THE SCRATCH REPORT

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Investing In the Aftermath of the Energy Trading Debacle

Company	Williams Companies
Ticker	NYSE: WMB
Price (3/30/04)	$9.57
52 - week range	$4.53 - $11.47
Shares outstanding (in millions)	519
Market capitalization (in millions)	$4,967
Dividend yield	0.4%
Price/book value	1.2x
Total debt (in millions)	$11,297
Debt/capital	73%
Recommendation	**Buy**

Overview

- *It appears that Williams is now positioned to generate a relatively consistent operating margin and subsequent earnings growth from its core natural gas pipeline operations as a result of deleveraging and the disposal of telecommunications and certain energy trading assets.*

- *Debt has been reduced to a manageable level such that a stronger balance sheet and lower future interest payments should create disproportionately higher earnings.*

- *On an ongoing basis, Williams should be able to generate an average operating margin of 7.4% and, if debt is further reduced to the company's desired level, which appears reasonable, then the Williams shares could be worth $14.59, suggesting a large amount of appreciation over the next few years.*

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Investment Thesis

Williams Companies was once a struggling company threatened by the very real likelihood of bankruptcy. It unwisely and egregiously expanded into telecommunications and energy trading, which was financed by a similarly excessive amount of debt. When both industries collapsed with great velocity, Williams was left to service its debt load and the successive maturities of this debt with a less than capable portfolio of assets. It desperately sold assets and secured short term financings at unfavorable terms in a panic mode that, to the company's credit, has significantly reduced its debt and brought it back to a state whereby ongoing solvency is now assured. The risk of a near term liquidity crisis is no longer an issue. Furthermore, it appears that an acceptable level of earnings growth can be achieved, and in the consistent manner indicative of the natural gas pipeline transmission business. On this basis, Williams is a going concern.

In an attempt to correct its past follies, Williams has since sold its communications portfolio, much of the energy trading assets with a modest diminution of its core assets and has regained focus on these natural gas properties. This should prove to be very profitable to the prospective investor in the Williams equity, since operating profits of this business tend to be very stable. The pressing issue with Williams is whether or not the company can continue to retire its debt to the satisfaction of the investment community. Debt is currently 73% of its total capital structure. Yet, if it is able to lower total debt to $9.5 billion and reduce its average borrowing cost to 7%, both of which appear attainable, annual interest payments will be sufficiently low so as to create disproportionately higher earnings.

It is asserted that Williams can once again generate its historical 7.4% average operating return on the existing natural gas assets, which include both the exploration and production, transmission, and processing of this fuel. Despite the neglect on the part of Williams to its core assets during the time of irrational expansion, it still produced a 6.6% natural gas operating margin in 2003. Therefore, an historical average does not appear out of the question. Readers seeking a time frame might expect this thesis to be tested over the next two to three years.

If these assumptions prove to be correct, the Williams shares could ultimately be worth $14.59. This, of course, assumes that it can earn $0.97 per share and the market places a reasonable multiple on these earnings of 15x, as this paper suggests. Due to further asset sales proceeds, internally generated excess cash flow, relief from prior lending agreements and unrestricted cash on hand, Williams could comfortably lower its debt and subsequent interest payments to desired levels. If this takes two years, returns would be on the order of 30% per annum. Or, if this is a three year process, annualized returns could be 20%. Readers will also find in the appropriate section a discussion of the existing Williams Power assets. Williams is in a far more favorable position now than it was a year ago to dispose of these assets, and, if completed, the savings from the corresponding SG&A expenses would have a large impact on earnings per share.

For shorter term investors, Williams is currently repositioning its business strategy and capital structure such that one might once again envision consistently positive earnings. It is then only a matter of time before an appropriate valuation is afforded to reflect recent improvements. The Williams shares currently trade at 1.17x book value, while it should be noted natural gas companies typically are not afforded high valuations. If Williams were to merely trade at 1.5x book, which is its pre-energy trading average, the shares would be worth $11.86, or a 28% return. Additionally, despite the company's recent success in restructuring, the possibility always remains that debt will not be retired to the satisfaction of investors or a disruption to the pipeline assets could occur. However, at this point in time, this set of circumstances does not present an immediate concern. Accordingly, the purchase of the Williams shares is recommended.

