

Public Gas Partners

Financial Statements

As of and for the Years Ended
June 30, 2013 and 2012



Public Gas Partners, Inc.

Financial Statements and Supplemental Schedules

As of and for the Years Ended June 30, 2013 and 2012

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Report of Independent Auditors

The Board of Directors
Public Gas Partners, Inc.

We have audited the accompanying financial statements of Public Gas Partners, Inc., as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the basic financial statements listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Public Gas Partners, Inc. at June 30, 2013 and 2012, and the changes in its financial position and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Adoption of GASB Statement No.65, Items Previously Reported as Assets and Liabilities

As discussed in Note 1 to the financial statements, Public Gas Partners, Inc. changed its method of accounting for debt issuance costs as a result of the adoption of Governmental Accounting Standards Board (GASB) Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to this matter.

Required Supplementary Information

U.S. generally accepted accounting principles require that management’s discussion and analysis on pages 3–10 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary Information

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise Public Gas Partners, Inc.’s basic financial statements. The supplemental schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The supplemental schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied by us in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, based on our audit and the procedures performed as described above, the information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.



September 24, 2013

Management's Discussion and Analysis (Unaudited)

Corporate Structure

Public Gas Partners, Inc. (PGP) is a nonprofit corporation organized under Georgia law, formed on November 15, 2004. PGP is comprised of seven members: Florida Municipal Power Agency (FMPA), Lower Alabama Gas District (L.A. Gas), Municipal Gas Authority of Georgia (the Gas Authority), National Public Gas Agency, Patriots Energy Group, The Southeast Alabama Gas District, and Tennessee Energy Acquisition Corporation (collectively, the Members). L.A. Gas has agreed to assign its interests in PGP to the Gas Authority; this assignment is expected to be completed in October 2013.

PGP's mission is to build a portfolio of economic long-term gas supplies for its Members. PGP is organized into projects in which Members may elect to participate. Each of the Members participating in a PGP project has executed a Production Sharing Agreement (PSA) for that project. PGP has undertaken three projects: Gas Supply Pool No. 1 (Pool 1), Gas Supply Pool No. 2 (Pool 2), and Gas Supply Pool No. 3 (Pool 3). Pool 1 was formed in 2004, Pool 2 was formed in 2005, and Pool 3 was formed in 2009. Five Members are participants in Pools 1 and 2, and four Members are participants in Pool 3. For Pools 1 and 2, PGP was authorized to acquire gas reserves or other contract rights during a three-year acquisition period that ended June 30, 2008. Pool 3 is authorized to acquire gas reserves or other contract rights on an ongoing basis as necessary to fulfill gas deliveries requested by Pool 3 participants. PGP utilizes wholly owned subsidiaries to own the assets and manage the operations of its various projects.

Joint Action

Although Members are individually governed, through joint action they can share the costs of mutual endeavors, such as natural gas purchasing, and accomplish those tasks more efficiently than if they were conducted individually. In addition, by contracting with PGP, Members can diversify their source of long-term supplies through a portfolio of supply arrangements. Similarly, they can pool their credit strength to manage risks and reduce costs through joint financing of acquisitions, hedging of long-term gas supplies, and other financing activities. Through joint action, Members can use economies of scale to reduce the overall cost and price volatility of natural gas to their ultimate customers.

Authority

The Bylaws of PGP and each PSA provide that PGP will be governed by a Board of Directors that includes one representative from each PGP Member. In addition, each PGP project is managed by an Operating Committee made up of two representatives from each participating Member. The Operating Committees for each Pool have been authorized by the Board of Directors and their respective PSAs to undertake the acquisition and management of gas supplies that meet the property criteria or other requirements in the PSAs and to issue debt to finance the costs of such activities. The PSAs authorize the Board of Directors to establish rates and charges

Management's Discussion and Analysis (Unaudited) (continued)

to produce revenue sufficient to cover all project costs, including allocations from PGP or other projects, and obligate the participating Members to pay those charges.

Operations

The Gas Authority manages PGP's day-to-day operations under a contract that ends on November 1, 2014. This contract renews annually until either party provides notice of termination no later than 180 days from the date of expiration.

Derivative Instruments

PGP uses derivative instruments to hedge its commodity price risk associated with forecasted oil and gas sales from owned reserves by converting the revenues that PGP will receive from customers from a variable price, based on a spot market price, to a fixed price.

Proprietary Funds

PGP operates only one type of proprietary fund, the enterprise fund type, to account for its general operations in accordance with Governmental Accounting Standards Board (GASB) pronouncements. Enterprise funds are used to report business-type activities (as contrasted with tax-supported governmental activities).

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to PGP's basic financial statements. These financial statements are designed to provide readers with a broad overview of PGP's finances in a manner similar to a private-sector business.

The statements of net position present information on PGP's assets, liabilities, and deferred inflows/outflows of resources with the differences between these amounts reported as net position. Because PGP is a nonprofit organization and an extension of the municipal utilities participating in the Pools, net position is likely to be limited since, generally, all billings and revenues in excess of actual costs are returned to Members in the form of billing credits or rate changes. The statements of revenues, expenses, and changes in net position present information showing how PGP's net position changed during the most recent fiscal year. All changes in net position are reported when the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Therefore, certain revenues and expenses, such as costs recoverable from future billings, will result in cash flows in future fiscal periods. All of the activities of PGP are considered business-type activities.

Notes to Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the financial statements.

Management's Discussion and Analysis (Unaudited) (continued)

Financial Analysis – 2013 Compared to 2012

Following are the condensed statements of net position as of June 30, 2013 and 2012:

| | 2013 | 2012 |
|---|-----------------------|-----------------------|
| Capital assets | \$ 208,738,445 | \$ 219,517,080 |
| Noncapital assets | 78,682,886 | 73,770,512 |
| Deferred outflows of resources – costs recoverable | 178,043,403 | 187,313,610 |
| Total assets and deferred outflows of resources | \$ 465,464,734 | \$ 480,601,202 |
| | | |
| Current liabilities | \$ 29,664,345 | \$ 37,565,882 |
| Long-term liabilities | 415,889,767 | 415,626,308 |
| Total liabilities | 445,554,112 | 453,192,190 |
| Deferred inflows of resources – unrealized gain on derivative instruments | 19,910,622 | 27,409,012 |
| Net position | — | — |
| Total liabilities, deferred inflows of resources, and net position | \$ 465,464,734 | \$ 480,601,202 |

The decrease in total assets and deferred outflows of resources of \$15,136,468 was primarily due to a decrease in oil and gas properties and development costs of \$10,778,635, which represents depletion and property sales offset by acquisitions and capital development; a decrease in deferred outflows of resources of \$9,270,207 related to the excess of revenues over expenses; and a decrease in the market values of derivative instruments of \$7,498,390. These decreases were offset primarily by increases in cash and restricted cash of \$10,643,535.

The decrease in liabilities, deferred inflows of resources, and net position of \$15,136,468 was primarily due to a net decrease in deferred inflows of resources of \$7,498,390 due to changes in market values of derivative instruments and a decrease in the line-of-credit payable of \$9,000,000 due to a maturity and repayment made during the year.

