

**FORM 10-Q****SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549**

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

For the quarterly period ended **March 31, 2004**

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 1-06446

**Kinder Morgan, Inc.**

(Exact name of registrant as specified in its charter)

Kansas

(State or other jurisdiction of  
incorporation or organization)

48-0290000

(I.R.S. Employer  
Identification No.)

500 Dallas Street, Suite 1000, Houston, Texas 77002

(Address of principal executive offices, including zip code)

(713) 369-9000

(Registrant's telephone number, including area code)

\_\_\_\_\_  
(Former name, former address and former fiscal year, if changed since last report)

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 ☒ No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes ☒ No ☐

The number of shares outstanding of the registrant's common stock, \$5 par value, as of April 30, 2004 was 124,075,167 shares.

KINDER MORGAN, INC. AND SUBSIDIARIES  
FORM 10-Q  
QUARTER ENDED MARCH 31, 2004

Contents

	<u>Page Number</u>
<b>PART I. FINANCIAL INFORMATION</b>	
Item 1. Financial Statements (Unaudited)	
Consolidated Balance Sheets .....	3-4
Consolidated Statements of Operations .....	5
Consolidated Statements of Cash Flows .....	6
Notes to Consolidated Financial Statements .....	7-22
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations .....	23-36
Item 3. Quantitative and Qualitative Disclosures About Market Risk .....	36
Item 4. Controls and Procedures .....	36
<b>PART II. OTHER INFORMATION</b>	
Item 1. Legal Proceedings .....	37
Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities .....	37
Item 3. Defaults Upon Senior Securities .....	37
Item 4. Submission of Matters to a Vote of Security Holders .....	37
Item 5. Other Information .....	37
Item 6. Exhibits and Reports on Form 8-K .....	38
SIGNATURE .....	39

**PART I. - FINANCIAL INFORMATION****Item 1. Financial Statements.**

**CONSOLIDATED BALANCE SHEETS (Unaudited)**  
**Kinder Morgan, Inc. and Subsidiaries**

	<b>March 31, 2004</b>	<b>December 31, 2003</b>
	(In thousands)	
<b>ASSETS:</b>		
<b>Current Assets:</b>		
Cash and Cash Equivalents .....	\$ 15,534	\$ 11,076
Restricted Deposits .....	64,952	17,158
Accounts Receivable, Net:		
Trade .....	80,088	75,903
Related Parties .....	4,592	1,584
Inventories .....	19,077	22,096
Gas Imbalances .....	5,448	33,320
Other .....	108,725	115,183
	<u>298,416</u>	<u>276,320</u>
<b>Investments:</b>		
Kinder Morgan Energy Partners .....	2,145,910	2,106,312
Goodwill .....	947,730	972,380
Other .....	205,233	208,860
	<u>3,298,873</u>	<u>3,287,552</u>
<b>Property, Plant and Equipment, Net .....</b>	<u>6,075,137</u>	<u>6,083,937</u>
<b>Deferred Charges and Other Assets .....</b>	<u>421,804</u>	<u>388,902</u>
<b>Total Assets .....</b>	<u><u>\$10,094,230</u></u>	<u><u>\$10,036,711</u></u>

The accompanying notes are an integral part of these statements.

**CONSOLIDATED BALANCE SHEETS (Unaudited)**  
**Kinder Morgan, Inc. and Subsidiaries**

	<b>March 31, 2004</b>	<b>December 31, 2003</b>
	(In thousands except shares)	
<b>LIABILITIES AND STOCKHOLDERS' EQUITY:</b>		
<b>Current Liabilities:</b>		
Current Maturities of Long-term Debt.....	\$ 505,000	\$ 5,000
Notes Payable .....	97,200	127,900
Accounts Payable:		
Trade.....	36,138	61,385
Related Parties .....	-	10,632
Accrued Interest.....	33,603	68,596
Accrued Taxes .....	82,443	35,795
Gas Imbalances.....	30,237	38,494
Other .....	117,478	128,559
	<u>902,099</u>	<u>476,361</u>
<b>Other Liabilities and Deferred Credits:</b>		
Deferred Income Taxes .....	2,493,159	2,477,329
Other .....	171,280	197,435
	<u>2,664,439</u>	<u>2,674,764</u>
<b>Long-term Debt:</b>		
Outstanding Notes and Debentures.....	2,337,510	2,837,487
Deferrable Interest Debentures Issued to Subsidiary Trusts .....	283,600	283,600
Value of Interest Rate Swaps.....	131,604	88,242
	<u>2,752,714</u>	<u>3,209,329</u>
<b>Minority Interests in Equity of Subsidiaries .....</b>	<u>1,036,203</u>	<u>1,010,140</u>
<b>Stockholders' Equity:</b>		
Common Stock-		
Authorized - 150,000,000 Shares, Par Value \$5 Per Share		
Outstanding - 132,944,416 and 132,229,622 Shares,		
Respectively, Before Deducting 8,927,884 and 8,912,660		
Shares Held in Treasury.....	664,722	661,148
Additional Paid-in Capital .....	1,807,899	1,780,761
Retained Earnings.....	789,946	732,492
Treasury Stock.....	(447,754)	(446,095)
Deferred Compensation .....	(33,893)	(36,506)
Accumulated Other Comprehensive Loss .....	(42,145)	(25,683)
Total Stockholders' Equity .....	<u>2,738,775</u>	<u>2,666,117</u>
<b>Total Liabilities and Stockholders' Equity .....</b>	<u>\$10,094,230</u>	<u>\$10,036,711</u>

The accompanying notes are an integral part of these statements.

**CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)****Kinder Morgan, Inc. and Subsidiaries**

	<b>Three Months Ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
	(In thousands except per share amounts)	
<b>Operating Revenues:</b>		
Natural Gas Transportation and Storage.....	\$ 198,793	\$ 182,853
Natural Gas Sales.....	137,102	122,999
Other.....	16,691	13,016
Total Operating Revenues .....	<u>352,586</u>	<u>318,868</u>
<b>Operating Costs and Expenses:</b>		
Gas Purchases and Other Costs of Sales.....	133,471	112,955
Operations and Maintenance .....	36,194	29,901
General and Administrative.....	22,288	16,408
Depreciation and Amortization.....	29,481	29,625
Taxes, Other Than Income Taxes.....	8,381	7,174
Total Operating Costs and Expenses .....	<u>229,815</u>	<u>196,063</u>
<b>Operating Income .....</b>	<u>122,771</u>	<u>122,805</u>
<b>Other Income and (Expenses):</b>		
Equity in Earnings of Kinder Morgan Energy Partners.....	128,767	111,495
Equity in Earnings of Other Equity Investments.....	2,807	2,483
Interest Expense, Net.....	(32,434)	(39,974)
Interest Expense – Deferrable Interest Debentures.....	(5,478)	-
Minority Interests .....	(9,308)	(15,921)
Other, Net .....	759	996
Total Other Income and (Expenses) .....	<u>85,113</u>	<u>59,079</u>
<b>Income Before Income Taxes.....</b>	<u>207,884</u>	<u>181,884</u>
Income Taxes.....	<u>80,842</u>	<u>70,814</u>
<b>Net Income .....</b>	<u>\$ 127,042</u>	<u>\$ 111,070</u>
<b>Basic Earnings Per Common Share .....</b>	<u>\$ 1.03</u>	<u>\$ 0.91</u>
Number of Shares Used in Computing Basic		
Earnings Per Common Share (Thousands).....	<u>123,715</u>	<u>121,877</u>
<b>Diluted Earnings Per Common Share .....</b>	<u>\$ 1.02</u>	<u>\$ 0.90</u>
Number of Shares Used in Computing Diluted		
Earnings Per Common Share (Thousands).....	<u>124,938</u>	<u>123,078</u>
<b>Dividends Per Common Share .....</b>	<u>\$ 0.5625</u>	<u>\$ 0.1500</u>

The accompanying notes are an integral part of these statements.

**CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)****Kinder Morgan, Inc. and Subsidiaries  
Increase (Decrease) in Cash and Cash Equivalents**

	<b>Three Months Ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
	(In thousands)	
<b>Cash Flows From Operating Activities:</b>		
Net Income.....	\$ 127,042	\$ 111,070
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation and Amortization.....	29,481	29,625
Deferred Income Taxes.....	31,213	30,350
Equity in Earnings of Kinder Morgan Energy Partners .....	(128,767)	(111,495)
Distributions from Kinder Morgan Energy Partners.....	101,411	86,965
Equity in Earnings of Other Investments .....	(2,807)	(2,483)
Minority Interests in Income of Consolidated Subsidiaries .....	9,308	10,443
Deferred Purchased Gas Costs.....	3,662	(7,129)
Net Gains on Sales of Facilities .....	(389)	-
Changes in Gas in Underground Storage .....	30,045	38,575
Changes in Working Capital Items .....	(30,619)	(52,105)
Proceeds from Termination of Interest Rate Swap .....	-	28,147
Other, Net.....	(1,784)	1,999
Net Cash Flows Provided by Continuing Operations .....	167,796	163,962
Net Cash Flows Used in Discontinued Operations .....	(358)	(366)
<b>Net Cash Flows Provided by Operating Activities.....</b>	<b>167,438</b>	<b>163,596</b>
<b>Cash Flows From Investing Activities:</b>		
Capital Expenditures.....	(19,923)	(19,480)
Investment in Kinder Morgan Energy Partners (Note 7) .....	(17,504)	-
Investment in Margin Deposits .....	(47,794)	(3,895)
Other Investments .....	(280)	(7,945)
Proceeds from Sales of Other Assets .....	510	2,629
<b>Net Cash Flows Used in Investing Activities.....</b>	<b>(84,991)</b>	<b>(28,691)</b>
<b>Cash Flows From Financing Activities:</b>		
Short-term Debt, Net.....	(30,700)	331,900
Long-term Debt Retired.....	-	(500,317)
Issuance of Shares by Kinder Morgan Management .....	15,000	-
Common Stock Issued .....	23,219	9,538
Short-term Advances (To) From Unconsolidated Affiliates .....	(13,640)	40,235
Repurchase of Kinder Morgan Management LLC Shares .....	-	(928)
Treasury Stock Acquired .....	(2,097)	(3,092)
Cash Dividends, Common Stock .....	(69,588)	(18,289)
Minority Interests, Net .....	(108)	(140)
Securities Issuance Costs .....	(75)	-
<b>Net Cash Flows Used in Financing Activities .....</b>	<b>(77,989)</b>	<b>(141,093)</b>
Net Increase (Decrease) in Cash and Cash Equivalents.....	4,458	(6,188)
Cash and Cash Equivalents at Beginning of Period.....	11,076	35,653
Cash and Cash Equivalents at End of Period.....	<u>\$ 15,534</u>	<u>\$ 29,465</u>

For supplemental cash flow information, see Note 4.  
The accompanying notes are an integral part of these statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

We are an energy transportation, storage and related services provider and have operations in the Rocky Mountain and mid-continent regions of the United States, with principal operations in Arkansas, Colorado, Illinois, Iowa, Kansas, Nebraska, Oklahoma, Texas and Wyoming. Our business activities include: (i) storing, transporting and selling natural gas, (ii) providing retail natural gas distribution services and (iii) operating and, in previous periods, constructing electric generation facilities. We have both regulated and nonregulated operations. In addition, we own the general partner interest, as well as significant limited partner interests, in Kinder Morgan Energy Partners, L.P., a publicly traded pipeline master limited partnership, referred to in these Notes as “Kinder Morgan Energy Partners,” and receive a substantial portion of our earnings from returns on these investments. Our common stock is traded on the New York Stock Exchange under the symbol “KMI.”