Company History

The history of Williams originated in 1908 with two brothers who began to construct natural gas and petroleum pipelines across the country. In 1919, they relocated to Tulsa, Oklahoma and for more than 60 years, conducted business under the name Williams Brothers. In 1966, Williams paid $287 million for what was at the time the largest petroleum products pipeline, the Great Lakes Pipe Line Company. Interstate pipeline transmission was further enhanced with the purchases of Northwest Energy Company in 1982 and Transco Energy Company in 1995.

Williams began to stray from its core natural gas transmission business by venturing into telecommunications and, later, into the trading of energy contracts. The communications network was actually quite influential to the telecommunications industry, as Williams ran an extensive network of fiber-optic cables through its decommissioned pipelines. However, as the telecom bubble burst with great fury and speed, so, too, did this business. Williams has since sold its communications portfolio. The collapse of both the energy trading market and the value of the Williams Power assets was the result of a similar set of circumstances.

Business Description

The present compilation of assets reflects the company's actions towards once again becoming a sole provider of natural gas supplies and transmission. Williams is now comprised of the following four business divisions, the later of which is intended for disposal: *Gas Pipeline*, *Exploration and Production*, *Midstream Gas and Liquids* and *Power*.

<u>*Gas Pipeline*</u> – With 14,600 miles of interstate gas transmission pipelines, Williams is one of the largest transmission companies in the United States. Its primary pipelines include the Transco, Northwest Pipeline Corporation and several other pipeline joint ventures. It also owns a 50% interest in the Gulfstream Pipeline. In the aggregate, the transmission business averages 2,600 trillion BTU of natural gas annually.

The Transco interstate system operates 10,500 miles of pipeline through the states of Texas, Louisiana, Mississippi, Alabama, Georgia, South Carolina, North Carolina, Virginia, Maryland, Pennsylvania, New Jersey and New York.

The Northwest Pipeline company owns and operates approximately 4,100 miles of pipeline through New Mexico, Colorado, Utah, Wyoming, Idaho, Oregon, Washington and into parts of Canada. In May of 2003, a line break occurred in Washington. The cost of repair is estimated to range from $365 million to $430 million, which Williams intends to recover with a rate increase.

<u>*Exploration and Production*</u> – This segment produces, develops and explores for natural gas reserves primarily in the Rocky Mountain and Mid-Continent regions of the United States from tight sand formations and coal bed methane reserves. As of December 2003, Williams reported 2.7 trillion cubic feet equivalent of proved natural gas reserves. Readers will note that little mention is given to the Williams reserves, as this calculation is often debatable amongst the parties involved in the reserve measuring process.

Rocky Mountain properties include the Piceance Basin, San Juan Basin and Powder River Basin. Mid-Continent properties are comprised of the Arkoma Basin in Oklahoma and the Green River Basin located in Wyoming and regions of the Gulf Coast.

Midstream Gas and Liquids – Williams operates one of the larger gathering, processing, storage and transportation facilities in the United States. The activities are focused in the basins of San Juan, Wyoming, Gulf Coast, Venezuela and Canada. This segment primarily takes the natural gas and other liquids from the wellhead to the consumer in a finished product. The company typically leverages the transportation and processing of natural gas and liquids from existing exploration and production sites.

Power – The Power portfolio, which consists mostly of electricity-related contracts and other financial instruments rather than physical assets, is intended for complete disposal as soon as the company can negotiate a reasonable sale price. Towards this end, the remaining Power assets consist of the following tolling contracts:

Table 1: Remaining Williams Power Assets

Location	Megawatts
California	4,141
Alabama	844
Louisiana	765
New Jersey	766
Pennsylvania	666
Michigan	541
Total	7,723

*A more comprehensive discussion of the Power assets is provided in the section entitled "The Lingering Debate Over the Williams Power Portfolio."

