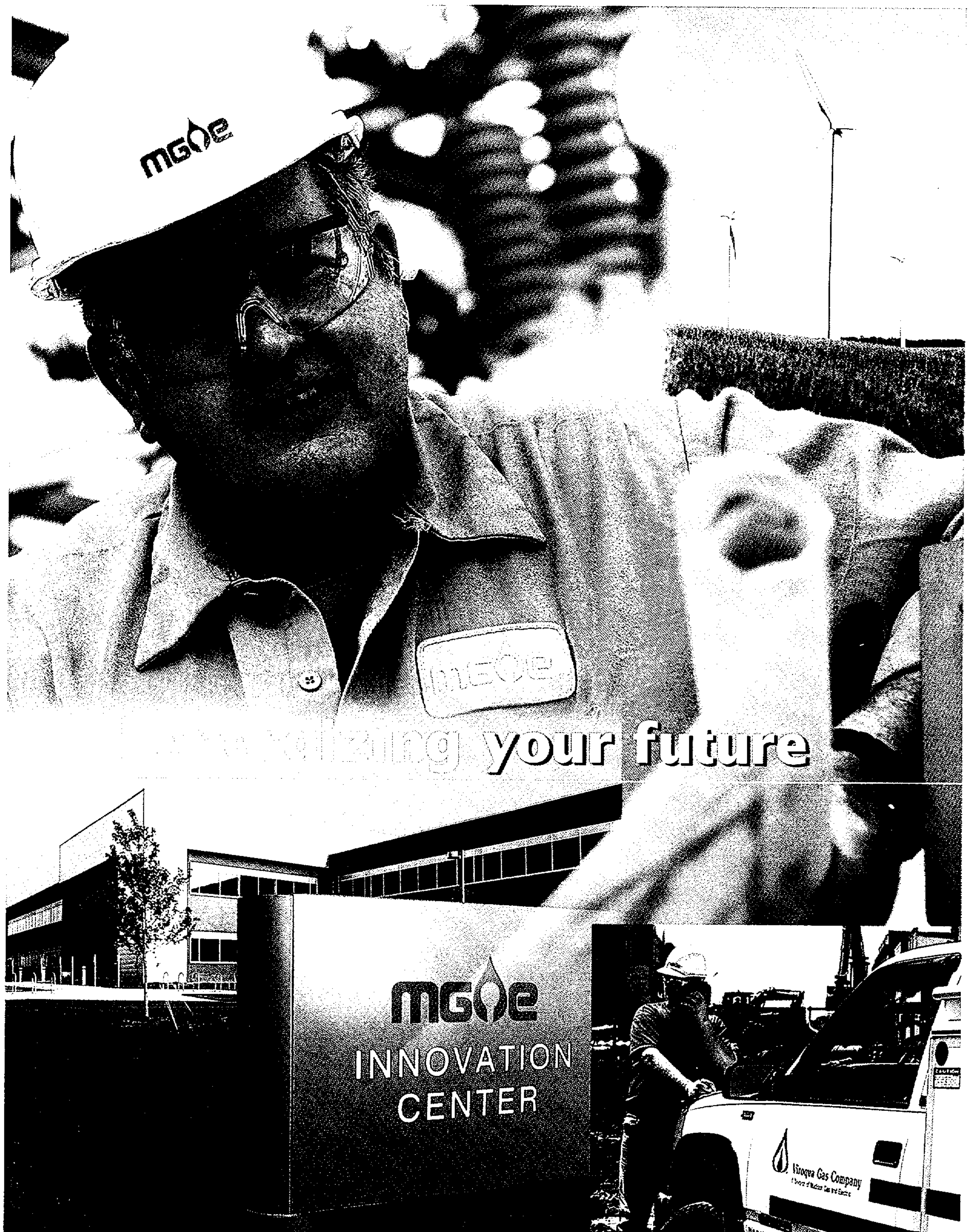
# Madison Gas and Electric Company 1999 Annual Report

MGE®

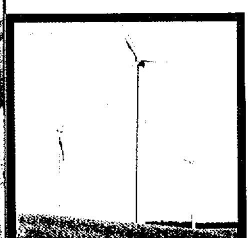


# Contents

### About the Cover

*Foreman Ron Stewart helps rebuild the Blount Substation in downtown Madison to increase operating flexibility and improve reliability. (See page 9)*

*MGE leads the nation with the highest percentage of customers buying wind power. (See page 9)*





*MGE committed $1 million to triple the space available for start-up, high-tech firms at the new MGE Innovation Center. (See page 5)*

*Gas Serviceman Karl Lavold upgrades the natural gas system in downtown Viroqua to accommodate growth. (See page 10)*



### Madison Gas and Electric Company

MGE is an investor-owned public utility headquartered in Madison, Wisconsin. The company generates, transmits and distributes electricity to more than 125,000 customers in a 250-square-mile area of Dane County.

MGE also transports and distributes natural gas to nearly 112,000 customers in 1,325 square miles of service territory in seven counties. MGE has served the Madison area since 1896.

**www.mge.com**

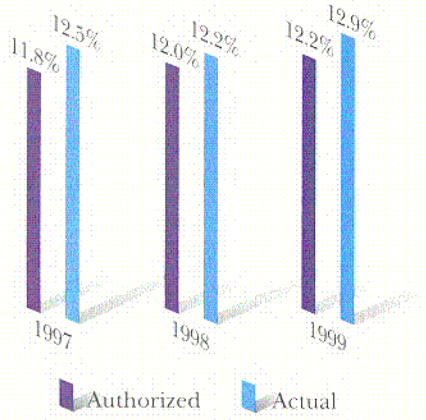
# 1999 Highlights

## Year at a Glance

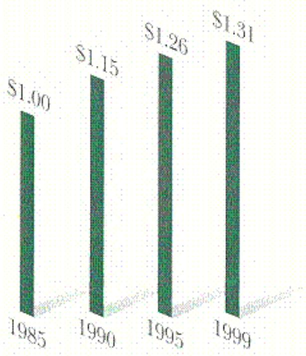
*(In thousands, except per-share amounts)*

| | 1999 | 1998 | Change |
|---|---|---|---|
| Operating Revenues | $ 274,034 | $ 249,752 | 9.7% |
| Net Income | $ 23,746 | $ 22,230 | 6.8% |
| Electric Sales (kwh) | 3,224,040 | 2,927,741 | 10.1% |
| Gas Deliveries (therms) | 196,478 | 184,318 | 6.6% |
| Total Assets (year-end) | $ 495,510 | $ 466,265 | 6.3% |
| Basic and Diluted Earnings Per Share | $ 1.48 | $ 1.38 | 7.2% |
| Dividends Paid Per Share | $ 1.31 | $ 1.30 | 0.8% |
| Return on Common Stock Equity | 12.9% | 12.2% | 5.7% |

Authorized vs. Actual
Return on Common Stock Equity




Dividend Growth
Dividends Paid Per Share

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# To Our Share

MGE is energizing your future by:

- Producing solid financial results.
- Developing new products and services.
- Investing in customer and community growth.

**Achieving Results.** In 1999, we produced earnings of $1.48 per share, up 10¢ per share over last year. This is an outstanding achievement despite a significantly warmer-than-normal heating season. Proactive business planning and cost-saving measures contributed to our success.

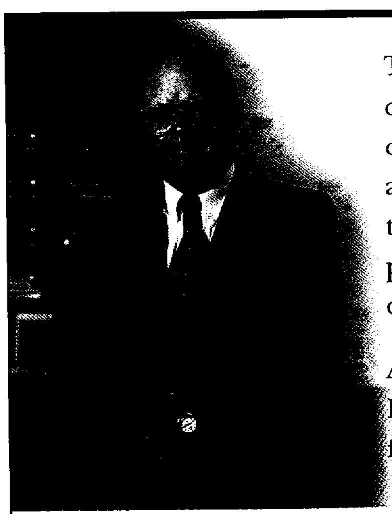
MGE was one of the first utilities in the nation to use weather "insurance" to help offset the risk of lost natural gas revenue. We have received payments exceeding $330,000 since 1998, due to extremely mild winter weather. We will expand our use of innovative financial tools to manage gas supply risk and maximize shareholder value, while maintaining a reliable gas supply.

**Increasing Dividends.** Your board of directors increased the quarterly dividend paid on MGE common stock to 32.83¢ per share last year. MGE has increased dividends each year since 1980 and paid annual cash dividends since 1909. Our steady dividend performance is remarkable in an era when many utilities across the nation have cut or eliminated dividends.

**Keeping Pace.** A tight energy supply and regional transmission line constraints are driving up electricity prices. The Public Service Commission of Wisconsin approved a 5.53% electric rate increase effective Jan. 1, 2000, allowing us to keep pace with these rising costs. The increase will also cover the cost of repairs needed at the Kewaunee Nuclear Power Plant.

**Improving Reliability.** MGE was instrumental in shaping Wisconsin's Reliability 2000 law that passed last fall. We vigorously support state and federal policies that produce fair prices for customers, protect shareholders' interests and result in a fair return on your investment.

## Thank You



Thanks for your support and confidence over the years. The commitment of our shareholders and employees has enabled MGE to maintain its position as the best-performing utility in Wisconsin and one of the very best in the nation.

Also, the leadership of the Wisconsin Legislature should be commended for their good judgment in enacting the two recent electric reliability bills that will strengthen this vital industry for many years.

We also commend Governor Thompson for his strong leadership and vision that have greatly enhanced our superior economy, business climate and quality of life here in Wisconsin.

*David C. Mebane*
*Chairman*

# holders

We are taking action to enhance electric reliability in our growing service area:

- Building an 83 megawatt (MW) gas-fired combustion turbine that will be on line this summer.
- Installing 48 MW of backup generators at commercial customers' sites.
- Upgrading transmission, distribution and substation equipment.

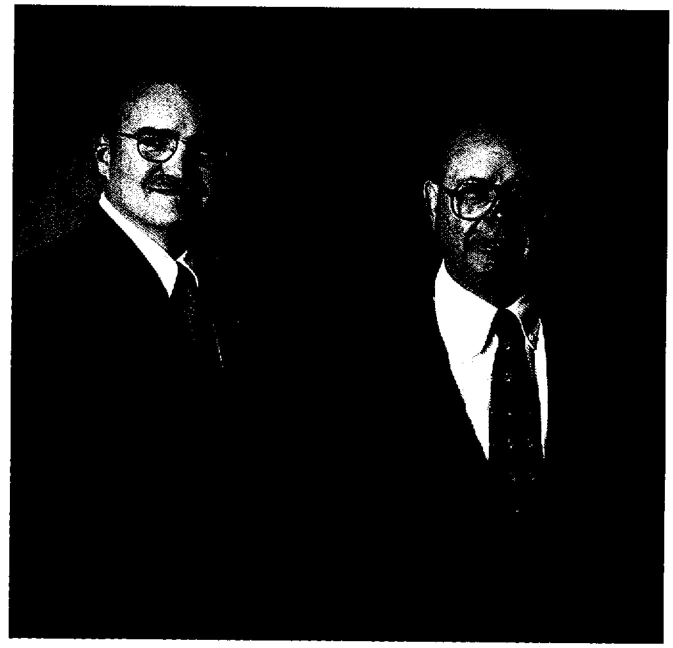
**Growing Economy.** MGE serves one of the most vibrant economies in the region. Dane County and Madison rank among the best places in the nation to do business. We have a diverse economic base that's virtually recession-proof.

Our fast-growing technology sector soared to new heights when a California company announced plans to pay $330 million for Third Wave Technologies. MGE helped this Madison biotech firm get started. Our equity interest in Third Wave will help support future earnings growth. Investing in local firms is an excellent way to maintain a strong economy and increase shareholder value.

**Energizing Your Future.** MGE boldly finds new ways to meet customers' needs, strengthen communities and support business growth to produce solid results for investors. We will maintain our position as a national leader in financial performance – energizing your future with competitive returns.

David C. Mebane
Chairman

Gary J. Wolter
President and Chief Executive Officer
Feb. 7, 2000



*Gary J. Wolter*
*President and CEO*

*David C. Mebane*
*Chairman*

## Management Changes

Your board of directors approved a change in leadership effective Feb. 1, 2000. Gary Wolter succeeds David Mebane as president and CEO. Mebane continues as chairman of the board. Wolter joined MGE in 1984 and most recently served as senior vice president – administration and secretary.

