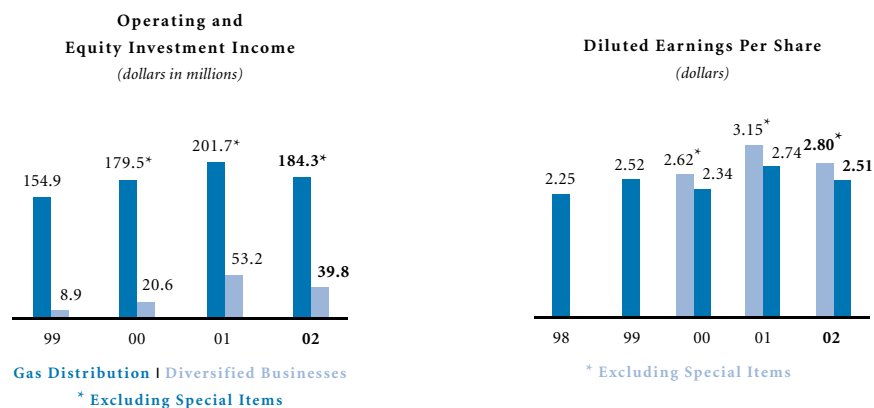


Financial Highlights

(Dollars in Millions, except earnings per share) For Fiscal Years Ended September 30,	2002	2001	Percent Change
Financial Data			
Operating Revenues	\$1,482.5	\$2,270.2	(34.7)
Operating and Equity Investment Income	\$ 182.1	\$ 205.1	(11.2)
Operating and Equity Investment Income Before Special Items ⁽¹⁾	\$ 199.1	\$ 229.4	(13.2)
Net Income	\$ 89.1	\$ 96.9	(8.0)
Net Income Before Special Items ⁽¹⁾	\$ 99.3	\$ 111.6	(11.0)
Basic and Diluted Earnings Per Share	\$ 2.51	\$ 2.74	(8.4)
Basic Earnings Per Share Before Special Items ⁽¹⁾	\$ 2.80	\$ 3.16	(11.4)
Diluted Earnings Per Share Before Special Items ⁽¹⁾	\$ 2.80	\$ 3.15	(11.1)
Total Assets at September 30	\$2,727.6	\$2,982.9	(8.6)
Fixed Charges Coverage Ratio	3.62	2.95	23.1
Operating Data			
Gas Distribution Deliveries (<i>billion cubic feet</i>)	224.6	249.2	(9.9)
Degree Days as a Percent of Normal (<i>6,427</i>)	88%	104%	(15.4)
Degree Days (<i>actual</i>)	5,639	6,713	(16.0)
Gas Distribution Capital Spending	\$ 92.7	\$ 97.7	(5.5)
Diversified Businesses Capital Spending	\$ 108.2	\$ 166.5	(37.8)
Gas Distribution and Corporate Employees at September 30	2,368	2,521	(6.1)
Diversified Businesses Employees at September 30	111	108	2.8
Oil and Gas Proved Reserves (<i>billion cubic feet equivalent</i>)	134.5	128.5	4.7
Average Production (<i>million cubic feet of gas equivalent per day</i>)	53.0	43.9	20.7
Retail Energy Gas and Electric Customers	11,388	13,780	(17.4)
Megawatt Capacity	805	675	15.6
Total Debt/Total Debt Plus Equity			
Total Debt (<i>including short-term</i>)	\$ 931.9	\$1,251.8	(25.6)
Total Equity	\$ 806.3	\$ 798.6	1.0
Percentage of Total Debt to Total Debt Plus Equity	54%	61%	(11.5)
Common Stock Data			
Market Price (<i>year-end closing</i>)	\$ 33.69	\$ 39.76	(15.3)
Price-Earnings Ratio	13.4	14.5	(7.6)
Dividend Yield	6.2%	5.1%	21.6
Annualized Dividend Rate	\$ 2.08	\$ 2.04	2.0
Dividends Declared as a Percent of Net Income	82%	74%	10.8
Book Value Per Share — Year-End	\$ 22.74	\$ 22.56	0.8
Return on Common Equity — Year-End	11.0%	12.1%	(9.1)
Average Shares Outstanding (<i>thousands</i>)	35,454	35,380	0.2
Number of Shareowners	21,688	22,442	(3.4)

(1) Special items related to an adjustment to the company's reserve for uncollectible accounts in both fiscal years, cost associated with special retirement program and activity associated with the mercury program in fiscal 2001. See Management's Discussion and Analysis of Results of Operations and Financial Condition — Summary Section.



Results of Operations

Summary

Results for fiscal 2002 reflect a special charge to increase the reserve for uncollectible accounts, as described below. Results for fiscal years 2001 and 2000 reflect the restatement for the impact of the change in the accounting method for oil and gas properties from the full cost method to the successful efforts method (see Note 1H of the Notes to Consolidated Financial Statements). The previous periods also reflect the impact of other special items described below.

Fiscal 2002 net income decreased to \$89.1 million, or \$2.51 per share, compared to \$96.9 million, or \$2.74 per share, in the fiscal 2001 period. Before the impact of the special items in fiscal years 2002 and 2001, net income for fiscal 2002 decreased to \$99.3 million, or \$2.80 per share, compared to \$111.6 million, or \$3.15 per share, in the previous period. The decrease in fiscal year results was largely due to the negative impact of weather that was 16 percent warmer than fiscal 2001 and lower pension credits (a noncash item) and equity investment income, which together more than offset the benefits of lower operating costs in the Gas Distribution segment and lower interest expense. The company's weather insurance policy offset approximately 25 percent of the negative impact of weather.

Fiscal 2001 net income increased to \$96.9 million, or \$2.74 per share, compared to \$82.9 million, or \$2.34 per share, in fiscal 2000. Before the impact of the special items in fiscal years 2001 and 2000, net income for fiscal 2001 increased to \$111.6 million, or \$3.15 per share, compared to \$92.7 million, or \$2.62 per share, in the previous period. The increase was mainly a result of increased earnings from the Gas Distribution segment, which benefited from colder weather, reduced depreciation expense and from an increase in pension credits. Partially offsetting these effects was an increase in the utilities' provision for uncollectible accounts due to unusually cold weather and higher natural gas prices. Also having a positive effect on fiscal 2001 earnings was continued growth from the diversified energy businesses and an increase in miscellaneous interest income, partially offset by an increase in interest expense.

