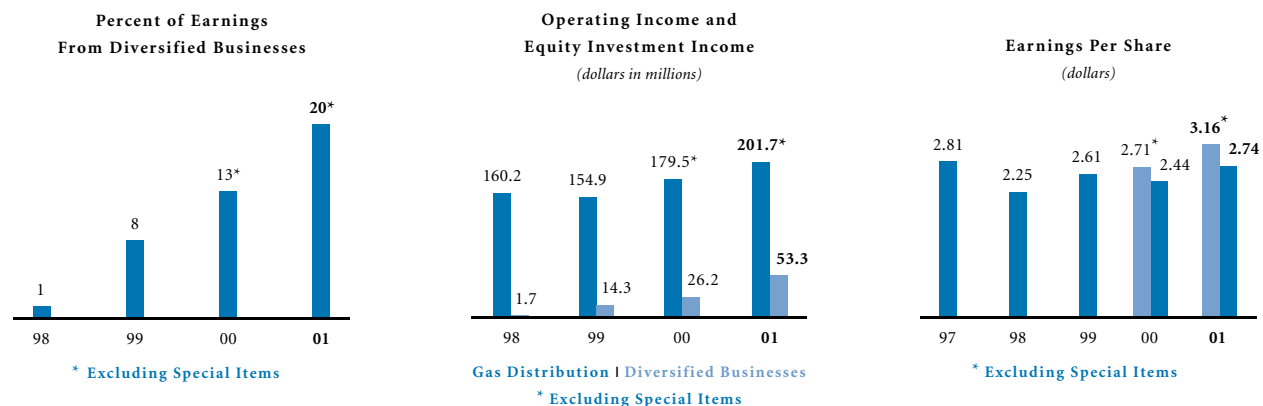


Financial Highlights

(Dollars in Millions, except earnings per share)

For Fiscal Years Ended September 30,	2001	2000	Percent Change
Financial Data			
Operating Revenues	2,270	1,418	60.1
Operating Income and Equity Investment Income	205.2	176.9	16.0
Operating Income and Equity Investment Income Excluding Special Items ⁽¹⁾	229.6	193.0	19.0
Net Income	97.0	86.4	12.3
Net Income Excluding Special Items ⁽¹⁾	111.7	96.1	16.2
Basic and Diluted Earnings Per Share	2.74	2.44	12.3
Earnings Per Share Excluding Special Items ⁽¹⁾	3.16	2.71	16.6
Total Assets at September 30	2,994	2,502	19.7
Operating Data			
Gas Distribution Deliveries (<i>billion cubic feet</i>)	249	240	3.8
Degree Days as a Percent of Normal (6,427, 6,536)	104%	86%	20.9
Degree Days (<i>actual</i>)	6,712	5,650	18.8
Gas Distribution Capital Spending	97.7	108.2	(9.7)
Diversified Businesses Capital Spending	168.5	140.4	20.0
Advances to Joint Venture Partnerships	79.2	68.4	15.8
Gas Distribution and Corporate Employees at September 30	2,521	2,601	(3.1)
Diversified Businesses Employees at September 30	103	93	10.8
Oil and Gas Proved Reserves (<i>billion cubic feet equivalent</i>)	129	67	93
Average Production (<i>million cubic feet of gas equivalent per day</i>)	43.9	32.2	36
Retail Energy Gas and Electric Customers	13,780	11,649	18
Megawatt Capacity	675	300	125
Total Debt/Total Debt Plus Equity			
Total Debt (<i>including short-term</i>)	1,252	988	26.7
Total Equity	806	777	3.7
Percentage of Total Debt to Total Debt Plus Equity	61%	56%	8.9
Common Stock Data			
Market Price (<i>year-end closing</i>)	39.76	33.39	19.1
Price-Earnings Ratio	14.5	13.7	5.8
Dividend Yield	5.1%	6.0%	(15.0)
Annualized Dividend Rate	2.04	2.00	2.0
Dividends Declared as a Percent of Net Income	74%	82%	(9.8)
Book Value Per Share — Year-End	22.76	22.02	3.4
Return on Common Equity — Year-End	12.0%	11.1%	8.1
Average Shares Outstanding (<i>thousands</i>)	35,380	35,413	(0.1)
Number of Shareowners	22,442	23,736	(5.5)

(1) Excluding Special Items related to the company's special retirement program, activity associated with the mercury program, and an adjustment to its reserve for uncollectible accounts. See Management's Discussion and Analysis of Results of Operations and Financial Condition — Summary Section.



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

Results of Operations

Summary

Fiscal 2001 net income increased to \$97.0 million, or \$2.74 per share, compared to \$86.4 million, or \$2.44 per share, in the year-ago period. Operating income from the company's diversified businesses more than doubled from the previous year. The company's core utility businesses remained strong resulting in an increase in operating income of \$22.2 million, excluding the impacts of three special items described below.

In the fourth quarter of 2001 and 2000, the company recorded special items. The after-tax impacts of these items in 2001 reduced earnings by \$14.7 million, or \$.42 per share. The after-tax impact of a fiscal 2000 fourth quarter mercury adjustment reduced earnings by \$9.7 million, or \$.27 per share. The special items are as follows:

On August 2, the company announced a special retirement program, which was offered to nonunion employees. Of the 170 employees eligible to retire, 131 employees, or 77 percent, accepted the offer. As a result, the company recorded a one-time charge of \$26.2 million, or \$.45 per share, to reflect the additional pension expense impact of these early retirements. This amount will be paid from the pension trust fund and therefore will have no impact on operating cash flow. The company expects fiscal 2002 labor savings to be about \$7 million. (See Note 9 of the Notes to Consolidated Financial Statements.)

During the fourth quarter of fiscal 2000, the company recorded \$16.1 million in total anticipated costs for the company's utilities' mercury inspection and remediation program. At this time, the company does not expect any further costs associated with that program and has therefore reversed the remaining reserve of \$10.3 million, or \$.18 per share. (See Note 5C of the Notes to Consolidated Financial Statements.)