Management's Discussion and Analysis (Unaudited) (continued)

Financial Analysis – 2013 Compared to 2012 (continued)

Following is a summary of operations for the years ended June 30, 2013 and 2012:

| | 2013 | 2012 |
|-------------------------------------|---------------------|---------------|
| Operating revenues: | | |
| From customers | \$ 78,879,534 | \$ 79,325,417 |
| From Members | 31,235,241 | 31,811,207 |
| Total operating revenues | 110,114,775 | 111,136,624 |
| Operating expenses: | | |
| Oil and gas field operations | 32,416,871 | 30,758,398 |
| Gas supplies delivered to Members | 23,923,364 | 21,092,128 |
| Depletion of oil and gas properties | 38,407,672 | 43,585,189 |
| General and administrative | 2,471,150 | 2,641,587 |
| Total operating expenses | 97,219,057 | 98,077,302 |
| Operating income | 12,895,718 | 13,059,322 |
| Nonoperating income (expense): | | |
| Interest expense | (9,094,089) | (9,073,707) |
| Equity in earnings of affiliates | 5,468,578 | 6,462,879 |
| Costs refundable in future billings | (9,270,207) | (10,448,494) |
| Total nonoperating expense | (12,895,718) | (13,059,322) |
| Changes in net position | – | – |
| Net position: | | |
| Beginning of year | – | – |
| End of year | \$ – | \$ – |

Operating Revenues

Operating revenues from customers decreased \$445,883, or 0.6%, due to a 9.0% decrease in total production driven by normal production declines offset by the inclusion in the current year of a full year of a prior mid-year acquisition. Price changes were mixed, with gas prices increasing 7.2% year over year, while oil prices decreased 3.0%. Operating revenues from Members decreased \$575,966, or 1.8%, due to lower gas prices.

Management's Discussion and Analysis (Unaudited) (continued)

Financial Analysis – 2013 Compared to 2012 (continued)

Operating Expenses

Operating expenses decreased \$858,245, or 0.9%, primarily due to an increase in oil and gas field operations and gas supplies delivered to Members of \$4,489,709, or 8.7%, primarily due to an increase in gas prices. This increase was offset by a \$5,177,517 decrease in depletion expense caused by a lower impairment in the current year than the prior year.

Liquidity and Capital Resources

PGP's cash balance increased \$10,643,535 to \$17,321,434 at June 30, 2013. See the accompanying statements of cash flows for details of cash activity during fiscal 2013.

On December 26, 2012, PGP's two \$25,000,000 lines of credit matured and were not renewed as PGP is utilizing its advance prepayment arrangement with the Gas Authority for any short-term cash needs.

PGP is exposed to credit risk in the normal course of business. PGP has adopted policies and procedures to minimize this risk. Expected borrowing arrangements with banks, along with operating cash flow, are expected to provide sufficient liquidity for planned operations. PGP uses derivative instruments, including swaps and options (collectively, commodity derivatives) to hedge its commodity price risk associated with short- and long-term changes in oil and natural gas prices.

Management's Discussion and Analysis (Unaudited) (continued)

Financial Analysis – 2012 Compared to 2011

Following are the condensed statements of net position as of June 30, 2012 and 2011:

| | 2012 | 2011 |
|--|-----------------------|----------------|
| Capital assets | \$ 219,517,080 | \$ 221,947,272 |
| Noncapital assets | 73,770,512 | 51,665,349 |
| Deferred outflows of resources – costs recoverable | 187,313,610 | 197,762,104 |
| Deferred outflows of resources – unrealized loss on derivative instruments | — | 626,204 |
| Total assets and deferred outflows of resources | \$ 480,601,202 | \$ 472,000,929 |
| Current liabilities | \$ 37,565,882 | \$ 47,128,043 |
| Long-term liabilities | 415,626,308 | 423,226,245 |
| Total liabilities | 453,192,190 | 470,354,288 |
| Deferred inflows of resources – unrealized gain on derivative instruments | 27,409,012 | 1,646,641 |
| Net position | — | — |
| Total liabilities, deferred inflows of resources, and net position | \$ 480,601,202 | \$ 472,000,929 |

The increase in total assets and deferred outflows of resources of \$8,600,273 was primarily due to an increase in fair value of derivative instruments of \$21,450,927 due to changes in market values of derivative instruments and an increase in investments of \$5,206,629 from PGP's share of investee earnings net of distributions received, offset by a decrease in oil and gas properties and unproved properties and development costs not being amortized of \$2,430,192, which represents depletion offset by acquisitions and capital development, and a decrease in deferred outflows of resources - costs recoverable of \$10,448,494 related to the excess of revenues over expenses.

The increase in liabilities, deferred inflows of resources, and net position of \$8,600,273 was primarily due to a net increase in deferred inflows of resources and fair value of financial instruments of \$20,824,724 due to changes in market values of derivative instruments and an increase in advances from the Gas Authority of \$9,532,251, offset by a decrease in long-term debt of \$13,667,505 due to a principal payment and amortization of bond premium and a decrease in the line-of-credit payable of \$5,602,454 due to net repayments made during the year.

Management's Discussion and Analysis (Unaudited) (continued)

Financial Analysis – 2012 Compared to 2011 (continued)

Following is a summary of operations for the years ended June 30, 2012 and 2011:

| | 2012 | 2011 |
|-------------------------------------|----------------------|---------------|
| Operating revenues: | | |
| From customers | \$ 79,325,417 | \$ 71,973,281 |
| From Members | 31,811,207 | 33,720,943 |
| Total operating revenues | 111,136,624 | 105,694,224 |
| Operating expenses: | | |
| Oil and gas field operations | 30,758,398 | 29,127,760 |
| Gas supplies delivered to Members | 21,092,128 | 27,127,040 |
| Depletion of oil and gas properties | 43,585,189 | 23,737,361 |
| General and administrative | 2,641,587 | 2,716,986 |
| Total operating expenses | 98,077,302 | 82,709,147 |
| Operating income | 13,059,322 | 22,985,077 |
| Nonoperating income (expense): | | |
| Interest expense | (9,073,707) | (12,061,877) |
| Equity in earnings of affiliates | 6,462,879 | 3,579,054 |
| Costs refundable in future billings | (10,448,494) | (14,502,254) |
| Total nonoperating expense | (13,059,322) | (22,985,077) |
| Changes in net position | – | – |
| Net position: | | |
| Beginning of year | – | – |
| End of year | \$ – | \$ – |

Operating Revenues

Operating revenues from customers increased \$7,352,136, or 10.2%, due to a 12% increase in production driven by an acquisition of producing reserves, as well as capital development that partially offset the production decline curve. Price changes were mixed, with gas prices declining 23% year over year, while oil prices increased 10%. Operating revenues from Members declined \$1,909,736, or 5.7%, due to slightly lower volumes and gas prices.

Management's Discussion and Analysis (Unaudited) (continued)

Financial Analysis – 2012 Compared to 2011 (continued)

Operating Expenses

Operating expenses increased \$15,368,155, or 19%, primarily due to a \$19,847,828 increase in depletion caused by the addition to the amortization pool of properties that were previously classified as unproved, an acquisition of producing reserves, and an impairment charge of \$12,780,223 due to the reclassification of unproved properties, as well as significantly lower gas prices experienced in the current year. This increase was offset by a decrease in gas supplies delivered to Members of \$6,034,912, or 22%, primarily due to a decline in gas prices.

Liquidity and Capital Resources

PGP's cash balance decreased \$1,393,267 to \$6,677,899 at June 30, 2012. See the accompanying statements of cash flows for details of cash activity during fiscal 2012. In December 2011, PGP renewed its \$25,000,000 lines of credit with each of two banks for the purpose of paying down debt and funding potential acquisitions. Such lines were secured by the Pool 3 PSAs and matured on December 26, 2012. As of June 30, 2012, \$9,000,000 was outstanding under the lines of credit.