During the third quarter of fiscal 2002, Peoples Gas recorded a special charge of \$17.0 million, or \$.29 per share, to increase the reserve for utility uncollectible accounts. Despite an aggressive collection program, receipts from customers with balances over 150 days past due had not improved as much as anticipated. The additional charge will not materially affect the company's liquidity. The reserve for uncollectible accounts remains an estimate

and additional adjustments may be required depending on the level of success of ongoing credit and collection activities. (See Note 7 of the Notes to Consolidated Financial Statements.)

During the fourth quarter of fiscal 2001, Peoples Gas adjusted its reserve for uncollectible accounts by recording a special charge of \$8.5 million, or \$.14 per share, to reflect collection experience at that time related to the extremely high gas costs associated with the winter of 2000/2001.

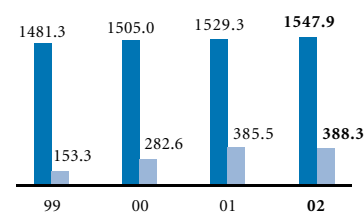
In August 2001, Peoples Gas and North Shore Gas announced a special retirement program, which was offered to nonunion employees. Of the 170 employees eligible to retire, 131 employees accepted the offer. As a result, a one-time charge of \$26.2 million, or \$.45 per share, was recorded to reflect the additional pension expense impact of these early retirements. This adjustment primarily affected the Gas Distribution segment with approximately \$1.0 million reflected as corporate activity. This charge reflected the cost of enhancing the benefits for the retirees. Benefits were paid from the pension trust assets and therefore had no impact on operating cash flow. (See Note 9 of the Notes to Consolidated Financial Statements.)

During the fourth quarter of fiscal 2000, the company recorded \$16.1 million, or \$.27 per share, in the Gas Distribution segment in total anticipated costs for the mercury inspection and remediation program. This program was completed in the fourth quarter of fiscal 2001 and the remaining reserve of \$10.3 million (\$.18 per share) was reversed.

The total impact on earnings of these special items is shown in the following table:

(In Millions, except per share amounts)	Pretax Impact	After-tax Impact	Earnings Per Share Impact
2002	\$(17.0)	\$(10.3)	\$(.29)
2001	\$(24.3)	\$(14.7)	\$(.41)
2000	\$(16.1)	\$(9.7)	\$(.27)

Assets and Investments
(dollars in millions)



Gas Distribution | Diversified Businesses

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

Fiscal 2003 Outlook

The company's estimated earnings for fiscal 2003 are in the range of \$2.70 to \$2.80 per diluted share assuming

normal weather. The earnings outlook reflects continued improvement in operating results, offset by lower pension credits and the expected expiration of Section 29 tax credits. (See Forward-Looking Information)

Income Variations

The following table summarizes net income by segment before and including special items:

Fiscal Year (In Thousands)	2002			2001			Increase/ (Decrease) ⁽²⁾
	Before Special Item	Special Item ⁽¹⁾	As Reported (GAAP)	Before Special Items	Special Items ⁽¹⁾	As Reported (GAAP)	
Operating and Equity Investment Income:							
Gas Distribution	\$184,313	\$(17,000)	\$167,313	\$201,722	\$(23,360)	\$178,362	\$(17,409)
Power Generation	10,065	—	10,065	19,946	—	19,946	(9,881)
Midstream Services	12,802	—	12,802	18,016	—	18,016	(5,214)
Retail Energy Services	1,549	—	1,549	(3,007)	—	(3,007)	4,556
Oil and Gas Production	16,142	—	16,142	19,130	—	19,130	(2,988)
Other	(777)	—	(777)	(880)	—	(880)	103
Corporate and Adjustments	(24,949)	—	(24,949)	(25,489)	(999)	(26,488)	540
Total Operating and Equity Investment Income	199,145	(17,000)	182,145	229,438	(24,359)	205,079	(30,293)
Other Income and (Expense)	9,686	—	9,686	15,317	—	15,317	(5,631)
Interest Expense	56,439	—	56,439	72,051	—	72,051	(15,612)
Income Taxes	53,064	(6,743)	46,321	61,035	(9,663)	51,372	(7,971)
Income before Cumulative Effect of Change in Accounting Principle	99,328	(10,257)	89,071	111,669	(14,696)	96,973	(12,341)
Cumulative Effect of Accounting Change, net of tax	—	—	—	(34)	—	(34)	34
Net Income	\$ 99,328	\$(10,257)	\$ 89,071	\$111,635	\$(14,696)	\$ 96,939	\$(12,307)
Fiscal Year (In Thousands)	2001			2000			Increase / (Decrease) ⁽²⁾
	Before Special Items	Special Items ⁽¹⁾	As Reported (GAAP)	Before Special Item	Special Item ⁽¹⁾	As Reported (GAAP)	
Operating and Equity Investment Income:							
Gas Distribution	\$201,722	\$(23,360)	\$178,362	\$179,523	\$(16,126)	\$163,397	\$ 22,199
Power Generation	19,946	—	19,946	11,487	—	11,487	8,459
Midstream Services	18,016	—	18,016	10,368	—	10,368	7,648
Retail Energy Services	(3,007)	—	(3,007)	(4,165)	—	(4,165)	1,158
Oil and Gas Production	19,130	—	19,130	3,477	—	3,477	15,653
Other	(880)	—	(880)	(607)	—	(607)	(273)
Corporate and Adjustments	(25,489)	(999)	(26,488)	(12,704)	—	(12,704)	(12,785)
Total Operating and Equity Investment Income	229,438	(24,359)	205,079	187,379	(16,126)	171,253	42,059
Other Income and (Expense)	15,317	—	15,317	5,803	—	5,803	9,514
Interest Expense	72,051	—	72,051	52,919	—	52,919	19,132
Income Taxes	61,035	(9,663)	51,372	47,592	(6,397)	41,195	13,443
Income before Cumulative Effect of Change in Accounting Principle	111,669	(14,696)	96,973	92,671	(9,729)	82,942	18,998
Cumulative Effect of Accounting Change, net of tax	(34)	—	(34)	—	—	—	(34)
Net Income	\$111,635	\$(14,696)	\$ 96,939	\$ 92,671	\$(9,729)	\$ 82,942	\$ 18,964

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

(2) Comparisons between periods are calculated before 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. Peoples Gas and North Shore Gas purchase, store, distribute, sell and transport natural gas to approximately one million customers through a 6,000-mile distribution system serving the City of Chicago and 54 communities in northeastern Illinois. The customer base includes residential, commercial and industrial retail sales and transportation accounts, and provides a broad foundation with no reliance on any particular group of customers. The company also owns a storage facility in central Illinois and a pipeline that connects the storage facility and six major interstate pipelines to Chicago.