The company adjusted its reserve for uncollectible accounts by recording an additional provision of \$8.5 million, or \$.15 per share, to reflect current collection experience related to last winter's extremely high gas costs. (See Note 7 of the Notes to Consolidated Financial Statements.)

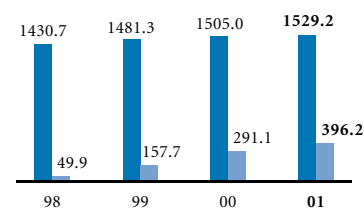
In fiscal 2001, all three of these adjustments affected the gas distribution segment (\$23.4 million). Additionally, approximately \$1.0 million of the pension costs were booked to corporate and adjustments. In fiscal 2000, the mercury accrual affected only the gas distribution segment (\$16.1 million).

Net income, excluding these special items in both years, increased to \$111.7 million, or \$3.16 per share, compared to \$96.1 million, or \$2.71 per share, in the year-ago period. The \$15.6 million increase (\$26.9 million before taxes) was mainly a result of increased earnings from the gas distribution segment (\$22.2 million). The gas distribution segment benefited from reduced depreciation expense (\$16.4 million) and from the positive effects of pension benefit accounting (\$7.1 million). Partially offsetting these effects was an increase in the utilities' provision for uncollectible accounts (\$12.7 million), excluding the fourth quarter adjustment, due to unseasonably cold weather and higher natural gas prices. Margin increased \$3.6 million and was positively affected by an increase in gas delivery volumes due to weather that was 19 percent colder than the previous year, partially offset by customer conservation resulting from higher natural gas costs. Margin also includes the fiscal 2000 benefit of the company's weather insurance policy. Also having a positive effect on fiscal 2001 earnings was continued growth from the diversified energy businesses, primarily Oil and Gas Production (\$10.2 million), Power Generation (\$8.5 million) and Midstream Services (\$7.6 million). Negatively impacting net income was an increase in long-term (\$12.6 million) and short-term (\$4.8 million) interest expense offset by an increase in miscellaneous interest income (\$8.2 million).

In fiscal 2000, net income, excluding the nonrecurring mercury charge, increased to \$96.1 million, or \$2.71 per share, compared to \$92.6 million, or \$2.61 per share, in fiscal 1999. Net income for fiscal 2000 and fiscal 1999 was negatively impacted by 14 percent warmer-than-normal weather (\$27.9 million and \$28.3 million, respectively), however, these effects were partially mitigated in 2000 by the net benefits from the company's weather insurance policy (\$8.9 million). Increases in interest expense (\$13.4 million) and depreciation expense (\$17.4 million) had a negative impact on fiscal 2000 results. Positive impacts in fiscal 2000

Assets and Investments

(dollars in millions)



Gas Distribution | Diversified Businesses

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

resulted from growth in diversified segment earnings (\$11.9 million) and the positive effects of pension benefit accounting (\$16.1 million). Also affecting the year-to-year comparison were the elimination of the decommissioning liability associated with Peoples Gas' 1995 retirement of its

synthetic natural gas (SNG) plant (\$13.0 million) and a state income tax refund (\$3.3 million).

A summary of variations affecting income between years is presented below, with explanations of significant differences following:

(In Thousands)	Fiscal Year		Increase/ (Decrease)
	2001	2000	
Excluding Special Items⁽¹⁾			
Operating Income and Equity Investment Income:			
Gas Distribution ⁽¹⁾	\$201,722	\$179,523	\$ 22,199
Power Generation	19,946	11,487	8,459
Midstream Services	18,016	10,368	7,648
Retail Energy Services	(3,007)	(4,165)	1,158
Oil and Gas Production	19,256	9,101	10,155
Other	(880)	(607)	(273)
Corporate and Adjustments ⁽¹⁾	(25,489)	(12,704)	(12,785)
Total Operating Income and Equity Investment Income	229,564	193,003	36,561
Other Income and (Deductions)	15,317	5,803	9,514
Interest Expense	72,051	52,919	19,132
Income Taxes	61,080	49,743	11,337
Income Before Cumulative Effect of Change in Accounting Principle	111,750	96,144	15,606
Cumulative Effect of Accounting Change, net of tax	(34)	—	(34)
Net Income Excluding Special Items⁽¹⁾	\$111,716	\$ 96,144	\$ 15,572
Net Income	\$ 97,020	\$ 86,415	\$ 10,605

(In Thousands)	Fiscal Year		Increase / (Decrease)
	2000	1999	
Excluding Special Item⁽¹⁾			
Operating Income and Equity Investment Income:			
Gas Distribution ⁽¹⁾	\$179,523	\$154,851	\$ 24,672
Power Generation	11,487	6,884	4,603
Midstream Services	10,368	8,991	1,377
Retail Energy Services	(4,165)	(3,590)	(575)
Oil and Gas Production	9,101	2,209	6,892
Other	(607)	(220)	(387)
Corporate and Adjustments	(12,704)	(4,237)	(8,467)
Total Operating Income and Equity Investment Income	193,003	164,888	28,115
Other Income and (Deductions)	5,803	19,840	(14,037)
Interest Expense	52,919	39,511	13,408
Income Taxes	49,743	52,581	(2,838)
Net Income Excluding Special Item⁽¹⁾	\$ 96,144	\$ 92,636	\$ 3,508
Net Income	\$ 86,415	\$ 92,636	\$ (6,221)

(1) See Management's Discussion and Analysis of Results of Operations and Financial Condition — Summary Section for discussion of special items.

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

Gas Distribution Segment

The company's core business is the distribution of natural gas. Its two regulated utilities purchase, distribute, sell and transport natural gas to approximately one million retail customers through a 6,000-mile distribution system serving the City of Chicago and 54 communities in north-eastern Illinois. The company also owns a storage facility in central Illinois and a pipeline which connects the facility and six major interstate pipelines to Chicago.