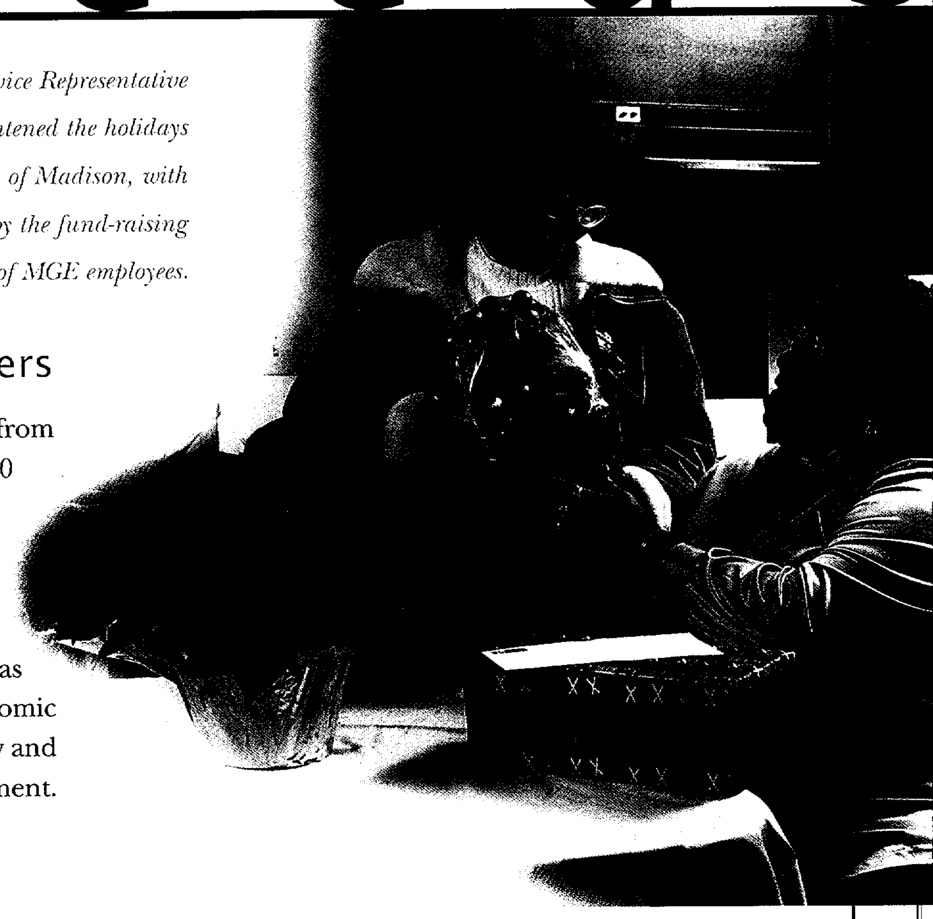
Several other executives were promoted effective Feb. 1, 2000: Mark Williamson, executive vice president and chief strategic officer; Ronald Semmann, executive vice president; Lynn Hobbie, senior vice president; Thomas Krull, group vice president; James Bidlingmaier, vice president – administration and chief information officer; and Scott Neitzel, vice president – gas rates and fuels.

The board also elected three new officers in 1999: Mark Frankel, vice president, general counsel and secretary; Joseph Pellitteri, assistant vice president – human resources; and John Yogerst, assistant vice president – gas operations.

*"MGE's Innovation Center provides* high-quality *space for small, start-up firms and a* vital link *to resources at the University of Wisconsin."*

*Norm Draeger*
*PIEZOMAX Technologies*

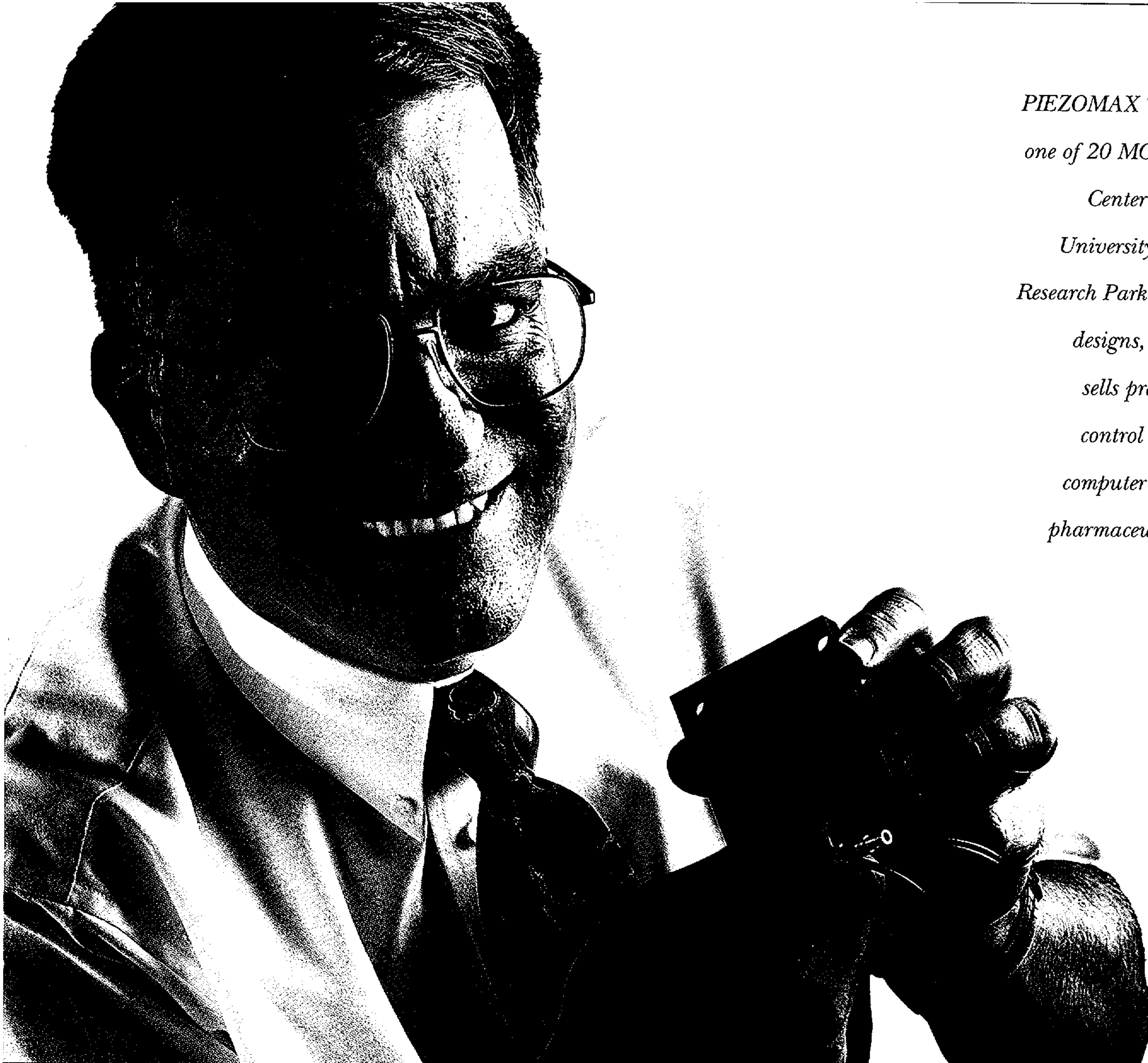
# anticipating needs



*MGE Customer Service Representative Merl Smith (left) brightened the holidays for Dorothy Bowie, of Madison, with gifts provided by the fund-raising efforts of MGE employees.*

## Helping others

MGE employees sold everything from cookbooks to ice cream to raise nearly $6,000 to help customers in need over the holidays. Employees' volunteer efforts, along with MGE's strong community support, earned the company a Community Asset Award from Downtown Madison, Inc., in 1999. MGE was praised for its involvement in economic development, community philanthropy and neighborhood redevelopment.



*PIEZOMAX Technologies is one of 20 MGE Innovation Center tenants at the University of Wisconsin Research Park. PIEZOMAX designs, produces and sells precision motion control devices for the computer industry and pharmaceutical research.*

## Fueling high-tech business growth

In 1999, MGE committed $1 million for a new, larger MGE Innovation Center. The extra space meets growing demand from start-up, high-tech businesses. The Center offers shared conference rooms, laboratory space and office equipment. This allows new technology companies to invest more money in developing their products. Most Innovation Center "graduates" expand locally. They contribute to a strong economy and steady growth in MGE's electric and natural gas sales.

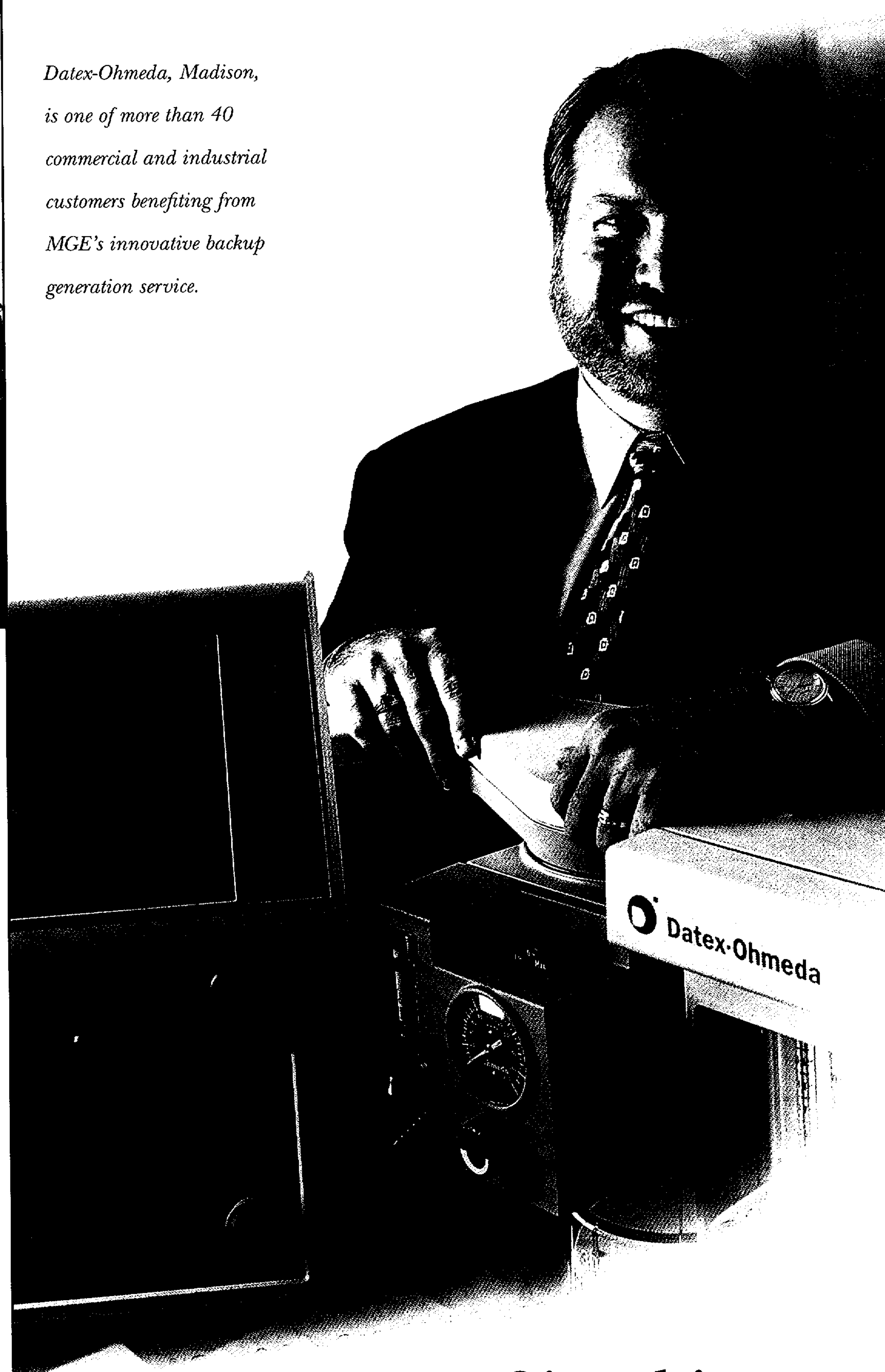
*MGE Multifamily Services Manager Mark Faultersack (right) works with Erik Longreen, Project Home program assistant, to improve energy efficiency as part of a major neighborhood revitalization effort.*

## Revitalizing neighborhoods

An MGE Neighborhood Revitalization Grant of more than $75,000 will fund energy-saving improvements in 48 Allied Drive apartments on Madison's southwest side. Project Home, a nonprofit agency, is investing $2.7 million to refurbish these units. Since 1998, MGE has committed more than $260,000 to provide efficient, affordable housing and re-energize blighted neighborhoods.


*Datex-Ohmeda, Madison, is one of more than 40 commercial and industrial customers benefiting from MGE's innovative backup generation service.*

*As the world's leading supplier of anesthesia machines, Datex-Ohmeda can't afford to be without electricity. MGE owns, operates and maintains a backup generator at this customer's site to provide added reliability.*




finding

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"*We must meet our customers' expectations. With* backup generation *on site, we'll never be down for more than 30 seconds.*" *Dan Prueher*
*Datex-Ohmeda*

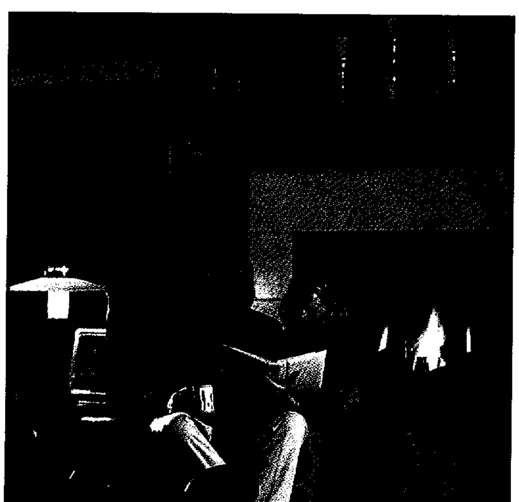
## Energizing customers' operations

When commercial and industrial customers said they wanted added reliability, MGE offered an innovative solution. MGE is one of the first utilities in the nation to own, operate and maintain backup generators at customers' sites. More than 40 customers pay a monthly fee for this service. As a result, 48 megawatts of backup generation will be available to energize these customers' facilities during local outages. The units can also be used to help meet MGE customers' needs during an emergency. Shareholders earn a return on this investment.