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. In a normal gas price environment, the unit cost of gas does not have a significant direct effect on operating income because the utilities' tariffs provide for dollar-for-dollar recovery of gas costs. (See Note 1L of the Notes to Consolidated Financial Statements.) However, significant changes in gas costs can materially affect the reserve for uncollectible accounts and working capital needs.

The following table sets forth net margin and degree day statistics for the Gas Distribution segment.

Gas Distribution Statistics

Net Margin (In Thousands)	For the Fiscal Years Ended			Variations	
	September 30,			Fiscal Year	Fiscal Year
	2002	2001	2000	2002 vs. 2001	2001 vs. 2000
Total Operating Revenues	\$1,067,297	\$1,835,427	\$1,116,141	\$(768,130)	\$719,286
Less: Gas Costs	463,844	1,158,851	506,162	(695,007)	652,689
Revenue Taxes	112,187	167,110	117,030	(54,923)	50,080
Environmental Costs Recovered	6,620	6,606	2,093	14	4,513
Net Margin Before Tax	\$ 484,646	\$ 502,860	\$ 490,856	\$ (18,214)	\$ 12,004
Gas Distribution Deliveries (MDth):					
Gas Sales					
Residential					
Heating	110,001	124,328	114,412	(14,327)	9,916
Non-heating	3,321	3,208	3,402	113	(194)
Commercial	17,345	19,350	18,974	(2,005)	376
Industrial	3,570	4,043	4,003	(473)	40
Total Gas Sales	134,237	150,929	140,791	(16,692)	10,138
Transportation					
Residential	21,605	24,186	23,206	(2,581)	980
Commercial	42,724	44,531	40,896	(1,807)	3,635
Industrial	26,047	29,569	34,708	(3,522)	(5,139)
Total Transportation	90,376	98,286	98,810	(7,910)	(524)
Total Gas Distribution Deliveries	224,613	249,215	239,601	(24,602)	9,614
Margin per Dth Delivered	\$ 2.16	\$ 2.02	\$ 2.05	\$ 0.14	\$ (0.03)
Degree Days as a Percent of Normal*	88	104	86		

* Normal degree days for fiscal 2002 and 2001 (6,427) are based on a 30-year average of monthly temperatures at Chicago's O'Hare Airport for the years 1970-1999. Normal degree days for fiscal 2000 (6,536) are based on a 30-year average of monthly temperatures at Chicago's O'Hare Airport for the years 1961-1990.

The comparisons below are before the impact of the special items for all periods.

In 2002, revenues decreased \$768.1 million compared to 2001 due primarily to weather that was 16 percent warmer than the previous period and the lower unit cost of gas partially offset by recoveries under the company’s weather insurance policy. Operating income decreased \$17.4 million resulting from the net effect of the warmer weather and from lower pension credits (\$21.0 million). Partially offsetting these effects was a reduction in the ongoing provision for uncollectible accounts (\$14.0 million) associated with significantly lower current period revenues.

In 2001, revenues increased \$719.3 million compared to 2000 due mainly to the higher unit cost of gas and higher gas deliveries resulting from weather that was 19 percent colder than the prior period offset, in part, by customer conservation due to the higher gas costs as well as from the company’s weather insurance policy recorded in 2002. Operating income increased \$22.2 million to \$201.7 million, due mainly to the effects of colder weather, a reduction in depreciation expense (\$16.4 million) resulting from revised depreciation rates, from lower outside services costs (\$4.9 million) and from an increase in pension credits (\$7.1 million). Negatively impacting operating income was an increase in the provision for uncollectible accounts (\$12.7 million).

Power Generation Segment

The Power Generation segment, through Peoples Energy Resources, is engaged in the development, construction, operation and ownership of electric generation facilities for sales to electric utilities and marketers. Currently, the company has an ownership interest in two electric generation facilities. The company and Dominion Energy, Inc. (Dominion) are equal investors in Elwood Energy LLC (Elwood), which owns and operates a 1,400-megawatt peaking facility near the City of Chicago. Power generated by Elwood is sold through long-term contracts with Exelon Generation Company LLC (Exelon), Engage

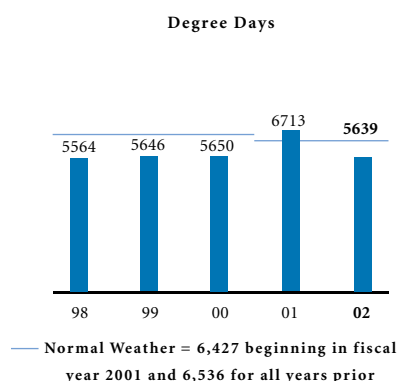
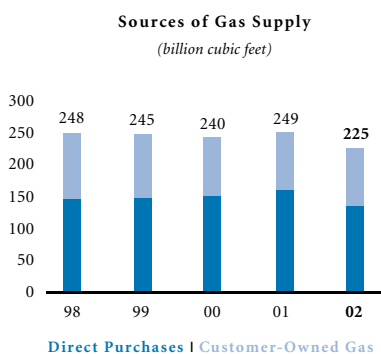
Energy America LLC (Engage) and Aquila, Inc. (Aquila). The company has also made an investment in the Southeast Chicago Energy Project (SCEP) a partnership with Exelon. The company has a 30 percent interest in SCEP, which owns and operates a 350-megawatt facility. Commercial operations began in July 2002.