Gross revenues of Peoples Gas and North Shore Gas are affected by changes in the unit cost of the utilities' gas purchases and do not include the cost of gas supplies for customers who purchase gas directly from producers and marketers rather than from the utilities. In general, the unit cost of gas does not have a significant direct effect on gross margin because of the utilities' tariffs that provide for dollar-for-dollar recovery of gas costs. (See Note 1N of the Notes to Consolidated Financial Statements.)

However, changes in gas costs can affect the provision for uncollectible accounts and working capital requirements.

The comparison below excludes the impact from the special retirement program and adjustments for mercury and uncollectible accounts.

In 2001, operating revenues increased \$719.3 million compared to 2000 due mainly to the higher unit cost of gas (\$617.4 million) and weather that was four percent colder than normal and 19 percent colder than the prior period. Operating income, excluding the previously described special items, increased \$22.2 million to \$201.7 million, due mainly to reductions in depreciation expense (\$16.4 million) and outside services costs (\$4.9 million), as well as from the positive effects of pension benefit accounting (\$7.1 million). Negatively impacting operating income was an increase in the provision for uncollectible accounts (\$12.7 million), excluding the fourth quarter adjustment. Margin increased \$3.6 million and was positively affected

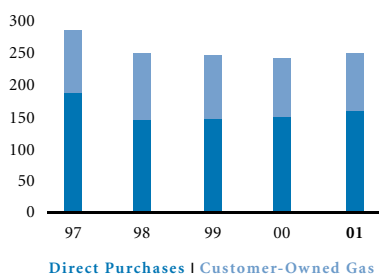
by an increase in gas delivery volumes due to weather that was 19 percent colder than the prior period, partially offset by customer conservation resulting from higher gas costs. Margin also includes the benefit of the company's weather insurance policy recorded in fiscal 2000.

In August 2000, Peoples Gas and North Shore Gas filed petitions with the Illinois Commerce Commission (Commission) requesting approval of revised depreciation rates based on an average service life study. In November 2000, the Commission issued orders approving Peoples Gas and North Shore Gas filed rates, which reduced depreciation expense, starting in fiscal year 2001. (See Note 1H of the Notes to Consolidated Financial Statements.)

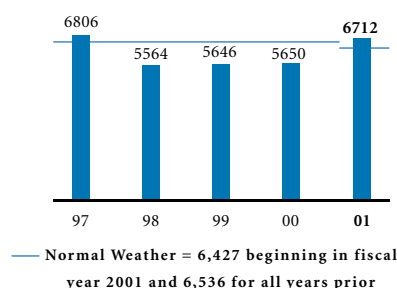
Weather for fiscal years 2000 and 1999 was warmer than normal in both periods by 14 percent, but the negative impact in 2000 was reduced substantially due to the company's weather insurance policy. The five-year weather insurance policy protects earnings when weather falls below 6,000 degree days. In fiscal 2000, the weather insurance benefit, net of the premium, amounted to \$8.9 million. The company will continue to retain all upside revenue potential when weather is colder than normal.

In 2000, operating revenues increased compared to 1999 due primarily to the higher unit cost of gas (\$130.0 million) and the benefits associated with the weather insurance policy (\$10.5 million). These effects were offset, in part, by a decline of \$3.6 million in gas deliveries. Operating income, exclusive of the previously described special item related to the company's mercury investigation and remediation program, increased \$24.7 million to \$179.5 million. This increase was primarily the result of pension benefit accounting (\$16.1 million) and the net benefits associated with the weather insurance policy (\$8.9 million). Partially offsetting these positive effects was an increase of \$6.8 million in depreciation expense.

Sources of Gas Supply
(billion cubic feet)



Degree Days



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

The company's objective is to become the primary player in the midwest energy market, developing additional hub services such as storage, transportation and title tracking while pursuing an exchange-traded Chicago contract. The Midstream Services segment is anticipated to grow through development of new products and services, development of wholesale business for the Chicago niche marketplace and identification of asset-based projects in the Chicago area that have a clear strategic fit. The results for 2001 were significantly higher than 2000 due primarily to unprecedented movement in natural gas prices. During fiscal 2002, the company expects a return to more normal market activity and thus is expecting lower earnings from this segment. Enron's bankruptcy has resulted in a restriction of some of enovate's activities. The company's earnings outlook for fiscal year 2002 includes \$4.0 million in operating income and equity investment income from enovate's trading activities that is likely to be adversely affected by these developments. Management believes that the other aspects of its Midstream Services business associated with physical deliveries will not be materially affected by Enron's bankruptcy. (See Note 19 of the Notes to Consolidated Financial Statements.)

Retail Energy Services Segment

The company markets gas and electricity and provides energy management and other services to retail customers.

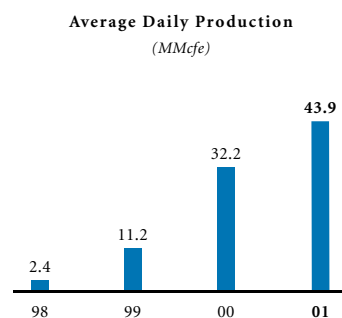
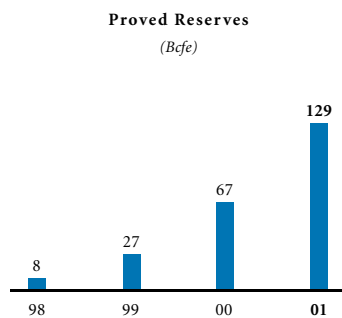
In 2001, operating revenues increased \$114.3 million to \$256.5 million due primarily to increased revenues resulting from higher natural gas commodity prices and from increased electricity sales. Current year results reflect an operating loss of \$3.0 million, an improvement of \$1.2 million over the prior period loss of \$4.2 million. The improvement is a result of higher gas (\$1.4 million) and electric margins (\$647,000) offset, in part, by higher operating expenses. The year-to-year comparison was negatively affected by a sale of excess inventory (\$1.5 million) in fiscal 2000.

