values of the derivative instruments, was not material at December 31, 2019. We generally do not have credit-risk-related contingent features in our derivative contracts.

(Thousands 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, most 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, 2019 | September 30, 2019 | December 31, 2018 |
|---|---|---|---|
| **Derivative assets:** | | | |
| **Derivatives designated as hedging instruments:** | | | |
| Interest rate contracts | $ 2,172 | $ — | $ — |
| **Derivatives not designated as hedging instruments:** | | | |
| Commodity contracts | $ 24,398 | $ 29,965 | $ 40,852 |
| Total derivative assets - gross | 26,570 | 29,965 | 40,852 |
| Gross amounts offset in balance sheet | (17,378) | (24,479) | (25,423) |
| Total derivative assets - net | $ 9,192 | $ 5,486 | $ 15,429 |
| **Derivative liabilities:** | | | |
| **Derivatives designated as hedging instruments:** | | | |
| Interest rate contracts | $ — | $ (3,130) | $ — |
| **Derivatives not designated as hedging instruments:** | | | |
| Commodity contracts | (63,724) | (68,682) | (48,753) |
| Total derivative liabilities - gross | (63,724) | (71,812) | (48,753) |
| Gross amounts offset in balance sheet | 17,378 | 24,479 | 25,423 |
| Total derivative liabilities - net | $ (46,346) | $ (47,333) | $ (23,330) |

(Thousands of dollars, except where indicated otherwise)

**Effect of Derivative Instruments**

The following tables provide information on the effects of derivative instruments on the Condensed Consolidated Statements of Income and Comprehensive Income for three months ended December 31, 2019 and 2018:

| | Gain (Loss) Recognized in AOCI | | Gain (Loss) Reclassified from AOCI into Income | | Location of Gain (Loss) Reclassified from AOCI into Income |
|---|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 | |
| **Cash Flow Hedges:** | | | | | |
| Interest rate contracts | $ 4,382 | $ — | $ (862) | $ — | Interest expense |

| | Gain (Loss) Recognized in Income | | Location of Gain (Loss) Recognized in Income |
|---|---|---|---|
| | 2019 | 2018 | |
| **Derivatives Not Designated As Hedging Instruments:** | | | |
| Commodity contracts | $ 2,487 | $ (2,850) | Revenues |
| Commodity contracts | (20,073) | 19,471 | Cost of sales |
| **Total** | $ (17,586) | $ 16,621 | |

Included in "Gain (Loss) Recognized in Income" in the table above are the following unrealized gains (losses) from changes in fair value of derivative instruments for three months ended December 31, 2019 and 2018:

| **Unrealized Gain (Loss):** | 2019 | 2018 |
|---|---|---|
| Revenue | $ 1,951 | $ (2,322) |
| Cost of sales | (9,394) | 4,140 |
| **Total** | $ (7,443) | $ 1,818 |

We are also a party to a number of other contracts that have elements of a derivative instrument. 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. Although certain of these contracts have the requisite elements of a derivative instrument, 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.

(Thousands of dollars, except where indicated otherwise)

**Note 11 — Accumulated Other Comprehensive Income (Loss)**

Changes in AOCI during the three months ended December 31, 2019 are as follows:

| | Derivative Instruments |
|---|---|
| **AOCI - September 30, 2019** | $ (2,225) |
| Other comprehensive income before reclassification adjustments (after-tax) | 3,151 |
| Amounts reclassified from AOCI: | |
| Reclassification adjustments (pre-tax) | 862 |
| Reclassification adjustments tax benefit | (245) |
| Reclassification adjustments (after-tax) | 617 |
| Other comprehensive income | 3,768 |
| **AOCI - December 31, 2019** | $ 1,543 |

There was no AOCI activity during the three months ended December 31, 2018.

Activity in AOCI during three months ended December 31, 2019 relate solely to a pay-fixed, receive variable interest rate swap agreement used to fix the variable rate on the Energy Services Term Loan.

**Note 12 — Related Party Transactions**

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 were provided. Management believes that this allocation method is reasonable and equitable to the Company. During the three months ended December 31, 2019 and 2018, such corporate expenses, which are included in "Operating and administrative expenses" on the Condensed Consolidated Statements of Income and Comprehensive Income, totaled $3,296 and $2,211 respectively.