Revenue recognition for the Elwood facility is based on contract provision, which assign higher value to summer capacity. The majority of Elwood’s annual capacity revenues are recognized in the June to September period, resulting in operating losses in the first and second quarters. Revenue recognition by SCEP is on a straight-line basis based on contract provisions.

Elwood closed a \$402 million nonrecourse bond financing on October 23, 2001. (See Note 16 of the Notes to Consolidated Financial Statements.)

In 2002, operating and equity investment income decreased \$9.8 million mainly due to the inclusion in this year’s results of interest expense associated with Elwood’s bond financing. In the prior year, the interim financing costs for this project were reflected as corporate interest expense. The inclusion of this cost significantly reduced equity investment income from Elwood by \$16.5 million. Last year’s results also benefited from a gain on the liquidation of financial hedges associated with Elwood’s gas supply requirements (\$4.0 million). Adjusting for the financing and hedge impacts, operating and equity investment income increased significantly due to Elwood’s first full year of operation with its expanded facilities, which became commercially operable in June 2001 (\$5.9 million), and from the site-development income and start up of operations at SCEP, which began commercial operations in July 2002 (\$5.6 million). These benefits were somewhat offset by higher development expenses related to the pursuit of new power projects.

In 2001, operating and equity investment income increased \$8.5 million to \$19.9 million. The increase was due mainly to additional equity investment income resulting from



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

During fiscal 2002, Peoples Gas and North Shore Gas increased their accrual for environmental liabilities associated with former manufactured gas operations by a total of \$56.1 million. This resulted in related increases in regulatory assets, as these costs will be recovered as incurred under rate mechanisms approved by the commission.

The increase in the debit balance in Accumulated Other Comprehensive Income (AOCI) is due to deferred losses from cash flow hedges resulting from higher commodity prices, partially offset by decreases in the company's pension liability. The change in deferred losses from the cash flow hedges is offset by the gains in the forecasted transactions being hedged.

The change in the net of gas costs recoverable and gas costs refundable is a short-term timing difference between cost of gas delivered by Peoples Gas and North Shore Gas and the gas costs billed to customers.

Financial Sources

The company and its two regulated utilities have access to outside capital markets, commercial paper markets and internal sources of funds that together provide sufficient resources to meet cash requirements. The company 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 January and June. 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.

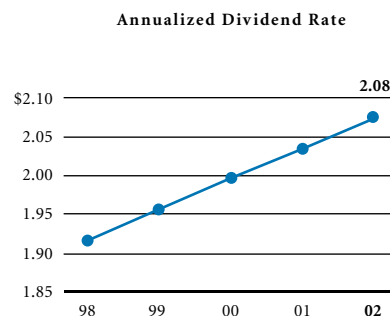
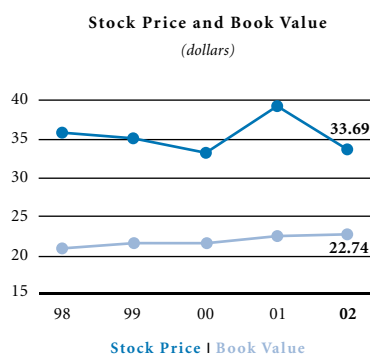
In addition to cash generated internally by operations, as of September 30, 2002, the company had credit facilities of \$257.7 million which primarily support its commercial

paper borrowing, of which \$254.5 million was uncommitted. The company's credit facilities provide that the lenders under such facilities may terminate the credit commitments and declare any outstanding amounts due and payable if the company's debt-to-total capital ratio exceeds 65 percent during any period of time that the company's senior unsecured debt rating falls below A- (Standard & Poor's) or A3 (Moody's Investor Services). Also, Peoples Gas has \$117.3 million of credit facilities of which up to \$24.0 million is also available to North Shore Gas. As of September 30, 2002, \$34.6 million was uncommitted. The credit facilities of the company as well as those of the utilities are expected to be renewed when they expire, although the exact amount of the renewals will be evaluated at that time and may change.

The company's current credit ratings were recently downgraded by Moody's Investor Service and Standard & Poor's, and Fitch Ratings lowered its outlook from stable to negative. The company has been assigned corporate credit ratings of A3 by Moody's, A- by Standard & Poor's and A+ by Fitch Ratings. The commercial paper ratings are P-2, A-2 and F-1, respectively. The senior unsecured debt rating is BBB+ by Standard & Poor's, A3 by Moody's and A+ by Fitch Ratings. Senior secured debt of each utility subsidiary is rated Aa3 by Moody's, A- by Standard & Poor's and AA by Fitch Ratings. The commercial paper of each utility subsidiary is rated P-1 by Moody's, A-2 by Standard & Poor's and F-1+ by Fitch Ratings.

Off-balance sheet debt at September 30, 2002 and September 30, 2001 consists of the company's pro rata share of nonrecourse debt of various equity investments, including Trigen-Peoples (\$15.7 million and \$15.8 million), EnerVest (\$5.7 million and \$19.8 million) and Elwood (\$196.9 million and \$0). At September 30, 2002 and September 30, 2001, this debt amounted to \$218.3 million and \$35.6 million, respectively.

