ONEOK INC /NEW/
Form 10-Q/A
November 14, 2002

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q/A
(Amendment No. 1)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE QUARTERLY PERIOD ENDED June 30, 2002

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE TRANSITION PERIOD FROM _________ TO _________.

Commission file number 001-13643

ONEOK, Inc.
(Exact name of registrant as specified in its charter)

Oklahoma	**73-1520922**
(State or other jurisdiction of incorporation of organization)	**(I.R.S. Employer Identification No.)**
100 West Fifth Street, Tulsa, OK	**74103**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code (918) 588-7000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Common stock, with par value of $0.01 60,408,566 shares outstanding at August 9, 2002.

Explanatory Statement:

The purpose of this Amendment No. 1 is to restate the Consolidated Statements of Cash Flows on p. 6 of the ONEOK, Inc. Form 10-Q for the quarter ended June 30, 2002 to correct mathematical errors related to the treatment of bank overdrafts in 2002, to add Note L to the consolidated financial statements discussing the restatement, and to modify the discussion of operating cash flows on p. 38 for the restatement. Except as amended as described above, the Consolidated Financial Statements of the Company being filed herewith (and included in the Company s Form 10-Q for the quarter ended June 30, 2002 as previously filed with the Securities and Exchange Commission) remain unchanged.

Part I FINANCIAL INFORMATION

Item 1. Financial Statements

ONEOK, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)	Three Months Ended June 30, **2002**	Three Months Ended June 30, 2001	Six Months Ended June 30, **2002**	Six Months Ended June 30, 2001
	(Thousands of Dollars, except per share amounts)			
Operating Revenues	**$ 1,171,444**	$ 1,402,399	**$ 2,637,102**	$ 4,359,323
Cost of gas	**916,525**	1,181,444	**2,074,611**	3,847,507
Net Revenues	**254,919**	220,955	**562,491**	511,816
Operating Expenses				
Operations and maintenance	**110,098**	96,179	**219,164**	190,974
Depreciation, depletion, and amortization	**44,976**	37,856	**85,212**	74,811
General taxes	**15,528**	14,978	**30,850**	31,043
Total Operating Expenses	**170,602**	149,013	**335,226**	296,828
Operating Income	**84,317**	71,942	**227,265**	214,988
Other income, net	**5,131**	566	**4,411**	3,865
Interest expense	**27,853**	36,249	**54,035**	73,784
Income taxes	**26,212**	12,651	**69,660**	54,451
Income before cumulative effect of a change in accounting principle	**35,383**	23,608	**107,981**	90,618
Cumulative effect of a change in accounting principle, net of tax (Note H)				(2,151)
Net Income	**35,383**	23,608	**107,981**	88,467
Preferred stock dividends	**9,275**	9,275	**18,550**	18,550
Income Available for Common Stock	**$ 26,108**	$ 14,333	**$ 89,431**	$ 69,917
Earnings Per Share of Common Stock *(Note D)*				
Basic	**$ 0.29**	$ 0.20	**$ 0.90**	$ 0.74
Diluted	**$ 0.29**	$ 0.20	**$ 0.89**	$ 0.74
Average Shares of Common Stock (Thousands)				
Basic	**99,877**	99,407	**99,808**	99,311
Diluted	**100,707**	99,733	**100,488**	99,665

See accompanying Notes to Consolidated Financial Statements.

ONEOK, Inc. and Subsidiaries
CONSOLIDATED BALANCE SHEETS

(Unaudited)	**June 30, 2002**	December 31, 2001
	(Thousands of Dollars)	
Assets		
Current Assets		
Cash and cash equivalents	**$ 43,778**	$ 28,229
Trade accounts and notes receivable, net	**561,753**	677,796
Materials and supplies	**17,897**	20,310
Gas in storage	**57,309**	82,694
Unrecovered purchased gas costs		45,098
Assets from price risk management activities	**798,610**	587,740
Deposits		41,781
Other current assets	**25,872**	78,321
Total Current Assets	**1,505,219**	1,561,969
Property, Plant and Equipment		
Marketing and Trading	**123,751**	122,172
Gathering and Processing	**1,065,447**	1,040,195
Transportation and Storage	**808,214**	792,641
Distribution	**2,035,353**	1,985,177
Production	**505,723**	482,404
Other	**91,681**	85,168
Total Property, Plant and Equipment	**4,630,169**	4,507,757
Accumulated depreciation, depletion, and amortization	**1,307,681**	1,234,789
Net Property, Plant and Equipment	**3,322,488**	3,272,968
Deferred Charges and Other Assets		
Regulatory assets, net (Note B)	**228,568**	232,520
Goodwill	**113,868**	113,868
Assets from price risk management activities	**359,781**	475,066
Investments and other	**176,207**	222,768
Total Deferred Charges and Other Assets	**878,424**	1,044,222
Total Assets	**$ 5,706,131**	$ 5,879,159

See accompanying Notes to Consolidated Financial Statements.