From time to time, Energy Services is a party to SCAAs with UGI Utilities which have terms of up to three years. At December 31, 2019, UGI Utilities was a party to three SCAAs with Energy Services, and, during the periods covered by the financial statements, was a party to other SCAAs with Energy Services. 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. During the three months ended December 31, 2019 and 2018, Energy Services received payments from UGI Utilities for storage inventories and pipeline transportation and storage capacity charges associated with SCAAs, which are included in "Revenues" on the Condensed Consolidated Statements of Income and Comprehensive Income, totaling $2,204 and $3,101, respectively. Energy Services, in turn, provides a firm delivery service and makes certain payments to UGI Utilities for its various obligations under the SCAAs. During the three months ended December 31, 2019 and 2018, these payments totaled $644 and $743, respectively. In conjunction with the SCAAs, Energy Services paid UGI Utilities security deposits. During the three months ended December 31, 2019 and 2018, the amounts of such security deposits, which are included in "Prepaid expenses and other current assets "on the Condensed Consolidated Balance Sheets were $7,500 and $9,040, respectively.

Pursuant to gas supply and delivery service agreements with UGI Utilities, Energy Services provides certain gas supply and related delivery service to UGI Utilities primarily during the heating-season months of November through March. During the three months ended December 31, 2019 and 2018, the aggregate amount of these transactions (exclusive of transactions pursuant to the SCAAs) totaled $37,694 and $36,237, respectively.

In addition, from time to time, Energy Services purchases natural gas or pipeline capacity from UGI Utilities. During the three months ended December 31, 2019 and 2018, such purchases from UGI Utilities, which are included in "Cost of sales" on the

Condensed Consolidated Statements of Income and Comprehensive Income, totaled $14,102 and $22,862, respectively. 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 purchases a firm storage service from a subsidiary of Energy Services. During the three months ended December 31, 2019 and 2018, such sales, which are included in "Revenues" on the Condensed Consolidated Statements of Income and Comprehensive Income, totaled $23,442 and $44,382, respectively.

From time to time, Energy Services sells propane on an as needed basis to AmeriGas. 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, 2019 and 2018.

## Executive Overview

Energy Services' net income as determined in accordance with GAAP was $30.9 million for the three months ended December 31, 2019 compared to $33.0 million for the three months ended December 31, 2018. Our GAAP results in the 2019 three-month period reflect after-tax losses on commodity derivative instruments not associated with current-period transactions of $5.3 million compared to after-tax gains of $1.3 million in the 2018 three-month period. The higher after-tax losses on commodity derivative instruments during the 2019 three-month period principally reflect decreases in forward prices for natural gas. Our GAAP results in the 2019 three-month period also reflect after-tax acquisition and integration expenses associated with CMG of $0.5 million. Although these items are reflected in our GAAP results, we have excluded these items from our non-GAAP measures. See "Non-GAAP Financial Measures" below.

Excluding the impacts of derivative commodity instruments not associated with current-period transactions and the CMG acquisition and integration expenses, adjusted net income for the 2019 three-month period was $5.0 million higher than the prior-year period. This increase principally reflects incremental net income from CMG, which was acquired in August 2019, including income from an equity method investment that was included as part of the acquisition, partially offset by increased interest expense related to debt issued to finance a portion of the CMG Acquisition.