The company has filed a universal shelf registration statement on Form S-3 for the issuance from time-to-time



Consolidated Statements of Income

Peoples Energy Corporation

(In Thousands, except per-share amounts)

For fiscal years ended September 30,

	2002	2001 (Restated)	2000 (Restated)
Revenues	\$1,482,534	\$2,270,218	\$1,417,533
Operating Expenses:			
Cost of energy sold	782,157	1,524,492	746,619
Operation and maintenance	294,219	297,797	274,320
Depreciation, depletion and amortization	98,852	93,190	101,513
Taxes — other than income taxes	135,957	192,848	141,522
Total Operating Expenses	1,311,185	2,108,327	1,263,974
Operating Income	171,349	161,891	153,559
Equity Investment Income	10,796	43,188	17,694
Total Operating and Equity Investment Income	182,145	205,079	171,253
Other Income	14,177	21,699	5,827
Other Expense	4,491	6,382	24
Interest Expense	56,439	72,051	52,919
Earnings Before Income Taxes	135,392	148,345	124,137
Income Taxes	46,321	51,372	41,195
Income Before Cumulative Effect of Change in Accounting Principle	89,071	96,973	82,942
Cumulative Effect of Accounting Change, Net of Tax	—	(34)	—
Net Income	\$ 89,071	\$ 96,939	\$ 82,942
Average Shares of Common Stock Outstanding			
Basic	35,454	35,380	35,413
Diluted	35,492	35,439	35,417
Earnings Per Share of Common Stock			
Basic	\$ 2.51	\$ 2.74	\$ 2.34
Diluted	\$ 2.51	\$ 2.74	\$ 2.34

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

Consolidated Balance Sheets

	Peoples Energy Corporation	
(In Thousands) At September 30,	2002	2001 (Restated)
Assets		
Capital Investments:		
Property, plant and equipment		
Utility plant	\$2,493,323	\$2,432,307
Oil and gas	285,885	254,441
Other	15,422	5,107
Total property, plant and equipment	2,794,630	2,691,855
Less — Accumulated depreciation, depletion and amortization	1,020,729	949,117
Net property, plant and equipment	1,773,901	1,742,738
Investment in equity investees	154,857	160,490
Other investments	22,893	26,020
Total Capital Investments — Net	1,951,651	1,929,248
Current Assets:		
Cash and cash equivalents	9,435	73,769
Deposits	28,645	3,325
Advances to joint venture partnerships	—	147,616
Receivables —		
Customers, net of reserve for uncollectible accounts of \$34,669 and \$46,644, respectively	180,601	291,038
Other	42,979	109,975
Materials and supplies, at average cost	12,691	14,450
Gas in storage	86,825	86,504
Gas costs recoverable through rate adjustments	10,218	6,841
Regulatory assets of utility subsidiaries	18,274	3,881
Other	6,203	2,232
Total Current Assets	395,871	739,631
Other Assets:		
Prepaid pension costs	179,678	153,700
Noncurrent regulatory assets of utility subsidiaries	167,236	114,382
Deferred charges	33,213	45,920
Total Other Assets	380,127	314,002
Total Assets	\$2,727,649	\$2,982,881
Capitalization and Liabilities		
Capitalization (see Consolidated Capitalization Statements)	\$1,360,338	\$1,442,922
Current Liabilities:		
Current maturities of long-term debt	90,000	100,000
Short-term debt	287,871	507,454
Accounts payable	217,914	296,086
Regulatory liabilities of utility subsidiaries	29,976	—
Dividends payable	18,495	18,171
Customer deposits	70,641	40,370
Accrued taxes	47,283	31,200
Gas costs refundable through rate adjustments	28	47,339
Accrued interest	11,582	12,570
Total Current Liabilities	773,790	1,053,190
Deferred Credits and Other Liabilities:		
Deferred income taxes	378,225	331,239
Investment tax credits	28,340	29,028
Noncurrent regulatory liabilities of utility subsidiaries, environmental and other	186,956	126,502
Total Deferred Credits and Other Liabilities	593,521	486,769
Total Capitalization and Liabilities	\$2,727,649	\$2,982,881

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

1: Summary of Significant Accounting Policies

A. Principles of Consolidation

Peoples Energy Corporation (the company) is solely a holding company whose name is derived principally from its utility subsidiaries. The utilities are primarily engaged in the sale and transportation of natural gas to residential, commercial and industrial customers in the Chicago and northeast section of Illinois. It also engages in Midstream Services, Power Generation, Retail Energy Services and Oil and Gas Production.

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 2002 have been reclassified to conform to the current-year presentation. (See Note 1H.)

The company was a 50 percent partner with Enron Midwest in enovate until March 29, 2002, when Enron's interest in the partnership was purchased by the company. From late March and until its dissolution in September 2002, enovate was reported as a wholly owned subsidiary instead of an investment accounted for under the equity method.

B. Use of Estimates

The preparation of financial statements in conformity with 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. The amount of accrued unbilled revenues at September 30, 2002 and 2001, for the company was \$32.1 million and \$33.1 million, respectively. The amount of accrued unbilled revenues at September 30, 2002 and 2001, for Peoples Gas was \$21.0 million and \$22.5 million, respectively. The amount of accrued unbilled revenues at September 30, 2002 and 2001, for North Shore Gas was \$3.4 million and \$3.5 million, respectively.

D. Weather Insurance

The company is partially protected from the impact of unusually mild weather by a five-year weather insurance policy purchased in fiscal year 2000. The weather insurance program protects earnings when weather falls below 6,000 degree days per fiscal year or about seven percent warmer than normal with payments limited to a maximum of \$12.0 million per year and \$36.0 million over the life of the policy. As of September 30, 2002, the company has recorded \$17.1 million in weather insurance revenue. The company retains 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 additional pension liability not yet recognized as net periodic pension cost and the unrealized hedge gain or loss on derivative instruments. The company has reported AOCI in its Consolidated Statements of Stockholders' Equity.

F. Income Taxes

The company follows the asset and liability method of accounting for deferred income taxes. Under this method, deferred income taxes have been recorded using currently enacted tax rates for the differences between the tax basis of assets and liabilities and the basis reported in the financial statements. Due to the effects of regulation on Peoples Gas and North Shore Gas, certain adjustments made to deferred income taxes are, in turn, debited (credited) to regulatory assets (liabilities). (See Note 10C.)

Each utility subsidiary within the consolidated group nets its income tax-related regulatory assets and liabilities. At September 30, 2002 and 2001, net regulatory income tax assets for the company and Peoples Gas recorded in other assets and other receivables amounted to \$18.7 million and \$18.8 million, respectively, while net regulatory income tax liabilities for the company and North Shore Gas recorded in other liabilities equaled \$3.4 million and \$3.9 million, respectively.

Investment tax credits have been deferred and are being amortized to income over the remaining book lives of related property.

As a result of qualified production from oil and gas reserves that were acquired in December 1999, the company recognized \$4.5 million, \$4.7 million and \$3.8 million of Section 29 tax credits in fiscal 2002, 2001 and 2000, respectively. Future production credits are scheduled to expire on December 31, 2002.