PGP is exposed to credit risk in the normal course of business. PGP has adopted policies and procedures to minimize this risk. Expected borrowing arrangements with banks, along with operating cash flow, are expected to provide sufficient liquidity for planned operations. PGP uses derivative instruments, including swaps and options (collectively, commodity derivatives) to hedge its commodity price risk associated with short- and long-term changes in oil and natural gas prices.

Public Gas Partners, Inc.
Statements of Net Position

| | June 30 | |
|---|----------------|----------------|
| | 2013 | 2012 |
| Assets and deferred outflows of resources | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 8,417,020 | \$ 6,677,899 |
| Restricted cash held by trustee | 8,904,414 | – |
| Accounts receivable – Members | 2,228,937 | 2,445,604 |
| Accounts receivable – other | 12,657,178 | 11,816,988 |
| Fair value of derivative instruments | 6,473,417 | 9,466,105 |
| Other assets | 622,586 | 941,778 |
| Total current assets | 39,303,552 | 31,348,374 |
| Noncurrent assets: | | |
| Oil and gas properties – net | 208,738,445 | 214,031,507 |
| Unproved properties and development costs not being amortized | – | 5,485,573 |
| Investments | 25,209,123 | 23,318,256 |
| Fair value of derivative instruments | 14,170,211 | 19,103,882 |
| Total noncurrent assets | 248,117,779 | 261,939,218 |
| Deferred outflows of resources - costs recoverable | 178,043,403 | 187,313,610 |
| Total assets and deferred outflows of resources | \$ 465,464,734 | \$ 480,601,202 |
| Liabilities, deferred inflows of resources, and net position | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | \$ 9,985,349 | \$ 9,275,685 |
| Advance billings – FMPA | 4,420,037 | 4,540,392 |
| Fair value of derivative instruments | 583,393 | 611,361 |
| Current portion of long-term debt | 13,497,668 | 13,667,505 |
| Lines-of-credit payable | – | 9,000,000 |
| Asset retirement obligation | 1,177,898 | 470,939 |
| Total current liabilities | 29,664,345 | 37,565,882 |
| Noncurrent liabilities: | | |
| Advances from the Gas Authority | 240,747,706 | 228,111,325 |
| Advance billings – FMPA | 83,980,706 | 86,267,440 |
| Fair value of derivative instruments | 149,612 | 549,614 |
| Long-term debt | 80,843,056 | 94,340,723 |
| Asset retirement obligation | 10,168,687 | 6,357,206 |
| Total noncurrent liabilities | 415,889,767 | 415,626,308 |
| Total liabilities | 445,554,112 | 453,192,190 |
| Deferred inflows of resources - unrealized gain on derivative instruments | 19,910,622 | 27,409,012 |
| Net position | – | – |
| Total liabilities, deferred inflows of resources, and net position | \$ 465,464,734 | \$ 480,601,202 |

See accompanying notes.

Public Gas Partners, Inc.
 Statements of Revenues,
 Expenses, and Changes in Net Position

| | Year Ended June 30 | |
|---|---------------------------|---------------|
| | 2013 | 2012 |
| Operating revenues: | | |
| From customers | \$ 78,879,534 | \$ 79,325,417 |
| From Members | 31,235,241 | 31,811,207 |
| Total operating revenues | 110,114,775 | 111,136,624 |
| Operating expenses: | | |
| Oil and gas field operations | 32,416,871 | 30,758,398 |
| Gas supplies delivered to Members | 23,923,364 | 21,092,128 |
| Depletion of oil and gas properties | 38,407,672 | 43,585,189 |
| General and administrative | 2,471,150 | 2,641,587 |
| Total operating expenses | 97,219,057 | 98,077,302 |
| Operating income | 12,895,718 | 13,059,322 |
| Nonoperating income (expense): | | |
| Interest expense | (9,094,089) | (9,073,707) |
| Equity in earnings of affiliates | 5,468,578 | 6,462,879 |
| Deferred outflows of resources - costs refundable | (9,270,207) | (10,448,494) |
| Total nonoperating expense | (12,895,718) | (13,059,322) |
| Changes in net position | - | - |
| Net position: | | |
| Beginning of year | - | - |
| End of year | \$ - | \$ - |

See accompanying notes.

Public Gas Partners, Inc.
Statements of Cash Flows

| | Year Ended June 30 | |
|--|---------------------------|----------------------|
| | 2013 | 2012 |
| Operating activities | | |
| Receipts from customers and Members | \$ 101,822,523 | \$ 108,217,423 |
| Payments to Members | (2,407,089) | (1,990,684) |
| Payments to suppliers | (57,669,832) | (54,557,600) |
| Payments from oil and gas derivative counterparties, net | 7,668,728 | 5,512,676 |
| Net cash provided by operating activities | 49,414,330 | 57,181,815 |
| Capital and related financing activities | | |
| Acquisition of oil and gas reserves | (381,013) | (13,880,706) |
| Sales of oil and gas reserves | 256,578 | 1,008,875 |
| Capital expenditures | (22,946,233) | (27,782,120) |
| Repayments of gas revenue bonds | (12,250,000) | (12,250,000) |
| Proceeds from lines of credit | - | 19,000,000 |
| Repayments on lines of credit | (9,000,000) | (24,602,454) |
| Advances from the Gas Authority | 12,912,000 | 19,513,168 |
| Repayments to the Gas Authority | (275,620) | (9,871,132) |
| Interest payments and debt issuance costs | (10,664,388) | (10,967,116) |
| Net cash used in capital and related financing activities | (42,348,676) | (59,831,485) |
| Investing activities | | |
| Investment distributions and interest receipts | 3,577,881 | 1,256,403 |
| Net cash provided by investing activities | 3,577,881 | 1,256,403 |
| Net increase/(decrease) in cash and cash equivalents | 10,643,535 | (1,393,267) |
| Cash and cash equivalents: | | |
| Beginning of year | 6,677,899 | 8,071,166 |
| End of year | \$ 17,321,434 | \$ 6,677,899 |
| Reconciliation of revenues in excess of operating expenses to net cash provided by operating activities: | | |
| Operating income | \$ 12,895,718 | \$ 13,059,322 |
| Adjustments to reconcile to net cash flows provided by operating activities: | | |
| Accretion of asset retirement obligation | 345,522 | 300,985 |
| Depletion of oil and gas reserves | 38,407,672 | 43,585,189 |
| Changes in certain assets and liabilities: | | |
| Accounts receivable – Members | 216,667 | 230,332 |
| Accounts receivable – other | (840,190) | 2,363,143 |
| Accounts payable and accrued expenses | 796,030 | (369,685) |
| Advance billings – FMPA | (2,407,089) | (1,987,471) |
| Net cash provided by operating activities | \$ 49,414,330 | \$ 57,181,815 |

See accompanying notes.