ONEOK, Inc. and Subsidiaries
CONSOLIDATED BALANCE SHEETS

(Unaudited)	**June 30, 2002**	December 31, 2001
	(Thousands of Dollars)	
Liabilities and Shareholders Equity		
Current Liabilities		
Current maturities of long-term debt	**$ 10,000**	$ 250,000
Notes payable	**351,106**	599,106
Accounts payable	**435,940**	390,479
Accrued taxes	**13,957**	11,528
Accrued interest	**31,433**	31,954
Unrecovered purchased gas costs	**14,112**	
Customers deposits	**21,147**	21,697
Liabilities from price risk management activities	**506,303**	381,409
Other	**190,868**	132,244
Total Current Liabilities	**1,574,866**	1,818,417
Long-term Debt, excluding current maturities	**1,519,249**	1,498,012
Deferred Credits and Other Liabilities		
Deferred income taxes	**571,458**	499,432
Liabilities from price risk management activities	**374,141**	491,374
Lease obligation	**115,531**	122,011
Other deferred credits	**208,955**	184,623
Total Deferred Credits and Other Liabilities	**1,270,085**	1,297,440
Total Liabilities	**4,364,200**	4,613,869
Commitments and Contingencies (Note E)		
Shareholders Equity		
Convertible preferred stock, $0.01 par value:		
Series A authorized 20,000,000 shares; issued and outstanding 19,946,448 shares at June 30, 2002 and December 31, 2001	**199**	199
Common stock, $0.01 par value:		
authorized 300,000,000 shares; issued 63,438,441 shares with 60,352,331 and 60,002,218 shares outstanding at June 30, 2002 and December 31, 2001, respectively	**634**	634
Paid in capital (Note G)	**902,963**	902,269
Unearned compensation	**(3,716)**	(2,000)
Accumulated other comprehensive income (loss) (Note I)	**(747)**	(1,780)
Retained earnings	**486,381**	415,513
Treasury stock at cost: 3,036,534 shares at June 30, 2002; and 3,436,223 shares at December 31, 2001	**(43,783)**	(49,545)
Total Shareholders Equity	**1,341,931**	1,265,290
Total Liabilities and Shareholders Equity	**$ 5,706,131**	$ 5,879,159

ONEOK, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)	Six Months Ended June 30, **2002 (Restated)**	2001
	(Thousands of Dollars)	
Operating Activities		
Net income	**$ 107,981**	$ 88,467
Depreciation, depletion, and amortization	**85,212**	74,811
Gain on sale of assets	**(813)**	(1,120)
Gain on sale of equity investment	**(7,622)**	(758)
(Income) loss from equity investments	**553**	(6,209)
Deferred income taxes	**110,954**	16,582
Amortization of restricted stock	**1,058**	627
Allowance for doubtful accounts	**4,344**	13,839
Mark-to-market income	**(52,416)**	(27,609)
Changes in assets and liabilities:		
Accounts and notes receivable	**111,699**	942,459
Inventories	**27,798**	(4,743)
Unrecovered purchased gas costs	**59,210**	(80,237)
Deposits	**41,781**	37,170
Accounts payable and accrued liabilities	**75,576**	(652,369)
Price risk management assets and liabilities	**(35,031)**	(121,777)
Other assets and liabilities	**113,008**	(24,821)
Cash Provided by Operating Activities	**643,292**	254,312
Investing Activities		
Changes in other investments, net	**1,869**	1,504
Acquisitions	**(3,489)**	(15,337)
Capital expenditures	**(133,872)**	(173,990)
Proceeds from sale of property	**1,400**	7,911
Proceeds from sale of equity investment	**57,461**	7,425
Cash Used in Investing Activities	**(76,631)**	(172,487)
Financing Activities		
Payments of notes payable, net	**(248,000)**	(390,750)
Change in bank overdraft	**(28,757)**	(57,739)
Issuance of debt		400,000
Payment of debt	**(241,040)**	(2,455)
Issuance of common stock		5,169
Issuance of treasury stock, net	**3,798**	839
Dividends paid	**(37,113)**	(36,896)
Cash Used In Financing Activities	**(551,112)**	(81,832)
Change in Cash and Cash Equivalents	**15,549**	(7)
Cash and Cash Equivalents at Beginning of Period	**28,229**	249
Cash and Cash Equivalents at End of Period	**$ 43,778**	$ 242

See accompanying Notes to Consolidated Financial Statements.