## 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.

## UGI ENERGY SERVICES, LLC AND SUBSIDIARIES

| (Millions of dollars) | Three Months Ended December 31, 2019 | | Three Months Ended December 31, 2018 | |
|---|---|---|---|---|
| **Adjusted total margin:** | | | | |
| Total revenues | $ | 364.2 | $ | 445.4 |
| Cost of sales | | (268.4) | | (366.8) |
| Total margin | | 95.8 | | 78.6 |
| Net losses (gains) on commodity derivative instruments not associated with current-period transactions | | 7.5 | | (1.8) |
| Adjusted total margin | $ | 103.3 | $ | 76.8 |
| | | | | |
| **Adjusted operating income:** | | | | |
| Operating income | $ | 48.0 | $ | 44.1 |
| Net losses (gains) on commodity derivative instruments not associated with current-period transactions | | 7.5 | | (1.8) |
| CMG acquisition and integration expenses | | 0.7 | | — |
| Adjusted operating income | $ | 56.2 | $ | 42.3 |
| | | | | |
| **Adjusted income before income taxes:** | | | | |
| Income before income taxes | $ | 43.0 | $ | 45.1 |
| Net losses (gains) on commodity derivative instruments not associated with current-period transactions | | 7.5 | | (1.8) |
| CMG acquisition and integration expenses | | 0.7 | | — |
| Adjusted income before income taxes | $ | 51.2 | $ | 43.3 |
| | | | | |
| **Adjusted net income:** | | | | |
| Net income | $ | 30.9 | $ | 33.0 |
| Net losses (gains) on commodity derivative instruments not associated with current-period transactions | | 5.3 | | (1.3) |
| CMG acquisition and integration expenses | | 0.5 | | — |
| Adjusted net income | $ | 36.7 | $ | 31.7 |

**Analysis of Results of Operations**

The following analysis compares Energy Services' results of operations for the 2019 three-month period with the 2018 three-month period.

| **For the three months ended December 31,** | 2019 | | 2018 | | Increase (Decrease) | | |
|---|---|---|---|---|---|---|---|
| (Dollars in millions) | | | | | | | |
| Revenues | $ | 364.2 | $ | 445.4 | $ | (81.2) | (18.2)% |
| Total margin (a) | $ | 95.8 | $ | 78.6 | $ | 17.2 | 21.9 % |
| Operating and administrative expenses (b) | $ | 29.7 | $ | 23.8 | $ | 5.9 | 24.8 % |
| Operating income | $ | 48.0 | $ | 44.1 | $ | 3.9 | 8.8 % |
| Income before income taxes | $ | 43.0 | $ | 45.1 | $ | (2.1) | (4.7)% |
| Non-GAAP financial measures (c): | | | | | | | |
| Adjusted total margin | $ | 103.3 | $ | 76.8 | $ | 26.5 | 34.5 % |
| Adjusted operating income | $ | 56.2 | $ | 42.3 | $ | 13.9 | 32.9 % |
| Adjusted income before income taxes | $ | 51.2 | $ | 43.3 | $ | 7.9 | 18.2 % |
| Adjusted net income | $ | 36.7 | $ | 31.7 | $ | 5.0 | 15.8 % |

(a) Total margin represents total revenues less total cost of sales and includes the impact of net unrealized (losses) gains of $(7.5) million and $1.8 million, respectively, on commodity derivative instruments not associated with current-period transactions for the three months ended December 31, 2019 and 2018.
(b) The 2019 three-month period includes $0.7 million of acquisition and integration expenses associated with CMG.
(c) 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 three months ended December 31, 2019 were slightly warmer than normal and approximately 4.6% warmer than the prior-year period.

Revenues in the 2019 three-month period were $81.2 million lower compared to the 2018 three-month period principally reflecting decreased natural gas revenues ($108.1 million) and, to a much lesser extent, lower retail power ($1.6 million) and capacity revenues ($1.6 million). The significant decrease in natural gas revenues is primarily attributable to lower average natural gas prices during the 2019 three-month period. The effect of these revenue decreases were partially offset by higher natural gas gathering revenues ($32.8 million) largely attributable to incremental revenues from CMG, which was acquired on August 1, 2019. Cost of sales were $268.4 million in the 2019 three-month period compared to $366.8 million in the prior-year period, a decrease of $98.4 million, principally reflecting lower natural gas costs.

Total margin increased $17.2 million in the 2019 three-month period. Adjusted total margin increased $26.5 million principally reflecting higher natural gas gathering total margin ($32.8 million) largely attributable to incremental margins from CMG and, to a much lesser extent, the Auburn IV natural gas gathering system, which was placed into service in November 2019. The effect of these increases was partially offset by lower capacity management margin and lower margin from the Hunlock generating facility reflecting lower volumes.