## Protecting the environment

MGE is committed to superior environmental performance. It is one of only 10 Wisconsin companies that will participate in a five-year Environmental Cooperation Pilot Program with the state Department of Natural Resources (DNR). MGE and the DNR will work together to evaluate new ways to meet environmental standards and protect valuable resources.

*MGE customers Steven and Julie Phillips, Madison, enjoy the extra efficiency in their Green Built Home.*



## Building green homes

MGE helped the Madison Area Builders Association introduce the Green Built Home program in the 1999 Parade of Homes. Nearly 75% of the builders participated. They built 26 "green" homes that are 25% more energy efficient, on average, than required by state code. The builders incorporated options ranging from recycled building materials to high-efficiency heating and cooling systems. The program eventually will expand to builders throughout Wisconsin.

w a y s

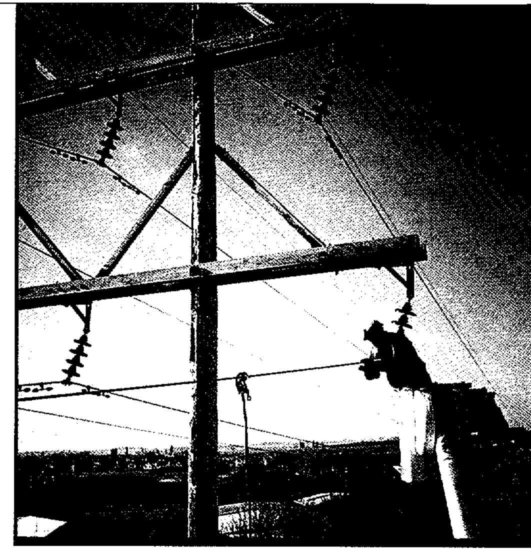
*"There's nothing cleaner than wind energy. It helps ensure* future generations *can enjoy clean air."* *Lynn Kinnard*
*Property Owner*

*Lynn Kinnard (below) is proud to have four MGE wind turbines located on her property in Kewaunee County.*

# Upgrading equipment

MGE places a top priority on upgrading its electric system to enhance reliability for customers. In 1999, projects included:

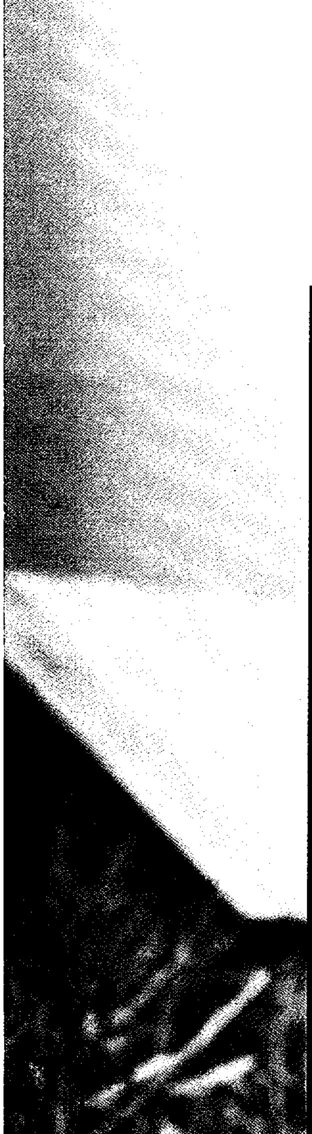
- Rebuilding a key transmission line in the fast-growing Waunakee area.
- Upgrading substations, including MGE's main facility that serves downtown Madison.
- Replacing underground cable in neighborhoods.



*MGE Lineman Larry Heuvelmans works on a major transmission line upgrade in the Waunakee area.*

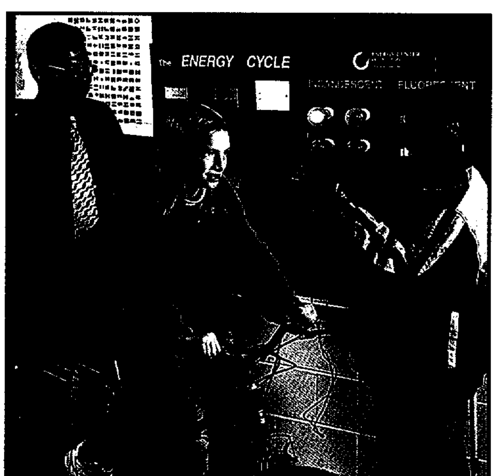
# preparing for

# morrow



## Investing in renewable energy

In June 1999, MGE started operating the largest wind farm east of the Mississippi River. Seventeen wind turbines, located in northeastern Wisconsin, produce up to 11.22 megawatts of electricity. MGE leads the nation with the highest percentage of customers buying wind power. In just a few months, more than 5,000 residential customers and nearly 100 businesses signed up to buy all available wind energy. Shareholders earn a return on MGE's $15 million investment in this renewable energy.




*MGE Community Education Coordinator Jim Jenson (left) uses an Energy Cycle to teach students about electric generation and conservation.*

## Teaching good habits for life

Teaching students the value of energy conservation and safety helps develop good energy-use habits for life. MGE reaches thousands of students each year through classroom programs and power plant tours. The company also provides extensive training for teachers and the tools they need to succeed in the classroom.

# Financing energy efficiency

A Shared Savings loan from MGE was the catalyst needed for Butler Plaza to be built in downtown Madison. This unique project combines residential, office and retail space. MGE financing paid for an innovative heating and cooling system and other energy-saving measures.

Over the past six years, nearly 140 MGE customers have used Shared Savings loans to finance more than $10.25 million in energy-saving projects. Customers use the energy savings to repay their loans.

*Gas Servicemen Karl Lavold (left) and Charles Steinhoff relocate and upgrade the natural gas system in downtown Viroqua to accommodate a highway expansion project along Main Street.*

# Expanding natural gas service

Customer demand for new MGE gas service rose significantly last year. MGE installed 12% more residential and 25% more commercial services than in 1998, which was also an exceptional growth year.

MGE aggressively pursues the lowest price for gas, while maintaining reliable service. Its astute business practices benefit investors and customers. When MGE beats a gas-price benchmark set by state regulators, the savings will now be split between investors and customers.

# Serving a growing area

A new reporting center for MGE crews increases efficiency and enables the company to better serve its growing communities. Located in Fitchburg, this 31,000-square-foot facility helps cut MGE's response time for service calls and emergencies. Ample indoor storage space for vehicles also reduces maintenance costs.

MGE will capitalize on its energy expertise and superior customer service to continue growing its business.

*MGE serves customers more efficiently with a new crew reporting center in Fitchburg.*

growing

t o g e t

*"MGE financing made it possible for Butler Plaza to fill a niche in Madison and contribute to a* vibrant downtown." *Erik Minton*
*Butler Plaza Developer*

h e r

*Butler Plaza Developer Erik Minton inspects rooftop vents for the heating and cooling system financed with an MGE Shared Savings loan.*

# Responsibility for Financial Statements

The management of Madison Gas and Electric Company (MGE) is responsible for preparing and presenting the financial information in this Annual Report. The following financial statements have been prepared in accordance with generally accepted accounting principles consistently applied. They reflect management's best estimates and informed judgments, as required.

To fulfill these responsibilities, management has developed and maintains a comprehensive system of internal operating, accounting and financial controls. These controls provide reasonable assurance that MGE's assets are safeguarded, transactions are properly recorded and the resulting financial statements are reliable. An internal audit function assists management in monitoring the effectiveness of these controls.

The Report of Independent Accountants on the financial statements by PricewaterhouseCoopers LLP appears below. The responsibility of the independent accountants is limited to the audit of the financial statements presented and the expression of an opinion as to their fairness.

The Board of Directors oversees MGE's financial situation through its monthly review of operations and financial condition and its selection of the independent accountants. The Audit Committee is comprised of all Board members who are not MGE employees or officers. The Audit Committee meets periodically with the independent accountants and MGE's internal audit staff – without management representatives present – to review accounting, auditing and financial matters. Pertinent items discussed at the meetings are reviewed with the full Board of Directors.

David C. Mebane

David C. Mebane
Chairman

Gary J. Wolter

Gary J. Wolter
President and Chief Executive Officer

Terry A. Hanson

Terry A. Hanson
Vice President – Finance

## Report of Independent Accountants

To the Board of Directors and Shareholders
of Madison Gas and Electric Company:

In our opinion, the accompanying consolidated balance sheets and statements of capitalization and the related consolidated statements of income, common equity, and cash flows present fairly, in all material respects, the financial position of Madison Gas and Electric Company (the Company) and subsidiaries at December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP

Philadelphia, Pennsylvania
February 7, 2000

## General

The following discussion and analysis provides information which management believes is relevant to an assessment and understanding of Madison Gas and Electric Company's (MGE) consolidated results of operations and financial condition. This discussion should be read in conjunction with the consolidated financial statements and notes.

This report, and certain other MGE public documents, contain forward-looking statements that reflect management's current assumptions and estimates of future performance and economic conditions, especially as they relate to future revenues, expenses, financial resources and regulatory matters. These forward-looking statements are made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. MGE cautions investors that forward-looking statements are subject to known and unknown risks and uncertainties that may cause MGE's actual results to differ materially from those projected, expressed or implied. Some of those risks and uncertainties include the:

- Economic and market conditions in MGE's service territory;
- Magnitude and timing of capital expenditures;
- Regulatory environment *(including restructuring the electric utility industry in Wisconsin);* and
- Availability and cost of power supplies.

## Results of Operations

### Earnings Overview

In 1999, MGE produced earnings of $23.7 million, or $1.48 per share. Revenues and net operating income were up nearly 10% in 1999 due to: 1) a 5.1% electric rate increase effective in January and 2) an increase in gas margin due to higher deliveries in 1999.

Earnings Per Share


In 1998, MGE produced consolidated earnings of $22.2 million, or $1.38 per share, despite one of the warmest heating seasons on record. MGE minimized the impact of weather on earnings by: 1) controlling costs, 2) selling its remaining assets in National Energy Management, L.L.C. (NEM) and 3) implementing risk management strategies to limit the loss of gas revenue due to abnormally warm weather.

In 1997, MGE earned $22.5 million, or $1.40 per share. An extended outage at the Kewaunee Nuclear Power Plant (Kewaunee) caused MGE to incur higher costs for replacement power. Tight regional power supplies also prompted MGE to take extra steps to prevent power outages. These actions resulted in higher operating costs, which were offset by: 1) greater electric sales, 2) a 3.1% increase in electric rates effective in August and 3) an interim rate surcharge effective March through June.

### Electric Sales and Revenues

In 1999, electric retail sales increased 2.1% and sales for resale increased 306.9%. The sharp rise in sales for resale occurred after MGE agreed to sell 30 megawatts (MW) of firm capacity to Wisconsin Public Power Inc. starting in March 1999 *(See Footnote 5 – Commitments).*

Electric revenues increased $16.4 million, or 9.7%, primarily due to:

- Growth in retail sales;
- A 5.1% electric rate increase effective in January 1999;
- A 3.6% interim electric rate increase that was in effect during the fourth quarter *(See Footnote 3 – Rate Matters);* and
- Higher sales for resale.

| Electric Sales (Megawatt Hours) | 1999 | 1998 | % Change |
|---|---|---|---|
| Residential | 770,153 | 750,831 | 2.6 |
| Commercial | 1,524,641 | 1,481,315 | 2.9 |
| Industrial | 315,238 | 306,022 | 3.0 |
| Other | 301,147 | 312,684 | (3.7) |
| Total Retail | 2,911,179 | 2,850,852 | 2.1 |
| Resale – Utilities | 312,861 | 76,889 | 306.9 |
| Total Sales | 3,224,040 | 2,927,741 | 10.1 |

In 1998, warm summer weather contributed to a 2.5% increase in electric retail sales and a $6.4 million, or 3.9%, rise in electric revenues. Revenues were up due to growth in sales and a customer surcharge for deferred expenses related to 1997 repairs at Kewaunee.

### Gas Sales and Revenues

In 1999, total retail gas therms delivered by MGE rose 4.9%. Total heating degree days *(as measured by the number of degrees that the mean daily temperature is below 65 degrees Fahrenheit)* were up 10.4% compared to 1998.

Gas revenues were up $7.9 million, or 9.8%, in 1999 due to: 1) increased deliveries and 2) higher gas costs that were passed on to customers through the Purchased Gas Adjustment Clause. The table below shows total gas deliveries by customer class.

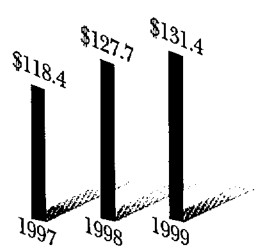
| Therms Delivered *(In thousands)* | 1999 | 1998 | % Change |
|---|---|---|---|
| Residential | 81,219 | 75,283 | 7.9 |
| Commercial and Industrial | 69,246 | 68,109 | 1.7 |
| Total Retail System | 150,465 | 143,392 | 4.9 |
| Transport | 46,013 | 40,926 | 12.4 |
| Total Gas Deliveries | 196,478 | 184,318 | 6.6 |

In 1998, total gas therms delivered by MGE dropped 14.8% and gas revenues were down $21.3 million, or 21%. These declines were caused by one of the warmest winters in more than 50 years. Heating degree days were down 19.3% in 1998 compared to 1997.

### Electric Fuel and Natural Gas Costs

In 1999, electric fuel and purchased power costs rose $12.7 million, or 30.2%. Extended outages at the Columbia Energy Center (Columbia) required MGE to generate more power at its Blount Generating Station (Blount), which has higher fuel costs. MGE also needed to pay more for purchased power when Columbia was out of service and during times of peak demand. MGE customers set a new record for peak demand *(634 MW)* on July 23. Electric margins *(revenues less fuel and purchased power)* were up $3.7 million, or 2.9%, due to the electric rate increases previously described, higher retail sales and sales for resale.