ONEOK, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

A. Summary of Accounting Policies

Interim Reporting The accompanying unaudited consolidated financial statements of ONEOK, Inc. and its subsidiaries (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. The interim consolidated financial statements reflect all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. All such adjustments are of a normal recurring nature. Due to the seasonal nature of the Company s business, the results of operations for the three and six months ended June 30, 2002, are not necessarily indicative of the results that may be expected for a twelve-month period. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2001.

Goodwill On January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (Statement 142). Accordingly, the Company has discontinued the amortization of goodwill effective January 1, 2002. In accordance with the provisions of Statement 142, the Company has completed its analysis of goodwill for impairment and there was no impairment indicated. See Note J.

Reclassifications Certain amounts in the consolidated financial statements have been reclassified to conform to the 2002 presentation.

Critical Accounting Policies

Energy Trading and Risk Management Activities The Company engages in price risk management activities for both energy trading and non-trading purposes. The Company accounts for price risk management activities for its energy trading contracts in accordance with Emerging Issues Task Force Issue No. 98-10, Accounting for Contracts Involved in Energy Trading and Risk Management Activities (EITF 98-10). EITF 98-10 requires entities involved in energy trading activities to account for energy trading contracts using mark-to-market accounting. Forwards, swaps, options, and energy transportation and storage contracts utilized for trading activities are reflected in the consolidated balance sheets at fair value as assets and liabilities resulting from price risk management activities. The fair value of these assets and liabilities is affected by the actual timing of settlements related to these contracts and current period changes resulting primarily from newly originated transactions and the impact of price movements. Changes in fair value are recognized in net revenues in the consolidated statements of income. Market prices used to determine the fair value of these assets and liabilities reflect management s best estimate considering various factors including closing exchange and over-the-counter quotations, time value and volatility underlying the commitments. Market prices are adjusted for the potential impact of liquidating the Company s position in an orderly manner over a reasonable period of time under currently existing market conditions.

The Marketing and Trading segment s gas in storage inventory is recorded at fair value and is included in current price risk management assets.

Regulation The Company s intrastate transmission pipelines and distribution operations are subject to the rate regulation and accounting requirements of the Oklahoma Corporation Commission (OCC), Kansas Corporation Commission (KCC) and Texas Railroad Commission (TRC). Certain other transportation activities of the Company are subject to regulation by the Federal Energy Regulatory Commission (FERC). Oklahoma Natural Gas (ONG) and Kansas Gas Service (KGS) follow the accounting and reporting guidance contained in Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation (Statement 71). Allocation of costs and revenues to accounting periods for ratemaking and regulatory purposes may differ from allocations generally applied by non-regulated operations. Allocations of costs and revenues made by the Company to meet regulatory accounting requirements are considered to be in accordance with generally accepted accounting principles for regulated utilities.

During the ratemaking process, regulatory commissions may require a utility to defer recognition of certain costs to be recovered through rates over time as opposed to expensing such costs as incurred. This allows the utility to stabilize rates over time rather than passing such costs on to the customer for immediate recovery. This causes certain expenses to be deferred as a regulatory asset and amortized to expense as they are recovered through rates. Total regulatory assets resulting from this deferral process were approximately $228.6 million and $232.5 million at June 30, 2002 and December 31, 2001, respectively. Should unbundling of services occur, certain of these assets may no longer meet the criteria for accounting for these assets in accordance with Statement 71 and, accordingly, a write-off of regulatory assets and stranded costs may be required. However, the Company does not anticipate that these costs, if any, will be significant. See Note B.

KGS was subject to a three-year rate moratorium, which was set to expire in November 2000. As a result of implementing a weather normalization mechanism in Kansas, KGS agreed to a two-year extension of the rate moratorium. The extended rate moratorium expires in November 2002 and KGS expects to file a rate case at that time. ONG is not subject to a rate moratorium.