Other Investments – Through several partnerships and ownership interests, Williams maintains an investment portfolio that totals roughly $1.5 billion:

Table 2: Other Williams Investments

Equity Cost Method Investments

Gulfstream Natural Gas System, LLC - 50%	$730.8 million	
Discovery Pipeline - 50%	$194.6	
Longhorn Partners Pipeline, L.P. - 32.7%	$85.1	
ACCROVEN - 49.3%	$67.1	
Alliance AuxSable - 14.6%	$42.8	
Petrolera Entre Lomas S.A. - 40.8%	$41.5	
Other	$71.8	
Total	*$1,233.7*	*$1,233.7*

Other Investments

George Strait Crossing Pipeline Project - 50%	$105.0
Apco Argentina (NASDAQ: APAGF) - 69%	$160.1
Williams Coal Seam Gas Royalty Trust (NYSE: WTU) - 22.3%	$29.2
Total	*$294.3*

Current Business Strategy

Through a series of ill-advised expansions and diversification into so-called "high-growth" businesses, Williams experienced the severe effects that such excessive attempts can render upon a company that deviates from its core set of competencies. The most obvious example was Williams Communications. The failure of Williams Communications was not resultant of the underlying thought process that unused natural gas pipelines could be profitably utilized to run fiber optic cables. This actually is quite innovative. Rather, it was the perceived growth, which some then believed to be infinite, of the telecommunications industry that led Williams to grossly over-expand, and fund this expansion with tremendous amounts of debt capital. After a tax-free carve-out in 2001 and subsequent bankruptcy in 2002 of Williams Communications, $2.3 billion of claims by Williams against Williams Communications was sold to Leucadia Corp. for $180 million.

It is not the intention of this paper to give a detailed account of Williams's involvement in the energy trading debacle. The fierce aftermath of this venture occurred nearly two years ago. Williams has since settled approximately 90% of these litigations, with a minimal impact to its continued survival, and it is widely believed that remaining claims will have limited repercussions. It is however important to note, as most readers are undoubtedly aware, that the simultaneous collapse of Williams Communications and the energy trading market nearly cost Williams its solvency. In a rather spectacular past 18 months, Williams has been able to desperately sell these corresponding assets, as well as profitable natural gas ones, often at distressed prices, to unwind previous mistakes and deleverage its balance sheet. Williams has once again found virtue in its natural gas properties and intends to complete the current restructuring around these assets. Essentially, Williams, in its post-restructuring state, will resemble the Williams of ten years ago, which was a provider and transporter of natural gas. Recent asset sales are listed below:

- 170–megawatt power plant and contracts purchased by Hoosier Energy for $67 million
- Texas Gas Pipeline purchased by a subsidiary of Loews Corp. for $1,045 million
- Exploration and production assets purchased by XTO Energy for $400 million
- Williams Energy Partners purchased by Madison Dearborn Partners/Carlyle Group/Riverstone for $1,082 million
- Memphis Refinery purchased by Premcor Inc. for $455 million

An Improving Williams Balance Sheet

Let it first be known that the Williams balance sheet remains highly leveraged with debt at an alarming 73% of total capital. Debt did not constitute that percentage of capital even as the company nearly collapsed in 2002. Yet, a series of asset write-downs over the last two years has lowered the company's book equity such that its capital structure is still overly dependent upon debt, which is rated as below investment grade. However, through a series of refinancings, short term borrowings and early maturity retirements assisted by asset sales, it now appears that Williams can support existing annual interest payments from its ongoing operations. The progression of debt accumulation over the years is best characterized in the tables provided below.