Public Gas Partners, Inc.
Notes to Financial Statements
June 30, 2013

1. Summary of Significant Accounting Policies

Overview of Business and Reporting Entity

Public Gas Partners, Inc. (PGP) is a nonprofit corporation organized under Georgia law, formed on November 15, 2004. PGP's mission is to build a portfolio of economic long-term gas supplies for its members (collectively, the Members). PGP is organized into projects in which the Members may elect to participate. Each of the Members participating in a PGP project has executed a Production Sharing Agreement (PSA) for that project. PGP has undertaken three projects: Gas Supply Pool No. 1 (Pool 1), Gas Supply Pool No. 2 (Pool 2), and Gas Supply Pool No. 3 (Pool 3). The following table summarizes the Members' participation share by Pool as of June 30, 2013 (totals may not equal 100% due to rounding). As described further below, in December 2008, Florida Municipal Power Agency (FMPPA) prepaid for its share of acquisitions and, therefore, does not have a specific obligation with respect to PGP's debt (including advances payable to the Gas Authority).

| Member | Pool 1 Participation Share | Pool 2 Participation Share | Pool 3 Participation Share* |
|------------------------------------|----------------------------------|----------------------------------|-----------------------------------|
| Florida Municipal Power Agency | 22.04% | 25.90% | 0.00% |
| Lower Alabama Gas District* | 3.32% | 4.50% | 2.97% |
| Municipal Gas Authority of Georgia | 46.43% | 53.60% | 73.23% |
| National Public Gas Agency | 0.00% | 0.00% | 3.02% |
| Patriots Energy Group | 8.29% | 10.00% | 3.66% |
| The Southeast Alabama Gas District | 17.91% | 5.00% | 17.11% |
| Tennessee Energy Acquisition Corp. | 2.02% | 1.00% | 0.00% |

* L.A. Gas has agreed to assign its interest in each Pool to the Gas Authority; this assignment is expected to be completed in October 2013. Also, the Gas Authority has increased its nominations in Pool 3, which would take effect upon consummation of the acquisition discussed in Note 7 and result in a higher participation share of the Gas Authority and a lower participation share for each of the other Members.

Public Gas Partners, Inc.
Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Pool 1 was formed in 2004, Pool 2 was formed in 2005, and Pool 3 was formed in 2009. Each PSA obligates the Member to pay, as a component of its gas operations expense, its participation share of all costs incurred by the related PGP pool until all related debt has been paid and the last volumes have been delivered. The PSAs include a step-up provision that may obligate the Members to increase their participation share in the related pool in the event of default by another Member. The Members are obligated to purchase their share of gas produced by the respective Pools, or cash from the sale of the Members' share of gas produced may be received by the Members in lieu of physical supply. Each of PGP's gas supply pools are held by wholly-owned subsidiary limited liability companies which are blended component units of PGP.

For Pools 1 and 2, PGP was authorized to acquire gas reserves or other contract rights during a three-year acquisition period that ended June 30, 2008. Pool 3 is authorized to acquire gas reserves or other contract rights on an ongoing basis as necessary to fulfill the gas deliveries requested by Pool 3 participants. PGP utilizes wholly owned subsidiaries to own the assets and manage the operations of its various projects. All intercompany transactions have been eliminated.

The Gas Authority manages PGP's day-to-day operations under a contract that ends on November 1, 2014, and renews automatically for one-year periods unless either party gives 180 days' notice. Under this agreement, PGP paid the Gas Authority \$1,447,309 and \$1,392,020 for management fees for the years ended June 30, 2013 and 2012, respectively.

In preparing the accompanying financial statements, management reviewed all known events that have occurred after June 30, 2013, and through September 20, 2013, for inclusion in the financial statements and footnotes.

Basis of Accounting

PGP follows proprietary fund accounting in accordance with Governmental Accounting Standards Board (GASB) pronouncements. Proprietary fund accounting is used to report business-type activities, as contrasted with tax-supported governmental activities.

Public Gas Partners, Inc.
Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

PGP also complies with policies and practices prescribed by its Board of Directors and to practices common in the natural gas industry. As the Board of Directors has the authority to set rates, PGP follows GASB-regulated accounting guidance in GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (GASB 62), which provides for the reporting of assets and liabilities consistent with the economic effect of the rate structure. Under GASB 62, regulatory assets are recorded to reflect probable future revenues associated with certain costs that are expected to be recovered from customers through the ratemaking process. Regulatory liabilities are recorded to reflect probable future reductions in revenues associated with amounts that are expected to be credited to customers through the ratemaking process. At June 30, 2013 and 2012, PGP's significant regulatory assets and liabilities are included in the accompanying statements of net position as deferred outflows of resources – costs recoverable.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect (1) the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and (2) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

PGP's financial statements include certain significant estimates, including oil and gas reserve quantities, which are the basis for calculating depletion and impairment of oil and gas properties, the timing and cost of its asset retirement obligations, accrued revenues and expenses associated with oil and gas properties, and estimates of fair values of derivative contracts.

Cash and Cash Equivalents

Cash and equivalents include cash on hand, bank demand accounts, and cash deposited in local government investment pools. Restricted cash represents funds held by a trustee restricted for future service pursuant to a bond resolution. PGP is subject to custodial credit risk, which is the risk that in the event of a bank failure, PGP's deposits may not be returned to it. At June 30, 2013, \$750,000 of PGP's cash balances were covered by federal depository insurance, \$9,021,219 was collateralized with securities held by a third-party bank's trust department, and \$8,175,457 was subject to custodial credit risk as it was uninsured and uncollateralized. At June 30, 2012, \$750,000 of PGP's cash balances were covered by federal depository insurance, \$117,537 was collateralized with securities held by a third-party bank's trust department, and \$5,905,822 was subject to custodial credit risk as it was uninsured and uncollateralized.

Public Gas Partners, Inc.
Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Oil and Gas Properties

Oil and gas properties represent working and royalty interests in oil and natural gas wells and related contract rights, facilities, and equipment. PGP uses the full-cost method of accounting for its investments in oil and gas properties. Under this method, PGP capitalizes all acquisition, exploration, and development costs incurred for the purpose of finding oil and gas reserves. Costs associated with production are expensed in the period incurred. PGP also includes the present value as of the date of incurrence of its dismantlement, restoration, and abandonment costs within the capitalized oil and gas property balance.

PGP computes the depreciation, depletion, and amortization (DD&A) of oil and gas properties, including unproved properties, except those noted below, using the unit-of-production method based upon a ratio of production and estimates of proved reserve quantities. Accumulated depletion was \$353,326,992 for Pool 1, \$134,108,392 for Pool 2, and \$29,278,258 for Pool 3 as of June 30, 2013, and \$332,004,826 for Pool 1, \$128,483,001 for Pool 2, and \$17,818,143 for Pool 3 as of June 30, 2012.

PGP excludes from amortization the cost of certain unproved properties. As of June 30, 2013 and 2012, \$0 and \$5,485,573, respectively, of development costs are not being amortized. The excluded costs related to certain wells under development in Oklahoma which were moved to the proved category in 2013.

Under the full-cost method, capitalized costs are limited to an amount not to exceed the value of the related gas reserves (referred to as a ceiling on capitalized costs). In performing its annual ceiling test, PGP limits the capitalized costs of gas properties, net of accumulated DD&A, to the present value of estimated future net cash flows, including cash flows from hedging transactions, from proved gas reserves, plus the lower of cost or fair value of any unproved properties included in the costs being amortized. The full-cost method stipulates that future cash flows are discounted at 10%. If capitalized costs exceed this limit, the excess is charged as additional DD&A expense. The full-cost method also stipulates that revenues for all future periods are calculated by applying the average first-of-month price over the preceding 12 months, except in those instances where future natural gas prices are covered by derivative contracts. Consequently, the preceding 12-month average prices could have a significant impact on the ceiling test calculation and could result in write-downs of gas properties. As of June 30, 2013, under the ceiling test calculation, PGP recognized an impairment loss of \$7,183,874. The impairment was the result of pricing all future gas production at the prior 12-month average of \$3.44/mcf, as required by the full-cost method, as well as the addition to the amortization pool of one project that previously was accounted for as a development project. An impairment loss of

Public Gas Partners, Inc.
Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

\$12,780,223 was recognized during the year ended June 30, 2012. Hedging transactions cover approximately 24% and 22% of expected future production from proved reserves for the years ended June 30, 2013 and 2012, respectively. If hedging transactions had not been considered in the impairment tests, additional expense of \$24,359,799 and \$28,075,418 for the years ended June 30, 2013 and 2012, respectively, would have been included in the impairment test.