Impairment of Long-Lived Assets The Company recognizes the impairment of a long-lived asset when indicators of impairment are present and the undiscounted cash flow is not sufficient to recover the carrying amount of these assets. The impairment loss is measured by comparing the fair value of the asset to its carrying amount. Fair values are based on discounted future cash flows or information provided by sales and purchases of similar assets.

B. Regulatory Assets

The following table is a summary of the Company s regulatory assets, net of amortization, for the periods indicated.

	June 30, 2002	December 31, 2001
	(Thousands of Dollars)	
Recoupable take-or-pay	**$ 72,588**	$ 75,336
Pension costs	**9,033**	11,124
Postretirement costs other than pension	**59,976**	60,170
Transition costs	**21,307**	21,598
Reacquired debt costs	**21,925**	22,351
Income taxes	**26,754**	28,365
Weather normalization	**9,717**	7,984
Line replacements	**2,392**	94
Other	**4,876**	5,498
Regulatory assets, net	**$ 228,568**	$ 232,520

C. Supplemental Cash Flow Information

The following table sets forth supplemental information with respect to the Company s cash flows for the periods indicated.

	Six Months Ended June 30, **2002**	2001
	(Thousands of Dollars)	
Cash paid during the period		
Interest (including amounts capitalized)	**$ 54,557**	$ 64,024
Income taxes	**$ 8,527**	$ 12,666
Income tax refund received	**$ 61,058**	$
Noncash transactions		
Dividends on restricted stock	**$ 116**	$ 96
Treasury stock transferred to compensation plans	**$ 25**	$ 131
Issuance of restricted stock, net	**$ 2,658**	$ 1,984
Acquisitions		
Property, plant and equipment	**$ 3,489**	$ 837
Goodwill	**$**	$ 14,500

D. Earnings Per Share Information

The Company computes its earnings per common share (EPS) in accordance with a pronouncement of the Financial Accounting Standards Board s Staff at the Emerging Issues Task Force meeting in April 2001, codified as EITF Topic No. D-95 (Topic D-95). In accordance with Topic D-95, the dilutive effect of the Company s Series A Convertible Preferred Stock is considered in the computation of basic EPS utilizing the if-converted method. Under the Company s if-converted method, the dilutive effect of the Company s Series A Convertible Preferred Stock on EPS cannot be less than the amount that would result from the application of the two-class method of computing EPS. The two-class method is an earnings allocation formula that determines EPS for the Company s common stock and its participating Series A Convertible Preferred Stock according to dividends declared and participating rights in the undistributed earnings. The Company s Series A Convertible Preferred Stock is a participating instrument with the Company s common stock with respect to the payment of dividends. For all periods presented, the two-class method resulted in additional dilution. Accordingly, EPS for such periods reflects this further dilution.

The following is a reconciliation of the basic and diluted EPS computations for the periods indicated.

	Three Months Ended June 30, 2002		
	Income	Shares	Per Share Amount
	(Thousands, except per share amounts)		
Basic EPS			
Income available for common stock	**$ 26,108**	**59,985**	
Convertible preferred stock	**9,275**	**39,892**	
Income available for common stock and assumed conversion of preferred stock	**35,383**	**99,877**	**$ 0.35**
Further dilution from applying the two-class method			**(0.06)**
Basic earnings per share			**$ 0.29**
Effect of Other Dilutive Securities			
Options and other dilutive securities		**830**	
Diluted EPS			
Income available for common stock and assumed exercise of stock options	**$ 35,383**	**100,707**	**$ 0.35**
Further dilution from applying the two-class method			**(0.06)**
Diluted earnings per share			**$ 0.29**

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	Three Months Ended June 30, 2001		
	Income	Shares	Per Share Amount
	(Thousands, except per share amounts)		
Basic EPS			
Income available for common stock	$ 14,333	59,515	
Convertible preferred stock	9,275	39,892	
Income available for common stock and assumed conversion of preferred stock	23,608	99,407	$ 0.24
Further dilution from applying the two-class method			(0.04)
Basic earnings per share			$ 0.20
Effect of Other Dilutive Securities			
Options and other dilutive securities		326	
Diluted EPS			
Income available for common stock and assumed exercise of stock options	$ 23,608	99,733	$ 0.24
Further dilution from applying the two-class method			(0.04)
Diluted earnings per share			$ 0.20