Electric Margin
in millions

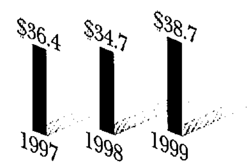



During 1998, Kewaunee availability reduced MGE's need for purchased power – contributing to a $2.9 million, or 6.4%, drop in electric fuel and purchased power costs. Electric margins were up $9.3 million, or 7.9%, partially because of an interim rate surcharge.

In 1999, natural gas costs increased $3.9 million, or 8.7%, because retail sales were up 4.9%. Gas margins *(revenues less natural gas purchased)* increased $4 million, or 11.4%, in 1999. Contributing factors included: 1) a rise in retail deliveries and 2) a 0.7% rate increase effective in January 1999.

In 1998, natural gas costs decreased $19.6 million, or 30.1%. Extremely warm winter weather in 1998 caused a 14.8% drop in gas deliveries. Gas margins fell $1.7 million, or 4.7%, because MGE sold less gas.

Gas Margin
in millions




### Other Operating Expenses

In 1999, electric operating expense increased $2.3 million, or 4.9%. The increase is primarily related to payroll and benefits of $1.3 million and transmission wheeling expenses of $1 million. Gas operating expenses rose approximately $0.9 million, or 5.5%, due to higher administrative and general expenses. Electric maintenance expense was down $1.8 million, or 13.6%, primarily because of lower maintenance costs at Kewaunee. Depreciation expense increased $2 million, or 5.9%. Electric depreciation expense comprised $1.7 million of the increase, resulting from increased plant additions and decommissioning depreciation expense. Income taxes charged to operations increased approximately $1.5 million, or 14.4%, in 1999. This increase relates solely to higher operating income. Interest on long-term debt increased $1.3 million, or 12.4%, in 1999. In September 1998, MGE issued $30 million in unsecured debt, which was outstanding throughout 1999.

In 1998, electric operating expense increased $1.6 million, or 3.6%, while electric maintenance expense rose $2.3 million, or 20.4%. Factors contributing to these increases included:

- Amortization of deferred 1997 expenses for repairing the steam generator at Kewaunee *(offset by the interim rate surcharge MGE collected in 1998).*
- Amortization of deferred costs associated with industry restructuring and regional power shortages.

In 1998, depreciation and amortization expenses increased $4.9 million, or 17.2%. Approximately $3.4 million of this increase was due to accelerating both the depreciation and collection of decommissioning funds for Kewaunee. In 1998, operating income taxes were down $1.2 million, or 10.2%, from the prior period, primarily due to a decrease in operating income.

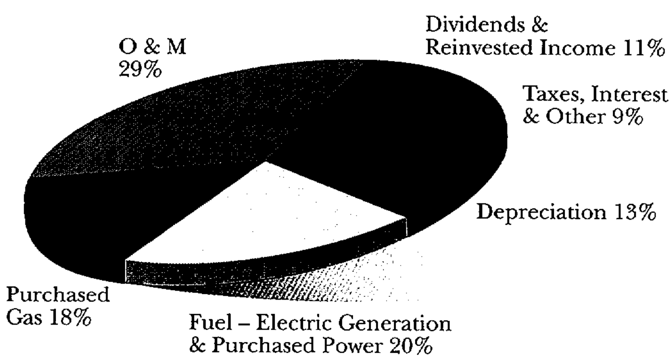
**Other Nonoperating Items**

In 1999, MGE earned $3.1 million on its decommissioning trust. These earnings are included in other income and depreciation expense. MGE also resolved certain contingencies in the amount of $1 million *(net of tax)* related to its gas marketing subsidiaries. In 1996, MGE wrote down its investment in both gas marketing subsidiaries Great Lakes Energy Corp. (GLENCO) and American Energy Management, Inc. (AEM), to reflect its current value. These outstanding contingencies included:

- The expiration of lighting warranties and outstanding accounts payable for AEM.
- One-time benefits on some outstanding legal and tax issues for GLENCO and AEM.

In 1998, MGE sold its remaining assets in NEM for $1.8 million *(See Footnote 4 – Gas Marketing Subsidiaries)*. NEM was formed in January 1997 as a joint venture between MGE's gas marketing subsidiaries and National Gas and Electric L.P. Earnings on the decommissioning trusts totaled $1.8 million in 1998. This amount is included in other income and depreciation expense.

1999 Revenue Distribution




**Electric and Gas Operations Outlook**

MGE anticipates electric and gas sales will grow at a compounded rate of 1% to 2% through December 2004. MGE expects to maintain a competitive advantage in a deregulated industry because of its:

- Vibrant service territory, which is well-insulated against economic downturns.
- Competitive distribution costs, low percentage of industrial customers and lower risk of stranded investments.
- Size and agility, which allow employees to respond quickly and offer more flexibility as customers' needs change.

MGE will sell its ownership interest *(17.8%)* in Kewaunee in the fall of 2001. This will help eliminate the risk of future stranded investment. The capacity lost from Kewaunee will be replaced with purchased power contracts.

The Public Service Commission of Wisconsin (PSCW) currently regulates MGE for both its electric and gas operations. Current trends are moving toward electric deregulation. MGE believes it can continue to offer competitive rates and service to meet the needs of its customers in a deregulated market.

## Kewaunee Nuclear Power Plant

Kewaunee is jointly owned by MGE, Wisconsin Public Service Corp. (WPSC) and Alliant Energy. Kewaunee has been operated since 1974 by WPSC. The plant's license will expire in 2013.

On April 7, 1998, WPSC received state regulatory approval to replace the two steam generators at Kewaunee. The project will cost approximately $113 million *(MGE's share would be $20.1 million)*.

On Sept. 29, 1998, MGE finalized an agreement to sell its share of Kewaunee to WPSC. MGE will receive a cash payment from WPSC for Kewaunee upon closing. The payment would be comprised of Kewaunee's book value *(currently $12.4 million)* plus the book value of other assets related to Kewaunee. MGE believes it can secure electric capacity and energy more cost-effectively from other sources and eliminate the risk of future stranded costs. If approved by state regulators, this agreement will close when steam generators are replaced at Kewaunee. The work, which will take approximately 60 days, is scheduled for the fall of 2001.

MGE will have an option to buy electric capacity and energy *(up to 93 MW)* from WPSC for two years after the sale closes. MGE's decommissioning liability will be limited to the current fund balance until the sale closes, plus all decommissioning collections through 2002. WPSC assumes MGE's decommissioning liability on the date the sale closes.

Kewaunee completed 1999 with 100% availability. The plant returned to service on Nov. 27, 1998, after a planned maintenance and refueling outage. An inspection of the plant's two steam generators showed that 1997 tube repairs held up well and few additional repairs were needed. A major overhaul was also performed on the main turbine generator. The next shutdown for refueling and maintenance is scheduled for spring 2000.

MGE contracted with WPSC to build and operate an 83 MW natural gas-fired combustion turbine near Marinette, Wisconsin. MGE will purchase the combustion turbine for approximately $32 million when the unit is completed, which is anticipated in the second quarter of 2000.

## Liquidity and Capital Resources

### Cash Provided by Operating Activities

In 1999, cash provided by operating activities decreased $10.2 million, or 14.5%, primarily due to a decrease in net working capital.

In 1998, cash provided by operating activities increased to $70 million, up from $41 million, as MGE decreased its deferred assets *(particularly regulatory assets)*. In 1997, MGE's gas marketing subsidiaries had also entered into a joint venture with another gas company, which reduced the current payables for GLENCO and AEM.

### Capital Requirements and Investing Activities

MGE's liquidity is primarily affected by its construction requirements. 1999 capital expenditures totaled $51 million, which included $12.6 million for a wind energy project, $10 million for distributed generation and $3 million for improvements at the Blount plant.

It is anticipated that 2000 capital expenditures will be $76.4 million. Major projects include:

- An 83 MW gas-fired combustion turbine.
- MGE-owned backup generators that are located at customers' sites *(distributed generation)*.
- A gas pipeline expansion project.
- Improvements at the Blount plant.
- Nitrogen oxide ($NO_X$) emissions equipment at the jointly owned Columbia plant.

These projects either comply with new legislation or help maintain the reliability of MGE's distribution system. Capital expenditures for the years 2001 through 2004 will average an estimated $34 million per year. The table below shows capital expenditures and nuclear fuel estimates for 2000, actuals for 1999 and the three-year average for 1996 to 1998. MGE also has $11 million in debt maturing in November 2000.

In 1999, MGE's cash used for investing activities increased $21 million, or 51.5%, due to the plant additions previously described. MGE used internally generated funds and short-term borrowing to satisfy most of its capital requirements. For larger capital investments, MGE will issue additional long-term debt or common stock.

In 1998, MGE increased its cash used for investing activities by $12.7 million, or 45.1%, due to $9 million in plant additions and accelerating the collection of decommissioning funds *($3 million)* for the Kewaunee plant.

### Financing Activities and Capitalization Matters

In 1999, cash used for financing activities was down $20.8 million, or 84.6%. MGE added short-term debt totaling $15.8 million. In December 1999, MGE started issuing new shares of common stock for its Dividend Reinvestment and Direct Stock Purchase Plan *(Investors Plus Plan)* to improve cash flow and capitalization ratios.

In 1998, cash used for financing activities increased $8.6 million, or 54.3%. In September 1998, MGE issued $30 million in unsecured Medium-Term Notes to reduce short-term debt and help finance capital spending.

MGE's First Mortgage Bonds are currently rated Aa2 by Moody's Investors Service, Inc. (Moody's), and AA by Standard & Poor's Corp (S&P). MGE's Medium-Term Notes are rated Aa3 by Moody's and AA- by S&P. MGE's dealer-issued commercial paper carries the highest ratings assigned by Moody's and S&P.

## Capital Expenditures (Including Nuclear Fuel)

| For the years ended December 31: *(In thousands)* | 2000 Estimated | | 1999 | | Annual Average 1996 to 1998 | |
|---|---|---|---|---|---|---|
| Electric | | | | | | |
| Production | $46,859 | 61.3% | $26,462 | 51.9% | $ 5,805 | 21.7% |
| Transmission | 1,975 | 2.6 | 3,828 | 7.5 | 1,303 | 4.9 |
| Distribution and General | 12,987 | 17.0 | 11,641 | 22.9 | 9,234 | 34.3 |
| Nuclear Fuel | 2,161 | 2.8 | 1,086 | 2.1 | 2,617 | 9.8 |
| Total Electric | 63,982 | 83.7 | 43,017 | 84.4 | 18,959 | 70.7 |
| Gas | 8,491 | 11.1 | 5,866 | 11.5 | 5,778 | 21.6 |
| Common | 3,927 | 5.2 | 2,105 | 4.1 | 2,060 | 7.7 |
| Total | $76,400 | 100.0% | $50,988 | 100.0% | $26,797 | 100.0% |

## Business and Regulatory Environment

On Oct. 29, 1999, Reliability 2000 legislation took effect *(Part of 1999 Wisconsin Act 9)*. The new law addresses a wide range of electric utility topics, including:

- Providing a public utility holding company with partial relief from "asset-cap" restraints *(which limit the amount of nonutility assets it could own)*, if the utility transfers its electric transmission facilities to a separate transmission company (TRANSCO).
- Creating a statewide TRANSCO that will transfer operational control of transmission facilities to the Midwest Independent System Operator.
- Continuing and expanding public benefits programs related to: a) low-income energy assistance and b) energy conservation, renewable energy and other related topics.
- Limiting real estate activities of holding companies.
- Addressing future requirements that may be placed on electric utilities to control $NO_x$ air emissions.
- Creating protections for employees of utilities and cooperatives.

Most Wisconsin public utility holding companies are joining the TRANSCO. Management will analyze its options and determine if it is beneficial for MGE to join the TRANSCO. The TRANSCO's effective date of operation is Nov. 1, 2000.

The PSCW will decide when it is appropriate for retail competition to proceed in the electric industry. MGE cannot predict what impact future PSCW actions may have on its future financial condition, cash flows and results of operations. However, MGE believes it is well-positioned to compete in a deregulated market.

Restructuring the electric industry could affect MGE's ability to continue to establish certain regulatory asset and liability amounts allowed under Statement of Financial Accounting Standard (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation." MGE is unable to predict whether any adjustments to regulatory assets and liabilities will occur in the future. However, the PSCW's restructuring plan specifically recognizes the need to allow recovery for commitments made under prior regulatory regimes.

On Nov. 1, 1999, MGE started operating under the new gas cost incentive mechanism (GCIM). Under the GCIM, gas commodity costs are compared to a monthly price benchmark set by state regulators. If actual costs are above or below the benchmark, MGE gas sales service customers and shareholders will participate equally in the increased costs or savings. Any savings or costs that exceed $1.5 million will be passed on to gas sales service customers.

The PSCW allows MGE to resell gas pipeline capacity reserved to meet peak-day demands, but not needed every day to serve actual customers. Revenues from capacity release that exceed the target level approved by the PSCW will be shared equally between firm gas sales service customers and shareholders.

MGE has contracted with WPSC to build and operate an 83 MW natural gas-fired combustion turbine near Marinette, Wisconsin. MGE received rate recovery for this asset and related operations and maintenance expenses. The revenue collected in 1999 associated with this asset *($1.7 million)* has been deferred until the unit is purchased in 2000.