Given the volatility of oil and gas prices, it is reasonably possible that PGP's estimate of discounted future net cash flows from proved oil and gas reserves could change in the near term. If oil and gas prices decline significantly, even if only for a short period of time, it is possible that additional impairments of oil and gas properties could occur.

Investments

PGP owns a noncontrolling interest in a partnership, accounted for under the equity method (see Note 2).

Deferred Outflows of Resources - Costs Recoverable From Future Billings

Under the provisions of the PSAs, the Board of Directors establishes rates and charges to produce revenues sufficient to cover PGP's costs. Expenses in excess of amounts currently billable to the Members under the pricing mechanism will be recovered from future billings to the Members and are classified as a deferred debit.

Asset Retirement Obligation

Asset retirement obligation represents the present value of the estimated costs for well shut-in and abandonment upon retirement of the related oil and gas properties. Such costs are recorded in oil and gas properties and amortized to expense using the unit-of-production method.

Advance Billings – FMPA

Advance billings – FMPA represents FMPA's payment to PGP in December 2008 of \$101,649,489 for a portion of its participation share of future gas deliveries over the life of Pools 1 and 2, adjusted by payments to or from FMPA subsequent to December 2008 for FMPA's participation share of net cash flows from oil and gas operations. The original amount advanced was based on FMPA's participation share of the December 2008 balances of PGP's lines of credit, which had been used to fund acquisitions and certain capital development costs in accordance with the terms of FMPA's PSAs for Pools 1 and 2.

Public Gas Partners, Inc.
Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Derivative Instruments

PGP uses derivative instruments, including swaps and options, to hedge its commodity price risk associated with short- and long-term changes in oil and natural gas prices. Realized gains or losses on hedging derivative instruments are recognized in operating revenues in the period to which the derivative instruments relate. Realized gains or losses on derivative instruments that do not meet the criteria to be accounted for as hedging derivative instruments (investment derivative instruments), if any, are recognized in investment income in the period to which the derivative instruments relate. GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* (GASB 53), requires PGP to record the fair value of derivative instruments on the statement of net position as an asset or liability. The change in fair value of hedging derivative instruments (unrealized gains or losses) is recorded as a deferred gain or deferred loss on the statement of net position (referred to as deferred inflows or outflows of resources). Changes in the fair value of investment derivative instruments (unrealized gains or losses) are recognized as investment income (loss) and then deferred as regulatory assets or liabilities under GASB 62. The fair values of derivative instruments with individual counterparties under master netting arrangements are offset as current and/or long-term net position or liabilities on the statements of net position. Cash receipts and payments for commodity instruments are classified as operating activities in the statements of cash flows. Unrealized gains and losses on commodity derivatives held on behalf of PGP are deferred and offset corresponding fair value changes in the Gas Authority's receivable from PGP.

Deferred Inflows of Resources – Unrealized Gain on Derivative Instruments

Deferred inflows of resources represent the unrealized gain on hedging derivative instruments.

Revenues

Oil and gas revenues are recognized when production or acquired gas is sold to a purchaser at a fixed or determinable price, when delivery has occurred and title has transferred, and if collectability of the revenue is probable. Oil and gas are sold in their local markets and shown as revenue from customers in the financial statements. PGP acquires comparable volumes of produced gas in its Members' service areas and delivers that gas to the Members, shown as revenue from Members in the financial statements. Additionally, realized gains and losses related to PGP's natural gas and oil derivatives are recognized in operating revenues, as described above. Under the provisions of the PSAs, PGP is required to set rates sufficient to recover all its costs. Any excess revenues or expenses are either credited or billed, respectively, to the Members in accordance with policies established by the Board of Directors.

Public Gas Partners, Inc.
Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Income Taxes

PGP is a nonprofit corporation comprised of governmental entities and, therefore, claims exemption from federal and state income taxes. Accordingly, no provision for such taxes is made in the accompanying financial statements.

Fair Value of Financial Instruments

PGP's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, and other current liabilities, are carried at cost, which approximates fair values due to the short-term maturities of these instruments. PGP's derivative instruments to hedge its commodity price risk are recorded at estimated fair values (see Note 4).

Reclassifications

Certain amounts in the 2012 financial statements have been reclassified to conform to the 2013 presentation.

New Accounting Standards

In April 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities* (GASB 65). GASB 65 reclassifies certain items that were reported as assets and liabilities as deferred outflows of resources and deferred inflows of resources. GASB 65 also specifies that costs of debt issuance should be expensed as incurred. GASB 65 requires retroactive application for prior periods presented. Therefore, PGP has adjusted its fiscal 2012 statement of net position and the statement of revenues, expenses, and changes in net position as of and for the year ended June 30, 2012, as follows:

| | <u>As Previously Reported</u> | <u>Change</u> | <u>As Adjusted</u> |
|---|-----------------------------------|---------------|------------------------|
| Statement of Net Position | | | |
| Noncurrent assets: | | | |
| Other assets | \$ 674,487 | \$ (674,487) | \$ — |
| Deferred outflows of resources – costs recoverable | 185,687,966 | 1,625,644 | 187,313,610 |
| Noncurrent liabilities: | | | |
| Advances from the Gas Authority | 227,160,168 | 951,157 | 228,111,325 |
| Statement of Revenues, Expenses, and Changes in Net Position | | | |
| Nonoperating revenues (expenses): | | | |
| Interest expense | \$ (9,354,189) | \$ 280,482 | \$ (9,073,707) |
| Deferred outflows of resources – costs recoverable | (10,168,012) | (280,482) | (10,448,494) |

Public Gas Partners, Inc.
Notes to Financial Statements (continued)

2. Investments

PGP owns a noncontrolling interest in a partnership that owns oil and gas properties. Summarized financial information for this investment as of and for the years ended June 30, 2013 and 2012, is as follows:

| | <u>2013</u> | <u>2012</u> |
|-------------|---------------|---------------|
| Assets | \$ 33,902,681 | \$ 29,926,372 |
| Liabilities | \$ 1,217,982 | \$ 1,217,982 |
| Revenues | \$ 17,833,794 | \$ 17,419,046 |
| Expenses | (10,652,638) | (9,025,403) |
| Net income | \$ 7,181,156 | \$ 8,393,643 |

The difference between PGP's carrying amount and its share of net assets of investees at June 30, 2013 and 2012, primarily relates to the acquisition of additional interests from other partners.

3. Debt and Advances from the Gas Authority

PGP's two \$25,000,000 lines of credit matured on December 26, 2012. In October 2009, PGP issued 10-year, fixed-rate bonds (the Series A Bonds) in a principal amount of \$125,000,000. Annual principal payments are due through October 1, 2027.