	Six Months Ended June 30, 2002		
	Income	Shares	Per Share Amount
	(Thousands, except per share amounts)		
Basic EPS			
Income available for common stock	$ 89,431	59,916	
Convertible preferred stock	18,550	39,892	
Income available for common stock and assumed conversion of preferred stock	107,981	99,808	$ 1.08
Further dilution from applying the two-class method			(0.18)
Basic earnings per share			$ 0.90
Effect of Other Dilutive Securities			
Options and other dilutive securities		680	
Diluted EPS			
Income available for common stock and assumed exercise of stock options	$ 107,981	100,488	$ 1.07
Further dilution from applying the two-class method			(0.18)
Diluted earnings per share			$ 0.89

	Six Months Ended June 30, 2001		
	Income	Shares	Per Share Amount
	(Thousands, except per share amounts)		
Basic EPS			
Income available for common stock	$ 69,917	59,419	
Convertible preferred stock	18,550	39,892	
Income available for common stock and assumed conversion of preferred stock	88,467	99,311	$ 0.89
Further dilution from applying the two-class method			(0.15)
Basic earnings per share			$ 0.74
Effect of Other Dilutive Securities			
Options and other dilutive securities		354	
Diluted EPS			
Income available for common stock and assumed exercise of stock options	$ 88,467	99,665	$ 0.89
Further dilution from applying the two-class method			(0.15)
Diluted earnings per share			$ 0.74

There were 51,839 and 64,148 option shares excluded from the calculation of diluted EPS for the three months ended June 30, 2002 and 2001, respectively, since their inclusion would be antidilutive for each period. For the six months ended June 30, 2002 and 2001, there were 139,897 and 37,384 option shares, respectively, excluded from the calculation of diluted EPS since their inclusion would be antidilutive for each period.

The following is a reconciliation of the basic and diluted EPS computations before the cumulative effect of a change in accounting principle to net income for the periods indicated.

	Six Months Ended June 30,			
	Basic EPS		Diluted EPS	
	2002	2001	**2002**	2001
	(Per share amounts)			
Income available for common stockbefore cumulative effect of a change in accounting principle	**$ 0.90**	$ 0.76	**$ 0.89**	$ 0.76
Cumulative effect of a change in accounting principle, net of tax		(0.02)		(0.02)
Income available for common stock	**$ 0.90**	$ 0.74	**$ 0.89**	$ 0.74

E. Commitments and Contingencies

Enron Certain of the financial instruments discussed in the Company s Annual Report on Form 10-K for the year ended December 31, 2001, have Enron North America as the counterparty. Enron Corporation and various subsidiaries, including Enron North America, filed for protection from creditors under Chapter 11 of the United States Bankruptcy Code on December 3, 2001. In the fourth quarter of 2001, the Company took a charge of $37.4 million to provide an allowance for forward financial positions and to establish an allowance for uncollectible accounts related to previously settled financial and physical positions with Enron. In the first quarter of 2002, the Company recorded a cash recovery of approximately $22.1 million resulting in a gain of approximately $14.0 million as a result of an agreement to sell the related Enron claim to a third party. The sale of the Enron claim is subject to normal representations as to the validity of the claims and the guarantees from Enron.

The filing of the voluntary bankruptcy proceeding by Enron created a possible technical default related to various financing leases tied to the Company s Bushton gas processing plant in south central Kansas. The Company acquired the Bushton gas processing plant and related leases from Kinder Morgan, Inc. (KMI) in April 2000. KMI had previously acquired the plant and leases from Enron. Enron is one of three guarantors of these Bushton plant leases. However, the Company is the primary guarantor. In January 2002, the Company was granted a waiver on the possible technical default related to these leases. The Company will continue to make all payments due under these leases.

Westar Energy In May 2002, Westar Energy, Inc. (formerly known as Western Resources, Inc.) and its wholly owned subsidiary, Westar Industries, Inc., delivered a sale notice to the Company giving notice of Westar s intent to sell 4,714,434 shares of the Company s common stock and 19,946,448 shares of the Company s Series A Convertible Preferred Stock, representing all of the Company s common and preferred stock held by Westar.

The delivery of the sale notice to the Company gives the Company or its designee the option to purchase all, but not less than all, of the common and preferred stock held by Westar at a price equal to 98.5% of the average of the closing prices of the Company s common stock during the 20 trading days prior to the date of the sale notice, which equals $21.77 per share for a total purchase price of approximately $971 million. The purchase period is 90 days after the date of notice and expires August 28, 2002. This period can be extended for 30 days after any necessary regulatory approvals, but cannot exceed 180 days after the date of the sale notice. The Company is currently considering its options related to the notice.