G. 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.

H. Oil and Gas Production Properties/ Change in Accounting

In the first quarter of fiscal 2002, the company elected to change its method of accounting for oil and gas properties from the full cost method to the successful efforts method. Under the successful efforts method, the cost of exploratory dry holes and other exploration costs are expensed in the period they occur, whereas under the full cost method these costs are capitalized and amortized over future production. In accordance with GAAP, previously reported results have been restated. The impact of the restatement resulted in a reduction in net income of \$0.1 million and \$3.5 million (\$0.10 per share) for fiscal years 2001 and 2000, respectively. The total effect of the restatement on years prior to fiscal 2000 was \$3.3 million (\$0.09 per share).

I. 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 recorded as depreciation expense 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 3.5 percent, 3.5 percent and 4.0 percent for fiscal years 2002, 2001 and 2000, respectively.

In the case of oil and gas producing properties, the company is amortizing the capitalized costs by utilizing the successful efforts method of accounting on an overall units-of-production method based on total estimated proved oil and gas reserves. The fiscal 2002, 2001 and 2000 average rate of depletion was \$1.40, \$1.39 and \$1.23 per Mcf equivalent unit of production, respectively.

J. Gas in Storage

The company's utility subsidiaries price storage injections at the fiscal-year average of the costs of natural gas supply purchased. Withdrawals from storage for the utilities are priced on the last-in, first-out (LIFO) cost method. The estimated replacement cost of gas in inventory at September 30, 2002 and 2001, exceeded the LIFO cost by approximately \$131.2 million and \$20.1 million, respectively. The Retail Energy Services and Midstream Services segments account for gas in inventory using the average cost method.

K. Regulated Operations

Peoples Gas' and North Shore Gas' utility operations are subject to regulation by the Commission. Regulated operations are accounted for in accordance with SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation." This standard controls the application of GAAP for companies whose rates are determined by an independent regulator such as the Commission. Under this standard, certain costs or revenues are deferred on the Balance Sheet until recovered or refunded through rates.

Notes to Consolidated Financial Statements

The company is involved in other activities such as district heating and cooling. These 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 2002								
Operating Revenues	\$1,067,297	\$ 4,619	\$193,004	\$167,787	\$ 65,710	\$ 48	\$(15,931)	\$1,482,534
Depreciation, Depletion and Amortization	68,779	120	749	1,758	27,312	30	104	98,852
Operating Income (Loss)	167,313	(1,151)	11,505	1,549	18,276	(1,194)	(24,949)	171,349
Equity Investment Income	—	11,216	1,297	—	(2,134)	417	—	10,796
Operating and Equity Investment Income	167,313	10,065	12,802	1,549	16,142	(777)	(24,949)	182,145
Segment Capital Assets	1,547,891	1,002	5,270	9,129	215,870	1,231	925	1,781,318
Investments in Equity Investees	—	123,254	—	—	27,400	4,203	—	154,857
Capital Spending	92,652	56,725	3,962	1,087	45,748	625	53	200,852
Return of Advances to Joint Venture Partnerships	\$ —	\$(147,616)	\$ —	\$ —	\$ —	\$ —	\$ —	\$ (147,616)
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	22,292	66	284	93,190
Operating Income (Loss)	178,362	(4,620)	6,668	(3,007)	12,703	(1,727)	(26,488)	161,891
Equity Investment Income	—	24,566	11,348	—	6,427	847	—	43,188
Operating and Equity Investment Income	178,362	19,946	18,016	(3,007)	19,130	(880)	(26,488)	205,079
Segment Capital Assets	1,529,279	5,061	6,517	10,177	199,746	2,453	1,064	1,754,297
Investments in Equity Investees	—	116,663	11,665	—	27,375	4,787	—	160,490
Capital Spending	97,661	14,180	2,163	3,158	146,016	1,006	18	264,202
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	14,400	66	127	101,513
Operating Income (Loss)	163,397	(3,710)	10,151	(4,165)	1,741	(1,151)	(12,704)	153,559
Equity Investment Income	—	15,197	217	—	1,736	544	—	17,694
Operating and Equity Investment Income	163,397	11,487	10,368	(4,165)	3,477	(607)	(12,704)	171,253
Segment Capital Assets	1,504,983	42,082	7,010	8,679	81,717	2,514	1,282	1,648,267
Investments in Equity Investees	—	106,048	1,233	—	27,097	4,939	—	139,317
Capital Spending	108,230	41,911	868	1,431	87,832	3,301	(895)	242,678
Advances to Joint Venture Partnerships	\$ —	\$ 68,442	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 68,442

Notes to Consolidated Financial Statements

Reconciliation of Capital Investments

(In Thousands) Fiscal years ended September 30,	2002	2001	2000
Capital Investments			
Segment capital assets	\$1,781,318	\$1,754,297	\$1,648,267
Investments in equity investees	154,857	160,490	139,317
Other investments not included in above categories	15,476	14,461	22,508
Total Capital Investments — Net	\$1,951,651	\$1,929,248	\$1,810,092

3: Equity Investments

The company has a number of investments that are accounted for as unconsolidated equity method investments. During the second quarter of fiscal 2002, the company acquired Enron's 50 percent interest in enovate, its partnership with Enron. Results from this business were recorded in the Midstream Services segment as a consolidated subsidiary from March 2002 until enovate was liquidated in September 2002. Individually, the company's equity investments do not meet the requirements for financial disclosure. However, in aggregate these investments were material at September 30, 2002. The company records its share of income gains and losses based on financial information it receives from the partnerships.

The following table presents total activity of equity method investees and the company's share of financial results from unconsolidated equity method investments.