Following is a summary of activity for the lines of credit and the Series A Bonds:

| | <u>June 30, 2012</u> | <u>Proceeds</u> | <u>Payments</u> | <u>June 30, 2013</u> |
|-----------------|----------------------|-----------------|-----------------|----------------------|
| Lines of credit | \$ 9,000,000 | \$ — | \$ 9,000,000 | \$ — |
| Series A Bonds | 101,750,000 | — | 12,250,000 | 89,500,000 |

Public Gas Partners, Inc.
Notes to Financial Statements (continued)

3. Debt and Advances from the Gas Authority (continued)

| | <u>June 30, 2011</u> | <u>Proceeds</u> | <u>Payments</u> | <u>June 30, 2012</u> |
|-----------------|----------------------|-----------------|-----------------|----------------------|
| Lines of credit | \$ 14,602,454 | \$ 19,000,000 | \$ 24,602,454 | \$ 9,000,000 |
| Series A Bonds | 114,000,000 | - | 12,250,000 | 101,750,000 |

The summary of annual debt service, along with expected interest payments, for the years ending June 30 is as follows:

| | <u>Principal</u> | <u>Interest</u> | <u>Total Debt Service</u> |
|-------------------------------------|----------------------|----------------------|---------------------------|
| Years Ending June 30: | | | |
| 2014 | \$ 12,250,000 | \$ 4,117,750 | \$ 16,367,750 |
| 2015 | 12,250,000 | 3,508,250 | 15,758,250 |
| 2016 | 11,000,000 | 2,935,700 | 13,935,700 |
| 2017 | 11,000,000 | 2,394,400 | 13,394,400 |
| 2018 | 16,000,000 | 1,719,400 | 17,719,400 |
| 2019 – 2020 | 27,000,000 | 1,429,100 | 28,429,100 |
| Total | <u>89,500,000</u> | <u>\$ 16,104,600</u> | <u>\$ 105,604,600</u> |
| Unamortized bond premium | 4,840,724 | | |
| Total per statement of net position | <u>\$ 94,340,724</u> | | |

The Series A Bonds have fixed interest rates ranging from 3.0% to 5.0%, with an effective rate, including bond premium, of 3.39%. The estimated fair value of the Series A Bonds as of June 30, 2013, computed using a discounted cash flow method based on current rates, was \$97,972,482.

In December 2008, PGP entered into Advance Payment Agreements (APAs) with the Gas Authority under which the Gas Authority provides funding to PGP. The APAs mature in 2019. Interest expense is charged based on the Gas Authority's actual borrowing costs or contractual line-of-credit costs. As of June 30, 2013, the weighted-average rate charged to PGP was approximately 2.62%. PGP made interest payments to the Gas Authority totaling \$6,310,612 and \$5,050,489 for fiscal 2013 and 2012, respectively. The Members are obligated for their participation share of all Pool costs in which they have elected to participate, including related debt, unless such Members have also elected to pay a portion of their share of costs as an Advance Billing (see Note 1).

Public Gas Partners, Inc.
Notes to Financial Statements (continued)

4. Derivative Instruments

Hedging Derivative Instruments

PGP uses derivative instruments to hedge its commodity price risk associated with forecasted oil and gas sales from owned reserves by converting the revenues that PGP will receive from customers from a variable price, based on a spot market price, to a fixed price. The derivative agreements require monthly payments to be paid or received based on the difference between the spot market price and the contract strike price on notional volumes. None of PGP's derivatives require a cash payment at inception.

Effective June 30, 2009, PGP, the Gas Authority, and the Bank of Montreal, counterparty to certain of PGP's derivative instruments, entered into a novation agreement whereby the Bank of Montreal transferred and the Gas Authority accepted all the rights, liabilities, duties, and obligations with respect to PGP's outstanding derivative contracts with the Bank of Montreal. Accordingly, the Gas Authority has entered into various commodity derivatives to convert forecasted sales by PGP for gas reserves to fixed prices. PGP is obligated to repay all amounts incurred by the Gas Authority under these arrangements in full as required by the Gas Authority. Trades executed on behalf of PGP result in a derivative between the Gas Authority and PGP with a value that corresponds and offsets the value of the derivatives executed by the Gas Authority on PGP's behalf. At June 30, 2013 and 2012, PGP has a receivable from the Gas Authority of \$3,056,084 and \$7,875,429, respectively, for the fair value of these contracts. These amounts are reflected within the fair values of derivative instruments on the accompanying statements of net position.

Fair Values of Derivatives

The fair value estimates reflected on the statements of net position are based on pertinent information available to management at each statement of net position date. The fair value estimates for PGP's derivative instruments represent the present value of the differences of the fixed prices in the related instruments less the NYMEX (gas) or NYMEX – WTI (oil) forward price curve (or, for basis hedges at local delivery points, the forward price curve at that delivery point), multiplied by the corresponding monthly oil or gas volume using the LIBOR forward interest rate curve as a discount rate. The fair values of option contracts are estimated using option pricing models that consider similar factors and also include an estimate of expected volatility. These estimated fair values may be significantly impacted by changes in underlying oil and natural gas commodity prices or the general interest rate environment. The fair values presented have not been comprehensively revalued for purposes of these financial statements since June 30, 2013, and current estimates of fair value may differ significantly from the amounts presented herein.

Public Gas Partners, Inc.
Notes to Financial Statements (continued)

4. Derivative Instruments (continued)

The fair value balances of derivative instruments outstanding at June 30, 2013 and 2012, classified by type, and the changes in fair value of such derivative instruments for the years then ended, as reported in the financial statements are as follows (losses and liabilities in parentheses).

As of and for the year ended June 30, 2013:

| | Notional Amount at June 30, 2012* | | Fair Value at June 30, 2012 | | Change in Fair Value | | Fair Value at June 30, 2013 | | Notional Amount at June 30, 2013* |
|----------------------------|---|----|--------------------------------|----|-------------------------|----|--------------------------------|--|---|
| Hedging derivatives | | | | | | | | | |
| Henry Hub Swaps – Gas – | | | | | | | | | |
| Receive fixed | 11,855,200 | \$ | 28,388,916 | \$ | (11,082,085) | \$ | 17,306,831 | | 11,724,400 |
| Henry Hub Options – | | | | | | | | | |
| Bought put | 1,497,400 | | 2,979,987 | | (199,101) | | 2,780,886 | | 1,497,400 |
| Henry Hub Options – | | | | | | | | | |
| Sold call | 1,497,400 | | (225,214) | | 158,702 | | (66,512) | | 1,497,400 |
| WTI Swaps – Oil – | | | | | | | | | |
| Receive fixed | 918,300 | | (2,068,661) | | 2,646,442 | | 577,781 | | 1,501,460 |
| WTI Options – | | | | | | | | | |
| Bought put | 248,750 | | 2,159,737 | | (2,024,110) | | 135,627 | | 66,500 |
| WTI Options – Sold call | 248,750 | | (2,325,365) | | 1,892,461 | | (432,904) | | 66,500 |
| Basis Swaps – Gas – | | | | | | | | | |
| Receive fixed | 3,423,700 | | (1,500,388) | | 1,109,293 | | (391,095) | | 2,714,000 |

As of and for the year ended June 30, 2012:

| | Notional Amount at June 30, 2011* | | Fair Value at June 30, 2011 | | Change in Fair Value | | Fair Value at June 30, 2012 | | Notional Amount at June 30, 2012* |
|----------------------------|---|----|--------------------------------|----|-------------------------|----|--------------------------------|--|---|
| Hedging derivatives | | | | | | | | | |
| Henry Hub Swaps – Gas – | | | | | | | | | |
| Receive fixed | 10,100,800 | \$ | 23,456,938 | \$ | 4,931,978 | \$ | 28,388,916 | | 11,855,200 |
| Henry Hub Options – | | | | | | | | | |
| Bought put | 1,497,400 | | 1,528,424 | | 1,451,563 | | 2,979,987 | | 1,497,400 |
| Henry Hub Options – | | | | | | | | | |
| Sold call | 1,497,400 | | (861,001) | | 635,787 | | (225,214) | | 1,497,400 |
| WTI Swaps – Oil – | | | | | | | | | |
| Receive fixed | 1,065,270 | | (18,315,472) | | 16,246,811 | | (2,068,661) | | 918,300 |
| WTI Options – | | | | | | | | | |
| Bought put | 272,900 | | 1,810,111 | | 349,626 | | 2,159,737 | | 248,750 |
| WTI Options – Sold call | 272,900 | | (4,502,212) | | 2,176,847 | | (2,325,365) | | 248,750 |
| Basis Swaps – Gas – | | | | | | | | | |
| Receive fixed | 5,732,600 | | (2,096,351) | | 595,963 | | (1,500,388) | | 3,423,700 |

* Notional amounts are in MMBtu except WTI Swaps, which are in barrels.