Southwest Gas Corporation In connection with the now terminated proposed acquisition of Southwest Gas Corporation (Southwest), the Company is a party to various lawsuits.

The Company and certain of its officers, as well as Southwest and certain of its officers, and others have been named as defendants in a lawsuit brought by Southern Union Company (Southern Union). The Southern Union allegations include, but are not limited to, violations of the Racketeer Influenced and Corrupt Organizations Act and improper interference in a contractual relationship between Southwest and Southern Union. The original claim asked for not less than $750 million compensatory damages, to be trebled for racketeering and unlawful violations, and rescission of a Confidentiality and Standstill Agreement between the Company and Southern Union.

On June 29, 2001, the Company filed Motions for Summary Judgment. On September 26, 2001, the Court entered an order that, among other things, denied the Motions for Summary Judgment by the Company on Southern Union s claim for tortious interference with Southern Union s prospective relationship with Southwest. However, the Court s ruling limited any recovery by Southern Union to out-of-pocket damages and punitive damages. On June 10, 2002, the Company filed a motion for summary judgment against Southern Union as to Southern Union s sole remaining claim for tortious interference with a prospective relationship, and also moved for summary judgment on Southern Union s claim for punitive damages. Eugene Dubay and John A. Gaberino, Jr., each an officer of the Company, joined in that motion. Trial is currently scheduled to begin October 15, 2002. Based on discovery at this point, the Company believes that Southern Union s out-of-pocket damages potentially recoverable at trial, exclusive of punitive damages, legal fees and expenses, are less than $1.0 million.

Southwest filed a lawsuit against the Company and Southern Union alleging, among other things, fraud and breach of contract. On August 9, 2002, the Company settled with Southwest all claims asserted against each other in these cases in consideration for a payment of $3.0 million to be paid by the Company to Southwest.

On August 6, 2002, Southwest and Southern Union settled their claims against each other. Trial on the remaining claims asserted by Southern Union against the Company is scheduled to begin October 15, 2002.

Two substantially identical derivative actions were filed by shareholders against members of the Board of Directors of the Company alleging violation of their fiduciary duties to the Company by causing or allowing the Company to engage in certain fraudulent and improper schemes related to the planned acquisition of Southwest and waste of corporate assets. These two cases have been consolidated. They allege conduct by the Company caused the Company to be sued by both Southwest and Southern Union, which exposed the Company to millions of dollars in liabilities. The plaintiffs seek an award of compensatory and punitive damages and costs, disbursements and reasonable attorney fees. The Company and its independent directors and officers named as defendants filed Motions to Dismiss the action for failure of the plaintiffs to make a pre-suit demand on the Company s Board of Directors. In addition, the independent directors and certain officers filed Motions to Dismiss the action for failure to state a claim. On February 26, 2001, the action was stayed until one of the parties notifies the Court that a dissolution of the stay is requested.

Except as set forth above, the Company is unable to estimate the possible loss, if any, associated with these matters. If substantial damages were ultimately awarded, this could have a material adverse effect on the Company s results of operations, cash flows and financial position. The Company is defending itself vigorously against all claims asserted by Southern Union and all other matters relating to the now terminated proposed acquisition of Southwest.

Environmental The Company has 12 manufactured gas sites in Kansas, which were acquired in 1997, that may contain potentially harmful materials classified as hazardous. Hazardous materials are subject to control or remediation under various state and federal environmental laws and regulations. A consent agreement with the Kansas Department of Health and Environment (KDHE) presently governs all future work at these sites. The terms of the consent agreement allow the Company to investigate and set remediation priorities for these sites based upon the results of the investigations and risk analysis. The prioritized sites will be investigated over a period of time as negotiated with the KDHE. Through June 30, 2002, the costs of the investigation and risk analysis related to these manufactured gas sites have been immaterial.

Although remedial investigation and interim clean up has begun on four sites, limited information is available about the sites. Management s best estimate of the cost of remediation ranges from $100,000 to $10 million per site based on a limited comparison of costs incurred to remediate comparable sites. These estimates do not give effect to potential insurance recoveries, recoveries through rates or recoveries from unaffiliated parties. The KCC has permitted others to recover remediation costs through rates. It should be noted that additional information and testing could result in costs significantly below or in excess of current estimates. To the extent that such remediation costs are not recovered, the costs could be material to the Company s results of operations and cash flows depending on the remediation done and number of years over which the remediation is completed.