We have prepared the accompanying unaudited interim consolidated financial statements under the rules and regulations of the Securities and Exchange Commission. Under such rules and regulations, we have condensed or omitted certain information and notes normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America. We believe, however, that our disclosures are adequate to make the information presented not misleading. The consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair presentation of our financial results for the interim periods presented. You should read these interim consolidated financial statements in conjunction with our consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2003 (“2003 Form 10-K”). Certain prior period amounts have been reclassified to conform to the current presentation. Unless the context requires otherwise, references to “we,” “us,” “our,” or the “Company” are intended to mean Kinder Morgan, Inc. and its consolidated subsidiaries.

1. Summary of Significant Accounting Policies

For a complete discussion of our significant accounting policies, see Note 1 of Notes to Consolidated Financial Statements included in our 2003 Form 10-K.

Stock-Based Compensation

Statement of Financial Accounting Standards (“SFAS”) No. 123, *Accounting for Stock-Based Compensation*, encourages, but does not require, entities to adopt the fair value method of accounting for stock-based compensation plans. As allowed under SFAS No. 123, we continue to apply Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. Accordingly, compensation expense is not recognized for stock options unless the options are granted at an exercise price lower than the market price on the grant date. Had compensation cost for these plans been determined consistent with SFAS No. 123, net income and diluted earnings per share would have been reduced to the pro forma amounts shown in the table below. Because the SFAS No. 123 method of accounting has not been applied to options granted prior to January 1, 1995, the resulting pro forma compensation cost may not be representative of that to be expected in future years. Additionally, the pro forma amounts include approximately \$229,000 and \$247,000 for the three months ended March 31, 2004 and 2003, respectively, related to the purchase discount offered under the employee stock purchase plan.

	<b>Three Months Ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
	(In thousands, except per share amounts)	
Net Income, As Reported .....	\$ 127,042	\$ 111,070
Add: Stock-based Employee Compensation Expense		
Included in Reported Net Income, Net of Related Tax Effects .....	775	240
Deduct: Total Stock-based Employee Compensation Expense		
Determined under Fair Value Method for All Awards,		
Net of Related Tax Effects .....	(4,525)	(4,005)
Pro Forma .....	<u>\$ 123,292</u>	<u>\$ 107,305</u>
<b>Earnings Per Basic Share:</b>		
As Reported .....	<u>\$ 1.03</u>	<u>\$ 0.91</u>
Pro Forma .....	<u>\$ 1.00</u>	<u>\$ 0.88</u>
<b>Earnings Per Diluted Share:</b>		
As Reported .....	<u>\$ 1.02</u>	<u>\$ 0.90</u>
Pro Forma .....	<u>\$ 0.99</u>	<u>\$ 0.87</u>

## 2. Earnings Per Share

Basic earnings per common share is computed based on the weighted-average number of common shares outstanding during each period. In recent periods, we have repurchased a significant number of our outstanding shares, see Note 11. Diluted earnings per common share is computed based on the weighted-average number of common shares outstanding during each period, increased by the assumed exercise or conversion of securities (stock options are currently the only such securities outstanding) convertible into common stock, for which the effect of conversion or exercise using the treasury stock method would be dilutive.

	<b>Three Months Ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
	(In thousands)	
Weighted-average Common Shares Outstanding .....	123,715	121,877
Dilutive Common Stock Options .....	1,223	1,201
Shares Used to Compute Diluted Earnings Per Common Share .....	<u>124,938</u>	<u>123,078</u>

Weighted-average stock options outstanding totaling 0.1 million and 2.6 million for the three months ended March 31, 2004 and 2003, respectively, were excluded from the diluted earnings per common share calculation because the effect of including them would have been antidilutive.

## 3. Interest Expense, Net

“Interest Expense, Net” as presented in the accompanying interim Consolidated Statements of Operations is net of the debt component of the allowance for funds used during construction, which was \$0.2 million and \$0.3 million for the three months ended March 31, 2004 and 2003, respectively.

## 4. Cash Flow Information

We consider all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.



**Changes in Working Capital Items:  
(Net of Effects of Acquisitions and Sales)  
Increase (Decrease) in Cash and Cash Equivalents**

	<b>Three Months Ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
	(In thousands)	
Accounts Receivable.....	\$ (2,823)	\$ (1,418)
Materials and Supplies Inventory .....	167	(316)
Other Current Assets.....	17,574	63,045
Accounts Payable.....	(25,247)	(36,954)
Other Current Liabilities .....	(20,290)	(76,462)
	<u>\$ (30,619)</u>	<u>\$ (52,105)</u>

**Supplemental Disclosures of Cash Flow Information:**

**Cash Paid During the Period for:**

Interest, Net of Amount Capitalized .....	<u>\$ 61,879</u>	<u>\$ 75,811</u>
Income Taxes Paid (Received) .....	<u>\$ 2,384</u>	<u>\$ (281)</u>

Distributions received by our Kinder Morgan Management subsidiary from its investment in i-units of Kinder Morgan Energy Partners are in the form of additional i-units, while distributions made by Kinder Morgan Management to its shareholders are in the form of additional Kinder Morgan Management shares, see Note 6. "Other, Net" as presented in the accompanying interim Consolidated Statements of Cash Flows principally consists of other non-cash increases and decreases to earnings, including amortization of deferred revenue, amortization of debt discount and expense and amortization of interest rate swap proceeds previously received upon termination of the swap.

**5. Comprehensive Income**

Our comprehensive income for the three months ended March 31, 2004 and 2003 is as follows:

	<b>Three Months Ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
	(In thousands)	
<b>Net Income:</b> .....	<u>\$ 127,042</u>	<u>\$ 111,070</u>
<b>Other Comprehensive Income (Loss), Net of Tax:</b>		
Change in Fair Value of Derivatives Utilized for Hedging Purposes, Net of Tax .....	(8,373)	(21,104)
Reclassification of Change in Fair Value of Derivatives to Net Income, Net of Tax .....	756	18,731
Equity in Other Comprehensive Loss of Equity Method Investees .....	(17,327)	(1,388)
Minority Interest in Other Comprehensive Loss of Equity Method Investees .....	8,482	1,579
<b>Other Comprehensive Loss</b> .....	<u>(16,462)</u>	<u>(2,182)</u>
<b>Comprehensive Income</b> .....	<u>\$ 110,580</u>	<u>\$ 108,888</u>

The Accumulated Other Comprehensive Loss of \$42.1 million at March 31, 2004 consisted of (i) \$27.3 million representing our pro rata share of the accumulated other comprehensive loss of Kinder Morgan Energy Partners and (ii) \$14.8 million representing unrecognized net losses on hedging activities.

## 6. Kinder Morgan Management, LLC

On February 13, 2004, Kinder Morgan Management made a distribution totaling 778,309 of its shares to shareholders of record as of January 30, 2004, based on the \$0.68 per common unit distribution declared by Kinder Morgan Energy Partners for the fourth quarter of 2003. On May 14, 2004, Kinder Morgan Management will make a distribution of 872,958 of its shares to shareholders of record as of April 30, 2004, based on the \$0.69 per common unit distribution declared by Kinder Morgan Energy Partners for the first quarter of 2004. These distributions are paid in the form of additional shares or fractions thereof calculated by dividing the Kinder Morgan Energy Partners' cash distribution per common unit by the average market price of a Kinder Morgan Management share determined for a ten-trading day period ending on the trading day immediately prior to the ex-dividend date for the shares.

## 7. Investments

In February 2004, Kinder Morgan Energy Partners issued 5.3 million common units in a public offering at a price of \$46.80 per common unit, receiving total net proceeds (after underwriting discount) of \$237.8 million. We did not acquire any of these common units. This transaction reduced our percentage ownership of Kinder Morgan Energy Partners (at the time of the transaction) from approximately 19.0% to approximately 18.5% and had the associated effects of increasing (i) our investment in the net assets of Kinder Morgan Energy Partners by \$23.2 million, (ii) associated accumulated deferred income taxes by \$24,000 and (iii) paid-in capital by \$40,000 and reducing our equity method goodwill in Kinder Morgan Energy Partners by \$23.1 million. In addition, in February 2004, in order to maintain our one percent general partner interest in Kinder Morgan Energy Partners' operating partnerships, we made a contribution of approximately \$2.6 million.

On March 25, 2004, Kinder Morgan Management closed the issuance and sale of 360,664 listed shares in a limited registered offering. None of the shares from the offering were purchased by Kinder Morgan, Inc. Kinder Morgan Management used the net proceeds of approximately \$14.9 million from the offering to buy additional i-units from Kinder Morgan Energy Partners.

## 8. Summarized Income Statement Information for Kinder Morgan Energy Partners

Following is summarized income statement information for Kinder Morgan Energy Partners, a publicly traded master limited partnership in which we own the general partner interest, in addition to limited partner interests in the form of Kinder Morgan Energy Partners common units, i-units and Class B limited partner units. This investment, which is accounted for under the equity method of accounting, is described in more detail in our 2003 Form 10-K. Additional information on Kinder Morgan Energy Partners' results of operations and financial position are contained in its Quarterly Report on Form 10-Q for the quarter ended March 31, 2004 and in its Annual Report on Form 10-K for the year ended December 31, 2003.

	<u>Three Months Ended March 31,</u>	
	<u>2004</u>	<u>2003</u>
	(In thousands)	
Operating Revenues.....	\$ 1,822,256	\$ 1,788,838
Operating Expenses .....	1,597,114	1,593,686
Operating Income .....	<u>\$ 225,142</u>	<u>\$ 195,152</u>
Income Before Cumulative Effect of a Change in Accounting Principle .....	<u>\$ 191,754</u>	<u>\$ 167,013</u>
Net Income .....	<u>\$ 191,754</u>	<u>\$ 170,478</u>

## 9. Discontinued Operations

During 1999, we adopted and implemented a plan to discontinue a number of lines of business. During 2000, we essentially completed the disposition of these discontinued operations. The cash flows attributable to discontinued operations included in the accompanying interim Consolidated Statements of Cash Flows under the caption "Net Cash Flows Used in Discontinued Operations" result from cash activity attributable to retained liabilities associated with these discontinued operations. Note 7 of Notes to Consolidated Financial Statements included in our 2003 Form 10-K contains additional information on these matters.

## 10. Financing

At March 31, 2004, we had available a \$445 million 364-day credit facility dated October 14, 2003, and a \$355 million three-year revolving credit agreement dated October 15, 2002. These bank facilities can be used for general corporate purposes, including backup for our commercial paper program and, as discussed in our 2003 Form 10-K, include covenants that are common in such arrangements. Under these bank facilities, we are required to pay a facility fee based on the total commitment, whether used or unused, at a rate that varies based on our senior debt rating. We had no borrowings under our bank facilities at March 31, 2004.

The commercial paper we issue, which is supported by the credit facilities described above, is comprised of unsecured short-term notes with maturities not to exceed 270 days from the date of issue. Commercial paper outstanding at March 31, 2004 was \$97.2 million, representing a reduction of \$30.7 million from the \$127.9 million outstanding at December 31, 2003. Our weighted-average interest rate on short-term borrowings outstanding at March 31, 2004 was 1.14 percent. Average short-term borrowings outstanding during the first quarter of 2004 were \$120.7 million and the weighted-average interest rate was 1.11 percent.

On March 3, 2003, our \$500 million 6.45% Senior Notes matured, and we paid the holders of the notes, utilizing a combination of cash on hand and incremental short-term borrowings. Our current maturities of long-term debt at March 31, 2004 includes the \$500 million of our 6.65% Senior Notes due March 2005.

On February 13, 2004, we paid a cash dividend on our common stock of \$0.5625 per share to shareholders of record as of January 30, 2004. On April 21, 2004, our Board of Directors approved a cash dividend of \$0.5625 per common share payable on May 14, 2004 to shareholders of record as of April 30, 2004.

## 11. Common Stock Repurchase Plan

On August 14, 2001, we announced a program to repurchase up to \$300 million of our outstanding common stock, which program was increased to \$400 million, \$450 million, \$500 million and \$550 million in February 2002, July 2002, November 2003 and April 2004, respectively. As of March 31, 2004, we had repurchased a total of approximately \$454.8 million (9,067,800 shares) of our outstanding common stock under the program, of which \$2.1 million (35,000 shares) were repurchased in the three months ended March 31, 2004.