In 2000, operating revenues increased \$41.0 million to \$142.2 million due primarily to higher gas prices and from the start-up of electricity sales. Operating results reflected a loss of \$4.2 million, slightly more than the \$3.6 million loss in 1999. Reflected in this period was a decrease in gross margin from gas sales as well as a nonrecurring revenue adjustment totaling \$1.4 million. Also impacting the fiscal year were positive gross margins from electricity sales (\$1.2 million) and a sale of excess inventory (\$1.5 million).

The company intends to develop proprietary products as it participates in the electric and gas unbundling process as a result of deregulation and will continue to build the necessary infrastructure to support its growth. As a result of growing customer base and volumes, margin enhancement and cost management initiatives, the company expects that the fiscal 2002 results for this segment will continue to show improvement.

Oil and Gas Production Segment

The company is active in the acquisition, development and production of oil and gas reserves in selected onshore basins in North America. The company also has an equity investment in EnerVest Energy, L.P. (EnerVest) which acquires, develops and manages a portfolio of oil and gas producing properties. The company's primary focus is on natural gas, with growth coming from low-to-moderate-risk drilling opportunities and the acquisition of proved reserves with upside potential, which can be realized through drilling, production enhancements and reservoir optimization programs. Certain producing properties owned by the company qualify for income tax credits as defined in Section 29 of the Internal Revenue Code of 1986. The Section 29 income tax credits are computed based on units of production and are scheduled to expire December 31, 2002.



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

Income Taxes

In 2001, income taxes, exclusive of the effect of the previously mentioned special items, increased \$11.3 million to \$61.1 million due primarily to higher pretax income. Partially offsetting this increase was \$922,000 in Section 29 tax credits associated with production from certain oil and gas production properties.

In 2000, income taxes, exclusive of the effect of the previously mentioned special item, decreased \$2.8 million to \$49.7 million, due principally to lower pretax income and to \$3.8 million in Section 29 tax credits associated with production from a reserve acquisition in December 1999. Offsetting these impacts was a \$1.9 million state income tax refund reflected in 1999's results.

Other Matters

Accounting Standards. In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." (See Note 1Q of the Notes to Consolidated Financial Statements.)

In July 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." (See Note 1Q of the Notes to Consolidated Financial Statements.)

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." (See Note 1Q of the Notes to Consolidated Financial Statements.)

Competition and Deregulation. Competition in varying degrees exists between natural gas and other fuels or forms of energy available to consumers in the midwest and the utilities' respective service territories.

On December 16, 1997, the State of Illinois enacted legislation to restructure the electric market in Illinois. Under the legislation, approximately one-third of nonresidential electric customers, including customers with very large loads, were able to purchase electric power from the supplier of their choice beginning on October 1, 1999. All nonresidential customers received this choice by December 31, 2000. All residential customers will be given this choice by May 1, 2002. Customers who buy their electricity from a supplier other than the local electric utility will be required to pay transition charges to the utility

through the year 2006. These charges are intended to compensate the electric utilities for revenues lost because of customers buying electricity from other suppliers. The legislation also allows an electric utility to issue bonds, in aggregate amounts up to 50 percent of its Illinois jurisdictional capitalization, to be financed by a specific charge to its customers. An electric utility also may transfer up to 15 percent of its assets to an affiliated or unaffiliated entity without approval from the Commission. In return for these and other benefits, electric utilities are required to reduce their rates to residential customers. The state's largest electric utility, the utility that serves northeastern Illinois, reduced the residential rates by 15 percent on August 1, 1998, and by another five percent on October 1, 2001. The legislation does not require electric utilities to divest their power generation assets. However, subject to certain capacity restrictions, electric utilities can divest assets without Commission approval. Management believes that the restructuring of the electric market in Illinois under this legislation will not have a material adverse effect on the competitive position of the company's subsidiaries.

In addition to restructuring the electric market, the legislation provides for additional funding for assistance to low-income energy users, including customers of the company's utility subsidiaries. The legislation creates a fund, financed by charges to electric and gas customers of public utilities and participating municipal utilities and electric co-ops, which supplements currently available federal energy assistance.

Liquidity and Capital Resources

The following is a summary of cash flows for the fiscal years ended September 30:

(In Thousands)	2001	2000	1999
Net cash provided by operations	\$ 169,541	\$ 49,234	\$ 190,601
Net cash (used in) investing activities	\$(295,345)	\$(317,874)	\$(237,267)
Net cash provided by financing activities	\$ 193,617	\$ 261,589	\$ 49,051

See the Consolidated Statements of Cash Flows and the discussion of major Balance Sheet Variations for more detail.

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

Balance Sheet Variations

The company's total assets at September 30, 2001 increased \$492.1 million, or 20 percent, from September 30, 2000. The increase was primarily due to a \$135.2 million increase in utility customer accounts receivable resulting from extremely high gas prices and an increase of \$68.1 million in other receivables. Also affecting the change in total assets were increases in cash and cash equivalents (\$67.8 million) due to short-term timing issues, advances to Elwood for expansion of the peaking facility (\$79.2 million), increased total regulatory assets (\$41.8 million) due to a reserve increase for environmental activities (see Note 5A of the Notes to Consolidated Financial Statements) and prepaid pension costs (\$21.7 million). These effects were partially offset by a \$48.0 million reduction in gas costs recoverable through rate adjustments due to the timing difference of gas costs paid by the utilities and gas costs charged to customers.

Record prices for natural gas coupled with extremely cold weather resulted in an increase in past due amounts. The utility accounts receivable balances at September 30, 2001 increased \$135.2 million to \$286.5 million as compared to September 30, 2000.

The utilities offer, and many of their customers participate in, budget payment programs and other programs designed to assist customers in paying their bills and avoiding shut-off. At September 30, 2001, \$56.3 million of receivables represented amounts owed by customers who have utilized these programs. Timing of cash receipts and reduction of accounts receivable have been affected by these programs, making period-to-period comparison less meaningful.