Table 3: Ten Year Debt Accumulation

Year	Interest Expense as % of Operating Income	Year	Debt / total capital
1994	42.7%	1994	46.5%
1995	41.4%	1995	47.4%
1996	37.9%	1996	56.1%
1997	44.6%	1997	56.1%
1998	71.0%	1998	59.9%
1999	35.3%	1999	62.3%
2000	32.1%	2000	53.5%
2001	34.1%	2001	61.1%
2002	227.5%	2002	68.7%
2003	101.5%	2003	72.9%
1994 - 1997 avg.	41.7%	1994 - 1997 avg.	51.5%
2005 Estimate	49.7%	2005 Estimate	69.8%

It was the successive expiration of maturing debt over a relatively short time horizon that led to a near-default on the part of Williams. Currently, Williams does not appear to be at risk of a similar set of expirations. On March 15th of this year, the company retired one of the last high cost pieces of debt due to expire in the next few years, which was $679 million in 9.25% notes. The retirement was made with a cash payment. In the aggregate, remaining maturities in 2004 and 2005 are $474 million. Williams has $1.5 billion in unrestricted cash alone.

Since a near term liquidity crisis is no longer apparent and previous disadvantageous lending agreements have been settled, it is appropriate to view the Williams balance sheet on a forward looking basis. The retirement of the above-mentioned notes leaves the company with $11.3

billion in total short and long-term debt. It has stated its intentions to reduce this amount even further to $9.5 billion by the end of this year. Based on the analysis presented below, this appears possible.

Table 4: Balance Sheet Analysis

Long-term debt maturing within one year	$936
Less: retirement of 9.25% notes	$679
Total short term debt	$257
Long-term debt	$11,040
Total debt obligations	$11,297
Unrestricted cash	$1,500
Add: $800 million in 2004 asset sales	$2,300
Available cash for debt retirement after maintaining $1.3b cash requirement	$1,000
2004 Free cash flow	$379
Favorable amendment to $800m credit facility	$371
Remaining Debt	$9,547

($ in millions)

Williams intends to maintain an unrestricted cash position of $1.0 - $1.3 billion. Given its turbulent past, this is a prudent objective. It now has $1.5 billion in such cash. It also intends to sell additional assets this year for expected proceeds of $800 million, which would seemingly indicate the completion of a two year asset disposal effort. Let us assume that Williams can meet the high end of its desired cash need of $1.3 billion. After the expected asset sales, it would then have $1 billion remaining for debt reduction purely from the support of its balance sheet.

Yet there is reason to believe that Williams will also generate free cash flow in 2004 from its natural gas operations. The company has stated that it should produce $1,150 in cash flow from operations this year. Capital expenditures should average roughly $750 million. Williams also announced a $0.01 dividend in the fourth quarter of last year, which would translate into annualized dividend payments of $21 million in 2004 (.04 x 519 shares outstanding). On this basis, free cash flow would total $379 million, which could in theory be used for early debt retirement.

Based on the company's reports, it appears that one remnant of previous lending disadvantages exists, although it does not constitute a future payment. Williams has an $800 million credit revolver, of which $447 million is still available. This agreement was entered into in June of 2003. As part of the agreement, Williams was required to post 105% cash collateral for every dollar that was borrowed. Since roughly $353 million has been borrowed, Williams then has $371 million in cash restricted for collateral (1.05 x $353). Since its financial position has greatly improved from this time a year ago, it is quite possible that Williams can renegotiate this requirement and, if needed, post other tangible assets as a replacement.

While one should never rely on company projections, such as free cash flow used above, the nature of natural gas transmission lends itself to a relative state of predictability, and one can draw from this consistency reasonable conclusions as to a company's future levels of cash flow. Even if these estimates are completely incorrect and Williams produces zero free cash flow, it represents $400 million in debt that cannot be retired, which does not present an overwhelmingly negative circumstance.

The current cost of debt is 7.7%, which represents annualized interest payments of $735 million on $9.5 billion in debt at year end. Earnings before interest and taxes could be over $1,300 million in 2005. There is also a reasonable possibility that Williams will be able to further reduce the cost of its debt through a round of refinancings. While it certainly will not receive investment grade considerations for a few years, a 7% average debt cost does not seem out of the question. This would lower interest payments to $665 million next year, or $0.13 per share in additional earnings.