Public Gas Partners, Inc.
Notes to Financial Statements (continued)

4. Derivative Instruments (continued)

Following are key terms of PGP's derivative instruments as of June 30, 2013:

| | Effective Dates | Notional Amounts* | Strike Prices |
|---------------------------------------|----------------------------|------------------------------|-------------------------------|
| Hedging derivatives | | | |
| Henry Hub Swaps – Gas – Receive fixed | 2013 – 2018 | 11,724,400 | \$3.67 – \$8.78 |
| Henry Hub Options – Bought put | 2014 – 2016 | 1,497,400 | \$5.50 – \$6.00 |
| Henry Hub Options – Sold call | 2014 – 2016 | 1,497,400 | \$6.85 – \$7.00 |
| WTI Swaps – Oil – Receive fixed | 2013 – 2018 | 1,501,460 | \$65.35 – \$103.25 |
| WTI Options – Bought put | 2013 – 2015 | 66,500 | \$65.00 – \$80.00 |
| WTI Options – Sold call | 2013 – 2015 | 66,500 | \$88.00 – \$99.00 |
| Basis Swaps – Gas – Receive fixed | 2013 – 2015 | 2,714,000 | NYMEX minus (\$0.17 – \$1.04) |

* Notional amounts are in MMBtu except WTI Swaps, which are in barrels.

Risks

Basis Risk

The NYMEX-based commodity hedging transactions are subject to locational basis risk. NYMEX-based forward contract transactions are based on pricing at the Henry Hub or WTI delivery points; however, PGP's oil and gas properties produce and deliver at various delivery points. PGP enters into derivative instruments based on pricing at certain local delivery points to mitigate basis risk. Changes in NYMEX-based natural gas prices and NYMEX – WTI-based oil prices, coupled with basis swaps, have been, and are anticipated to be, highly correlated with oil and gas prices at PGP's properties' delivery points.

Credit Risk

PGP intends to hold all derivative instruments to maturity. PGP is exposed to market price risk in the event of nonperformance by any of its four counterparties; however, PGP does not anticipate nonperformance. The counterparties to these contracts are major financial institutions with credit ratings of at least A with one of the major rating agencies.

Each Pool has entered into netting arrangements whenever it has entered into more than one derivative instrument transaction with a counterparty. Under the terms of those arrangements, should one party become insolvent or otherwise default on its obligations, close-out netting provisions permit the non-defaulting party to accelerate and terminate all outstanding transactions and net the transactions' fair values so that a single sum will be owed by, or owed to, the non-defaulting party.

Public Gas Partners, Inc.
Notes to Financial Statements (continued)

4. Derivative Instruments (continued)

PGP's counterparty credit exposures from derivative transactions and counterparty credit ratings as of June 30, 2013, are as follows:

| Counterparty | Counterparty Credit Ratings S&P/Moody's | Fair Market Value of Derivative Instruments June 30, 2013 Asset (Liability) |
|------------------------------------|--|--|
| Municipal Gas Authority of Georgia | AA-/A1 | \$ 3,056,084 |
| BP Corporation North America, Inc. | A/Baa1 | (541,395) |
| JP Morgan Chase Bank, N.A. | A+/Aa3 | 11,594,109 |
| Royal Bank of Canada | AA-/Aa3 | 5,801,824 |

Termination Risk

PGP is exposed to termination risk in its commodity derivatives. Termination of certain PGP commodity hedges may occur if PGP's credit ratings fall below BBB and PGP elects not to collateralize the unrealized losses on those transactions with specified cash and securities. No such collateral has been required or posted as of or during the periods presented.

5. Asset Retirement Obligations (ARO)

PGP has recorded a liability representing the present value of expected future costs associated with site reclamation, facilities dismantlement, and plug and abandonment of oil and gas wells at June 30, 2013 and 2012, as follows:

| | June 30 | |
|--|----------------------|---------------------|
| | 2013 | 2012 |
| Balance of ARO – beginning of year | \$ 6,828,145 | \$ 5,957,835 |
| Additions from acquisitions and drilling | 152,289 | 681,291 |
| Changes in cost estimate | 4,215,611 | – |
| Accretion expense | 345,522 | 300,985 |
| ARO settled | (194,982) | (111,966) |
| Balance of ARO – end of year | <u>\$ 11,346,585</u> | <u>\$ 6,828,145</u> |

Public Gas Partners, Inc.
Notes to Financial Statements (continued)

6. Litigation

PGP is subject to various litigation incidental to its ownership interests in oil and gas reserves. While the outcome of such contingencies cannot be predicted with certainty, management does not believe that the resolution of such matters will have a material impact on the results of operations, financial position, or cash flows of PGP.

7. Subsequent Event

In August 2013, PGP's Pool 3 signed a definitive agreement to acquire working interests and operations in approximately 1,400 wells in Alabama for \$160 million. PGP expects to close the transaction in October 2013.