## 12. Business Segments

In accordance with the manner in which we manage our businesses, including the allocation of capital and evaluation of business segment performance, we report our operations in the following segments: (1) Natural Gas Pipeline Company of America and certain affiliates, referred to as Natural Gas Pipeline Company of America, a major interstate natural gas pipeline and storage system; (2) TransColorado Gas Transmission Company, referred to as TransColorado, an interstate natural gas pipeline located in western Colorado and northwest New Mexico; (3) Kinder Morgan Retail, the regulated sale and transportation of natural gas to residential, commercial and industrial customers (including a small distribution system in Hermosillo, Mexico) and the sales of natural gas to certain utility customers under the Choice Gas Program and (4) Power, the operation and, in previous periods, construction of natural gas-fired electric generation facilities.

The accounting policies we apply in the generation of business segment information are generally the same as those described in Note 1 of Notes to Consolidated Financial Statements included in our 2003 Form 10-K, except that (i) certain items below the “Operating Income” line are either not allocated to business segments or are not considered by management in its evaluation of business segment performance and (ii) equity in earnings of equity method investees, other than Kinder Morgan Energy Partners and certain insignificant international investees, are included in segment results. These equity method earnings are included in “Other Income and (Expenses)” in the accompanying interim Consolidated Statements of Operations. In addition, (i) certain items included in operating income (such as general and administrative expenses) are not allocated to individual business segments and (ii) gains and losses from incidental sales of assets are included in segment earnings. With adjustment for these items, we currently evaluate business segment performance primarily based on operating income in relation to the level of capital employed. We account for intersegment sales at market prices, while we account for asset transfers at either market value or, in some instances, book value.

## BUSINESS SEGMENT INFORMATION

	Three Months Ended March 31, 2004					March 31, 2004
	Segment Earnings	Revenues From External Customers	Intersegment Revenues	Depreciation And Amortization	Capital Expenditures	Segment Assets
	(In thousands)					
Natural Gas Pipeline Company of America .....	\$ 106,746	\$ 224,012	\$ -	\$ 23,380	\$ 11,382	\$ 5,510,139
TransColorado .....	5,627	7,905	-	1,059	1,110	265,946
Kinder Morgan Retail .....	33,681	111,459	-	4,169	7,431	410,885
Power .....	3,723	9,210	-	873	-	453,717
Segment Totals .....	149,777	<u>\$ 352,586</u>	<u>\$ -</u>	<u>\$ 29,481</u>	<u>\$ 19,923</u>	6,640,687
Earnings from Investment in Kinder Morgan Energy Partners .....	128,767					2,145,910
General and Administrative Expenses .....	(22,288)					947,730
Other Income and (Expenses) .....	(48,372)					359,903
Income Before Income Taxes .....	<u>\$ 207,884</u>					<u>\$10,094,230</u>

	Three Months Ended March 31, 2003					
	Segment Earnings	Revenues From External Customers	Intersegment Revenues	Depreciation And Amortization	Capital Expenditures	
	(In thousands)					
Natural Gas Pipeline Company of America .....	\$ 100,076	\$ 214,068	\$ -	\$ 22,305	\$ 14,808	
TransColorado .....	7,260	9,499	-	1,066	409	
Kinder Morgan Retail .....	31,459	88,989	-	3,924	1,586	
Power .....	2,920	6,312	-	2,330	2,677	
Segment Totals .....	141,715	<u>\$ 318,868</u>	<u>\$ -</u>	<u>\$ 29,625</u>	<u>\$ 19,480</u>	
Earnings from Investment in Kinder Morgan Energy Partners .....	111,495					
General and Administrative Expenses .....	(16,408)					
Other Income and (Expenses) .....	(54,918)					
Income Before Income Taxes .....	<u>\$ 181,884</u>					

<sup>1</sup> Includes market value of derivative instruments (including interest rate swaps) and miscellaneous corporate assets (such as information technology and telecommunications equipment) not allocated to individual segments.

## GEOGRAPHIC INFORMATION

All but an insignificant amount of our assets and operations are located in the continental United States of America.

13. Accounting for Derivative Instruments and Hedging Activities

Our normal business activities expose us to risks associated with changes in the market price of natural gas and associated transportation. We engage in derivative transactions for the purpose of mitigating these risks, which transactions are accounted for in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* and associated amendments. During the three months ended March 31, 2004 and 2003, our derivative activities relating to the mitigation of these risks were designated and qualified as cash flow hedges, and the impact of hedge ineffectiveness, while included in

our net income, was immaterial. As the hedged sales and purchases take place and we record them into earnings, we also reclassify the gains and losses included in accumulated other comprehensive income into earnings. We expect to reclassify into earnings, during the next twelve months, substantially all of our accumulated other comprehensive loss balance related to these derivatives of \$14.8 million, representing unrecognized net losses on derivative activities at March 31, 2004. During the three months ended March 31, 2004 and 2003, we reclassified no gains or losses into earnings as a result of the discontinuance of cash flow hedges due to a determination that the forecasted transactions would no longer occur by the end of the originally specified time period. In conjunction with these activities, we are required to place funds in margin accounts (included with “Restricted Deposits” in the accompanying interim Consolidated Balance Sheet) when the market value of these derivatives with specific counterparties exceeds established limits, or in conjunction with the purchase of exchange-traded derivatives.

We have outstanding fixed-to-floating interest rate swap agreements with a notional principal amount of \$1.5 billion at March 31, 2004. These agreements effectively convert the interest expense associated with our 7.25% Debentures due in 2028 and our 6.50% Senior Notes due in 2012 from fixed rates to floating rates based on the three-month London Interbank Offered Rate (“LIBOR”) plus a credit spread. These swaps have been designated as fair value hedges, and we have accounted for them utilizing the “shortcut” method prescribed for qualifying fair value hedges under SFAS No. 133. Accordingly, the carrying value of the swap is adjusted to its fair value as of the end of each reporting period, and an offsetting entry is made to adjust the carrying value of the debt securities whose fair value is being hedged. The fair value of the swaps of \$118.7 million at March 31, 2004 is included in the caption “Deferred Charges and Other Assets” in the accompanying interim Consolidated Balance Sheet. We record interest expense equal to the floating rate payments, which is accrued monthly and paid semi-annually.

On March 3, 2003, we terminated the interest rate swap agreements associated with our 6.65% Senior Notes due in 2005 and received \$28.1 million in cash. We are amortizing this amount (reducing interest expense) over the remaining period the 6.65% Senior Notes are outstanding. The unamortized balance of \$12.9 million at March 31, 2004 is included in the caption “Value of Interest Rate Swaps” under the heading “Long-term Debt” in the accompanying interim Consolidated Balance Sheet.

#### 14. Employee Benefits

##### (A) Retirement Plans

The components of net periodic pension cost for our retirement plans are as follows:

	<b>Three Months Ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
	(In thousands)	
Service Cost.....	\$ 2,148	\$ 1,969
Interest Cost.....	2,858	2,754
Expected Return on Assets.....	(4,071)	(3,221)
Amortization of:		
Transition (Asset)/Obligation.....	(41)	(41)
Prior Service Cost.....	44	44
(Gain)/Loss.....	662	(980)
Net Periodic Pension Cost.....	<u>\$ 1,600</u>	<u>\$ 525</u>

As of March 31, 2004, no contributions to our retirement plans have been made and we expect that contributions, if any, made during 2004 will not be significant.

## (B) Other Postretirement Employee Benefits

The components of net periodic benefit cost for our postretirement benefit plan are as follows:

	<b>Three Months Ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
	(In thousands)	
Service Cost.....	\$ 115	\$ 112
Interest Cost.....	1,653	1,749
Expected Return on Assets .....	(1,237)	(1,345)
Amortization of:		
Transition (Asset)/Obligation .....	232	232
Prior Service Cost.....	60	60
(Gain)/Loss .....	202	(108)
Net Periodic Postretirement Benefit Cost .....	<u>\$ 1,025</u>	<u>\$ 700</u>

We previously disclosed in our 2003 Form 10-K that we did not expect to make any significant contributions to our postretirement benefit plan during 2004. As of March 31, 2004, contributions of approximately \$12,000 have been made and we continue to expect that total contributions to our postretirement benefit plan during 2004 will not be significant.

In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (“the Act”) was signed into law. In January 2004, the FASB issued Staff Position FAS 106-1 to provide guidance on accounting and disclosure for the Act as it pertains to postretirement benefit plans (see Note 17). The amounts presented for net periodic postretirement benefit cost do not include the effects of the Act. Specific authoritative guidance on the accounting for the federal subsidy included in the Act is pending and that guidance, when issued, could require restatement of these amounts, although any such restatement is not expected to be material.

## 15. Regulatory Matters

On July 17, 2000, Natural Gas Pipeline Company of America filed its compliance plan, including pro forma tariff sheets, pursuant to the Federal Energy Regulatory Commission’s (“FERC”) Order Nos. 637 and 637-A. The FERC directed all interstate pipelines to file pro forma tariff sheets to comply with new regulatory requirements in these Orders regarding scheduling procedures, capacity segmentation, imbalance management services and penalty credits, or in the alternative, to explain why no changes to existing tariff provisions are necessary. On November 21, 2002, the FERC issued an order approving much of Natural Gas Pipeline Company of America’s Order 637 filing, but requiring additional changes. The primary changes relate to Natural Gas Pipeline Company of America’s segmentation proposal, the ability of shippers to designate additional primary points on a segmented release, a shipper’s rights to request discounts at alternate points and Natural Gas Pipeline Company of America’s unauthorized overrun charges. Natural Gas Pipeline Company of America made its compliance filing on December 23, 2002 and filed for rehearing. Other parties have objected to certain aspects of Natural Gas Pipeline Company of America’s compliance filing. On May 14, 2003, the FERC issued an order accepting most of Natural Gas Pipeline Company of America’s compliance filing, but requiring additional changes, particularly regarding the designation of additional primary points for a segmented release. This order also established an effective date for Natural Gas Pipeline Company of America’s Order 637 provisions of December 1, 2003. Natural Gas Pipeline Company of America made its further compliance filing on June 13, 2003. Limited protests have been filed. The Order No. 637 tariff provisions for Natural Gas Pipeline Company of America became effective on December 1, 2003, although certain aspects of these provisions are subject to FERC review of the most recent compliance filing, which is still pending.

FERC action.

On April 5, 2002, the D.C. Circuit issued an order largely affirming Order Nos. 637, et seq. The D.C. Circuit did remand the FERC's decision to impose a 5-year cap on bids the existing shipper would have to match in the right of first refusal process. The D.C. Circuit also remanded the FERC's decision to allow forward-hauls and backhauls to the same point. Finally, the D.C. Circuit held that several aspects of the FERC's segmentation policy and its policy on discounting at alternate points were not ripe for review. Numerous parties, including Natural Gas Pipeline Company of America, have filed comments on the remanded issues.

On October 31, 2002, the FERC issued an order in response to the D.C. Circuit's remand of certain Order 637 issues. The order: (i) eliminated the requirement of a 5-year cap on bid terms that an existing shipper would have to match in the right of first refusal process, and found that no term matching cap at all is necessary given existing regulatory controls and (ii) affirmed the FERC's policy that a segmented transaction consisting of both a forward-haul up to contract demand and a backhaul up to contract demand to the same point is permissible, and accordingly required, under Section 5 of the Natural Gas Act, pipelines that the FERC had previously found must permit segmentation on their systems to file tariff revisions within 30 days to permit such segmented forward-haul and backhaul transactions to the same point. On January 29, 2004, the FERC issued an order denying rehearing and reaffirming these rulings.