The salient point of this discussion is that the Williams balance sheet is now considerably stronger and the level of future of debt reduction will determine the level of future earnings. Given that Williams is no longer a distressed seller of its assets, it has a stable gas pipeline business and manageable amount of debt, and its improving financial position might well lower future borrowing costs, it is reasonable to believe that Williams might be in a position to generate an acceptable rate of earnings growth.

Future Williams Earnings Power

Since previous deleveraging was necessitated by frequent asset sales, future reductions will be smaller in comparison and Williams will be forced to generate excess cash from its operations for these purposes. Therefore, the earnings power of its core assets is essential to future prosperity.

Williams has conservatively provided an earnings model for the next few years, with the emphasis on conservative due to prior habits of overestimation. However, let us not rely on these calculations, but rather use them as a comparative measure from which to evaluate the following set of assumptions.

As eluded to earlier, the profit margins generated from natural gas transmission are relatively stable, with fluctuations arising mainly from deviations in the price of this fuel. But on a normalized basis, it typically provides operating margins of between 6% and 8%. This can be demonstrated by the historical returns on these assets.

Table 5: Williams EBIT Margin on Pipeline Assets, 1992-1997

1992	6.4%
1993	8.1%
1994	8.2%
1995	6.3%
1996	7.6%
1997	7.6%
Average	7.4%

The period 1992 – 1997 was used because these were the years that led up to expansion and diversification away from these assets, which led to an erosion of pipeline profitability. By comparison, operating profits generated a 5% margin in 2002 and 6.6% in 2003. If one were to view these six years as a state of normalcy, then it is reasonable to assume that Williams could achieve a comparable level of efficiency, since its future state should resemble this prior period. By the company's estimations, its 2004 operating margin on these assets could be 6.4%. Therefore, there is no fundamental reason to believe that the pipeline assets cannot produce historical profits on a normalized basis.

The company's Power portfolio is not included for two reasons. Firstly, Williams might not possess these assets in two years. If favorable arrangements are reached, these assets could be disposed of sometime this year. Secondly, the energy trading assets could actually provide operating earnings of up to $150 million this year. Since these profits are essentially hedged well into the future, this figure could be fairly accurate. However, it is best to exclude such cash flows since the assets are scheduled for immediate disposal.

The following table estimates future Williams earnings from a two year prospective, provided that debt is reduced to sufficient levels and pipeline operating profits reattain their historical efficiency. However, in practice, this does not always proceed as planned. As such, it may take three years for Williams to be in full success mode. Potential returns are quite acceptable under either scenario.

Table 6: Williams Earnings Analysis

Historical return on natural gas assets	7.3%
Non-energy trading assets	$18,332
Operating income	$1,338
Interest expense (7% interest on $9.5b)	$665
Earnings before taxes	$673
Taxes at 25%	$168
Net earnings	$505
Shares outstanding	519
Earnings per share	$0.97
At 15x earnings	$14.59
Current price	$9.09
Gain	60.5%
Annualized over 2 years	30.3%
Annualized over 3 years	20.2%

If the Power assets were sold today, Williams would be left with $18.3 billion in core assets. At a 7.3% operating margin, earnings before interest and taxes could well reach $1.3 billion in 2005. This is at the lower end of the company's own estimations of $1.3 to $1.6 billion. If debt is reduced to the desired level of $9.5 billion and Williams can refinance existing debt down to an average interest cost of 7%, pre-tax income would be $673 million.

The issue of taxation requires a separate discussion. Williams is estimating a 39% tax rate for the next three years. However, it also has $330 million in tax loss carryforwards according to its latest Form 10-K. Let us assume that it uses this sum in three equal installments of $110 million over the next three years. Assuming zero growth, Williams might earn $1,346 million in operating income by 2005 ($673 x 2). At a 40% tax rate, this would equal $538 million in required tax payments, or $269 million per year. If it applies $110 million per year in carryforwards, its actual tax rate becomes 23.7%. Interestingly, in the company's estimation of future EBITDA, it added back $80 - $175 million in taxes to earnings, which is nearly identical to the rate just calculated.