In June 1999, the Financial Accounting Standards Board (FASB) issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of SFAS No. 133." This new accounting standard will take effect after June 15, 2000, for all fiscal quarters of all fiscal years. Due to MGE's limited use of derivative instruments and hedging activities, SFAS No. 133 is not expected to have a significant effect on MGE's results of operations or its financial position.

## Inflation

The current financial statements report operating results in terms of historical cost, but they do not evaluate the impact of inflation. Since utilities can depreciate only the historical cost of utility plant, there may not be adequate cash flows from existing plant to replace this investment. Under PSCW rate treatment, projected operating costs – including the impacts of inflation – are recovered in revenues.

## Environmental Issues

On Jan. 1, 2000, Phase II of the 1990 Federal Clean Air Act amendments took effect, setting new emission limits for sulfur dioxides and $NO_X$. MGE's generating units were modified well in advance to meet year 2000 $NO_X$ requirements. Early modifications at Blount allow MGE to postpone meeting more stringent $NO_X$ requirements at this plant until 2007.

The Wisconsin Department of Natural Resources (DNR) is reviewing the current Phase II federal $NO_X$ emission limits. MGE is considering the following options to comply with $NO_X$ requirements: fuel switching, emissions trading, purchased power agreements, new emission-control devices or installing new fuel-burning and clean-coal technologies. MGE has evaluated compliance strategies and their costs. Implementing new measures will likely increase capital, operating and maintenance expenditures.

MGE is listed as a potentially responsible party for two sites that the EPA has placed on the national priorities Superfund list: 1) the Refuse Hideaway Landfill in Middleton, Wisconsin, where MGE disposed of fly ash sludge from 1980 to 1984; and 2) the Lenz Oil site in Lemont, Illinois, which was used for storing and processing waste oil for several years. These sites require cleanup under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). A group of companies is currently negotiating with the EPA on the cleanup of these two sites.

MGE, a potentially responsible party, is also negotiating with the City of Madison for cleanup costs at the Demetral Landfill. MGE used this site for coal ash disposal from 1954–1959. Management believes its share of the final cleanup costs will not result in any materially adverse effects on MGE's operations, cash flows or financial position. Insurance may cover a significant amount of the cleanup costs. Management believes that the cleanup costs not covered by insurance will be recovered in current and future rates. MGE estimates its future expense to clean up these sites could range from $400,000 to $850,000.

## Year 2000

MGE provided reliable gas and electric service to customers as the Year 2000 (Y2K) arrived in Wisconsin.

The Y2K issue was the result of computer programs that were written using two digits rather than four to define the applicable year. A failure due to the Y2K issue could have caused disruptions in normal business operations.

MGE staff dedicated more than 52,000 work hours over four years to prepare for the Year 2000 transition. MGE's Y2K work plan included awareness, assessment, remediation, verification, auditing, and contingency planning and preparedness. The work plan was completed well before Dec. 31, 1999.

More than 500 MGE staff worked New Year's Eve and New Year's weekend to check the operation of the Company's generating plants, substations, natural gas facilities and business systems. MGE experienced no material failure of its systems, equipment or suppliers due to Y2K problems during or immediately after the transition. MGE believes it would be an extremely remote possibility that any latent Y2K failures could significantly affect operations.

MGE's Y2K expenses totaled $4.3 million. The costs were expensed, as incurred, and funded through operating cash flow.

| For the years ended December 31<br>*(In thousands, except per-share amounts)* | 1999 | 1998 | 1997 |
|---|---|---|---|
| Operating Revenues | | | |
| Electric | $185,955 | $169,563 | $163,123 |
| Gas | 88,079 | 80,189 | 101,525 |
| Total Operating Revenues | 274,034 | 249,752 | 264,648 |
| Operating Expenses | | | |
| Fuel for electric generation | 32,388 | 32,289 | 30,764 |
| Purchased power | 22,198 | 9,624 | 14,008 |
| Natural gas purchased | 49,395 | 45,458 | 65,079 |
| Other operations | 67,471 | 64,231 | 62,018 |
| Maintenance | 13,304 | 15,167 | 12,735 |
| Depreciation and amortization | 35,154 | 33,185 | 28,317 |
| Other general taxes | 9,306 | 9,263 | 8,797 |
| Income tax provision | 12,268 | 10,723 | 11,940 |
| Total Operating Expenses | 241,484 | 219,940 | 233,658 |
| Net Operating Income | 32,550 | 29,812 | 30,990 |
| AFUDC – equity funds | 302 | 122 | 28 |
| Other income, net | 2,933 | 3,151 | 2,229 |
| Income Before Interest Expense | 35,785 | 33,085 | 33,247 |
| Interest Expense | | | |
| Interest on long-term debt | 11,500 | 10,234 | 9,641 |
| Other interest | 694 | 687 | 1,098 |
| AFUDC – borrowed funds | (155) | (66) | (15) |
| Net Interest Expense | 12,039 | 10,855 | 10,724 |
| Net Income | $ 23,746 | $ 22,230 | $ 22,523 |
| Earnings Per Share of Common Stock (basic and diluted) | $ 1.48 | $ 1.38 | $ 1.40 |
| Average Shares Outstanding | 16,084 | 16,080 | 16,080 |

*The accompanying notes are an integral part of the above statements.*

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# Consolidated Statements of Cash Flows

| For the years ended December 31 *(In thousands)* | 1999 | 1998 | 1997 |
|---|---|---|---|
| Operating Activities | | | |
| Net income | $23,746 | $ 22,230 | $ 22,523 |
| Items not affecting cash: | | | |
| Depreciation and amortization | 35,154 | 33,185 | 28,317 |
| Deferred income taxes | (708) | (1,229) | (1,400) |
| Amortization of nuclear fuel | 2,638 | 2,321 | 1,517 |
| Amortization of investment tax credits | (739) | (747) | (753) |
| AFUDC – equity funds | (302) | (122) | (28) |
| Other noncash items | (1,430) | (2,066) | (3,086) |
| Changes in working capital, excluding cash equivalents, sinking funds, maturities and short-term debt: | | | |
| (Increase)/decrease in current assets | (2,512) | 3,577 | 6,162 |
| Increase/(decrease) in current liabilities | 3,354 | 1,283 | (18,088) |
| Other noncurrent items, net | 1,104 | 12,055 | 5,675 |
| Cash Provided by Operating Activities | 60,305 | 70,487 | 40,839 |
| Investing Activities | | | |
| Additions to utility plant and nuclear fuel | (50,988) | (30,829) | (21,635) |
| AFUDC – borrowed funds | (155) | (66) | (15) |
| Increase in nuclear decommissioning fund | (10,692) | (9,910) | (6,467) |
| Cash Used for Investing Activities | (61,835) | (40,805) | (28,117) |
| Financing Activities | | | |
| Issuance of common stock | 1,678 | — | — |
| Cash dividends on common stock | (21,038) | (20,878) | (20,689) |
| Increase in long-term debt | — | 30,000 | 5,000 |
| Maturity/redemption of First Mortgage Bonds | — | — | (3,800) |
| Other decreases in First Mortgage Bonds | (162) | (162) | (163) |
| Increase/(decrease) in short-term debt | 15,750 | (33,500) | 3,750 |
| Cash Used for Financing Activities | (3,772) | (24,540) | (15,902) |
| Change in Cash and Cash Equivalents | (5,302) | 5,142 | (3,180) |
| Cash and cash equivalents at beginning of period | 7,250 | 2,108 | 5,288 |
| Cash and cash equivalents at end of period | $ 1,948 | $ 7,250 | $ 2,108 |

*The accompanying notes are an integral part of the above statements.*

| At December 31 *(In thousands)* | 1999 | 1998 |
|---|---|---|
| **Assets** | | |
| Utility Plant (at original cost, in service) | | |
| Electric | $ 554,392 | $ 520,753 |
| Gas | 190,137 | 184,868 |
| Gross Plant in Service | 744,529 | 705,621 |
| Less accumulated provision for depreciation | (484,428) | (446,984) |
| Net Plant in Service | 260,101 | 258,637 |
| Construction work in progress | 31,134 | 21,490 |
| Nuclear decommissioning fund | 97,056 | 79,089 |
| Nuclear fuel, net | 6,534 | 8,086 |
| Total Utility Plant | 394,825 | 367,302 |
| Other Property and Investments | 3,591 | 6,700 |
| Current Assets | | |
| Cash and cash equivalents | 1,948 | 7,250 |
| Accounts receivable, less reserves of $1,391 and $1,281, respectively | 27,913 | 26,812 |
| Unbilled revenue | 13,167 | 13,113 |
| Materials and supplies, at lower of average cost or market | 6,149 | 5,936 |
| Fossil fuel, at lower of average cost or market | 4,061 | 3,509 |
| Stored natural gas, at lower of average cost or market | 10,039 | 9,709 |
| Prepaid taxes | 6,802 | 6,573 |
| Other prepayments | 1,063 | 1,030 |
| Total Current Assets | 71,142 | 73,932 |
| Deferred Charges | 25,952 | 18,331 |
| Total Assets | $ 495,510 | $ 466,265 |
| **Capitalization and Liabilities** | | |
| Capitalization (see statement) | $ 334,285 | $ 342,036 |
| Current Liabilities | | |
| Long-term debt due within one year | 11,200 | 200 |
| Short-term debt – commercial paper | 15,750 | — |
| Accounts payable | 19,553 | 15,364 |
| Accrued taxes | 891 | 549 |
| Accrued interest | 2,770 | 2,734 |
| Accrued nonregulated items | 825 | 2,771 |
| Accrued payroll-related items | 4,064 | 3,189 |
| Deferred gas costs | 3,247 | — |
| Other | 2,023 | 1,507 |
| Total Current Liabilities | 60,323 | 26,314 |
| Other Credits | | |
| Deferred income taxes | 42,981 | 44,343 |
| Investment tax credit – deferred | 9,199 | 9,938 |
| Regulatory liability – SFAS 109 | 22,875 | 23,745 |
| Other regulatory liabilities | 5,078 | 2,995 |
| Other deferred liabilities | 20,769 | 16,894 |
| Total Other Credits | 100,902 | 97,915 |
| Total Liabilities | 161,225 | 124,229 |
| Total Capitalization and Liabilities | $ 495,510 | $ 466,265 |

*The accompanying notes are an integral part of the above statements.*

# Consolidated Statements of Capitalization

| At December 31 *(In thousands)* | 1999 | 1998 |
|---|---|---|
| **Common Shareholders' Equity** | | |
| Common stock – par value $1 per share: | | |
| Authorized 50,000,000 shares | | |
| Outstanding 16,161,305 and 16,079,718 shares, respectively | $ 16,161 | $ 16,080 |
| Amount received in excess of par value | 114,155 | 112,558 |
| Retained income | 56,345 | 53,637 |
| Accumulated other comprehensive income/(loss) | (975) | — |
| Total Common Shareholders' Equity | 185,686 | 182,275 |
| **First Mortgage Bonds** | | |
| 6½%, 2006 Series: | | |
| Pollution Control Revenue Bonds | 6,275 | 6,475 |
| 8.50%, 2022 Series | 40,000 | 40,000 |
| 6.75%, 2027A Series: | | |
| Industrial Development Revenue Bonds | 28,000 | 28,000 |
| 6.70%, 2027B Series: | | |
| Industrial Development Revenue Bonds | 19,300 | 19,300 |
| 7.70%, 2028 Series | 21,200 | 21,200 |
| First Mortgage Bonds Outstanding | 114,775 | 114,975 |
| Unamortized discount and premium on bonds, net | (976) | (1,014) |
| Long-term debt sinking fund requirements | (200) | (200) |
| Total First Mortgage Bonds | 113,599 | 113,761 |
| **Other Long-Term Debt** | | |
| 6.01%, due 2000 | — | 11,000 |
| 6.91%, due 2004 | 5,000 | 5,000 |
| 6.02%, due 2008 | 30,000 | 30,000 |
| Total Long-Term Debt | 148,599 | 159,761 |
| Total Capitalization | $334,285 | $342,036 |

*The accompanying notes are an integral part of the above statements.*

# Consolidated Statements of Common Equity

| *(In thousands)* | Common Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income(Loss) | Total Common Equity |
|---|---|---|---|---|---|
| **1997** | | | | | |
| Beginning balance – Dec. 31, 1996...... | $16,080 | $112,558 | $ 50,451 | $ — | $179,089 |
| Net income ........................................... | — | — | 22,523 | — | 22,523 |
| Common stock dividends | | | | | |
| ($1.29 per share).............................. | — | — | (20,689) | — | (20,689) |
| Ending balance – Dec. 31, 1997........... | 16,080 | 112,558 | 52,285 | — | 180,923 |
| **1998** | | | | | |
| Net income ........................................... | — | — | 22,230 | — | 22,230 |
| Common stock dividends | | | | | |
| ($1.30 per share).............................. | — | — | (20,878) | — | (20,878) |
| Ending balance – Dec. 31, 1998........... | 16,080 | 112,558 | 53,637 | — | 182,275 |
| **1999** | | | | | |
| Net income ........................................... | — | — | 23,746 | — | 23,746 |
| Other comprehensive income/(loss): | | | | | |
| Minimum pension liability | | | | | |
| (net of $654 tax)............................... | — | — | — | (975) | (975) |
| Common stock dividends | | | | | |
| ($1.31 per share).............................. | — | — | (21,038) | — | (21,038) |
| Common stock issued........................... | 81 | 1,597 | — | — | 1,678 |
| Ending balance – Dec. 31, 1999........... | $16,161 | $114,155 | $ 56,345 | $(975) | $185,686 |

*The accompanying notes are an integral part of the above statements.*

December 31, 1999, 1998 and 1997

## 1. Summary of Significant Accounting Policies

### a. General

Madison Gas and Electric Company (MGE) is an investor-owned public utility headquartered in Madison, Wisconsin. MGE generates, transmits and distributes electricity to more than 125,000 customers in a 250-square-mile area of Dane County. MGE also transports and distributes natural gas to nearly 112,000 customers in 1,325 square miles of service territory in seven counties.