On November 25, 2003, the FERC issued Order No. 2004, adopting new Standards of Conduct to become effective February 9, 2004. Every interstate pipeline was required to file a compliance plan by that date and was required to be in full compliance with the Standards of Conduct by June 1, 2004. The primary change from existing regulation is to make such standards applicable to an interstate pipeline's interaction with many more affiliates (termed "Energy Affiliates"), including intrastate/Hinshaw pipelines (in general, a Hinshaw pipeline is a pipeline that receives gas at or within a state boundary, is regulated by an agency of that state, and all the gas it transports is consumed within that state), processors and gatherers and any company involved in gas or electric markets (such as electric generators and electric or gas marketers) even if they do not ship on the affiliated interstate pipeline. Local distribution companies are excluded, however, if they do not make any off-system sales. The Standards of Conduct require, inter alia, separate staffing of interstate pipelines and their Energy Affiliates (but certain support functions and senior management at the central corporate level may be shared) and strict limitations on communications from an interstate pipeline to an Energy Affiliate. Natural Gas Pipeline Company of America and Kinder Morgan Interstate Gas Transmission LLC, a subsidiary of Kinder Morgan Energy Partners, filed for clarification and rehearing of Order No. 2004 on December 29, 2003, and numerous other rehearing requests have been submitted. In the request for rehearing, Natural Gas Pipeline Company of America and Kinder Morgan Interstate Gas Transmission LLC asked that intrastate/Hinshaw pipeline affiliates not be included in the definition of Energy Affiliates. On February 9, 2004, Natural Gas Pipeline Company of America, TransColorado Gas Transmission Company, Canyon Creek Compression Company and Horizon Pipeline Company filed their compliance plans under Order No. 2004. In addition, on February 19, 2004, all of these interstate pipelines filed a joint request with the interstate pipelines owned by Kinder Morgan Energy Partners asking that their interaction with intrastate/Hinshaw pipeline affiliates be exempted from the Standards of Conduct. Separation from these entities would be the most burdensome requirement of the new rules for us.

On April 16, 2004, the FERC issued Order No. 2004-A. The FERC extended the effective date of the new Standards of Conduct from June 1, 2004, to September 1, 2004. Otherwise, the FERC largely denied rehearing of Order No. 2004, but provided further clarification or adjustment in several areas.



The FERC continued the exemption for Local Distribution Companies (“LDCs”) which do not make off-system sales, but clarified that the LDC exemption still applies if the LDC is also a Hinshaw pipeline. The FERC also clarified that an LDC can engage in certain sales and other Energy Affiliate activities to the limited extent necessary to support sales to customers located on its distribution system, and sales necessary to remain in balance under pipeline tariffs, without becoming an Energy Affiliate. The FERC declined to exempt producers from the definition of Energy Affiliate. The FERC also declined to exempt intrastate and Hinshaw pipelines, processors and gatherers from the definition of Energy Affiliate, but did clarify that such entities will not be Energy Affiliates if they do not participate in gas or electric commodity markets or interstate capacity markets (as capacity holder, agent or manager) or in financial transactions related to such markets. The separate exemption request by the Kinder Morgan interstate pipelines as to their intrastate affiliates remains pending. The FERC also clarified further the personnel and functions that can be shared by interstate pipelines and their Energy Affiliates, including senior officers and risk management personnel and the permissible role of holding or parent companies and service companies. The FERC also clarified that day-to-day operating information can be shared by interconnecting entities. Finally, the FERC clarified that an interstate pipeline and its Energy Affiliate can discuss potential new interconnects to serve the Energy Affiliate, but subject to very onerous posting and record-keeping requirements.

On July 25, 2003, the FERC issued a Modification to Policy Statement stating that FERC regulated natural gas pipelines will, on a prospective basis, no longer be permitted to use gas basis differentials to price negotiated rate transactions. Effectively, we will no longer be permitted to use commodity price indices to structure transactions on our FERC regulated natural gas pipelines. Negotiated rates based on commodity price indices in existing contracts will be permitted to remain in effect until the end of the contract period for which such rates were negotiated. Price indexed contracts currently constitute an insignificant portion of our contracts on our FERC regulated natural gas pipelines; consequently, we do not believe that this Modification to Policy Statement will have a material impact on our operations, financial results or cash flows. Rehearing on this aspect of the Modification to Policy Statement has been sought by Natural Gas Pipeline Company of America and others, but the FERC has not yet acted on rehearing.

On February 11, 2004, the FERC approved a final rule in Docket No. RM03-8-000 requiring jurisdictional entities to file quarterly financial reports with the FERC. Electric utilities, natural gas companies, and licensees will file Form 3-Q, while oil pipeline companies will submit Form 6-Q. The final rule also adopts some minimal changes to the annual financial reports filed with the FERC. The final rule modifies the Notice of Proposed Rulemaking by eliminating the management discussion and analysis section from both the quarterly and annual reports, and eliminating the use of fourth quarter data in the annual report. In addition, the final rule eliminates the cash management notification requirement adopted in FERC Order No. 634-A. The FERC said it will also use the quarterly financial information when reviewing the adequacy of traditional cost-based rates. The first quarterly reports for major public utilities, licensees, and natural gas companies will be due on July 9, 2004. The first quarterly reports for non-major public utilities, licensees, natural gas companies, and all oil pipeline companies will be due on July 23, 2004. After the transition period, major public utilities, licensees and natural gas companies will file quarterly reports 60 days after the end of the quarter; non-major public utilities, licensees, natural gas companies, and all oil pipeline companies will file 70 days after the end of the quarter.

Currently, there are no material proceedings challenging the base rates on any of our pipeline systems. Nonetheless, shippers on our pipelines do have rights to challenge the rates we charge under certain circumstances prescribed by applicable statutes and regulations. There can be no assurance that we will not face challenges to the rates we receive for services on our pipeline systems in the future. In addition,

since many of our assets are subject to regulation, we are subject to potential future changes in applicable rules and regulations that may have an adverse effect on our business, financial position or results of operations.

See Note 8 of Notes to Consolidated Financial Statements included in our 2003 Form 10-K for additional information regarding regulatory matters.

## 16. Environmental and Legal Matters

### (A) Environmental Matters

We are subject to a variety of federal, state and local laws that regulate permitted activities relating to air and water quality, waste disposal, and other environmental matters. Additionally, we have established reserves to address known environmental remediation sites. After consideration of reserves established, we believe that costs for environmental remediation and ongoing compliance with these regulations will not have a material adverse effect on our cash flows, financial position or results of operations or diminish our ability to operate our businesses. However, there can be no assurances that future events, such as changes in existing laws, the promulgation of new laws, or the development of new facts or conditions will not cause us to incur significant costs.

See Note 9(A) of Notes to Consolidated Financial Statements included in our 2003 Form 10-K for additional information regarding environmental matters.

### (B) Litigation Matters

*United States of America, ex rel., Jack J. Grynberg v. K N Energy*, Civil Action No. 97-D-1233, filed in the U.S. District Court, District of Colorado. This action was filed on June 9, 1997 pursuant to the federal False Claims Act and involves allegations of mismeasurement of natural gas produced from federal and Indian lands. The complaint asks to recover all royalties the Government allegedly should have received had the volume and heating content of the natural gas been valued properly, along with treble damages and civil penalties as provided for in the False Claims Act. Mr. Grynberg, as relator, seeks his statutory share of any recovery, plus expenses and attorney fees and costs. The Department of Justice has decided not to intervene in support of the action. The complaint is part of a larger series of similar complaints filed by Mr. Grynberg against 77 natural gas pipelines (approximately 330 other defendants). An earlier single action making substantially similar allegations against the pipeline industry was dismissed by Judge Hogan of the U.S. District Court for the District of Columbia on grounds of improper joinder and lack of jurisdiction. As a result, Mr. Grynberg filed individual complaints in various courts throughout the country. In 1999, these cases were consolidated by the Judicial Panel for Multidistrict Litigation, and transferred to the District of Wyoming. The MDL case is called *In Re Natural Gas Royalties Qui Tam Litigation*, Docket No. 1293. Motions to dismiss were filed and an oral argument on the motion to dismiss occurred on March 17, 2000. On July 20, 2000, the United States of America filed a motion to dismiss those claims by Grynberg that deal with the manner in which defendants valued gas produced from federal leases (referred to as valuation claims). Judge Downes denied the defendant's motion to dismiss on May 18, 2001. The United States' motion to dismiss most of the plaintiff's valuation claims has been granted by the Court. Mr. Grynberg has appealed that dismissal to the 10<sup>th</sup> Circuit, which has requested briefing regarding its jurisdiction over that appeal. Discovery to determine issues related to the Court's subject matter jurisdiction, arising out of the False Claims Act, is coming to a close and defendants have been ordered to submit their jurisdictional briefs by May 14, 2004. On May 7, 2003, Grynberg sought leave to file a Third Amended Complaint, which adds allegations of undermeasurement related to CO<sub>2</sub> production. Defendants have

filed briefs opposing leave to amend.

*Adams vs. Kinder Morgan, Inc., et al.*, Civil Action No. 00-M-516, filed in the United States District Court for the District of Colorado. The case was originally filed on March 8, 2000 and is a purported class action. As of this date no class has been certified. Plaintiffs seek compensatory damages against all defendants jointly and severally, together with interest, attorney fees and expenses. The plaintiffs brought claims alleging securities fraud under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 on behalf of all people who purchased the common stock of Kinder Morgan during the class period from October 30, 1997 to June 21, 1999. The class period occurred prior to the installation of our current management team in October 1999. The complaint centers on allegations of misleading statements concerning operations of the Bushton Processing Plant and certain contracts, as well as allegations of overstatement of income in violation of accounting principles generally accepted in the United States of America during the class period. On February 23, 2001, the federal district court dismissed several claims raised by the plaintiff, with prejudice, and dismissed the remaining claims, without prejudice. On April 27, 2001, the Adams plaintiffs filed their second amended complaint. On March 29, 2002, the federal district court dismissed the Adams plaintiffs' second amended complaint with prejudice. On May 2, 2002, the Adams plaintiffs appealed the dismissal to the 10<sup>th</sup> Circuit Court of Appeals. In a published decision, on August 11, 2003, the 10<sup>th</sup> Circuit Court of Appeals reversed the district court's dismissal, but upheld the dismissal of Mr. Kinder, our Chairman and Chief Executive Officer, from this action. The mandate from the 10<sup>th</sup> Circuit Court of Appeals was issued on October 17, 2003. A scheduling conference has been set for May 11, 2004. The Court has ordered the plaintiffs to file their motion for class certification by May 28, 2004 and has ordered that class certification discovery proceed.

*Darrell Sargent d/b/a Double D Production v. Parker & Parsley Gas Processing Co., American Processing, L.P. and Cesell B. Cheatham, et al.*, Cause No. 878, filed in the 100<sup>th</sup> Judicial District Court, Carson County, Texas. The plaintiff filed a purported class action suit in 1999 and amended its petition in late 2002 to assert claims on behalf of over 1,000 producers who process gas through as many as ten gas processing plants formerly owned by American Processing, L.P. ("American Processing"), a former wholly owned subsidiary of Kinder Morgan, Inc. in Carson and Gray counties and other surrounding Texas counties. The plaintiff claims that American Processing (and subsequently, ONEOK, Inc. ("ONEOK"), which purchased American Processing from us in 2000) improperly allocated liquids and gas proceeds to the producers. In particular, among other claims, the plaintiff challenges the methods and assumptions used at the plants to allocate liquids and gas proceeds among the producers and processors. The petition asserts claims for breach of contract and Natural Resources Code violations relating to the period from 1994 to the present. To date, the plaintiff has not made a specific monetary demand nor produced a specific calculation of alleged damages. The plaintiff has alleged generally in the petition that damages are "not to exceed \$200 million" plus attorney's fees, costs and interest. The defendants have filed a counterclaim for overpayments made to producers.