Customers of the utilities have received \$39.2 million in Low Income Home Energy Assistance Program funds during this fiscal year, and the company is actively seeking additional federal energy assistance for its customers. The utilities have also been working with the State of Illinois and the City of Chicago to develop programs that provide funds for assistance to customers in paying off their balances.

The utilities' reserves for uncollectible accounts at September 30, 2001 was \$45.5 million, including the \$8.5 million special provision, an increase of \$21.7 million from the September 30, 2000 balance. The company is continuing its outreach efforts to its customers and taking serious steps to collect past due accounts, including shut-offs for nonpayment. The ultimate outcome of these efforts is uncertain, and further increases to the reserve for uncollectible accounts may be required in future periods.

The company's current liabilities at September 30, 2001 increased \$204.7 million from September 30, 2000. The change was mostly a result of an increase in accounts payable (\$104.4 million) due to higher gas costs and increased gas sales revenue refundable through rate adjustments (\$45.6 million). Also affecting current liabilities were increases in short-term debt (\$39.2 million) and accrued taxes (\$16.0 million).

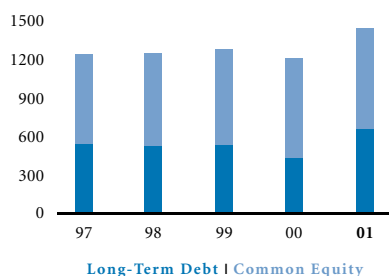
Variations in the company's deferred credits and other liabilities and accumulated other comprehensive income are due to the adoption of SFAS No. 133. (See Note 1I of the Notes to Consolidated Financial Statements.)

Financial Sources

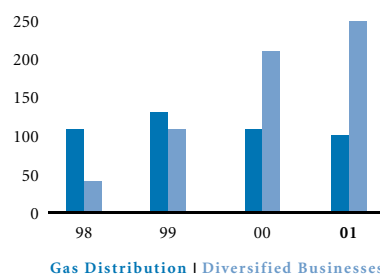
The company has access to outside capital markets and to internal sources of funds that together provide sufficient resources to meet capital requirements. It does not anticipate any changes that would materially alter its current liquidity position.

Due to the seasonal nature of gas usage, a major portion of the utilities' cash collections occurs between December and May. Because of timing differences in the receipt and disbursement of cash and the level of construction requirements, the utility subsidiaries borrow from time-to-time on a short-term basis. Short-term borrowings are repaid with cash from operations, other short-term borrowings, or refinanced on a permanent basis with debt or equity, depending on market conditions and capital structure considerations.

Capital Structure
(dollars in millions)



Capital Spending and Advances to Joint Venture Partnerships
(dollars in millions)



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

In the first quarter 2001, Peoples Gas issued short-term debt of \$200 million to supplement working capital needs and replace maturing short-term obligations. As of September 30, 2001, Peoples Energy had lines of credit of \$285.0 million and had unused credit available from banks of \$179.5 million. Peoples Gas had \$90.0 million of available credit facilities of which \$24.0 million was available to North Shore Gas, all of which was unused at September 30, 2001. (See Note 12 of the Notes to Consolidated Financial Statements.)

In January 2001, the company issued \$325.0 million 6.9% Notes, due January 15, 2011. In April 2001, the company completed an exchange offering of all of its outstanding 6.9% Notes due January 15, 2011, for an equal amount of 6.9% Notes due January 15, 2011, Series A. The proceeds from the issuance were used to pay off commercial paper.

The company has been assigned corporate credit ratings of A2 by Moody’s Investors Service, A+ by Standard & Poor’s Corporation and A+ by Fitch. The commercial paper ratings are P-1, A-1 and F-1, respectively.

The long-term debt of both gas distribution utility subsidiaries is rated Aa2 by Moody’s Investors Service, AA– by Standard & Poor’s Corporation and AA– by Fitch. The commercial paper of both subsidiaries has the top rating from the three rating agencies.

Financial Uses

Capital Spending. In fiscal 2001, the company spent \$266.2 million on property, plant and equipment, including partnership investments of \$21.2 million. The Gas Distribution segment spent \$97.7 million on property, plant and equipment. The remaining \$168.5 million was spent by the diversified business segments as follows: Power Generation, \$14.2 million; Midstream Services, \$2.2 million; Retail Energy Services, \$3.1 million; Oil

and Gas Production, \$148.0 million; and Corporate and Other, \$1.0 million. Oil and Gas Production spending relates primarily to the \$120.0 million acquisition of the South Texas properties and the subsequent development of those properties.

The company increased its advances to joint venture partnerships (\$79.2 million) to complete the expansion of the Elwood facility. The funds were repaid on October 23, 2001 as a result of permanent project financing. (See Note 18 of the Notes to Consolidated Financial Statements.)

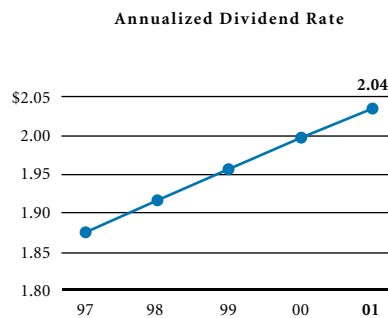
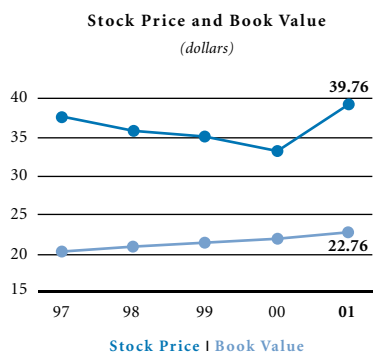
Dividends. On February 7, 2001, the Directors of the company voted to increase the regular quarterly dividend on the company’s common stock to 51 cents per share from the 50 cents per share previously in effect. The annualized dividend rate is \$2.04 per share.