On this basis, Williams could earn $505 million in net income, or $0.97 per share. If the market endowed these earnings with its normalized historical P/E ratio of 15x, then the Williams shares would be worth $14.59. This represents an annualized gain of 30% over the next two years, or 20% annual returns if this takes three years to occur.

The consensus estimates that Williams will earn $0.57 per share in 2005, although individual calculations vary quite dramatically. Readers should be aware that Williams is essentially beginning from a base of zero earnings from last year. Due to its large debt obligations, a small reduction to this amount could disproportionately create higher earnings. The discussion below highlights an alternative way to value these shares.

Alternative Valuation: Return on Total Assets and Book Equity

Williams could also be viewed from the perspective of a complete turnaround candidate in which its debt would be reduced to a comparable percentage of capital such that profit margins are normalized. Let us assume that this could take three years. It is not asserted that this will in fact happen, yet it is provided for illustrative purposes.

From 1992 to 1997, Williams averaged a 3.6% return on total assets and a 12.2% return on shareholders' equity. If this after-tax return is applied to post-energy trading assets of $18.3 billion, Williams would earn $1.27 per share. At 15x earnings, the shares would trade at $19.07. Similarly, the average 12.2% return on current book equity of $4.1 billion would result in net earnings of $0.96 per share, or a share price of $14.46 at the appropriate multiple. This also does not assume that book equity will expand over the next three years, which it often does as earnings are accumulated and retained.

Table 7: Alternative Valuation of Williams

Return on assets		**Return on equity**	
1992 - 1997 avg. return on assets	3.6%	1992-1997 avg. return on equity	12.2%
Non-energy trading assets	$18,332	Shareholders' equity	$4,102
Post-tax earnings	$660	Post-tax earnings	$500
Earnings per share	$1.27	Earnings per share	$0.96
At 15x earnings	$19.07	At 15x earnings	$14.46
Current price	$9.09	Current price	$9.09
Gain	109.8%	Gain	59.1%
Annualized over 3 years	36.6%	Annualized over 3 years	19.7%

($ in millions, except per share)

The Lingering Debate Over The Williams Power Portfolio

The remaining Power assets present a unique set of challenges for Williams. These assets consist of electricity tolling contracts. Tolling contracts give Williams the right to request a plant owner to convert Williams fuel (usually natural gas) to electricity in exchange for a fixed fee. The majority of these contracts are in California. Williams has been actively seeking a buyer for these agreements, but it is widely believed that few parties are interested in buying electricity contracts from the state of California at the present time.

However, most of these contracts are hedged for the next five years, providing positive operating earnings of $150 million to $200 million over the next three years alone. Yet, ratings agencies consider the underlying capital commitments of these contracts as debt, which now totals $2.5 billion. Williams also estimates that margin requirements of $350 million would be triggered in a worst case scenario.

Despite the positive benefits of the power portfolio, the unrealistic perception of energy trading has led investors to discount the Williams shares as long as these assets are present. Energy trading is quite legal and profitable. It was the manipulation of an infancy-stage trading market that led to abuses and subsequent legal ramifications.

Therefore, Williams is in a difficult conundrum. It is no longer a distressed operator and does not have to sell these assets at mere pennies on the dollar. So if it were to keep the present portfolio and wait for an acceptable offer, perhaps from LBO firms, which have indicated interest in the past, overall earnings might be higher. Yet, its share price could remain at a discount to an appropriate valuation.

Let us assume that Williams liquidates the portfolio this year. This could be done in two ways. Williams could capitulate, and sell the assets far below their intrinsic value. The total portfolio carries a book value of $800 million. In a panic mode, Williams would take an $800 million charge to book equity, essentially to be rid of the assets. Williams would then be left with $3.3 billion in equity. Total debt of $9.5 billion would constitute 74.3% of total capital. This is higher than the current 72.9%, but its debt is already at junk status, so credit downgrades are limited in their impact. However, this would disrupt the company's attempt to reduce its average borrowing cost, and therefore does not appear to be an acceptable alternative.