Pioneer Natural Resources USA, Inc., formerly known as Parker & Parsley Gas Processing Company ("Parker & Parsley"), is a co-defendant. Parker & Parsley has claimed indemnity from American Processing based on its sale of assets to American Processing on October 4, 1995. We have accepted indemnity and defense subject to a reservation of rights pending resolution of the suit. The plaintiff has also named ONEOK as a defendant. We and ONEOK are defending the case pursuant to an agreement whereby ONEOK is responsible for any damages that may be attributable to the period following ONEOK's acquisition of American Processing from us in 2000.

The purported class has not been certified. Class discovery is proceeding. The defendants expect to assert objections to class certification upon the completion of class discovery.

*Manna Petroleum Services, L.P. et al. v. American Processing, L.P. and Cesell B. Cheatham, et al.*, Cause No. 31,485, filed in the 223<sup>rd</sup> Judicial District Court of Gray County, Texas. Plaintiff filed suit in late 1999 and alleges that American Processing, L.P., a former wholly owned subsidiary of Kinder Morgan, Inc., and subsequently ONEOK, which purchased American Processing from us in 2000, misallocated proceeds from the sale of compression liquids at a gas processing plant in Pampa, Texas. On March 17, 2004, following a bench trial, the Court issued a letter ruling which stated that plaintiff Manna Petroleum Services is entitled to recover damages in the principal sum of \$556,932. The letter ruling also stated that the plaintiff may request an award of attorney's fees and costs and propose findings of fact and rulings of law before final judgment is entered. On April 28, 2004, defendants filed a motion for reconsideration of the Court's letter ruling and this motion is pending. Plaintiffs have yet to file an application for attorney's fees, costs or proposed findings of facts and rulings of law, and final judgment shall not be entered until a ruling on defendants' motion for reconsideration.

*Energas Company, a Division of Atmos Energy Company v. ONEOK Energy Marketing and Trading Company, L.P., et al.*, Cause No. 2001-516,386, filed in the 72<sup>nd</sup> District Court of Lubbock County, Texas. The plaintiff is suing several ONEOK entities for alleged overcharges in connection with gas sales, transportation, and other services, and alleged misallocations and meter errors, in and around Lubbock, under three different gas contracts. While the petition is vague, it is broad enough to include claims for the period before and after March 1, 2000 when the assets in question were conveyed by us to ONEOK. We have been defending the case pursuant to an agreement whereby ONEOK is responsible for any damages that may be attributable to the period following ONEOK's acquisition of the pertinent assets on March 1, 2000. On or about October 1, 2003, the plaintiff and ONEOK settled claims that relate to the period after March 1, 2000. Notwithstanding such settlement, the plaintiff continues to assert and we continue to defend against claims that relate to the period before March 1, 2000. In an amended petition filed in mid-2002, the plaintiff alleged damages in excess of \$12 million. The defendants have filed a counterclaim for offsetting damages and accounting corrections under the contracts with the plaintiff. The parties are currently engaged in an informal dispute resolution process in an attempt to resolve their accounting and other differences. In the event this process does not resolve the claims, a scheduling order will be established to complete fact discovery and trial. We believe that the resolution of the plaintiff's claims will be for amounts substantially less than the amounts sought.

We believe that we have meritorious defenses to all lawsuits and legal proceedings in which we are defendants and will vigorously defend against them. Based on our evaluation of the above matters, and after consideration of reserves established, we believe that the resolution of such matters will not have a material adverse effect on our business, cash flows, financial position or results of operations.

In addition, we are a defendant in various lawsuits arising from the day-to-day operations of our businesses. Although no assurance can be given, we believe, based on our investigation and experience to date, that the ultimate resolution of such items will not have a material adverse impact on our business, cash flows, financial position or results of operations.

#### 17. Recent Accounting Pronouncements

In January 2004, the FASB issued FASB Staff Position ("FSP") FAS 106-1, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003* (the "Act"). This FSP permits a sponsor of a postretirement health care plan that provides a prescription drug benefit to make a one-time election to postpone accounting for the effects of the Act. Regardless of whether a company elects that deferral, the FSP requires certain disclosures pending further consideration of the underlying accounting issues. We have elected to defer accounting for the effects of

the Act and have applied the disclosure provisions of the FSP effective December 31, 2003.

In December 2003, the FASB issued Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*. This interpretation of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, addresses consolidation by business enterprises of certain variable interest entities.

This interpretation explains how to identify variable interest entities and how an enterprise assesses its interests in a variable interest entity to decide whether to consolidate that entity. It requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. Variable interest entities that effectively disperse risks will not be consolidated unless a single party holds an interest or combination of interests that effectively recombines risks that were previously dispersed.

An enterprise that consolidates a variable interest entity is the primary beneficiary of the variable interest entity. The primary beneficiary of a variable interest entity is the party that absorbs a majority of the entity's expected losses, receives a majority of its expected residual returns, or both, as a result of holding variable interests, which are the ownership, contractual, or other monetary interests in an entity that change with changes in the fair value of the entity's net assets excluding variable interests. This interpretation requires the primary beneficiary of a variable interest entity, and an enterprise that holds significant variable interests in a variable interest entity but is not the primary beneficiary, to make certain disclosures about the variable interest entity.

Application of this interpretation is required in financial statements of public entities that have interests in variable interest entities or potential variable interest entities commonly referred to as special-purpose entities for periods ending after December 15, 2003. Application by public entities (other than small business issuers) for all other types of entities is required in financial statements for periods ending after March 15, 2004.

The principal impact of this interpretation on us is that, effective December 31, 2003, we began consolidation of Triton Power Company LLC and its wholly-owned subsidiary Triton Power Michigan LLC, which is the lessee of the Jackson, Michigan power generation facility. We operate and have a preferred interest in this entity in which the common interest is owned by others. Triton Power Company LLC has no debt but, as a result of this consolidation, we are including the lease obligation on the Jackson plant in our consolidated financial statements. The difference between the earnings impact under consolidation and under the previously applied equity method is not material.

In addition, as a result of the implementation of this interpretation, effective December 31, 2003, we (i) no longer include the transactions and balances of our business trusts, K N Capital Trust I and K N Capital Trust III, in our consolidated financial statements and (ii) began including our Junior Subordinated Deferrable Interest Debentures issued to the Capital Trusts in a separate caption under the heading "Long-term Debt" in our Consolidated Balance Sheets.

In December 2003, the FASB issued SFAS No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*. The statement revises employers' financial statement disclosures about defined benefit pension plans and other postretirement benefit plans. The statement does not change the measurement or recognition of those plans and retains the disclosures required by the original SFAS No. 132, which standardized the disclosure requirements for pensions and other postretirement benefits to the extent practicable and required additional information on changes in the benefit obligations and fair values of plans assets.

The revised statement requires additional disclosures to those in the original SFAS No. 132 about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans. The revised statement also requires interim disclosures; see Note 14.

This revised statement is effective for financial statements with fiscal years ending after December 15, 2003. The interim period disclosures required by this statement are effective for interim periods beginning after December 15, 2003. Disclosure of estimated future benefit payments required by portions of this revised statement is effective for fiscal years ending after June 15, 2004. We adopted SFAS No. 132 (revised 2003) effective December 31, 2003.

***Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.*****General**

The following discussion should be read in conjunction with (i) the accompanying interim Consolidated Financial Statements and related Notes and (ii) the Consolidated Financial Statements, related Notes and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our 2003 Form 10-K. Due to the seasonal variation in energy demand, among other factors, the following interim results may not be indicative of the results to be expected over the course of an entire year. In this report Kinder Morgan Energy Partners, L.P., a publicly traded pipeline master limited partnership in which we own the general partner interest and significant limited partner interests, is referred to as "Kinder Morgan Energy Partners."

**Critical Accounting Policies and Estimates**

Our discussion and analysis of financial condition and results of operations are based on our consolidated financial statements, prepared in accordance with accounting principles generally accepted in the United States of America and contained within this report. Certain amounts included in or affecting our financial statements and related disclosure must be estimated, requiring us to make certain assumptions with respect to values or conditions that cannot be known with certainty at the time the financial statements are prepared. The reported amounts of our assets and liabilities, revenues and expenses and associated disclosures with respect to contingent assets and obligations are necessarily affected by these estimates. We evaluate these estimates on an ongoing basis, utilizing historical experience, consultation with experts and other methods we consider reasonable in the particular circumstances. Nevertheless, actual results may differ significantly from our estimates.

In preparing our financial statements and related disclosures, we must use estimates in determining the economic useful lives of our assets, obligations under our employee benefit plans, provisions for uncollectible accounts receivable, unbilled revenues for our natural gas distribution deliveries for which meters have not yet been read, exposures under contractual indemnifications and various other recorded or disclosed amounts. Certain of these accounting estimates are of more significance in our financial statement preparation process than others. Information regarding our accounting policies and estimates that we considered to be "critical" can be found in our 2003 Form 10-K. There have not been any significant changes in these policies and estimates during the first quarter of 2004.

**Consolidated Financial Results**

	<b>Three Months Ended March 31,</b>		<b>Increase</b>
	<b>2004</b>	<b>2003</b>	<b>(Decrease)</b>
(In thousands except per share amounts)			
Operating Revenues .....	\$ 352,586	\$ 318,868	\$ 33,718
Gas Purchases and Other Costs of Sales .....	133,471	112,955	20,516
General and Administrative Expenses .....	22,288	16,408	5,880
Other Operating Expenses .....	74,056	66,700	7,356
Operating Income .....	122,771	122,805	(34)
Other Income and (Expenses) .....	85,113	59,079	26,034
Income Taxes .....	80,842	70,814	10,028
Net Income .....	<u>\$ 127,042</u>	<u>\$ 111,070</u>	<u>\$ 15,972</u>
Diluted Earnings Per Common Share .....	<u>\$ 1.02</u>	<u>\$ 0.90</u>	<u>\$ 0.12</u>
Number of Shares Used in Computing Diluted Earnings Per Common Share .....	<u>124,938</u>	<u>123,078</u>	<u>1,860</u>

Our net income increased from \$111.1 million in the first quarter of 2003 to \$127.0 million in the first quarter of 2004, an increase of \$15.9 million (14%). The increase in net income is principally comprised of an increase of \$26.0 million in “Other Income and Expenses,” partially offset by an increase of \$10.0 million in income tax expense. Following is a discussion of items affecting operating income and other income and expenses. Please refer to the individual business segment discussions included elsewhere herein for additional information regarding business segment results. Refer to the headings “Other Income and (Expenses)” and “Income Taxes” included elsewhere herein for additional information regarding these items.

Our results for the first quarter of 2004, in comparison to 2003, reflect an increase of \$33.7 million (11%) in operating revenues, with operating income essentially flat. The increase in operating revenues was attributable to increased revenues in our Natural Gas Pipeline Company of America, Kinder Morgan Retail and Power business segments, partially offset by decreased revenues in our TransColorado business segment (see the individual business segment discussions following for additional information). Operating income was positively impacted in the first quarter of 2004, relative to 2003, by increased earnings from our Natural Gas Pipeline Company of America, Kinder Morgan Retail and Power business segments. These positive impacts were offset by (i) decreased earnings from our TransColorado business segment, (ii) increased general and administrative expenses due principally to the timing of bonus accruals and increased legal expenses and employee benefit expenses and (iii) the consolidation of the results of operations of our Triton Power affiliates in our 2004 consolidated results, due to our adoption of a recent accounting pronouncement. Triton’s \$1.9 million operating loss is entirely offset by minority interests.

Below the operating income line, “Other Income and Expenses” increased from \$59.1 million in the first quarter of 2003 to \$85.1 million in 2004, an increase of \$26.0 million (44%). This increase reflected (i) increased equity in earnings of Kinder Morgan Energy Partners in the first quarter of 2004 due principally to the improved performance from the assets held by Kinder Morgan Energy Partners, (ii) decreased 2004 interest expense resulting from our lower weighted-average interest rates and our lower debt balances and (iii) the inclusion of the minority interests in Triton Power as discussed previously. These positive impacts were partially offset by an increase of \$0.9 million in minority interest expense attributable to the minority interests in Kinder Morgan Management, LLC.