Supplemental Schedules

Public Gas Partners, Inc.
Statement of Net Position

| | June 30, 2013 | | | |
|---|-----------------------|--------------------|--------------------|-----------------------|
| | Pool 1 | Pool 2 | Pool 3 | Total |
| | <i>(unaudited)</i> | <i>(unaudited)</i> | <i>(unaudited)</i> | |
| Assets and deferred outflows of resources | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | \$ 3,988,499 | 3,414,044 | 1,014,477 | \$ 8,417,020 |
| Restricted cash held by trustee | 8,904,414 | - | - | 8,904,414 |
| Accounts receivable – Members | 1,637,845 | 413,054 | 178,038 | 2,228,937 |
| Accounts receivable – other | 10,932,070 | 1,167,592 | 557,516 | 12,657,178 |
| Fair value of derivative instruments | 5,007,963 | 1,023,894 | 441,560 | 6,473,417 |
| Interproject receivables (payables) | 26,896 | 11,213 | (38,109) | - |
| Other assets | 265,894 | 356,692 | - | 622,586 |
| Total current assets | <u>30,763,581</u> | <u>6,386,489</u> | <u>2,153,482</u> | <u>39,303,552</u> |
| Noncurrent assets: | | | | |
| Oil and gas properties – net | 144,707,700 | 28,926,191 | 35,104,554 | 208,738,445 |
| Investments | - | 25,209,123 | - | 25,209,123 |
| Fair value of derivative instruments | 10,953,078 | 2,003,816 | 1,213,317 | 14,170,211 |
| Total noncurrent assets | <u>155,660,778</u> | <u>56,139,130</u> | <u>36,317,871</u> | <u>248,117,779</u> |
| Deferred outflows of resources - costs recoverable | 116,452,304 | 38,370,342 | 23,220,757 | 178,043,403 |
| Total assets and deferred outflows of resources | <u>\$ 302,876,663</u> | <u>100,895,961</u> | <u>61,692,110</u> | <u>\$ 465,464,733</u> |
| Liabilities, deferred inflows of resources, and net position | | | | |
| Current liabilities: | | | | |
| Accounts payable and accrued expenses | \$ 8,402,852 | 1,065,220 | 517,277 | \$ 9,985,349 |
| Advance billings – FMPA | 3,158,302 | 1,261,735 | - | 4,420,037 |
| Fair value of derivative instruments | 583,393 | - | - | 583,393 |
| Current portion of long-term debt | 13,497,668 | - | - | 13,497,668 |
| Asset retirement obligation | 755,444 | 147,610 | 274,844 | 1,177,898 |
| Total current liabilities | <u>26,397,659</u> | <u>2,474,565</u> | <u>792,121</u> | <u>29,664,345</u> |
| Noncurrent liabilities: | | | | |
| Advances from the Gas Authority | 112,763,020 | 70,038,841 | 57,945,845 | 240,747,706 |
| Advance billings – FMPA | 60,007,741 | 23,972,965 | - | 83,980,706 |
| Fair value of derivative instruments | 149,612 | - | - | 149,612 |
| Long-term debt | 80,843,056 | - | - | 80,843,056 |
| Asset retirement obligation | 7,487,540 | 1,381,881 | 1,299,266 | 10,168,687 |
| Total noncurrent liabilities | <u>261,250,969</u> | <u>95,393,687</u> | <u>59,245,111</u> | <u>415,889,767</u> |
| Total liabilities | <u>287,648,628</u> | <u>97,868,252</u> | <u>60,037,232</u> | <u>445,554,112</u> |
| Deferred inflows of resources - unrealized gain on derivative instruments | 15,228,035 | 3,027,709 | 1,654,878 | 19,910,622 |
| Net position | - | - | - | - |
| Total liabilities, deferred inflows of resources, and net position | <u>\$ 302,876,663</u> | <u>100,895,961</u> | <u>61,692,110</u> | <u>\$ 465,464,734</u> |

Public Gas Partners, Inc.
Statement of Revenues,
Expenses, and Changes in Net Position

| | Year Ended June 30, 2013 | | | |
|---|------------------------------|------------------------------|------------------------------|---------------|
| | Pool 1 <i>(unaudited)</i> | Pool 2 <i>(unaudited)</i> | Pool 3 <i>(unaudited)</i> | Total |
| Operating revenues: | | | | |
| From customers | \$ 63,063,419 | \$ 7,618,256 | \$ 8,197,859 | \$ 78,879,534 |
| From Members | 19,564,726 | 5,758,102 | 5,912,413 | 31,235,241 |
| Total operating revenues | 82,628,145 | 13,376,358 | 14,110,272 | 110,114,775 |
| Operating expenses: | | | | |
| Oil and gas operations | 23,730,614 | 3,810,730 | 4,875,527 | 32,416,871 |
| Gas supplies delivered to Members | 13,711,284 | 3,947,730 | 6,264,350 | 23,923,364 |
| Depletion of oil and gas properties | 21,322,165 | 5,625,391 | 11,460,116 | 38,407,672 |
| General and administrative | 1,640,158 | 443,898 | 387,094 | 2,471,150 |
| Total operating expenses | 60,404,221 | 13,827,749 | 22,987,087 | 97,219,057 |
| Operating income | 22,223,924 | (451,391) | (8,876,815) | 12,895,718 |
| Nonoperating income (expense): | | | | |
| Interest expense | (6,196,750) | (1,537,020) | (1,360,319) | (9,094,089) |
| Equity in earnings of affiliates | - | 5,468,578 | - | 5,468,578 |
| Deferred outflows of resources - costs refundable | (16,027,174) | (3,480,167) | 10,237,134 | (9,270,207) |
| Total nonoperating expense | (22,223,924) | 451,391 | 8,876,815 | (12,895,718) |
| Changes in net position | - | - | - | - |
| Net position: | | | | |
| Beginning of year | - | - | - | - |
| End of year | \$ - | \$ - | \$ - | \$ - |

Public Gas Partners, Inc.
Statement of Cash Flows

| | Year Ended June 30, 2013 | | | |
|--|------------------------------|------------------------------|------------------------------|----------------|
| | Pool 1 <i>(unaudited)</i> | Pool 2 <i>(unaudited)</i> | Pool 3 <i>(unaudited)</i> | Total |
| Operating activities | | | | |
| Receipts from customers and Members | \$ 75,703,809 | \$ 9,602,505 | \$ 16,516,209 | \$ 101,822,523 |
| Payments to Members | (2,388,464) | (18,625) | - | (2,407,089) |
| Payments to suppliers | (37,175,007) | (6,421,622) | (14,073,203) | (57,669,832) |
| Payments from oil and gas derivative counterparties, net | 5,352,939 | 1,825,305 | 490,484 | 7,668,728 |
| Net cash provided by operating activities | 41,493,277 | 4,987,563 | 2,933,490 | 49,414,330 |
| Capital and related financing activities | | | | |
| Acquisition of oil and gas reserves | (137,588) | (243,425) | - | (381,013) |
| Sale of oil and gas reserves | 256,578 | - | - | 256,578 |
| Capital expenditures | (18,057,991) | (4,409,053) | (479,189) | (22,946,233) |
| Repayments of gas revenue bonds | (12,250,000) | - | - | (12,250,000) |
| Proceeds from lines of credit | - | - | - | - |
| Repayments on lines of credit | - | - | (9,000,000) | (9,000,000) |
| Advances from the Gas Authority | 5,148,960 | - | 7,763,040 | 12,912,000 |
| Repayments to the Gas Authority | - | (275,620) | - | (275,620) |
| Interest payments and debt issuance costs | (7,767,019) | (1,537,035) | (1,360,334) | (10,664,388) |
| Net cash used in capital and related financing activities | (32,807,060) | (6,465,133) | (3,076,483) | (42,348,676) |
| Investing activities | | | | |
| Investment distributions and interest receipts | 141 | 3,577,725 | 15 | 3,577,881 |
| Net cash provided by investing activities | 141 | 3,577,725 | 15 | 3,577,881 |
| Net increase (decrease) in cash and cash equivalents | 8,686,358 | 2,100,155 | (142,978) | 10,643,535 |
| Cash and cash equivalents: | | | | |
| Beginning of year | 4,126,893 | 1,278,603 | 1,272,403 | 6,677,899 |
| End of year | \$ 12,813,251 | \$ 3,378,758 | \$ 1,129,425 | \$ 17,321,434 |
| Reconciliation of revenues in excess of operating expenses to net cash provided by operating activities: | | | | |
| Operating income | \$ 22,223,923 | \$ (451,390) | \$ (8,876,815) | \$ 12,895,718 |
| Adjustments to reconcile net cash flows provided by (used in) operating activities: | | | | |
| Accretion of asset retirement obligation | 277,414 | 41,069 | 27,039 | 345,522 |
| Depletion of oil and gas reserves | 21,322,165 | 5,625,391 | 11,460,116 | 38,407,672 |
| Changes in certain assets and liabilities: | | | | |
| Accounts receivable – Members | (749,432) | 273,554 | 692,545 | 216,667 |
| Accounts receivable – other | (936,835) | (438,051) | 534,696 | (840,190) |
| Accounts payable and accrued expenses | 1,744,506 | (44,385) | (904,091) | 796,030 |
| Advance billings – FMPA | (2,388,464) | (18,625) | - | (2,407,089) |
| Net cash provided by operating activities | \$ 41,493,277 | \$ 4,987,563 | \$ 2,933,490 | \$ 49,414,330 |