The consolidated financial statements reflect the application of certain accounting policies described in this note. Certain 1998 balances have been reclassified to conform to the 1999 presentation. The financial statements include the accounts of MGE and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Revenues are recorded based on services rendered or energy delivered to customers. MGE accrues an estimate on a monthly basis for unbilled revenue on the same basis. Gas revenues are subject to an adjustment clause related to periodic changes in the cost of gas. In November 1999, MGE started operating under the new gas cost incentive mechanism (GCIM). Under the GCIM, if actual gas commodity costs are above or below the benchmark set by state regulators, MGE gas sales service customers and shareholders will participate equally in the increased cost or savings.

In order to prepare consolidated financial statements in conformity with generally accepted accounting principles, management must make estimates and assumptions that affect the following: 1) reported amounts of assets and liabilities at the dates of the financial statements, 2) reported amounts of revenues and expenses during the reported periods and 3) disclosure of contingencies. Actual results could differ from management's estimates.

### b. Utility Plant

Utility plant is stated at the original cost of construction, which includes: indirect costs consisting of payroll taxes, pensions, postretirement benefits, other fringe benefits, administrative and general costs, and an allowance for funds used during construction (AFUDC).

AFUDC represents the approximate cost of debt and equity capital devoted to plant under construction. MGE presently capitalizes AFUDC at a rate of 10.52% on 50% of construction work in progress. The AFUDC rate approximates MGE's cost of capital. The portion of the allowance applicable to borrowed funds is presented in the Consolidated Statements of Income as a reduction of interest expense. The portion of the allowance applicable to equity funds is presented as other income. Although the allowance does not represent current cash income, it is recovered under the ratemaking process over the service lives of the related properties.

### c. Nuclear Fuel

The cost of nuclear fuel used for electric generation is amortized to fuel expense and recovered in rates based on the units of production method for generating electricity at the Kewaunee Nuclear Power Plant (Kewaunee).

These costs include a provision for estimated future disposal costs of spent nuclear fuel. MGE currently pays disposal fees to the Department of Energy based on net nuclear generation. MGE has recovered, through rates, its known fuel disposal liability for past nuclear generation.

The 1992 National Energy Policy Act requires all utilities that have used federal enrichment facilities to pay a special assessment for decontaminating and decommissioning these facilities. This special assessment is based on past enrichment. MGE has accrued and deferred an estimated $1.8 million for its portion of the special assessment. MGE believes any additional costs will be recovered in future rates.

### d. Joint Plant Ownership

MGE and two other utilities jointly own two electric generating facilities, which account for 54% of MGE's net generating capability – 325 megawatts (MW). Power from these facilities is shared in proportion to each company's ownership interest. MGE owns:

- 22% *(232 MW)* of the coal-fired Columbia Energy Center (Columbia), which is operated by Alliant Energy.
- 17.8% *(93 MW)* of Kewaunee, which is operated by Wisconsin Public Service Corp. (WPSC).

On Sept. 29, 1998, MGE finalized an agreement to sell its share of Kewaunee to WPSC. MGE will receive a cash payment from WPSC for Kewaunee upon closing. The payment would be comprised of Kewaunee's book value *(currently $12.4 million)* plus the book value of other assets related to Kewaunee. MGE's decommissioning liability will be limited to the current fund balance until the sale closes, plus all decommissioning collections through 2002. MGE believes it can secure electric capacity and energy more cost-effectively from other sources and eliminate the risk of future stranded costs. If approved by state regulators, this agreement will close when steam generators are replaced at Kewaunee. The work, which will take approximately 60 days, is scheduled for the fall of 2001.

Each owner provides its own financing and reflects its respective portion of facilities and operating costs in its financial statements. MGE's interest in these facilities, included in its gross utility plant in service, and the related accumulated depreciation reserves at Dec. 31 were as follows:

| | Columbia | | Kewaunee | |
|---|---|---|---|---|
| *(In thousands)* | 1999 | 1998 | 1999 | 1998 |
| Utility plant | $ 86,875 | $ 86,175 | $ 58,835 | $ 58,364 |
| Accumulated depreciation | (53,417) | (51,108) | (46,462) | (42,520) |
| Net Plant | $ 33,458 | $ 35,067 | $ 12,373 | $ 15,844 |

## e. Depreciation

Provisions at composite straight-line depreciation rates – excluding decommissioning costs – approximate the following percentages for the cost of depreciable property:

- Electric – 3.6% in 1999 and 1998, and 3.4% in 1997.
- Gas – 3.4% in 1999, 1998 and 1997.

Depreciation rates are approved by the Public Service Commission of Wisconsin (PSCW) and are generally based on the estimated economic lives of property.

Nuclear decommissioning costs are being accrued to an end-of-service life of 2002 for Kewaunee. These costs are currently recovered from customers in rates and are deposited in external trusts. For 1999, the decommissioning costs recovered in rates were $8.1 million.

Decommissioning costs are recovered through depreciation expense. Net earnings on the trusts are included in other income. It is expected that the decommissioning contributions to the trusts – along with earnings on the trusts – will provide sufficient funds for decommissioning the plant. It is assumed the long-term, after-tax earnings on the assets held by the trusts are 5.6%.

As required by Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities," MGE's debt and equity security investments in the trusts are classified as available for sale. Gains and losses on the trusts were determined on the basis of specific identification; net unrealized holding gains on the trusts were recorded as part of accumulated provision for depreciation.

As of Dec. 31, 1999, the decommissioning trusts totaled $97.1 million – its pre-tax fair market value. Realized earnings on the trusts were $3.1 million, $1.8 million and $1.6 million for the years ended Dec. 31, 1999, 1998 and 1997, respectively. Unrealized earnings of the trusts totaled $33.3 million, $26 million and $16 million at Dec. 31, 1999, 1998 and 1997, respectively.

MGE's share of Kewaunee decommissioning costs is an estimated $88 million in current dollars based on a site-specific study performed in 1992 using immediate dismantlement as the method of decommissioning. This study assumed decommissioning costs would inflate at an average rate of 6% per year. MGE's decommissioning liability is limited to the current fund balances plus all decommissioning contributions through 2002, under the agreement that allows MGE to sell its share of Kewaunee to WPSC. Physical decommissioning is expected to occur from 2014 through 2021. Additional expenses will likely be incurred from 2022 through 2039 to store spent nuclear fuel at the plant site.

## f. Income Taxes

Total income taxes in the Consolidated Statements of Income are as follows:

| *(In thousands)* | 1999 | 1998 | 1997 |
|---|---|---|---|
| Income taxes charged to operations | $12,268 | $10,723 | $ 11,940 |
| Income taxes charged to other income | 1,608 | 2,384 | 1,571 |
| Total Income Taxes | $13,876 | $13,107 | $ 13,511 |

Total income taxes consist of the following provision *(benefit)* components for the years ended Dec. 31:

| *(In thousands)* | 1999 | 1998 | 1997 |
|---|---|---|---|
| Currently payable | | | |
| Federal | $11,772 | $11,832 | $12,229 |
| State | 3,551 | 3,251 | 3,435 |
| Net-deferred | | | |
| Federal | (476) | (1,092) | (1,308) |
| State | (232) | (137) | (92) |
| Amortized investment tax credits | (739) | (747) | (753) |
| Total Income Taxes | $13,876 | $13,107 | $13,511 |

Deferred income taxes are provided to reflect the expected tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. Investment tax credits from regulated operations are amortized over related property service lives.

The differences between the federal statutory income tax rate and MGE's effective rate are as follows:

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Statutory federal income tax rate | 35.0% | 35.0% | 35.0% |
| Amortized investment tax credits | (2.0) | (2.1) | (2.1) |
| State income taxes, net of federal benefit | 5.7 | 5.7 | 5.9 |
| Valuation allowance | (0.3) | (0.4) | (0.2) |
| Renewable electricity production credit | (0.5) | — | — |
| Other, individually insignificant | (1.0) | (1.1) | (1.1) |
| Effective Income Tax Rate | 36.9% | 37.1% | 37.5% |

The significant components of deferred tax liabilities *(assets)* that appear on the Consolidated Balance Sheets as of Dec. 31 are as follows:

| *(In thousands)* | 1999 | 1998 |
|---|---|---|
| Property-related | $ 53,841 | $ 55,560 |
| Other | 5,693 | 5,598 |
| Gross deferred income tax liabilities | 59,534 | 61,158 |
| Accrued expenses | (5,718) | (5,339) |
| Other | (2,503) | (2,896) |
| Deferred tax regulatory account | (9,181) | (9,530) |
| Gross deferred income tax assets | (17,402) | (17,765) |
| Less valuation allowance | 849 | 950 |
| Net deferred income tax assets | (16,553) | (16,815) |
| Deferred Income Taxes | $ 42,981 | $ 44,343 |

Excess deferred income taxes, resulting chiefly from taxes provided at rates higher than current rates, have been recorded as a net regulatory liability *($22.9 million and $23.7 million at Dec. 31, 1999 and 1998, respectively)*, refundable through future rates.

MGE's valuation allowance to reduce its deferred tax assets to estimated realizable value relates primarily to deferred tax assets arising from state tax carryforward losses of two subsidiaries which have sold their interests in a joint venture *(See Note 4 – Gas Marketing Subsidiaries)*. Realization of these deferred tax assets is dependent on future income in states where the two subsidiaries file separate tax returns and on tax planning techniques MGE may pursue in 2000 to realize certain state tax carryforward losses. MGE will continue to review its deferred-tax assets for recoverability, and tax benefits will be recognized to the extent it is determined the valuation allowance is no longer required.

For tax purposes, these subsidiaries, as of Dec. 31, 1999, had approximately $13.7 million of state tax net-operating carryforward losses that expire in 2013, if unused.

### g. Pension Plans

MGE maintains qualified and nonqualified pension plans. MGE also provides health care and life insurance benefits for its retired employees. The table on page 27 provides a reconciliation of benefit obligations, plan assets and funded status of the plans. The 1999 pension plan beginning net-benefit obligation balance includes certain additional amounts for a nonqualified pension plan.

The funded status information reported on page 27 includes a nonqualified pension plan and a postretirement plan with accumulated benefit obligations in excess of the fair value of assets. The projected benefit obligation, accumulated benefit obligation and fair value of assets for a nonqualified pension plan were $6.9 million, $6.6 million, and $0, respectively, at December 31, 1999. Similarly, the accumulated benefit obligation and fair value of assets for a postretirement plan were $15.6 million and $6.4 million.

MGE has elected to recognize the cost of its transition obligation *(the accumulated postretirement benefit obligation as of Jan. 1, 1993)* by amortizing it on a straight-line basis over 20 years.

MGE maintains two defined contribution 401(k) benefit plans for its employees. MGE's costs of the 401(k) plans were $0.5 million in 1999, $0.5 million in 1998 and $0.3 million in 1997.

**Sensitivity of Retiree Welfare Results:** The following table shows how an assumed 1% increase or 1% decrease in health care cost trends could impact postretirement benefits in 1999 dollars.

| *(In thousands)* | 1% Increase | 1% Decrease |
|---|---|---|
| Effect on: | | |
| – total service and interest cost components | $ 380 | $ (299) |
| – postretirement benefit obligation | $2,807 | $(2,249) |

MGE reports comprehensive income in accordance with FASB Statement No. 130, "Reporting Comprehensive Income." Comprehensive Income includes the minimum pension liability adjustment, net of tax, for a nonqualified pension plan and is reflected in the Consolidated Statements of Common Equity.