Diluted earnings per common share increased from \$0.90 in the first quarter of 2003 to \$1.02 in the first quarter of 2004, an increase of \$0.12 (13%), reflecting, in addition to the financial and operating impacts discussed preceding, an increase of 1.9 million (1.5%) in average shares outstanding resulting from (i) newly-issued shares due to exercise of stock options by employees and (ii) the increased dilutive effect of stock options resulting from the increase in the market price of our shares.

### **Results of Operations**

The following comparative discussion of our results of operations is by segment for factors affecting segment earnings, and on a consolidated basis for other factors.

We manage our various businesses by, among other things, allocating capital and monitoring operating performance. This management process includes dividing the company into business segments so that performance can be effectively monitored and reported for a limited number of discrete businesses. Currently, we manage and report our operations in four business segments. In addition, we derive a substantial portion of earnings from our investment in Kinder Morgan Energy Partners, which is discussed under “Earnings from Investment in Kinder Morgan Energy Partners” following.

<b><u>Business Segment</u></b>	<b><u>Business Conducted</u></b>	<b><u>Referred to As:</u></b>
Natural Gas Pipeline Company of America and certain affiliates .....	The ownership and operation of a major interstate natural gas pipeline and storage system	Natural Gas Pipeline Company of America
TransColorado Gas Transmission Company .....	The ownership and operation of an interstate natural gas pipeline system in Colorado and New Mexico	TransColorado
Retail Natural Gas Distribution .....	The regulated sale and transportation of natural gas to residential, commercial and industrial customers (including a small distribution system in Hermosillo, Mexico) and the sales of natural gas to certain utility customers under the Choice Gas program	Kinder Morgan Retail
Power Generation.....	The operation and, in previous periods, construction of natural gas-fired electric generation facilities	Power

The accounting policies we apply in the generation of business segment earnings are generally the same as those described in Note 1 of Notes to Consolidated Financial Statements included in our 2003 Form 10-K, except that (i) certain items below the “Operating Income” line are either not allocated to business segments or are not considered by management in its evaluation of business segment performance and (ii) equity in earnings of equity method investees, other than Kinder Morgan Energy Partners and certain insignificant international investees, are included in segment results. These equity method earnings are included in “Other Income and (Expenses)” in our Consolidated Statements of Operations. In addition, (i) certain items included in operating income (such as general and administrative expenses) are not allocated to individual business segments and (ii) gains and losses from incidental sales of assets are

included in segment earnings. We account for intersegment sales at market prices, while we account for asset transfers at either market value or, in some instances, book value.

Following are operating results by individual business segment (before intersegment eliminations), including explanations of significant variances between the periods presented.

### **Natural Gas Pipeline Company of America**

	<b><u>Three Months Ended March 31,</u></b>		<b><u>Increase</u></b>
	<b><u>2004</u></b>	<b><u>2003</u></b>	<b><u>(Decrease)</u></b>
	<b>(In thousands except systems throughput)</b>		
Operating Revenues.....	<u>\$224,012</u>	<u>\$214,068</u>	<u>\$ 9,944</u>
Gas Purchases and Other Costs of Sales.....	<u>\$ 69,784</u>	<u>\$ 69,557</u>	<u>\$ 227</u>
Segment Earnings.....	<u>\$106,746</u>	<u>\$100,076</u>	<u>\$ 6,670</u>
Systems Throughput (Trillion Btus).....	<u>444.4</u>	<u>445.9</u>	<u>(1.5)</u>

Natural Gas Pipeline Company of America's segment earnings increased from \$100.1 million in the first quarter of 2003 to \$106.7 million in the first quarter of 2004, an increase of \$6.6 million (7%). The increase in operating revenues was principally due to increased revenues from transportation and storage of natural gas, partially offset by decreased revenues from operational sales of natural gas. Segment earnings for the first quarter of 2004 were positively impacted, relative to 2003, by increased margin from transportation and storage services. The increase in transportation and storage margins was largely the result of successful re-contracting of existing transportation and storage capacity, as well as the expansion of storage capacity at our North Lansing facility, which is expected to be fully completed in May 2004, as discussed following. These positive impacts were partially offset by (i) increased operations and maintenance expenses, principally due to transportation and storage compression operations, (ii) increased depreciation expense, principally related to recent expansion and extension projects and (iii) increased ad valorem taxes. The small decrease in system throughput in 2004 did not have a significant direct impact on revenues due to the fact that transportation revenues are derived primarily from "demand" contracts in which shippers pay a fee to reserve a set amount of system capacity for their use.

During April 2003, Natural Gas Pipeline Company of America began construction of 10.7 Bcf of storage service expansion at its existing North Lansing storage facility in east Texas, all of which is fully subscribed under long-term contracts. Although construction on this approximately \$38 million project is not expected to be completed until May 2004, the service is available at this time. Please refer to our 2003 Form 10-K for additional information regarding Natural Gas Pipeline Company of America.

**TransColorado**

	<b>Three Months Ended March 31,</b>		
	<b>2004</b>	<b>2003</b>	<b>Decrease</b>
	(In thousands except systems throughput)		
Total Operating Revenues.....	<u>\$ 7,905</u>	<u>\$ 9,499</u>	<u>\$ (1,594)</u>
Segment Earnings.....	<u>\$ 5,627</u>	<u>\$ 7,260</u>	<u>\$ (1,633)</u>
Systems Throughput (Trillion Btus).....	42.3	46.5	(4.2)

TransColorado's segment earnings decreased from \$7.3 million in the first quarter of 2003 to \$5.6 million in the first quarter of 2004, a decrease of \$1.7 million (23%). Segment earnings declined primarily due to the fact that in 2004 17% of long haul transport contracts were tied to the basis differential and the basis differential in 2004 narrowed significantly as compared to 2003, when the basis differential spread was very wide. As a result of ongoing contracting activities, in which we entered into additional long-term, fixed price contracts for most of TransColorado's long haul capacity, the volume of activity that is subject to changes in basis differentials has decreased from 17% to 11% of its current long haul capacity. The decrease in TransColorado's system throughput volumes in the first quarter of 2004, relative to 2003, was due to reduced demand for short haul transport on the southern portion of TransColorado's system.

On September 25, 2003, we announced that we had signed a 10-year, firm natural gas transportation contract with an undisclosed shipper that will allow us to construct facilities resulting in a 125,000 dekatherm per day expansion of capacity on the TransColorado system. The facilities consist of three new compressor stations and modifications at two existing compressor stations, which will increase compression by more than 20,000 horsepower. In March 2004, we received FERC approval to construct the facilities and place them into service. We expect to complete the expansion project during the third quarter of 2004. Please refer to our 2003 Form 10-K for additional information regarding TransColorado.

**Kinder Morgan Retail**

	<u>Three Months Ended March 31,</u>		
	<u>2004</u>	<u>2003</u>	<u>Increase</u>
	(In thousands except systems throughput)		
Total Operating Revenues .....	<u>\$111,459</u>	<u>\$ 88,989</u>	<u>\$ 22,470</u>
Gas Purchases and Other Costs of Sales .....	<u>\$ 62,216</u>	<u>\$ 42,408</u>	<u>\$ 19,808</u>
Segment Earnings.....	<u>\$ 33,681</u>	<u>\$ 31,459</u>	<u>\$ 2,222</u>
Systems Throughput (Trillion Btus) <sup>1</sup> .....	<u>18.4</u>	<u>17.4</u>	<u>1.0</u>

<sup>1</sup> Excludes transport volumes of intrastate pipelines.

Kinder Morgan Retail's segment earnings increased from \$31.5 million in the first quarter of 2003 to \$33.7 million in the first quarter of 2004, an increase of \$2.2 million (7%). The increase in operating revenues in the first quarter of 2004, relative to 2003, is partially offset by gas purchases and other costs of sales, and primarily resulted from (i) higher natural gas prices in 2004, (ii) the fact that a higher

percentage of our Wyoming customers chose us as their natural gas supplier in 2004, either through regulated rates that pass-through the cost of gas to the customer, or through our Choice Gas commodity program that allows customers connected to our natural gas distribution system to choose from among several natural gas commodity suppliers, (iii) increased 2004 throughput volumes due to colder weather, (iv) increased revenues from non-regulated merchandise sales and (v) continued customer growth in Colorado. Our weather hedging program continued to contribute to stability in Kinder Morgan Retail's earnings pattern by reducing the impact of weather-related demand fluctuations.

Kinder Morgan Retail has undertaken two expansion projects in western Colorado that are expected to contribute to future earnings growth. A distribution project from Gypsum to Dotsero has been completed and is in service. A mainline project from near Montrose to Ouray is in progress with completion expected by mid-2004. Please refer to our 2003 Form 10-K for additional information regarding Kinder Morgan Retail.

## **Power**

	<b><u>Three Months Ended March 31,</u></b>		<b><u>Increase</u></b>
	<b><u>2004</u></b>	<b><u>2003</u></b> (In thousands)	
Total Operating Revenues.....	\$ <u>9,210</u>	\$ <u>6,312</u>	\$ <u>2,898</u>
Gas Purchases and Other Costs of Sales .....	\$ <u>1,471</u>	\$ <u>990</u>	\$ <u>481</u>
Segment Earnings .....	\$ <u>3,723</u>	\$ <u>2,920</u>	\$ <u>803</u>

Due to the adoption of a recently issued accounting standard, the results of operations of our Triton Power affiliates are included in our consolidated operating results and in the results of our Power segment beginning with the first quarter of 2004. Prior to December 31, 2003, Triton was accounted for as an equity-method investment. Although the results of Triton have an impact on the total operating revenues and expenses of the Power business segment, after taking into account the associated minority interests, Triton had no effect on Power's segment earnings. The increase in operating revenues in the first quarter of 2004, relative to 2003, was primarily attributable to the inclusion of Triton in our 2004 consolidated operating results. Segment earnings were positively impacted in the first quarter of 2004, relative to 2003, by (i) a \$1.5 million charge to 2003 depreciation expense related to the retirement of gas turbine components that were replaced, (ii) increased earnings from Thermo Cogeneration Partnership and (iii) lower staffing costs. These positive earnings impacts were partially offset by our reduced net profits interest from one Colorado power plant. Please refer to our 2003 Form 10-K for additional information regarding Power.

**Earnings from Investment in Kinder Morgan Energy Partners**

The impact on our pre-tax earnings from our investment in Kinder Morgan Energy Partners was as follows:

	<b>Three Months Ended March 31,</b>		<b>Increase (Decrease)</b>
	<b>2004</b>	<b>2003</b>	
	(In thousands)		
General Partner Interest, Including Minority Interest in the Operating Limited Partnerships .....	\$ 93,515	\$ 78,169	\$ 15,346
Limited Partner Units (Kinder Morgan Energy Partners).....	9,599	9,509	90
Limited Partner i-units (Kinder Morgan Management) ....	25,653	23,817	1,836
	128,767	111,495	17,272
Pre-tax Minority Interest in Kinder Morgan Management.....	(18,255)	(16,755)	(1,500)
Pre-tax Earnings from Investment in Kinder Morgan Energy Partners .....	<u>\$110,512</u>	<u>\$ 94,740</u>	<u>\$ 15,772</u>

The increase in our earnings from this investment in the first quarter of 2004 in comparison to the first quarter of 2003 is principally due to improved operating results from Kinder Morgan Energy Partners' various businesses. For 2004, pre-tax earnings attributable to our investment in Kinder Morgan Energy Partners are expected to increase by approximately 15% due to, among other factors, improved performance from its existing assets. However, there are factors beyond the control of Kinder Morgan Energy Partners that may affect its results, including developments in the regulatory arena and as yet unforeseen competitive developments or acquisitions. Additional information on Kinder Morgan Energy Partners is contained in its Quarterly Report on Form 10-Q for the three months ended March 31, 2004 and its Annual Report on Form 10-K for the year ended December 31, 2003.