(In Thousands) Fiscal years ended September 30,	2002	2001	2000
Gross Results from Equity Investments			
Revenues	\$235,759	\$ 437,579	\$106,421
Operating Income	60,194	102,735	43,131
Interest Expense	41,911	8,259	6,497
Equity Investment			
Income	18,777	95,555	37,867
Total Assets	895,400	1,026,063	496,350
Total Liabilities	\$467,500	\$ 673,152	\$183,206
Peoples Energy's Pro Rata Share Total Equity Investments			
Revenues	\$106,230	\$ 200,006	\$ 46,636
Operating Income	30,333	45,696	19,519
Interest Expense	19,734	3,031	2,420
Equity Investment			
Income	10,796	43,188	17,694
Undistributed			
Partnership Income			
Included in			
Retained Earnings	12,316	(7,587)	(11,545)
Total Assets	388,939	482,264	221,645
Total Liabilities	\$230,816	\$ 322,358	\$ 81,958

4: Concentration of Credit Risk

Peoples Gas provides natural gas service to approximately 850,000 customers within the City of Chicago. North Shore Gas provides natural gas service to about 150,000 customers within approximately 275 square miles in north-eastern Illinois. Credit risk for the utility companies is spread over a diversified base of residential, commercial and industrial customers.

Peoples Gas and North Shore Gas encourage customers to participate in their long-standing budget payment programs, which allow the cost of higher gas consumption levels associated with the heating season to be spread over a 12-month billing cycle. Customers' payment records are continually monitored and credit deposits are required, when appropriate.

Peoples Energy Resources, the company's Midstream Services and Power Generation subsidiary, buys and sells natural gas through a variety of counterparties. In addition, the company has ownership interests in two natural gas fired power plants: Elwood (50 percent) and SCEP (30 percent). Elwood's plant capacity and output has been sold on a long-term basis to three counterparties: Aquila, Engage and Exelon. SCEP's plant capacity and output has been sold on a long-term basis to Exelon.

Aquila's senior unsecured debt rating was downgraded to below investment grade by Moody's Investor Services in September 2002 and by Standard & Poor's in November 2002. Elwood's senior secured bonds were subsequently downgraded by Standard & Poor's to below investment grade. As a result of Aquila's credit rating downgrades, Aquila has posted letters of credit equal to six months of capacity payments as required by its power sales tolling agreement with Elwood. Also in November 2002, Aquila announced in a press release and conference call with securities analysts that it intends to negotiate a termination of its power sales tolling agreements. However, Aquila has not provided Elwood with any proposal. To date, Aquila has made timely payments to Elwood. A failure by Aquila to meet its payment obligations under its power sales tolling agreements with Elwood would have a material adverse effect on Elwood's business, and could substantially

Notes to Consolidated Financial Statements

In 1999, the EPA announced that it was reopening the ROD for the Denver site. The EPA's announcement followed a six-month scientific/technical review by the agency of the remedy's effectiveness. In 2000, the EPA amended the ROD to require removal of the radioactive wastes from the site to a licensed off-site disposal facility. The EPA estimates that this action will cost an additional \$21.5 million (representing the present worth of estimated capital costs and estimated operation and maintenance costs).

In December 2001, Shattuck entered into a proposed settlement agreement with the United States and the State of Colorado regarding past and future response costs at the site. In August 2002, the agreement was approved by the District Court for the District of Colorado. Under the terms of the agreement, Shattuck will pay, in addition to amounts already paid for response costs at the site, approximately \$7.2 million in exchange for a release from further obligations at the site. The release will not apply in the event that new information shows that the remedy selected in the amended ROD is not protective of human health or the environment or if it becomes necessary to remediate contaminated groundwater beneath or emanating from the site.

North Shore Gas does not believe that it has liability for the response costs, but cannot determine the matter with certainty. At this time, North Shore Gas cannot reasonably

estimate what range of loss, if any, may occur. In the event that North Shore Gas incurred liability, it would pursue reimbursement from insurance carriers, other responsible parties, if any, and through its rates for utility service.

6: Commitments and Contingencies

A. Leases

The company leases its headquarters and other office space under agreements that expire in various years through 2010. The rental obligations consist of a base rent plus operating expenses and taxes. Rental expenses under operating leases were \$9.2 million, \$8.7 million and \$8.1 million for September 30, 2002, 2001 and 2000, respectively.

At September 30, 2002, the minimum rental commitments payable in future years under all noncancelable leases are from \$4.0 million to \$4.4 million a year for fiscal years 2003 through 2007 and \$10.1 million for the remaining fiscal years thereafter.

B. Long-Term Commitments

Total commitments at September 30, 2002, were \$223.5 million and include gas purchases, storage, transportation, computer related and miscellaneous long-term commitments and short-term capital purchase commitments. Total commitments of Peoples Gas and North Shore Gas as of September 30, 2002, amounted to \$137.8 million and \$21.5 million, respectively.

(In Millions)	Payments Due by Period				
	Total	Less than 1 Year	1 to 3 Years	4 to 5 Years	More than 5 Years
Contractual cash obligations					
Long-term debt ⁽¹⁾	\$ 846.0	\$ 90.0	\$ —	\$ —	\$756.0
Operating leases	31.2	4.3	8.4	8.4	10.1
Other long-term obligations ⁽²⁾	223.5	67.1	87.4	50.0	19.0
Total contractual cash obligations	\$1,100.7	\$161.4	\$95.8	\$58.4	\$785.1

(1) Includes adjustable rate bonds classified as short-term debt.

(2) Includes gas purchases, storage, transportation, computer related and miscellaneous long-term commitments and short-term capital purchase commitments.

C. Guarantees and Standby Letters of Credit

As of September 30, 2002, there were \$55.4 million of guarantees for debt service and operational guarantees of the company's unconsolidated equity investments

or other third party obligation, which is down from \$64.4 million at September 30, 2001. Standby letters of credit were \$4.7 million compared to \$3.2 million at September 30, 2001.

	Commitments Due by Period				
	Total Amounts Committed	Less than 1 Year	1 to 3 Years	4 to 5 Years	More than 5 Years
Other commercial commitments					
Standby letters of credit	\$ 4.7	\$—	\$ —	\$—	\$ 4.7
Guarantees of unconsolidated equity investees	55.4	—	12.5	—	42.9
Total other commercial commitments	\$60.1	\$—	\$12.5	\$—	\$47.6

Notes to Consolidated Financial Statements

7: Accounts Receivable

The following table presents the status of accounts receivable balances of the company's utility subsidiaries.