Contingencies

Environmental Matters. The company’s gas distribution utility subsidiaries are conducting environmental investigations and work at certain sites that were the location of former manufactured gas operations. (See Note 5A of the Notes to Consolidated Financial Statements.)

In 1994, North Shore Gas received a demand from a responsible party under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (CERCLA) for environmental costs associated with a former mineral processing site in Denver, Colorado. The demand alleged that North Shore Gas is a successor to the liability of a former entity that allegedly disposed of mineral processing wastes there between 1934 and 1941. (See Note 5B of the Notes to Consolidated Financial Statements.)

Peoples Gas and North Shore Gas completed a mercury inspection and remediation program. (See Note 5C of the Notes to Consolidated Financial Statements.)



Consolidated Statements of Income

Peoples Energy Corporation

(In Thousands, Except Per-Share Amounts)			
For fiscal years ended September 30,			
	2001	2000	1999
Operating Revenues	\$2,270,218	\$1,417,533	\$1,194,381
Operating Expenses:			
Cost of energy sold	1,524,492	746,619	573,288
Operation and maintenance	295,815	269,274	251,036
Depreciation, depletion and amortization	95,046	100,935	83,531
Taxes — other than income taxes	192,848	141,522	130,512
Total Operating Expenses	2,108,201	1,258,350	1,038,367
Operating Income	162,017	159,183	156,014
Equity Investment Income	43,188	17,694	8,874
Total Operating Income and Equity Investment Income	205,205	176,877	164,888
Other Income and (Deductions)	15,317	5,803	19,840
Interest Expense	72,051	52,919	39,511
Earnings Before Income Taxes	148,471	129,761	145,217
Income Taxes	51,417	43,346	52,581
Income Before Cumulative Effect of Change in Accounting Principle	97,054	86,415	92,636
Cumulative Effect of Accounting Change, Net of Tax	(34)	—	—
Net Income	\$ 97,020	\$ 86,415	\$ 92,636
Average Shares of Common Stock Outstanding			
Basic	35,380	35,413	35,477
Diluted	35,439	35,417	35,490
Earnings Per Share of Common Stock			
Basic	\$ 2.74	\$ 2.44	\$ 2.61
Diluted	\$ 2.74	\$ 2.44	\$ 2.61

The Notes to Consolidated Financial Statements are an integral part of these statements.

Consolidated Balance Sheets

Peoples Energy Corporation

(In Thousands) At September 30,	2001	2000
Assets		
Capital Investments:		
Property, plant and equipment, at original cost	\$2,703,603	\$2,517,100
Less — Accumulated depreciation and depletion	949,691	871,760
Net property, plant and equipment	1,753,912	1,645,340
Investment in equity investees	160,490	139,317
Other investments	26,020	25,435
Total Capital Investments — Net	1,940,422	1,810,092
Current Assets:		
Cash and cash equivalents	73,769	5,956
Temporary investments and special deposits	3,325	10,091
Advances to joint venture partnerships	147,616	68,442
Receivables —		
Customers, net of allowance for uncollectible accounts of \$46,644 and \$24,958, respectively	291,038	175,644
Other	109,975	41,884
Materials and supplies, at average cost	14,450	14,695
Gas in storage	86,504	84,533
Gas costs recoverable through rate adjustments	6,841	54,866
Regulatory assets of subsidiaries	3,880	5,418
Prepayments	2,232	2,370
Total Current Assets	739,630	463,899
Other Assets:		
Prepaid pension costs	153,700	132,026
Non-current regulatory assets of subsidiaries	114,382	71,059
Deferred charges	45,920	24,842
Total Other Assets	314,002	227,927
Total Assets	\$2,994,054	\$2,501,918
Capitalization and Liabilities		
Capitalization (see Consolidated Capitalization Statements)	\$1,449,825	\$1,196,745
Current Liabilities:		
Short-term debt	607,454	568,215
Accounts payable	296,086	191,716
Dividends payable on common stock	18,171	17,905
Customer gas service and credit deposits	40,370	45,492
Accrued taxes	31,200	15,248
Gas sales revenue refundable through rate adjustments	47,339	1,731
Accrued interest	12,570	8,152
Total Current Liabilities	1,053,190	848,459
Deferred Credits and Other Liabilities:		
Deferred income taxes	335,510	343,359
Investment tax credits being amortized over the average lives of related property	29,027	29,739
Other	126,502	83,616
Total Deferred Credits and Other Liabilities	491,039	456,714
Total Capitalization and Liabilities	\$2,994,054	\$2,501,918

The Notes to Consolidated Financial Statements are an integral part of these statements.

Notes to Consolidated Financial Statements

1: Summary of Significant Accounting Policies

A. Principles of Consolidation

All subsidiaries are included in the consolidated financial statements. All significant intercompany transactions have been eliminated in consolidation. Investments for which the company's subsidiaries have at least a 20 percent interest, but less than a majority ownership, and partnerships in which the company has less than a majority interest are accounted for under the equity method. Certain items previously reported for years prior to 2001 have been reclassified to conform with the current-year presentation.

B. Use of Estimates

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

C. Revenue Recognition

Gas and electricity sales and transportation revenues are recorded on the accrual basis for all gas and electricity delivered during the month, including an estimate for gas and electricity delivered but unbilled at the end of each month. Oil and gas production revenues are accrued based on estimated monthly production from each property.

D. Weather Insurance

The company is protected from unusually mild weather by a five-year weather insurance policy originally purchased in fiscal year 2000. The weather insurance program protects earnings when weather falls below 6,000 degree days. The company will continue to retain all upside revenue potential when weather is colder than normal. On a monthly basis, the company amortizes the premium based on the normal 30-year average temperature and applies the intrinsic value method to measure the contract at an interim balance sheet date. The contract settles annually at the fiscal year-end. The insurance proceeds are reported as revenue.