In a more advantageous alternative, it could still be assumed that Williams will not receive a favorable price and a write-down of some magnitude will occur. However, to assist in the following analysis, let us assume that a draconian sale price scenario is not likely. The largest benefit from this transaction would be a reduction in SG&A expense associated with the operations. Williams has gone to great efforts to reduce the operating costs of the Power portfolio, which consists mainly of personnel. SG&A expenses were lowered from $209 million in 2002 to $124 million in 2003. The company estimates that these costs will total $75 million in each of the next three years.

If the Power assets were sold, at least in theory, Williams could earn another $75 million in pre-tax income. This would add another $0.14 per share in earnings. The table below employs the same methodology as presented in Table 6, yet includes the expected savings of $75 million. In this case, annualized returns would be on the order of 39%.

Table 8: Post-Power Williams Earnings

Earnings before taxes	$673
Add: $75m in Energy SG&A expenses	$748
Taxes at 25%	$187
Adjusted net earnings	$561
Shares outstanding	519
Earnings per share	$1.08
At 15x earnings	$16.21
Current price	$9.09
Gain	78.4%
Annualized over 2 years	39.2%
Annualized over 3 years	26.1%

($ in millions, except per share)

Investment Summary

Williams has been successful in its efforts to restructure its balance sheet and reposition the company's focus away from telecommunications and energy trading towards a more operationally stable and profitable natural gas transmission profile. The result of these actions could be highly profitable for the potential investor in these shares. The remaining natural gas assets should be able to support future debt payments, since the company's mere survival is no longer an imminent concern. On an ongoing basis, Williams should be able to produce an operating margin of between 7% and 8%. If debt is further reduced thereby providing relief from cumbersome interest payments, the Williams shares could be worth $14.59. Since the operational risks of natural gas transmission are historically low, and the probability of a Williams success scenario is increasing with each passing day, the purchase of these shares is recommended.

The Williams Companies, Inc.
Consolidate Statement of Operations
(Millions, except per-share amounts)

	Years Ended December 31,		
	2003	2002	2001
Revenues:			
Power………………………………………………….	$ 13,196	$ 56	$ 1,706
Gas Pipeline……………………………………………..	1,299	1,242	1,181
Exploration & Production……………………………..	780	860	604
Midstream Gas & Liquids……………………………..	3,319	1,525	1,621
Other…………………………………………………..	72	124	319
Intercompany eliminations…………………………….	(1,831)	(91)	(128)
Total revenues………………………………………….	$ 16,834	$ 3,717	$ 5,303
Segment costs and expenses:			
Costs and operating expenses………………………..	15,157	2,219	2,498
Selling, general and administrative expenses………..	412	569	661
Other (income) expense - net………………………….	(89)	277	(12)
Total segment costs and expenses……………………	15,480	3,064	3,147
General corporate expenses……………………………	87	143	124
Operating income (loss):			
Power………………………………………………….	145	(472)	1,295
Gas Pipeline……………………………………………..	539	471	398
Exploration & Production……………………………..	393	505	217
Midstream Gas & Liquids……………………………..	286	166	186
Other…………………………………………………..	(9)	(17)	60
General corporate expenses……………………………	(87)	(143)	(124)
Total operating income…………………………………	$ 1,267	$ 510	$ 2,032
Interest accrued…………………………………………	(1,286)	(1,160)	(692)
Interest capitalized……………………………………..	46	27	37
Interest rate swap loss…………………………………	(2)	(124)	-
Investing income (loss)………………………………..	73	(113)	(173)
Minority interest in income and preferred returns of consolidated subsidiaries…………………………..	(19)	(42)	(72)
Other income (expense) - net………………………….	(26)	24	26
Income (loss) from continuing operations before income taxes and cumulative effect of change in accounting principles………………………………….	52	(877)	1,159
Provision (benefit) for income taxes………………….	36	(266)	511
Income (loss) from continuing operations………….	15	(612)	648
Income (loss) from discontinued operations………..	254	(143)	(1,126)