| (In thousands) | Pension Benefits 1999 | Pension Benefits 1998 | Postretirement Benefits 1999 | Postretirement Benefits 1998 |
|---|---|---|---|---|
| **Change in Benefit Obligation** | | | | |
| Net benefit obligation at beginning of year | $ 81,548 | $65,110 | $16,432 | $ 15,783 |
| Service cost | 2,020 | 1,655 | 648 | 510 |
| Interest cost | 5,868 | 4,750 | 1,177 | 1,035 |
| Plan participants' contributions | — | — | 134 | 129 |
| Plan amendments | 3,244 | — | — | — |
| Actuarial (gain)/loss | (8,390) | 5,211 | (1,654) | (531) |
| Gross benefits paid | (2,615) | (2,288) | (493) | (494) |
| Net benefit obligation at end of year | $ 81,675 | $74,438 | $16,244 | $ 16,432 |
| **Change in Plan Assets** | | | | |
| Fair value of plan assets at beginning of year | $ 81,118 | $70,298 | $ 5,493 | $ 4,467 |
| Actual return on plan assets | 19,370 | 11,508 | 929 | 555 |
| Employer contributions | 1,600 | 1,600 | 960 | 836 |
| Plan participants' contributions | — | — | 134 | 129 |
| Gross benefits paid | (2,321) | (2,288) | (493) | (494) |
| Fair value of plan assets at end of year | $ 99,767 | $81,118 | $ 7,023 | $ 5,493 |
| Funded status at end of year | $ 18,092 | $ 6,680 | $(9,221) | $(10,939) |
| Unrecognized net actuarial gain | (24,385) | (6,156) | (4,466) | (2,414) |
| Unrecognized prior service cost | 3,889 | 997 | 1,731 | 1,921 |
| Unrecognized net transition obligation | 1,583 | 114 | 5,644 | 6,078 |
| Net amount recognized at end of year | $ (821) | $ 1,635 | $(6,312) | $ (5,354) |
| Amounts recognized in the balance sheet consist of: | | | | |
| Prepaid benefit cost | $ 3,121 | $ 1,635 | $ 67 | $ — |
| Accrued benefit liability | (3,942) | — | (6,379) | (5,354) |
| Additional minimum liability | (2,697) | — | — | — |
| Intangible asset | 1,068 | — | — | — |
| Accumulated other comprehensive income | 1,629 | — | — | — |
| Net amount recognized at end of year | $ (821) | $ 1,635 | $(6,312) | $ (5,354) |

| | Pension 1999 | Pension 1998 | Pension 1997 | Postretirement 1999 | Postretirement 1998 | Postretirement 1997 |
|---|---|---|---|---|---|---|
| **Components of Net Periodic Benefit Cost** | | | | | | |
| Service cost | $ 2,020 | $ 1,655 | $ 1,616 | $ 648 | $ 510 | $ 490 |
| Interest cost | 5,868 | 4,750 | 4,421 | 1,177 | 1,035 | 1,062 |
| Expected return on assets | (7,597) | (6,580) | (5,493) | (513) | (434) | (336) |
| Amortization of: | | | | | | |
| Transition obligation (asset) | 104 | (39) | (39) | 434 | 434 | 434 |
| Prior service cost | 352 | 143 | 144 | 190 | 190 | 189 |
| Actuarial gain (loss) | 89 | (28) | — | (19) | (132) | (92) |
| Regulatory effect based on phase-in | 113 | 103 | — | — | — | — |
| Net periodic benefit cost | $ 949 | $ 4 | $ 649 | $ 1,917 | $ 1,603 | $1,747 |
| **Weighted-average Assumptions as of Dec. 31** | | | | | | |
| Discount rate | 7.50% | 6.75% | 7.25% | 7.50% | 6.75% | 7.25% |
| Expected return on plan assets | 9.50% | 9.50% | 9.50% | 9.50% | 9.50% | 9.50% |
| Rate of compensation increase | 5.00% | 5.00% | 5.00% | 5.00% | 5.00% | 5.00% |
| Health care cost trend on covered charges | N/A | N/A | N/A | 8.00%[1] | 9.00%[1] | 10.00%[1] |

[1] *Decreasing gradually to 5% in 2003 and remaining constant thereafter.*

### h. Fair Value of Financial Instruments

At Dec. 31, 1999 and 1998, the carrying amount of cash, cash equivalents and outstanding commercial paper approximates fair market value due to the short maturity of those investments and obligations. MGE's nuclear decommissioning trusts are recorded at fair market value.

The estimated fair market value of MGE's long-term debt and interest rate swap agreements are based on quoted market prices at Dec. 31. The estimated fair market value of MGE's financial instruments are as follows:

| *(In thousands)* | 1999 Carrying Amount | 1999 Fair Value | 1998 Carrying Amount | 1998 Fair Value |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents | $ 1,948 | $ 1,948 | $ 7,250 | $ 7,250 |
| Decommissioning fund | $ 97,056 | $ 97,056 | $ 79,089 | $ 79,089 |
| **Liabilities** | | | | |
| Short-term debt | $ 15,750 | $ 15,750 | — | — |
| Long-term debt | $160,775 | $157,852 | $160,975 | $173,236 |
| Interest rate swap agreements | — | (13) | — | (576) |

Cash, cash equivalents and customer accounts receivable are the financial instruments that potentially subject MGE to concentrations of credit risk. MGE places its cash and cash equivalents with high-credit quality financial institutions. MGE has limited concentrations of credit risk from customer accounts receivable because of the large number of customers and strong economy in its service territory.

MGE has two interest rate swap agreements with commercial banks totaling $16 million for 1999 and 1998, with effective interest rates of 5.1% and 5.5%, respectively. These agreements have a fixed rate and are backed by MGE's commercial paper. MGE believes counterparties to the agreements will meet their obligations based on their high credit ratings.

## 2. Capitalization Matters

### a. Common Stock

Beginning in December 1999, MGE switched from buying shares on the open market to issuing new shares for its Dividend Reinvestment and Direct Stock Purchase Plan (Plan). Issuing new shares – rather than buying shares on the open market – will help improve cash flow and strengthen MGE's capital structure.

Under the Plan, 81,587 new shares of common stock were issued in 1999. The proceeds were allocated to common stock and amounts received in excess of par value.

### b. Preferred Stock

MGE has 1,175,000 shares of $25 par value redeemable preferred stock, cumulative, that is authorized but unissued at Dec. 31, 1999.

### c. First Mortgage Bonds and Other Long-Term Debt

MGE's utility plant is subject to the lien of its First Mortgage Bonds.

Long-term debt maturities, including mandatory sinking fund requirements relating to the 6½%, 2006 Series, First Mortgage Bonds are: $11.2 million *($11 million, 6.01% debt issue matures on Nov. 10)* in 2000; $0.2 million in 2001 and 2002; $0.5 million in 2003; and $1 million in 2004.

### d. Notes Payable to Banks, Commercial Paper and Lines of Credit

For short-term borrowings, MGE generally issues commercial paper *(issued at the prevailing discount rate at the time of issuance)* that is supported by unused bank lines of credit. Through negotiations with several banks, MGE has $40 million in bank lines of credit.

Information concerning short-term borrowings for the past three years is shown below:

| *(In thousands)* | 1999 | 1998 | 1997 |
|---|---|---|---|
| As of December 31: | | | |
| Available lines of credit | $40,000 | $45,000 | $52,000 |
| Commercial paper outstanding | $15,750 | $ — | $33,500 |
| Weighted-average interest rate | 6.44% | 0.00% | 6.06% |
| During the year: | | | |
| Maximum short-term borrowings | $15,750 | $33,500 | $33,500 |
| Average short-term borrowings | $ 1,899 | $ 9,223 | $16,816 |
| Weighted-average interest rate | 5.68% | 5.70% | 5.68% |

## 3. Rate Matters

In January 1999, the PSCW authorized an electric rate increase of $8.4 million, or 5.1%, and a natural gas rate increase of $0.7 million, or 0.7%. These rates are based on an authorized 12.2% return on common stock equity.

In August 1999, the PSCW approved a temporary retail electric rate surcharge of 3.6%, on average. This surcharge covers higher fuel expenses, including extended outages at Columbia, which MGE jointly owns with Alliant Energy and WPSC.

This temporary rate surcharge ended on Dec. 31, 1999. On Jan. 1, 2000, a PSCW-approved electric rate increase of $9.7 million, or 5.5%, went into effect. This electric rate increase was needed to cover higher fuel costs in 2000, an increase in backup generator costs and repairs at Kewaunee.

In its previous rate case, MGE assumed its ownership of Kewaunee would be transferred to WPSC in the spring of 2000 – when steam generators were scheduled to be replaced. However, a delay in manufacturing the steam generators postponed that work until the fall of 2001. MGE must now recover its share of Kewaunee's operating and maintenance costs through rates. These new rates will remain in place until the next rate proceeding, which is scheduled to begin Jan. 1, 2001.

## 4. Gas Marketing Subsidiaries

In 1996, MGE wrote down its investment in its gas marketing subsidiaries – Great Lakes Energy Corp. (GLENCO) and American Energy Management, Inc. (AEM) – to reflect its current value. As of Dec. 31, 1999, the remaining contingencies related to this write down account for a $0.8 million liability.

In 1999, MGE resolved certain contingencies related to the expiration of lighting warranties and outstanding accounts payable for AEM. MGE also recognized certain one-time benefits on some outstanding legal and tax issues for the gas marketing subsidiaries. The after-tax amount of these events was $1 million.

In December 1998, GLENCO and AEM sold their remaining assets in National Energy Management, L.L.C. (NEM), for $1.8 million. NEM was formed in January 1997 as a joint venture between MGE's gas marketing subsidiaries and National Gas and Electric L.P.

## 5. Commitments

**Coal Contracts:** MGE has no coal contracts that contain demand obligations for Blount Generating Station (Blount). Fuel procurement for MGE's ownership interest in Columbia is handled by Alliant Energy, the operating company. If any amounts must be paid under the demand obligations of these contracts, management believes these would be considered costs of service and recoverable in rates.

**Purchased Power Contract:** In the fall of 1998, MGE executed a five-year contract with Commonwealth Edison to buy 60 MW of firm capacity and energy. The agreement became effective in March 1999. In conjunction with the Commonwealth contract, MGE agreed to sell 30 MW of the 60 MW to Wisconsin Public Power Inc. for five years.

Purchased power contracts executed for capacity are estimated to be: $9.5 million in 2000, $3.7 million in 2001, $3.8 million in 2002 and $3.9 million in 2003. MGE is also soliciting bids for additional future purchased power contracts to serve growing electric demands. Management expects to recover these costs in future customer rates.

**Purchased Gas Contracts:** MGE has several natural gas supply and transportation contracts that provide for the availability of firm gas supply and firm pipeline capacity under which it must make fixed monthly payments. The pricing component of the fixed monthly payment for these contracts is established, but is subject to change by the Federal Energy Regulatory Commission. These payments are estimated to be: $12.3 million in 2000, $15.8 million in 2001, $14.7 million in 2002 and $12.4 million in 2003 and 2004. Management expects to recover these costs in future customer rates.

**Environmental:** MGE has been listed as a potentially responsible party for environmental cleanup at three waste sites: Refuse Hideaway Landfill, Demetral Landfill and Lenz Oil. These sites were used by MGE for disposing of fly ash sludge and coal ash, and storing and processing waste oil. It is estimated that MGE's future exposure to clean up these sites could range from $400,000 to $850,000. A liability for cleanup of these sites has been established with an offsetting regulatory asset. Management believes that cleanup costs not covered by insurance will be recovered in current and future customer rates.

MGE is in compliance with both Phase I and Phase II of the 1990 Federal Clean Air Act amendments. The Wisconsin Department of Natural Resources is reviewing the nitrogen oxide ($NO_X$) emission limits currently under Phase II. MGE is evaluating compliance strategies and their costs. Implementing new measures will likely increase capital, operating and maintenance expenditures. Management believes that all costs incurred for additional $NO_X$ compliance will be recoverable in future customer rates.

## 6. Supplemental Cash Flow Information

MGE considers cash equivalents to be those investments that are highly liquid with original maturity dates of less than three months.

Supplementary noncash investing items and cash paid for interest and income taxes for the years ended Dec. 31 were as follows:

| *(In thousands)* | 1999 | 1998 | 1997 |
|---|---|---|---|
| Interest paid, net of amounts capitalized...... | $12,053 | $10,227 | $10,841 |
| Income taxes paid, net... | $15,857 | $14,188 | $15,365 |
| Noncash investing item... | $ 5,301 | — | — |

## 7. Regulatory and Deferred Assets and Liabilities

Pursuant to SFAS No. 71 "Accounting for the Effects of Certain Types of Regulation," MGE capitalizes, as deferred charges, incurred costs that are expected to be recovered in future electric and natural gas rates. MGE also records as other credits, obligations to customers to refund previously collected revenue or to spend revenue collected from customers on future costs. Restructuring the electric industry could affect MGE's ability to continue to establish certain regulatory asset and liability amounts allowed under SFAS No. 71. MGE is unable to predict whether any adjustments to regulatory assets and liabilities will occur in the future. However, the PSCW's restructuring plan specifically recognizes the need to allow recovery for commitments made under prior regulatory regimes. MGE's regulatory and deferred assets and liabilities consisted of the following as of Dec. 31:

| | 1999 | | 1998 | |
|---|---|---|---|---|
| *(In thousands)* | Assets | Liabilities | Assets | Liabilities |
| Demand-side management | $ 5,879 | $ 1,487 | $ 7,820 | $ 998 |
| Decommissioning and decontamination | 1,955 | 1,787 | 2,333 | 1,997 |
| Environmental costs | 656 | — | 345 | — |
| Regulatory liability – SFAS 109 | — | 22,875 | — | 23,745 |
| Other | 2,255 | 1,804 | 1,062 | — |
| Subtotal Regulatory Assets/Liabilities | 10,745 | 27,953 | 11,560 | 26,740 |
| Pension and deferred compensation assets/liabilities | 3,121 | 14,001 | 1,477 | 9,863 |
| Unamortized debt expense | 5,064 | — | 5,294 | — |
| Customer advances for construction | — | 4,109 | — | 6,323 |
| Other deferred items | 7,022 | 2,659 | — | 708 |
| Subtotal Deferred Assets/Liabilities | 15,207 | 20,769 | 6,771 | 16,894 |
| Total | $25,952 | $48,722 | $18,331 | $43,634 |

MGE has entered into an agreement with WPSC to purchase an 83 MW natural gas-fired combustion turbine currently being constructed by WPSC. MGE will purchase the combustion turbine for approximately $32 million when the unit is completed, which is anticipated in the second quarter of 2000. MGE received rate recovery for this asset and the related operations and maintenance expenses over a two-year period *(1999 and 2000)*. The revenue collection in 1999 associated with this asset *($1.7 million)* has been deferred until the unit is purchased in 2000. The deferred revenue is included in liabilities under other deferred items.

## 8. Segments of Business

MGE has two main business segments – electric and gas – which are both regulated. The electric business generates, transmits and distributes electricity. The gas business transports and distributes natural gas. The following table shows key information about MGE's electric and gas operations, including the distribution of net assets for the years ended Dec. 31.