E. Comprehensive Income

Comprehensive income is the total of net income and all other nonowner changes in equity (other comprehensive income). Comprehensive income includes net income plus the effect of the additional pension liability not yet recognized as net periodic pension cost and the unrealized hedged gain or loss on derivative instruments. The company has reported accumulated other comprehensive income in its Consolidated Statements of Stockholders' Equity.

F. Property, Plant and Equipment

Property, plant and equipment is stated at original cost and includes appropriate amounts of capitalized labor costs, payroll taxes, employee benefit costs, administrative costs, and an allowance for funds used during construction or capitalized interest as appropriate.

G. Oil and Gas Production Properties

For oil and gas activities, the company follows the full-cost method of accounting as prescribed by the SEC. Under the full-cost method, all costs directly associated with acquisition, exploration and development activities are capitalized, with the principal limitation that such amounts not exceed the present value of estimated future net revenues to be derived from the production of proved oil and gas reserves (the full-cost ceiling). Such a charge would have no effect on the company's cash flow. For fiscal years 2001, 2000 and 1999 there was no such charge to income. (See Note 17G.)

H. Depreciation, Depletion and Amortization

The company's utility subsidiaries charge the cost of maintenance and repairs of property and minor renewals and improvements of property to maintenance expense. When depreciable property is retired, its original cost is charged to the accumulated provision for depreciation.

The provision for depreciation substantially reflects the systematic amortization of the original cost of depreciable property, net of the accumulated reserve for depreciation, over the estimated composite remaining useful lives on the straight-line method. Additionally, actual dismantling cost, net of salvage, is included in the provision for depreciation in the month incurred.

In August 2000, Peoples Gas and North Shore Gas filed petitions with the Commission requesting approval of revised depreciation rates, based on average service life studies. In November 2000, the Commission issued orders approving the filed rates, which reduced depreciation expense by \$17.2 million in fiscal year 2001.

Diversified businesses' depreciable property, other than oil and gas producing properties, is amortized over its estimated useful lives. Gains and losses are recognized at the time of asset sale or disposition.

The consolidated provision for depreciation and amortization, expressed as an annual percentage of the original cost of depreciable property, was 3.2 percent, 3.7 percent and 3.6 percent for fiscal years 2001, 2000 and 1999, respectively.

In the case of oil and gas producing properties, the company is amortizing the capitalized costs on an overall units-of-production method based on total estimated

Notes to Consolidated Financial Statements

The Oil and Gas Production segment is active in the acquisition, development and production of oil and gas reserves in selected onshore basins in North America. The company also has an equity investment in EnerVest, which acquires, develops and manages a portfolio of oil and gas producing properties. The company's primary focus is on natural gas, with growth coming from low-to-moderate-risk drilling opportunities and the acquisition of proved reserves with upside potential, which can be realized through drilling, production enhancement and reservoir optimization

programs. Certain producing properties owned by the company qualify for Section 29 income tax credits.

The company is involved in other activities such as district heating and cooling and the development of fueling stations for natural gas vehicles. The company has invested in Enertech, a venture capital fund specializing in energy-related and telecommunication entities. These and certain business development activities do not fall under the above segments and are reported in the Other segment.

(In Thousands)	Gas Distribution	Power Generation	Midstream Services	Retail Energy Services	Oil and Gas Production	Other	Corporate and Adjustments	Total
Fiscal 2001								
Operating Revenues	\$1,835,427	\$ —	\$131,957	\$256,535	\$ 53,988	\$ 123	\$ (7,812)	\$2,270,218
Depreciation, Depletion and Amortization	68,351	1	536	1,660	24,148	66	284	95,046
Operating Income (Loss)	178,362	(4,620)	6,668	(3,007)	12,829	(1,727)	(26,488)	162,017
Equity Investment Income	—	24,566	11,348	—	6,427	847	—	43,188
Operating Income and Equity Investment Income	178,362	19,946	18,016	(3,007)	19,256	(880)	(26,488)	205,205
Segment Assets	1,529,279	5,061	6,517	10,177	211,494	2,453	1,064	1,766,045
Investments in Equity Investees	—	116,663	11,665	—	27,375	4,787	—	160,490
Capital Spending	97,661	14,180	2,163	3,158	147,998	1,006	18	266,184
Advances to Joint Venture Partnerships	\$ —	\$ 79,174	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 79,174
Fiscal 2000								
Operating Revenues	\$1,116,141	\$ —	\$132,722	\$142,233	\$ 31,139	\$ 40	\$ (4,742)	\$1,417,533
Depreciation, Depletion and Amortization	84,704	—	527	1,689	13,822	66	127	100,935
Operating Income (Loss)	163,397	(3,710)	10,151	(4,165)	7,365	(1,151)	(12,704)	159,183
Equity Investment Income	—	15,197	217	—	1,736	544	—	17,694
Operating Income and Equity Investment Income	163,397	11,487	10,368	(4,165)	9,101	(607)	(12,704)	176,877
Segment Assets	1,504,983	42,082	7,010	8,679	91,483	2,514	1,282	1,658,033
Investments in Equity Investees	—	106,048	1,233	—	27,097	4,939	—	139,317
Capital Spending	108,230	41,911	868	1,431	92,878	3,301	(895)	247,724
Advances to Joint Venture Partnerships	\$ —	\$ 68,442	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 68,442
Fiscal 1999								
Operating Revenues	\$ 980,125	\$ —	\$106,916	\$101,258	\$ 9,239	\$ 25	\$ (3,182)	\$1,194,381
Depreciation, Depletion and Amortization	77,904	—	211	1,367	4,039	—	10	83,531
Operating Income (Loss)	154,851	(1,630)	8,991	(3,590)	2,151	(522)	(4,237)	156,014
Equity Investment Income	—	8,514	—	—	58	302	—	8,874
Operating Income and Equity Investment Income	154,851	6,884	8,991	(3,590)	2,209	(220)	(4,237)	164,888
Segment Assets	1,481,305	—	8,314	8,178	31,836	2,580	306	1,532,519
Investments in Equity Investees	—	96,021	—	—	6,602	4,174	—	106,797
Capital Spending	\$ 130,288	\$ 73,186	\$ 42	\$ 4,589	\$ 27,775	\$ 580	\$ (2,289)	\$ 234,171