**Other Income and (Expenses)**

	<b>Three Months Ended March 31,</b>		<b>Earnings Increase (Decrease)</b>
	<b>2004</b>	<b>2003</b>	
	(In thousands)		
Interest Expense, Net.....	\$ (32,434)	\$ (39,974)	\$ 7,540
Interest Expense – Deferrable Interest Debentures <sup>1</sup> .....	(5,478)	-	(5,478)
Equity in Earnings of Kinder Morgan Energy Partners....	128,767	111,495	17,272
Equity in Earnings of Power Segment <sup>2</sup> .....	2,419	2,173	246
Equity in Earnings of Horizon Pipeline <sup>3</sup> .....	388	329	59
Equity in Losses of Other Equity Investments .....	-	(19)	19
Minority Interests <sup>1</sup> .....	(9,308)	(15,921)	6,613
Other, Net .....	759	996	(237)
	<u>\$ 85,113</u>	<u>\$ 59,079</u>	<u>\$ 26,034</u>

<sup>1</sup> Due to our adoption of a recently issued accounting standard, the expense associated with our Deferrable Interest Debentures is recorded as interest expense for the three months ended March 31, 2004. For the three months ended March 31, 2003, the corresponding expense of \$5,478 was included in "Minority Interests." See Note 17.

<sup>2</sup> Included in Power segment earnings.

<sup>3</sup> Included in Natural Gas Pipeline Company of America segment earnings.

“Other Income and (Expenses)” increased from income of \$59.1 million in the first quarter of 2003 to income of \$85.1 million in the first quarter of 2004, an increase of \$26.0 million (44%). This increase was principally due to (i) increased equity in the earnings of Kinder Morgan Energy Partners due, in part, to the strong performance from the assets held by Kinder Morgan Energy Partners and (ii) decreased interest expense resulting from our lower weighted-average interest rates and our lower debt balances.

### **Income Taxes**

The income tax provision increased from \$70.8 million in the first quarter of 2003 to \$80.8 million in the first quarter of 2004, an increase of \$10.0 million (14%) due principally to a \$26 million increase in pre-tax income.

### **Discontinued Operations**

During 1999, we adopted and implemented a plan to discontinue a number of lines of business. During 2000, we essentially completed the disposition of these discontinued operations. The cash flow impacts associated with discontinued operations are discussed under “Cash Flows” following. Note 9 of the accompanying Notes to Consolidated Financial Statements contains additional information on these matters.

### **Liquidity and Capital Resources**

#### *Primary Cash Requirements*

Our primary cash requirements, in addition to normal operating, general and administrative expenses, are for debt service, capital expenditures, common stock repurchases and quarterly cash dividends to our common shareholders. Our capital expenditures (other than sustaining capital expenditures), our common stock repurchases and our quarterly cash dividends to our common shareholders are discretionary. We expect to fund these expenditures with existing cash and cash flows from operating activities. In addition to utilizing cash generated from operations, we could meet these cash requirements through borrowings under our credit facilities or by issuing short-term commercial paper, long-term notes or additional shares of common stock.

#### *Invested Capital*

The following table illustrates the sources of our invested capital. The balances at December 31, 2001 and thereafter reflect the May 2001 sale of shares of Kinder Morgan Management in its initial public offering. The balances at December 31, 2002 and thereafter also reflect the impact of Kinder Morgan Management’s August 2002 public sale of its shares. Our ratio of total debt to total capital has declined significantly since 2001. This decline has resulted from a number of factors, including our increased cash flows from operations as discussed under “Cash Flows” following. In recent periods, we have significantly increased our dividends per common share and have announced our intention to consider further increases on an annual basis, and we maintain an ongoing program to repurchase outstanding shares of our common stock. For these reasons, among others, any declines in our ratio of total debt to total capital in the future may be smaller.

In addition to the direct sources of debt and equity financing shown in the following table, we obtain financing indirectly through our ownership interests in unconsolidated entities as shown under

“Significant Financing Transactions” following. Our largest such unconsolidated investment is in Kinder Morgan Energy Partners. See “Investment in Kinder Morgan Energy Partners” following.

The discussion under the heading “Liquidity and Capital Resources” in Management’s Discussion and Analysis of Financial Condition and Results of Operations included in our 2003 Form 10-K includes a comprehensive discussion of (i) our investments in and obligations to unconsolidated entities, (ii) our contractual obligations and (iii) our contingent liabilities. These disclosures, which reflected balances and contractual arrangements existing as of December 31, 2003, also reflect current balances and contractual arrangements except for changes discussed following. Changes in our long-term debt and commercial paper are discussed under “Net Cash Flows from Financing Activities” following and in Note 10 of the accompanying Notes to Consolidated Financial Statements.

	March 31, 2004	December 31, 2003	December 31, 2002	2001
		(Dollars in thousands)		
Long-term Debt:				
Outstanding Notes and Debentures.....	\$2,337,510	\$2,837,487	\$2,852,181	\$2,409,798
Deferrable Interest Debentures Issued to Subsidiary Trusts <sup>1</sup> .....	283,600	283,600	-	-
Value of Interest Rate Swaps <sup>2</sup> .....	131,604	88,242	139,589	(4,831)
	2,752,714	3,209,329	2,991,770	2,404,967
Minority Interests .....	1,036,203	1,010,140	967,802	817,513
Common Equity.....	2,738,775	2,666,117	2,354,997	2,259,997
Capital Trust Securities <sup>1</sup> .....	-	-	275,000	275,000
	6,527,692	6,885,586	6,589,569	5,757,477
Less Value of Interest Rate Swaps .....	(131,604)	(88,242)	(139,589)	4,831
Capitalization.....	6,396,088	6,797,344	6,449,980	5,762,308
Short-term Debt, Less Cash and Cash Equivalents <sup>3</sup> ...	586,666	121,824	465,614	613,918
Invested Capital .....	<u>\$6,982,754</u>	<u>\$6,919,168</u>	<u>\$6,915,594</u>	<u>\$6,376,226</u>
<u>Capitalization:</u>				
Outstanding Notes and Debentures.....	36.6%	41.7%	44.2%	41.8%
Minority Interests .....	16.2%	14.9%	15.0%	14.2%
Common Equity.....	42.8%	39.2%	36.5%	39.2%
Deferrable Interest Debentures Issued to Subsidiary Trusts .....	4.4%	4.2%	-	-
Capital Trust Securities.....	-	-	4.3%	4.8%
<u>Invested Capital:</u>				
Total Debt <sup>4</sup> .....	41.9%	42.8%	48.0%	47.4%
Equity, Including Capital Trust Securities, Deferrable Interest Debentures Issued to Subsidiary Trusts and Minority Interests .....	58.1%	57.2%	52.0%	52.6%

<sup>1</sup> As a result of a recent change in accounting standards effective December 31, 2003, the subsidiary trusts associated with these securities are no longer consolidated. See Note 17.

<sup>2</sup> See “Significant Financing Transactions” following.

<sup>3</sup> Cash and cash equivalents netted against short-term debt were \$15,534, \$11,076, \$35,653 and \$16,134 for March 31, 2004 and December 31, 2003, 2002 and 2001, respectively.

<sup>4</sup> Outstanding notes and debentures plus short-term debt, less cash and cash equivalents.

### ***Short-term Liquidity***

Our principal sources of short-term liquidity are our revolving bank facilities, our commercial paper

program (which is supported by our revolving bank facilities) and cash provided by operations. As of March 31, 2004, we had available a \$445 million 364-day facility dated October 14, 2003, and a \$355 million three-year revolving credit agreement dated October 15, 2002. These bank facilities can be used for general corporate purposes, including as backup for our commercial paper program. At March 31, 2004 and April 30, 2004, we had \$97.2 million and \$151.0 million, respectively, of commercial paper issued and outstanding. After inclusion of applicable letters of credit, the remaining available borrowing capacity under the bank facilities was \$670.3 million and \$616.5 million at March 31, 2004 and April 30, 2004, respectively.

Our current maturities of long-term debt of \$505 million at March 31, 2004 consisted of \$5 million of current maturities of our 6.50% Series Debentures due September 1, 2013 and our \$500 million of 6.65% Series Debentures due March 1, 2005. Apart from our notes payable and current maturities of long-term debt, our current liabilities, net of our current assets, represents an additional short-term obligation of approximately \$1.5 million at March 31, 2004. Given our expected cash flows from operations and our unused debt capacity as discussed preceding, including our three-year revolving credit facility, and based on our projected cash needs in the near term, we do not expect any liquidity issues to arise. Our next significant debt maturity, apart from our 6.65% Senior Notes in 2005 mentioned above, is our \$300 million of 6.80% Senior Notes in 2008.

### ***Significant Financing Transactions***

On August 14, 2001, we announced a program to repurchase \$300 million of our outstanding common stock, which program was increased to \$400 million, \$450 million, \$500 million and \$550 million in February 2002, July 2002, November 2003 and April 2004, respectively. As of March 31, 2004, we had repurchased a total of approximately \$454.8 million (9,067,800 shares) of our outstanding common stock under the program, of which \$2.1 million (35,000 shares) and \$1.4 million (31,100 shares) were repurchased in the three months ended March 31, 2004 and 2003, respectively. In January 2003, our board of directors approved a plan to purchase shares of Kinder Morgan Management on the open market. During the three months ended March 31, 2003, we repurchased \$0.9 million (29,000 shares) of Kinder Morgan Management stock.

As further described under “Risk Management” in Item 7A of our 2003 Form 10-K, we had outstanding fixed-to-floating interest rate swap agreements with a notional principal amount of \$1.5 billion at March 31, 2004. These agreements, entered into in August 2001, September 2002 and November 2003, effectively convert the interest expense associated with our 7.25% Debentures due in 2028 and our 6.50% Senior Notes due in 2012 from fixed to floating rates based on the three-month London Interbank Offered Rate (“LIBOR”) plus a credit spread. These swaps are accounted for as fair value hedges under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

On March 25, 2004, Kinder Morgan Management closed the issuance and sale of 360,664 listed shares in a limited registered offering. None of the shares from the offering were purchased by Kinder Morgan, Inc. Kinder Morgan Management used the net proceeds of approximately \$14.9 million from the offering to buy additional i-units from Kinder Morgan Energy Partners, L.P.

On March 3, 2003, we terminated the interest rate swap agreements associated with our 6.65% Senior Notes due in 2005 and received \$28.1 million. We are amortizing this amount (as a reduction to interest expense) over the remaining period the 6.65% Senior Notes are outstanding. The unamortized balance of \$12.9 million at March 31, 2004 is included in the caption “Value of Interest Rate Swaps” under the heading “Long-term Debt” in the accompanying interim Consolidated Balance Sheet.



Certain of our customers are experiencing financial problems that have had a significant impact on their creditworthiness. We are working to implement, to the extent allowable under applicable laws, tariffs and regulations, prepayments and other security requirements such as letters of credit to enhance our credit position relating to amounts owed from these customers. We cannot assure that one or more of our financially distressed customers will not default on their obligations to us or that such a default or defaults will not have a material adverse effect on our business.

On March 3, 2003, our \$500 million of 6.45% Senior Notes matured and we paid the holders of the notes, utilizing a combination of cash and incremental short-term borrowings.