In January 2001, the Company s Yaggy gas storage facility, located in Hutchison, Kansas, was idled following a series of natural gas explosions and eruptions of natural gas geysers. In July 2002, the KDHE issued an administrative order that assesses a $180,000 civil penalty against the Company, based on alleged violations of several KDHE regulations. The Company is currently assessing if it will appeal this order. The Company believes there are no long-term environmental effects from the Yaggy storage facility.

Other The OCC staff filed an application on February 1, 2001 to review the gas procurement practices of ONG in acquiring its gas supply for the 2000/2001 heating season and to determine if these practices were consistent with least cost procurement practices and whether the Company s procurement decisions resulted in fair, just and reasonable costs being borne by ONG customers. In a hearing on October 31, 2001, the OCC issued an oral ruling that ONG not be allowed to recover the balance in the Company s unrecovered purchased gas cost (UPGC) account related to the unrecovered gas costs from the 2000/2001 winter. This was effective with the first billing cycle for the month following the issuance of a final order. A final order, issued on November 20, 2001, halted the recovery process effective December 1, 2001. On December 12, 2001, the OCC approved a request to stay the order and allowed ONG to begin collecting unrecovered gas costs, subject to refund should the Company ultimately lose the case. In the fourth quarter of 2001, the Company took a charge of $34.6 million as a result of this order. In May 2002, the Company, along with the staff of the Public Utility Division and the Consumer Services Division of the OCC, the Oklahoma Attorney General, and other stipulating parties, entered into a joint settlement agreement resolving this gas cost issue and ongoing litigation related to a contract with Dynamic Energy Resources, Inc.

The settlement agreement has a $33.7 million value to ONG customers that will be realized over a three-year period. In July 2002, immediate cash savings were provided to all ONG customers in the form of billing credits totaling approximately $10.1 million. ONG is replacing certain gas contracts, which is expected to reduce gas costs by approximately $13.8 million due to avoided reservation fees between April 2003 and October 2005. Additional savings of approximately $8.0 million from the use of storage service in lieu of those contracts are expected to occur between November 2003 and March 2005. Any expected savings from the use of storage that are not achieved and a $1.8 million credit will be added to the final billing credit scheduled to be provided to customers in December 2005. As a result of this settlement agreement, the Company revised its estimate of the charge taken in the fourth quarter of 2001 downward by $14.2 million to $20.4 million and recorded the adjustment in the second quarter of 2002 as a decrease to cost of gas.

Two separate class action lawsuits have been filed against the Company in connection with the natural gas explosions and eruptions of natural gas geysers that occurred at the Yaggy storage facility in Hutchinson, Kansas in January 2001. Although no assurances can be given, the Company believes that the ultimate resolution of these matters will not have a material adverse effect on its financial position or results of operations. The Company and its subsidiaries are represented by their insurance carrier in these cases. The Company is vigorously defending itself against all claims.

The Company is a party to other litigation matters and claims, which are normal in the course of its operations, and while the results of litigation and claims cannot be predicted with certainty, management believes the final outcome of such matters will not have a materially adverse effect on the Company s consolidated results of operations, financial position, or liquidity.

F. Segments

Management has divided the Company s operations into the following six reportable segments based on similarities in economic characteristics, products and services, types of customers, methods of distribution and regulatory environment: (1) the Marketing and Trading segment markets natural gas to wholesale and retail customers and markets electricity to wholesale customers; (2) the Gathering and Processing segment gathers and processes natural gas and fractionates, stores and markets natural gas liquids; (3) the Transportation and Storage segment transports and stores natural gas for others and buys and sells natural gas; (4) the Distribution segment distributes natural gas to residential, commercial and industrial customers, leases pipeline capacity to others and provides transportation services for end-use customers; (5) the Production segment develops and produces natural gas and oil; and (6) the Other segment primarily operates and leases the Company s headquarters building and a related parking facility.

During the first quarter of 2002, the Power segment was combined with the Marketing and Trading segment, eliminating the Power segment. This presentation reflects the Company s strategy of trading around the Company s recently completed electric generating power plant. The prior period has been restated to reflect this combination.

The accounting policies of the segments are substantially the same as those described in the Summary of Significant Accounting Policies in the Company s Annual Report on Form 10-K for the year ended December 31, 2001. Intersegment sales are recorded on the same basis as sales to unaffiliated customers. Corporate overhead costs relating to a reportable segment are allocated for the purpose of calculating operating income. The Company s equity method investments do not represent operating segments of the Company. The Company has no single external customer from which it receives ten percent or more of its consolidated revenues.