Income (loss) before cumulative effect of change in accounting principles……………………………….	269	(755)	(478)
Cumulative effect of change in accounting principles………………………………………………..	(761)	-	-
Net loss………………………………………………….	$ (492)	$ (755)	$ (478)
Preferred stock dividends……………………………..	30	90	-
Loss applicable to common stock…………………….	$ (522)	$ (845)	$ (478)
Basic earnings (loss) per common share:			
Income (loss) from continuing operations………….	$ (0.03)	$ (1.35)	$ 1.31
Income (loss) from discontinued operations………..	$ 0.49	$ (0.28)	$ (2.27)
Income (loss) before cumulative effect of change in accounting principles………………………	$ 0.46	$ (1.63)	$ (0.96)
Cumulative effect of change in accounting principles………………………………………………..	$ (1.47)	$ -	$ -
Net loss………………………………………………….	$ (1.01)	$ (1.63)	$ (0.96)
Diluted earnings (loss) per common share:			
Income (loss) from continuing operations………….	$ (0.03)	$ (1.35)	$ 1.30
Income (loss) from discontinued operations………..	$ 0.49	$ (0.28)	$ (2.25)
Income (loss) before cumulative effect of change in accounting principles………………………	$ 0.46	$ (1.63)	$ (0.95)
Cumulative effect of change in accounting principles………………………………………………..	$ (1.47)	$ -	$ -
Net loss………………………………………………….	$ (1.01)	$ (1.63)	$ (0.95)

The Williams Companies, Inc.
Consolidated Balance Sheet
(Dollars in millions, except per share amounts)

	Year Ended December 31, 2003	2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,316	$ 1,650
Restricted cash	47	103
Restricted investments	93	-
Accounts and notes receivable less allowance of $112.2 ($111.8 in 2002)	1,638	2,415
Inventories	246	368
Energy risk management and trading assets	-	297
Derivative assets	3,167	5,024
Margin deposits	554	805
Assets of discontinued operations	409	1,264
Deferred income taxes	107	569
Other current assets and deferred charges	218	391
Total current assets	$ 8,795	$ 12,886
Restricted cash	160	188
Restricted investments	288	-
Investments	1,464	1,469
Property, plant and equipment - net	12,079	12,026
Energy risk management and trading assets	-	1,822
Derivative assets	2,496	1,865
Goodwill	1,015	1,060
Assets of discontinued operations	-	2,941
Other assets and deferred charges	726	732
Total assets	$ 27,022	$ 34,989
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable	$ 3	$ 996
Accounts payable	1,238	1,878
Accrued liabilities	950	1,406
Liabilities of discontinued operations	78	532
Energy risk management and trading liabilities	-	244
Derivative liabilities	3,064	5,168
Long-term debt due within one year	936	1,083
Total current liabilities	6,270	11,309
Long-term debt	11,040	11,077
Deferred income taxes	2,453	3,354
Liabilities and minority interests of discontinued operations	-	1,264
Energy risk management and trading liabilities	-	681
Derivative liabilities	2,124	1,210
Other liabilities and deferred income	$ 948	$ 963

Contingent liabilities and commitments (Note 16)		
Minority interests in consolidated subsidiaries…………………….	84	84
Stockholders' equity:		
Preferred stock, $1 per share par value, 30 million shares authorized, 1.5 million issued in 2002………………………..	-	271
Common stock, $1 per share par value, 960 million shares authorized, 521.4 million issued in 2003, 519.9 million issued in 2002…………………………………………………………..	521	520
Capital in excess of par value…………………………………………	5,195	5,177
Accumulated deficit……………………………………………………	(1,427)	(884)
Accumulated other comprehensive income (loss)………………….	(121)	34
Other…………………………………………………………………….	(28)	(30)
	4,141	5,088
Less treasury stock (at cost), 3.2 million shares of common stock in 2003 and 2002………………………………………	(39)	(39)
Total stockholders' equity…………………………………………….	$ 4,102	$ 5,049
Total liabilities and stockholders' equity…………………………….	$ 27,022	$ 34,989