### **Investment in Kinder Morgan Energy Partners**

At March 31, 2004, we owned, directly, and indirectly in the form of i-units corresponding to the number of shares of Kinder Morgan Management, LLC we owned, approximately 32.6 million limited partner units of Kinder Morgan Energy Partners. These units, which consist of 13.0 million common units, 5.3 million Class B units and 14.3 million i-units, represent approximately 16.7 percent of the total limited partner interests of Kinder Morgan Energy Partners. In addition, we are the sole stockholder of the general partner of Kinder Morgan Energy Partners, which holds an effective 2 percent interest in Kinder Morgan Energy Partners and its operating partnerships. Together, our limited partner and general partner interests represented approximately 18.3 percent of Kinder Morgan Energy Partners' total equity interests at March 31, 2004. We receive quarterly distributions on the i-units owned by Kinder Morgan Management in additional i-units and distributions on our other units in cash.

In addition to distributions received on our limited partner interests as discussed above, we also receive an incentive distribution from Kinder Morgan Energy Partners as a result of our ownership of the general partner interest in Kinder Morgan Energy Partners. This incentive distribution is calculated in increments based on the amount by which quarterly distributions to unit holders exceed specified target levels as set forth in Kinder Morgan Energy Partners' partnership agreement, reaching a maximum of 50% of distributions allocated to the general partner for distributions above \$0.23375 per limited partner unit.

We reflect our investment in Kinder Morgan Energy Partners under the equity method of accounting and, accordingly, report our share of Kinder Morgan Energy Partners' earnings as "Equity in Earnings" in our interim Consolidated Statement of Operations in the period in which such earnings are reported by Kinder Morgan Energy Partners. See Notes 7 and 8 of the accompanying Notes to Consolidated Financial Statements for additional information regarding our investment in Kinder Morgan Energy Partners.

### **CASH FLOWS**

The following discussion of cash flows should be read in conjunction with the accompanying interim Consolidated Statements of Cash Flows and related supplemental disclosures, and the Consolidated Statements of Cash Flows and related supplemental disclosures included in our 2003 Form 10-K.

#### **Net Cash Flows from Operating Activities**

"Net Cash Flows Provided by Operating Activities" increased from \$163.6 million in the first quarter 2003 to \$167.4 million in the first quarter 2004, an increase of \$3.8 million (2.3%). This positive variance is principally due to (i) a \$14.4 million increase in cash distributions received in 2004 attributable to our interest in Kinder Morgan Energy Partners, (ii) a \$13.9 million reduction in cash paid for interest and (iii) an increase of \$10.8 million in 2004 cash attributable to deferred purchased gas

costs. These positive impacts were partially offset by (i) the fact that 2003 included \$28.1 million of cash proceeds received from termination of an interest rate swap (see “Significant Financing Transactions” for further information regarding this transaction) and (ii) a decrease of \$8.5 million in cash inflows for gas in underground storage during 2004. Significant period-to-period variations in cash used or generated from gas in storage transactions are due to changes in injection and withdrawal volumes as well as fluctuations in natural gas prices.

### Net Cash Flows from Investing Activities

“Net Cash Flows Used in Investing Activities” increased from \$28.7 million in the first quarter 2003 to \$85.0 million in the first quarter 2004, an increase of \$56.3 million (196.2%). This increased use of cash is principally due to a \$43.9 million increase in 2004 investments in margin deposits associated with hedging activities utilizing energy derivative instruments, and an additional \$17.5 million investment in Kinder Morgan Energy Partners during 2004.

### Net Cash Flows from Financing Activities

“Net Cash Flows Used in Financing Activities” decreased from \$141.1 million in the first quarter 2003 to \$78.0 million in the first quarter 2004, a decrease of \$63.1 million. This decrease is principally due to (i) the fact that 2003 included \$500 million of cash used to retire our \$500 million 6.45% Senior Notes, (ii) \$14.9 million of proceeds in 2004, net of issuance costs, from the issuance of Kinder Morgan Management shares in March 2004 and (iii) an increase of \$13.7 million received in 2004 for issuance of our common stock. Partially offsetting these factors were (i) a \$30.7 million reduction in short-term debt during the first quarter of 2004 versus incremental short-term borrowings of \$331.9 million during the first quarter of 2003, (ii) a \$51.3 million increase in cash paid for dividends in 2004, principally due to the increased dividends declared per share and (iii) a \$53.9 million decreased source of cash from short-term advances to unconsolidated affiliates during 2004.

### Recent Accounting Pronouncements

Refer to Note 17 of the accompanying Notes to Consolidated Financial Statements for information regarding recent accounting pronouncements.

### Information Regarding Forward-looking Statements

This filing includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements are identified as any statement that does not relate strictly to historical or current facts. They use words such as “anticipate,” “believe,” “intend,” “plan,” “projection,” “forecast,” “strategy,” “position,” “continue,” “estimate,” “expect,” “may,” “will,” or the negative of those terms or other variations of them or by comparable terminology. In particular, statements, express or implied, concerning future actions, conditions or events, future operating results or the ability to generate sales, income or cash flow or to pay dividends are forward-looking statements. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Future actions, conditions or events and future results of operations may differ materially from those expressed in these forward-looking statements. Many of the factors that will determine these results are beyond our ability to control or predict. Specific factors which could cause actual results to differ from those in the forward-looking statements include but are not limited to the following:

- price trends and overall demand for natural gas liquids, refined petroleum products, oil, carbon

dioxide, natural gas, electricity, coal and other bulk materials and chemicals in the United States;

- economic activity, weather, alternative energy sources, conservation and technological advances that may affect price trends and demand;
- changes in our tariff rates or those of Kinder Morgan Energy Partners implemented by the FERC or another regulatory agency or, with respect to Kinder Morgan Energy Partners, the California Public Utilities Commission;
- Kinder Morgan Energy Partners' ability and our ability to acquire new businesses and assets and integrate those operations into existing operations, as well as the ability to make expansions to our respective facilities;
- difficulties or delays experienced by railroads, barges, trucks, ships or pipelines in delivering products to or from Kinder Morgan Energy Partners' terminals or pipelines or our pipelines;
- Kinder Morgan Energy Partners' ability and our ability to successfully identify and close acquisitions and make cost-saving changes in operations;
- shut-downs or cutbacks at major refineries, petrochemical or chemical plants, ports, utilities, military bases or other businesses that use Kinder Morgan Energy Partners' or our services or provide services or products to Kinder Morgan Energy Partners or us;
- changes in laws or regulations, third-party relations and approvals, decisions of courts, regulators and governmental bodies that may adversely affect our business or our ability to compete;
- our ability to offer and sell equity securities and debt securities or obtain debt financing in sufficient amounts to implement that portion of our business plan that contemplates growth through acquisitions of operating businesses and assets and expansions of our facilities;
- our indebtedness could make us vulnerable to general adverse economic and industry conditions, limit our ability to borrow additional funds and/or place us at competitive disadvantages compared to our competitors that have less debt or have other adverse consequences;
- interruptions of electric power supply to our facilities due to natural disasters, power shortages, strikes, riots, terrorism, war or other causes;
- acts of nature, sabotage, terrorism or other acts causing damage greater than our insurance coverage limits;
- capital market conditions;
- the political and economic stability of the oil producing nations of the world;
- national, international, regional and local economic, competitive and regulatory conditions and developments;
- the ability to achieve cost savings and revenue growth;
- inflation;
- interest rates;

- the pace of deregulation of retail natural gas and electricity;
- foreign exchange fluctuations;
- the timing and extent of changes in commodity prices for oil, natural gas, electricity and certain agricultural products; and
- the timing and success of business development efforts.

You should not put undue reliance on any forward-looking statements.

See Items 1 and 2 “Business and Properties – Risk Factors” of our annual report filed on Form 10-K for the year ended December 31, 2003, for a more detailed description of these and other factors that may affect the forward-looking statements. Our future results also could be adversely impacted by unfavorable results of litigation and the fruition of contingencies referred to in Notes 15 and 16 of the accompanying Notes to Consolidated Financial Statements. When considering forward-looking statements, one should keep in mind the risk factors described in “Risk Factors” above. The risk factors could cause our actual results to differ materially from those contained in any forward-looking statement. We disclaim any obligation to update the above list or to announce publicly the result of any revisions to any of the forward-looking statements to reflect future events or developments.

***Item 3. Quantitative and Qualitative Disclosures about Market Risk.***

There have been no material changes in market risk exposures that would affect the quantitative and qualitative disclosures presented as of December 31, 2003, in Item 7A “Quantitative and Qualitative Disclosures About Market Risk” contained in our 2003 Form 10-K. See also Note 13 of the accompanying Notes to Consolidated Financial Statements.

***Item 4. Controls and Procedures.***

As of March 31, 2004, our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon and as of the date of the evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that the design and operation of our disclosure controls and procedures were effective in all material respects to provide reasonable assurance that information required to be disclosed in the reports we file and submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported as and when required. There has been no change in our internal control over financial reporting during the quarter ended March 31, 2004 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION*****Item 1. Legal Proceedings.***

The reader is directed to Note 16 of the accompanying Notes to Consolidated Financial Statements in Part I, Item 1, which is incorporated herein by reference.

***Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities.***

During the quarter ended March 31, 2004, we did not sell any equity securities that were not registered under the Securities Act of 1933, as amended.

**Our Purchases of Our Common Stock**

<u>Period</u>	<u>Total Number of Shares Purchased<sup>1</sup></u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs<sup>1</sup></u>	<u>Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs</u>
January 1 to January 31, 2004.....	10,000	<u>\$ 59.99</u>	10,000	<u>\$46,732,144</u>
February 1 to February 29, 2004.....	25,000	<u>\$ 59.85</u>	25,000	<u>\$45,235,459</u>
March 1 to March 31, 2004.....	<u>-</u>	<u>\$ -</u>	<u>-</u>	<u>\$45,235,459</u>
<b>Total</b>	<u>35,000</u>	<u>\$ 59.89</u>	<u>35,000</u>	<u>\$45,235,459<sup>2</sup></u>

<sup>1</sup> All purchases were made pursuant to our publicly announced repurchase plan. On August 14, 2001, we announced a plan to repurchase \$300 million of our outstanding common stock, which program was increased to \$400 million, \$450 million, \$500 million and \$550 million in February 2002, July 2002, November 2003, and April 2004, respectively.

<sup>2</sup> As of March 31, 2004. In April 2004, the program was increased by \$50 million.

***Item 3. Defaults Upon Senior Securities.***

None.

***Item 4. Submission of Matters to a Vote of Security Holders.***

None.

***Item 5. Other Information.***

None.

**Item 6. Exhibits and Reports on Form 8-K.****(A) Exhibits.**

- 31.1 Section 13a – 14(a) / 15d – 14(a) Certification of Chief Executive Officer
- 31.2 Section 13a – 14(a) / 15d – 14(a) Certification of Chief Financial Officer
- 32.1 Section 1350 Certification of Chief Executive Officer
- 32.2 Section 1350 Certification of Chief Financial Officer

**(B) Reports on Form 8-K.****(1) Current Report on Form 8-K dated January 21, 2004 was furnished on January 28, 2004 pursuant to Item 7 and Item 12 of that form.**

Pursuant to Item 12 of that form, we disclosed that on January 21, 2004 we issued a press release regarding our financial results for the quarter and year ended December 31, 2003, and held a webcast conference call on January 21, 2004 discussing those results.

Pursuant to Item 7 of that form, we filed our press release dated January 21, 2004 and an unedited transcript of the webcast conference call, prepared by an outside vendor, as exhibits.

**(2) Current Report on Form 8-K dated April 21, 2004 was furnished on April 21, 2004 pursuant to Item 7 and Item 12 of that form.**

Pursuant to Item 12 of that form, we disclosed that on April 21, 2004 we issued a press release regarding our financial results for the quarter ended March 31, 2004, and held a webcast conference call on April 21, 2004 discussing those results.

Pursuant to Item 7 of that form, we filed our press release dated April 21, 2004 as an exhibit.

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

KINDER MORGAN, INC.  
(Registrant)

May 6, 2004

/s/ C. Park Shaper

C. Park Shaper  
Vice President and Chief Financial Officer