The following tables set forth certain selected financial information for the Company s six operating segments for the periods indicated.

Three Months Ended June 30, 2002	Marketing and Trading	Gathering and Processing	Transportation and Storage	Distribution	Production	Other and Eliminations	Total
				(Thousands of Dollars)			
Sales to unaffiliated customers	$ 729,924	$ 189,051	$ 18,986	$ 211,663	$ 20,587	$ 1,233	$ 1,171,444
Intersegment sales	69,565	79,054	23,600	1,100	3,804	(177,123)	$
Total Revenues	$ 799,489	$ 268,105	$ 42,586	$ 212,763	$ 24,391	$ (175,890)	$ 1,171,444
Net revenues	$ 67,177	$ 44,559	$ 27,214	$ 91,444	$ 24,391	$ 134	$ 254,919
Operating costs	$ 8,076	$ 35,940	$ 16,556	$ 54,745	$ 7,809	$ 2,500	$ 125,626
Depreciation, depletion and amortization	$ 1,465	$ 8,591	$ 5,471	$ 19,575	$ 9,483	$ 391	$ 44,976
Operating income	$ 57,636	$ 28	$ 5,187	$ 17,124	$ 7,099	$ (2,757)	$ 84,317
Income from equity investments	$	$	$ 24	$	$	$ 438	$ 462
Capital expenditures	$ 1,442	$ 14,007	$ 9,741	$ 32,403	$ 11,349	$ 4,080	$ 73,022

Three Months Ended June 30, 2001	Marketing and Trading	Gathering and Processing	Transportation and Storage	Distribution	Production	Other and Eliminations	Total
				(Thousands of Dollars)			
Sales to unaffiliated customers	$ 909,114	$ 218,033	$ 22,173	$ 225,051	$ 27,842	$ 186	$ 1,402,399
Intersegment sales	105,810	135,634	25,706	772	7,182	(275,104)	$
Total Revenues	$ 1,014,924	$ 353,667	$ 47,879	$ 225,823	$ 35,024	$ (274,918)	$ 1,402,399
Net revenues	$ 39,333	$ 43,080	$ 32,698	$ 72,290	$ 35,024	$ (1,470)	$ 220,955
Operating costs	$ 2,383	$ 29,219	$ 12,348	$ 61,629	$ 7,149	$ (1,571)	$ 111,157
Depreciation, depletion and amortization	$ 142	$ 6,995	$ 4,751	$ 17,159	$ 8,159	$ 650	$ 37,856
Operating income	$ 36,808	$ 6,866	$ 15,599	$ (6,498)	$ 19,716	$ (549)	$ 71,942
Income (loss) from equity investments	$	$	$ 849	$	$ 39	$ (86)	$ 802
Capital expenditures	$ 11,975	$ 9,562	$ 7,308	$ 30,216	$ 14,959	$ 8,957	$ 82,977

Six Months Ended June 30, 2002	Marketing and Trading	Gathering and Processing	Transportation and Storage	Distribution	Production	Other and Eliminations	Total
				(Thousands of Dollars)			
Sales to unaffiliated customers	$ 1,503,488	$ 346,093	$ 38,115	$ 709,648	$ 37,425	$ 2,333	$ 2,637,102
Intersegment sales	208,485	137,607	53,674	2,244	6,623	(408,633)	$
Total Revenues	$ 1,711,973	$ 483,700	$ 91,789	$ 711,892	$ 44,048	$ (406,300)	$ 2,637,102
Net revenues	$ 139,086	$ 85,882	$ 63,946	$ 229,439	$ 44,048	$ 90	$ 562,491
Operating costs	$ 16,241	$ 68,010	$ 31,221	$ 117,630	$ 15,104	$ 1,808	$ 250,014
Depreciation, depletion and amortization	$ 2,648	$ 16,561	$ 10,045	$ 36,524	$ 18,657	$ 777	$ 85,212
Operating income	$ 120,197	$ 1,311	$ 22,680	$ 75,285	$ 10,287	$ (2,495)	$ 227,265
Income (loss) from equity investments	$	$	$ 462	$	$	$ (1,015)	$ (553)
Total assets	$ 1,511,871	$ 1,231,211	$ 818,742	$ 1,719,809	$ 327,957	$ 96,541	$ 5,706,131
Capital expenditures	$ 1,580	$ 24,815	$ 24,500	$ 53,524	$ 22,971	$	