Operating income increased $3.9 million and income before income taxes decreased $2.1 million in the 2019 three-month period, respectively. Adjusted operating income and adjusted income before income taxes increased $13.9 million and $7.9 million, respectively. The increases in adjusted operating income principally reflects the previously mentioned increase in adjusted total margin partially offset by higher depreciation and amortization expense ($6.9 million) and increased operating and administrative expenses ($5.2 million, excluding $0.7 million of CMG acquisition and integration expenses in the 2019 three-month period). The higher depreciation and amortization expense and operating and administrative expenses are largely attributable to CMG. The increase in adjusted earnings before income taxes reflects the increase in adjusted operating income and equity income from Pennant, a natural gas gathering and processing equity interest that was acquired as part of the CMG Acquisition.

### *Interest Expense and Income Taxes*

Interest expense in the 2019 three-month period increased $11.0 million compared to the prior-year period primarily attributable to long-term debt issued in August 2019 to fund a portion of the CMG Acquisition and higher short-term borrowings.

Our effective income tax rate for the three months ended December 31, 2019 and 2018 was 28.2% and 26.7%, respectively.

## Financial Condition and Liquidity

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 borrowings under the Energy Services Credit Agreement. Long-term cash requirements are generally met through the issuance of long-term debt. 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 borrowings; 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 $24.1 million at December 31, 2019 compared to $25.9 million at September 30, 2019. Our restricted cash balances at December 31, 2019 and September 30, 2019, principally comprising cash in brokerage accounts that are restricted from withdrawal, totaled $43.7 million and $33.9 million, respectively. Our debt outstanding at December 31, 2019, totaled $814.7 million (including current maturities of long-term debt of $9.8 million and short-term borrowings of $88.4 million). Our debt outstanding at September 30, 2019, totaled $778.0 million (including current maturities of long-term debt of $7.1 million and short-term borrowings of $91.4 million). Total long-term debt outstanding at December 31, 2019, including current maturities, comprises $696.5 million of Energy Services Term Loan and $41.3 million of other long-term debt including a finance lease recognized as a result of the adoption of ASU 2016-02, and is net of $11.5 million of unamortized debt issuance costs.

***Credit Facilities***

At December 31, 2019, there were $20.0 million borrowings outstanding under the Energy Services Credit Agreement and the available borrowing capacity was $180.0 million.

Energy Services also has a Receivables Facility with an issuer of receivables-backed commercial paper currently scheduled to expire on October 23, 2020. The Receivables Facility provides Energy Services with the ability to borrow up to $150 million of eligible receivables during the period November through April, and up to $75 million of eligible receivables during the period May through October. Energy Services uses the Receivables Facility to fund working capital, margin calls under commodity futures contracts, capital expenditures, dividends and for general corporate purposes.

At December 31, 2019, the outstanding balance of trade receivables was $86.0 million of which $68.4 million was sold to the bank. At December 31, 2018, the outstanding balance of trade receivables was $135.4 million of which $10.0 million 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, 2019 and 2018, peak sales of receivables were $68.4 million and $15.0 million, respectively, and average daily amounts sold were $49.8 million and $1.5 million, respectively.

***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 and cash paid for acquisitions of businesses and assets. 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.

Operating Activities: Cash flow from operating activities was $41.0 million in the 2019 three-month period compared to $63.4 million in 2018 three-month period. Cash flow from operating activities before changes in operating working capital were $42.3 million in the 2019 three-month period compared to $44.0 million in the 2018 three-month period. Changes in operating working capital used operating cash flow of $1.3 million in the 2019 three-month period compared to cash provided by operating cash flow of $19.4 million in the 2018 three-month period. Cash flow from changes in operating working capital in the 2019 three-month period principally reflects lower cash used to fund changes in accounts receivable more than offset by cash provided from changes in accounts payable.

Investing Activities: Cash flow used by investing activities was $28.0 million in the 2019 three-month period compared to $39.2 million in the 2018 three-month period. The higher cash used for investing activities in the 2018 three-month period principally reflects the acquisition of South Jersey Energy Company's natural gas marketing business. Cash capital expenditures for property, plant and equipment totaled $27.7 million in the 2019 three-month period compared to $23.9 million in F2018 three-month period.

Financing Activities: Cash flow (used) provided by financing activities was $(5.0) million in the 2019 three-month period and $8.0 million in the 2018 three-month period. The increase in cash used by financing activities in the 2019 three-month period primarily reflects higher net repayments on Receivables Facility and short-term borrowings compared to net repayments on the same facilities in the 2018 three-month period.