(Dollars in Millions)	Peoples Gas		North Shore Gas	
	At September 30, 2002	2001	At September 30, 2002	2001
Gross customer accounts receivable	\$151.2	\$263.7	\$14.0	\$22.8
Reserve for uncollectible accounts	31.6	44.1	0.5	1.3
Net customer accounts receivable	\$119.6	\$219.6	\$13.5	\$21.5
Reserve for uncollectible accounts as a percent of gross customer accounts receivable	20.9%	16.7%	3.6%	5.7%

At the end of fiscal 2001, Peoples Gas recorded an \$8.5 million special charge to increase its reserve for uncollectible accounts to \$44.1 million. This reserve balance was expected to be adequate to account for charge offs occurring over the following 12 months. At March 31, 2002, Peoples Gas' charge off expectations were still in line with the prior estimate. At that time, Peoples Gas' net charge offs for fiscal 2002 were estimated to be about \$44.8 million, in line with the September 30, 2001 reserve balances. However, at June 30, 2002, Peoples Gas estimated that a larger reserve for uncollectible accounts was needed. Therefore, in the third quarter of fiscal 2002, Peoples Gas recorded a \$17.0 million special charge increasing the total reserve

for uncollectible accounts. This charge is in addition to the fiscal 2002 provision for uncollectibles of \$34.7 million. This adjustment was based on an updated analysis, which reflected an additional quarter of credit and collection activity and customer payment experience. The company and Peoples Gas believe that with this adjustment, the reserve is adequate given what is known today. However, the reserve for uncollectible accounts remains an estimate and could require further adjustment if circumstances change. Peoples Gas is continuing its outreach efforts to its customers, is aggressively pursuing collections of past due balances and has instituted many new credit policies and procedures.

The following table details Peoples Gas' aging of accounts receivable balances.

(Dollars in Millions)	Total Accounts Receivable	Current	Past Due		
			30-89 Days	90-149 Days	Over 150 Days
September 30, 2002	\$151.2	\$52.0	\$21.7	\$19.0	\$ 58.5
Percentage	100	34	14	13	39
September 30, 2001	\$263.7	\$71.3	\$36.9	\$38.6	\$116.9
Percentage	100	27	14	15	44

8: Retirement and Postretirement Benefits

The company and its subsidiaries participate in two defined benefit pension plans covering substantially all employees. These plans provide pension benefits that generally are based on an employee's length of service, compensation during the five years preceding retirement and social security benefits. Employees who began participation in the nonunion pension plan July 1, 2001 and thereafter will have their benefits determined based on their compensation during the five years preceding termination of employment and an age-based percentage credited to them for each year of their participation. The company and its subsidiaries make contributions to the plans based upon actuarial determinations and in consideration of tax regulations and funding requirements

under federal law. The company also has a nonqualified pension plan that provides certain employees with pension benefits in excess of qualified plan limits imposed by federal tax law. Retiring employees have the option of receiving retirement benefits in the form of annuities or a lump sum payment.

In addition, the company and its subsidiaries currently provide certain health care and life insurance benefits for retired employees. Substantially all employees may become eligible for such benefit coverage if they reach retirement age while working for the company. The plans are funded based upon actuarial determinations and in consideration of tax regulations as well as the company's funding policy. The company accrues the expected costs of such benefits over the average remaining service lives of all employees.

Notes to Consolidated Financial Statements

Reconciliations of the beginning and ending balances of the projected pension benefit obligation and the accumulated postretirement benefit obligation, reconciliations of the

beginning and ending balances of the plan assets, and the funded status of these plans for years 2002 and 2001, based on a July 1 to June 30 measurement year, are as follows:

(In Millions) For Fiscal Years	2002		2001	
	Pension Benefits	Other Postretirement Benefits	Pension Benefits	Other Postretirement Benefits
Change in benefit obligation				
Benefit obligation at beginning of measurement period	\$ 453.9	\$104.6	\$356.0	\$109.4
Service cost	13.9	3.5	11.8	4.0
Interest cost	32.0	8.0	29.2	8.6
Participant contributions	—	3.9	—	3.7
Plan amendment	(8.3)	(5.9)	59.0	(4.9)
Special benefits cost	—	—	24.9	1.3
Actuarial (gain)/loss	30.0	3.7	32.6	(6.5)
Benefits paid	(111.1)	(12.4)	(59.6)	(11.0)
Benefit obligation at end of measurement period (June 30)	\$ 410.4	\$105.4	\$453.9	\$104.6
Change in plan assets				
Market value of plan assets as of measurement period (June 30)	\$ 634.1	\$ 72.7	\$669.5	\$ 83.0
Actual return on plan assets	(38.7)	(4.7)	24.2	(5.3)
Employer contributions (including nonqualified plans)	1.0	0.1	—	2.3
Participant contributions	—	3.9	—	3.7
Benefits paid	(111.1)	(12.4)	(59.6)	(11.0)
Market value of plan assets at end of measurement period	\$ 485.3	\$ 59.6	\$634.1	\$ 72.7
Excess (deficit) of plan assets over benefit obligation	\$ 74.9	\$ (45.8)	\$180.2	\$ (31.9)
Unrecognized net transition obligation (asset)	(3.7)	35.9	(5.9)	45.6
Unrecognized prior service cost	49.3	—	61.4	—
Unrecognized net (gain) / loss	52.6	(8.9)	(86.9)	(23.8)
Contributions: July 1 to September 30	5.7	0.1	—	—
Prepaid (accrued) benefit cost at September 30	\$ 178.8	\$ (18.7)	\$148.8	\$ (10.1)
Amounts recognized in the consolidated balance sheets consist of:				
Prepaid pension cost	\$ 179.7		\$153.7	
Accrued benefit liability	(1.7)		(11.3)	
Intangible asset	—		1.4	
Accumulated other comprehensive income	0.8		5.0	
	\$ 178.8		\$148.8	

The company's nonqualified pension plan has an accumulated benefit obligation in excess of plan assets. The accumulated benefit obligation for the nonqualified

plan was \$7.4 million at June 30, 2002 and \$11.3 million at June 30, 2001. There are no plan assets in the nonqualified plan due to the nature of the plan.