Notes to Consolidated Financial Statements

The following table reconciles total segment assets and investments in equity investees to the company's consolidated total assets for the fiscal years ended at September 30:

(In Thousands)	2001	2000
Segment Assets	\$1,766,045	\$1,658,033
Investments in Equity Investees	160,490	139,317
Other Investments not included in above categories	13,887	12,742
Total Capital		
Investments — Net	1,940,422	1,810,092
Current Assets	739,630	463,899
Other Assets	314,002	227,927
Total Assets	\$2,994,054	\$2,501,918

3: Loans and Advances to Joint Venture Partnerships

The company has made loans and advances to Elwood for the purpose of providing construction capital for the 750-megawatt expansion of the Elwood power facility. The company accrued interest on the loans and advances at market based rates. As of September 30, 2001, the total advances equaled \$147.6 million. On October 23, 2001, Elwood closed on a \$402 million non-recourse bond financing. The company received \$194.0 million from the partnership which paid off the loans and advances to joint venture partnerships and lowered its investment in the partnership. (See Note 18.)

4: Equity Investments

The company has a number of investments which are accounted for as unconsolidated equity method investments, the larger of which are reported in the Power Generation, Midstream Services and Oil and Gas Production segments. Individually, the company's equity investments are not material, however, in aggregate these investments are material at September 30, 2001. The company's pro rata share of financial results are as follows.

(In Thousands)	Fiscal years ended September 30,		
	2001	2000	1999
Total Equity Investments			
Operating revenues	\$200,006	\$ 46,636	\$ 20,671
Operating income	45,696	19,519	9,890
Interest expense	3,031	2,420	1,360
Earnings before income taxes	43,188	17,694	8,874
Investments in equity investees	\$160,490	\$139,317	\$106,797
Investment Results by Segment:			
Power Generation			
Operating revenues	\$ 48,320	\$ 31,500	\$ 15,591
Operating income	24,478	14,749	8,128
Interest expense	214	—	—
Earnings before income taxes	24,566	15,197	8,514
Investments in equity investees	\$116,663	\$106,048	\$ 96,021
Midstream Services			
Operating revenues	\$119,259	\$ 1,208	\$ —
Operating income	11,215	217	—
Interest expense	—	—	—
Earnings before income taxes	11,348	217	—
Investments in equity investees	\$ 11,665	\$ 1,233	\$ —
Oil and Gas Production			
Operating revenues	\$ 26,304	\$ 9,207	\$ 1,003
Operating income	7,942	2,866	172
Interest expense	1,538	1,160	114
Earnings before income taxes	6,427	1,736	58
Investments in equity investees	\$ 27,375	\$ 27,097	\$ 6,602
Other			
Operating revenues	\$ 6,123	\$ 4,721	\$ 4,077
Operating income	2,061	1,687	1,590
Interest expense	1,279	1,260	1,246
Earnings before income taxes	847	544	302
Investments in equity investees	\$ 4,787	\$ 4,939	\$ 4,174

Notes to Consolidated Financial Statements

9: Special Retirement Program

In August 2001, the company extended a voluntary special retirement offer to approximately 170 nonunion employees, excluding officers. The program was offered to employees who would complete at least 27 years of benefit service and whose age and service when added together equaled at least 79. Employees who met the criteria were given an enhancement of 3 years of age and 3 years of service to make them eligible for an unreduced

pension benefit under the nonunion pension plan. The actual number of employees accepting the program was 131 (77 percent of the eligible employees), resulting in a charge of \$26.2 million (\$15.8 million, net of tax) recorded in September 2001. This will result in a nonunion workforce reduction of 7.5 percent. As a result of the special retirement offer, it is expected that approximately \$65.0 million will be withdrawn from Trust assets to meet the December 1, 2001 pension payment obligation.

10: Tax Matters

A. Provision for Income Taxes

Total income tax expense as shown on the Consolidated Statements of Income is composed of the following:

(In Thousands) For fiscal years ended September 30,	2001	2000	1999
Current:			
Federal	\$49,248	\$ 3,825	\$27,607
State	8,952	757	2,517
Total current income taxes	58,200	4,582	30,124
Deferred:			
Federal	(5,761)	31,772	19,020
State	(385)	8,000	4,965
Total deferred income taxes	(6,146)	39,772	23,985
Investment tax credits — net:			
Federal	(928)	(1,190)	(1,634)
State	268	182	106
Total investment tax credits — net	(660)	(1,008)	(1,528)
Total provision for income taxes	51,394	43,346	52,581
Less — Included in cumulative effect of change in accounting principle	(23)	—	—
Net provision for income taxes	\$51,417	\$43,346	\$52,581

B. Tax Rate Reconciliation

The following is a reconciliation between the computed federal income tax expense (tax rate of 35 percent times book income before federal income tax) and the total provision for federal income tax expense:

For fiscal years ended September 30,	2001		2000		1999	
	Amount (000's)	Percent of Pretax Income	Amount (000's)	Percent of Pretax Income	Amount (000's)	Percent of Pretax Income
Computed federal income tax expense	\$48,852	35.00	\$42,287	35.00	\$48,170	35.00
Amortization of deferred taxes	(1,009)	(0.72)	(2,681)	(2.22)	(1,003)	(0.73)
Tax credits	(4,682)	(3.35)	(3,760)	(3.11)	(52)	(0.04)
Other, net	(602)	(0.43)	(1,439)	(1.18)	(2,122)	(1.54)
Total provision for federal income taxes	\$42,559	30.50	\$34,407	28.49	\$44,993	32.69