*(In thousands)*

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| **Electric Operations** | | | |
| Total revenues | $185,955 | $169,563 | $163,123 |
| Operation and maintenance expenses | 115,204 | 102,006 | 100,854 |
| Depreciation and amortization | 29,319 | 27,586 | 22,799 |
| Other general taxes | 7,622 | 7,378 | 6,937 |
| Pre-tax Operating Income | $ 33,810 | $ 32,593 | $ 32,533 |
| Income tax provision | 9,599 | 8,883 | 9,106 |
| Net Operating Income | $ 24,211 | $ 23,710 | $ 23,427 |
| **Electric Construction and Nuclear Fuel Expenditures** | $ 44,297 | $ 25,970 | $ 16,849 |
| **Gas Operations** | | | |
| Operating revenues | $ 88,079 | $ 80,189 | $101,525 |
| Revenues from sales to electric utility | 7,352 | 6,362 | 6,038 |
| Total Revenues | 95,431 | 86,551 | 107,563 |
| Operation and maintenance expenses | 76,904 | 71,125 | 89,788 |
| Depreciation and amortization | 5,835 | 5,599 | 5,518 |
| Other general taxes | 1,684 | 1,885 | 1,860 |
| Pre-tax Operating Income | 11,008 | 7,942 | 10,397 |
| Income tax provision | 2,669 | 1,840 | 2,834 |
| Net Operating Income | $ 8,339 | $ 6,102 | $ 7,563 |
| **Gas Construction Expenditures** | $ 6,691 | $ 4,859 | $ 4,786 |
| **Assets (year-end)** | | | |
| Electric | $342,130 | $311,563 | $313,855 |
| Gas | 114,881 | 111,762 | 118,339 |
| Assets not allocated | 38,499 | 42,940 | 39,596 |
| Total | $495,510 | $466,265 | $471,790 |

## 9. Quarterly Summary of Operations (unaudited)

| (In thousands, except per-share amounts) | Quarters Ended March 31 | June 30 | Sept. 30 | Dec. 31 |
|---|---|---|---|---|
| **1999** | | | | |
| Operating Revenues: | | | | |
| Electric | $ 41,194 | $ 44,409 | $ 55,439 | $ 44,913 |
| Gas | 38,340 | 12,753 | 9,036 | 27,950 |
| Total | 79,534 | 57,162 | 64,475 | 72,863 |
| Operating Expenses | 67,758 | 53,603 | 56,349 | 63,774 |
| Net Operating Income | 11,776 | 3,559 | 8,126 | 9,089 |
| Interest and Other | 2,720 | 1,079 | 2,097 | 2,908 |
| Net Income | $ 9,056 | $ 2,480 | $ 6,029 | $ 6,181 |
| Earnings per Common Share | 56.0¢ | 15.0¢ | 38.0¢ | 38.0¢ |
| Dividends per Common Share | 32.6¢ | 32.6¢ | 32.8¢ | 32.8¢ |
| **1998** | | | | |
| Operating Revenues: | | | | |
| Electric | $ 38,393 | $ 42,444 | $ 50,458 | $ 38,268 |
| Gas | 36,722 | 12,118 | 7,321 | 24,028 |
| Total | 75,115 | 54,562 | 57,779 | 62,296 |
| Operating Expenses | 64,881 | 50,001 | 49,258 | 55,800 |
| Net Operating Income | 10,234 | 4,561 | 8,521 | 6,496 |
| Interest and Other | 1,819 | 2,108 | 2,683 | 972 |
| Net Income | $ 8,415 | $ 2,453 | $ 5,838 | $ 5,524 |
| Earnings per Common Share | 52.0¢ | 15.0¢ | 36.0¢ | 34.0¢ |
| Dividends per Common Share | 32.3¢ | 32.3¢ | 32.6¢ | 32.6¢ |

Notes:

(1) The quarterly results of operations within a year are not comparable because of seasonal and other factors.

(2) The sum of earnings per share of common stock for any four quarterly periods may vary slightly from the earnings per share of common stock for the equivalent 12-month period due to the effect of rounding each quarterly period separately.

# Summary of Selected Financial and Operating Data

MGE

| | 1999 | 1998 | 1997 | 1996 | 1995 | 1989 |
|---|---|---|---|---|---|---|
| **Electric** | | | | | | |
| Operating Revenues ($000s) | | | | | | |
| Residential | $ 64,756 | $ 58,654 | $ 55,506 | $ 53,971 | $ 54,928 | $ 46,152 |
| Commercial power and lighting | 88,713 | 82,359 | 79,004 | 74,291 | 72,885 | 68,076 |
| Industrial power and lighting | 12,205 | 11,572 | 11,261 | 10,095 | 10,245 | 6,937 |
| Street and highway lighting and public authorities | 13,796 | 14,005 | 14,808 | 13,236 | 13,855 | 8,853 |
| Other utilities | 7,164 | 1,866 | 1,566 | 466 | 1,092 | 1,825 |
| Miscellaneous | (679) | 1,107 | 978 | 688 | 549 | 118 |
| Total Operating Revenues | $ 185,955 | $ 169,563 | $ 163,123 | $ 152,747 | $ 153,554 | $ 131,961 |
| Kilowatt-hour Sales (000s) | | | | | | |
| Residential | 770,153 | 750,831 | 720,576 | 725,471 | 735,442 | 620,003 |
| Commercial power and lighting | 1,524,641 | 1,481,315 | 1,420,347 | 1,381,043 | 1,347,947 | 1,233,262 |
| Industrial power and lighting | 315,238 | 306,022 | 307,485 | 289,903 | 292,649 | 149,524 |
| Street and highway lighting and public authorities | 301,147 | 312,684 | 332,995 | 305,962 | 320,869 | 198,969 |
| Other utilities | 312,861 | 76,889 | 64,914 | 26,815 | 26,344 | 14,191 |
| Total Sales | 3,224,040 | 2,927,741 | 2,846,317 | 2,729,194 | 2,723,251 | 2,215,949 |
| Average Number of Customers | | | | | | |
| Residential | 108,654 | 106,709 | 105,787 | 104,778 | 103,624 | 95,761 |
| Commercial power and lighting | 16,764 | 16,428 | 16,144 | 15,841 | 15,581 | 14,168 |
| Industrial power and lighting | 75 | 75 | 76 | 74 | 75 | 82 |
| Street and highway lighting and public authorities | 72 | 51 | 52 | 52 | 52 | 50 |
| Other utilities | 8 | 6 | 5 | 5 | 5 | 3 |
| Total Average Customers | 125,573 | 123,269 | 122,064 | 120,751 | 119,337 | 110,064 |
| **Gas** | | | | | | |
| Operating Revenues ($000s) | | | | | | |
| Residential | $ 51,953 | $ 46,604 | $ 55,652 | $ 57,486 | $ 53,021 | $ 47,666 |
| Commercial | 30,770 | 27,115 | 37,530 | 36,917 | 33,550 | 30,630 |
| Industrial | 1,819 | 3,592 | 1,582 | 1,105 | 2,361 | 1,833 |
| Best efforts (includes interruptible boiler fuel) | — | — | 2,554 | 3,849 | 4,147 | 5,017 |
| Gas transport, net | 3,061 | 2,573 | 2,035 | 2,360 | 1,540 | 445 |
| Miscellaneous | 476 | 305 | 2,172 | (1,173) | 417 | 36 |
| Total Operating Revenues | $ 88,079 | $ 80,189 | $ 101,525 | $ 100,544 | $ 95,036 | $ 85,627 |
| Therms Sold and Transported (000s) | | | | | | |
| Residential | 81,219 | 75,283 | 87,664 | 96,062 | 89,099 | 80,303 |
| Commercial | 64,461 | 57,842 | 75,822 | 79,381 | 73,307 | 65,374 |
| Industrial | 4,785 | 10,267 | 5,057 | 2,653 | 6,279 | 4,184 |
| Best efforts (includes interruptible boiler fuel) | — | — | 6,838 | 11,689 | 15,143 | 15,913 |
| Gas transport, net | 46,013 | 40,926 | 40,947 | 37,707 | 36,502 | 5,942 |
| Total Sold and Transported | 196,478 | 184,318 | 216,328 | 227,492 | 220,330 | 171,716 |
| Average Number of Customers | | | | | | |
| Residential | 98,690 | 95,988 | 93,847 | 91,918 | 89,952 | 73,795 |
| Commercial | 12,556 | 12,255 | 12,104 | 11,799 | 11,483 | 9,164 |
| Industrial | 60 | 61 | 69 | 76 | 74 | 71 |
| Best efforts (includes interruptible boiler fuel) | — | — | 21 | 52 | 60 | 45 |
| Total Average Customers | 111,306 | 108,304 | 106,041 | 103,845 | 101,569 | 83,075 |

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# Summary of Selected Financial and Operating Data

| *(In thousands, except per-share amounts)* | 1999 | 1998 | 1997 | 1996 | 1995 | 1989 |
|---|---|---|---|---|---|---|
| **Income, Earnings and Dividends** | | | | | | |
| Net income | $ 23,746 | $ 22,230 | $ 22,523 | $ 6,427 | $ 23,970 | $ 20,596 |
| Earnings on common stock | $ 23,746 | $ 22,230 | $ 22,523 | $ 6,427 | $ 23,906 | $ 20,038 |
| Earnings per average common share | $ 1.48 | $ 1.38 | $ 1.40 | $ 0.40 | $ 1.49 | $ 1.30 |
| Cash dividends paid per common share | $ 1.308 | $ 1.298 | $ 1.286 | $ 1.273 | $ 1.260 | $ 1.120 |
| **Internal Generation of Cash** | | | | | | |
| Total cash used for construction expenditures and nuclear fuel | $ 50,988 | $ 30,829 | $ 21,635 | $ 21,906 | $ 19,162 | $ 30,881 |
| Percent generated internally | 76.4% | 103.1% | 137.5% | 101.6% | 126.0% | 84.3% |
| **Long-term Debt and Redeemable Preferred Stock, Net** | $148,599 | $159,761 | $129,923 | $128,886 | $129,048 | $147,042 |
| **Capitalization Ratios** | | | | | | |
| Common shareholders' equity | 51.4% | 53.3% | 52.5% | 53.0% | 55.1% | 47.9% |
| Redeemable preferred stock | — | — | — | — | — | 1.9 |
| Long-term debt (includes current maturities) | 44.2 | 46.7 | 37.8 | 38.2 | 39.1 | 41.9 |
| Short-term debt | 4.4 | — | 9.7 | 8.8 | 5.8 | 8.3 |
| **Common Stock Data** | | | | | | |
| Per share – Close | $ 20⅛ | $ 22¾ | $ 23 | $ 20¼ | $ 23⅜ | $ $15\frac{25}{32}$ |
| – Book value | $ 11.49 | $ 11.34 | $ 11.25 | $ 11.14 | $ 12.01 | $ 10.30 |
| Shares (000s) – Outstanding | 16,161 | 16,080 | 16,080 | 16,080 | 16,080 | 15,622 |
| – Authorized | 50,000 | 50,000 | 50,000 | 50,000 | 28,000 | 14,000 |
| **Interest Coverages** | | | | | | |
| Pre-tax | 3.92 | 4.00 | 4.21 | 2.73 | 4.31 | 3.16 |
| After-tax | 2.91 | 3.02 | 3.09 | 1.58 | 3.07 | 2.29 |
| **Sources of Energy Generated and Purchased Power** | | | | | | |
| Coal | 49.1% | 60.8% | 63.2% | 63.4% | 61.3% | 56.4% |
| Nuclear | 23.3 | 21.4 | 14.2 | 19.6 | 23.5 | 28.5 |
| Purchased Power | 22.2 | 12.1 | 17.7 | 14.9 | 11.6 | 13.4 |
| Gas | 4.9 | 5.2 | 4.5 | 1.8 | 3.4 | 0.9 |
| Other | 0.5 | 0.5 | 0.4 | 0.3 | 0.2 | 0.8 |
| **Cooling Degree Days** (Normal – 601) | 637 | 654 | 410 | 408 | 982 | 524 |
| **Heating Degree Days** (Normal – 7,383) | 6,701 | 6,069 | 7,522 | 8,124 | 7,431 | 7,784 |

# Board of Directors

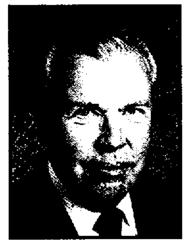
Jean Manchester Biddick
Retired Chief Executive Officer
Neesvig's Inc.
Age 73
Director since 1982

Richard E. Blaney
Retired President
Richard Blaney Seeds Inc.
Age 63
Director since 1974

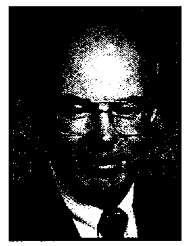
F. Curtis Hastings
President
J. H. Findorff & Son, Inc.
Age 54
Director since 1999

David C. Mebane
Chairman of the Board
Age 66
Director since 1984

Regina M. Millner
President
RMillner & Co., S.C.
Age 55
Director since 1996

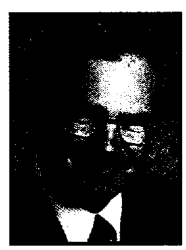


Frederic E. Mohs
Partner
Mohs, MacDonald, Widder
& Paradise, Attorneys at Law
Age 62
Director since 1975



John R. Nevin
Director, Grainger Center for
Distribution Management, and
Professor, School of Business,
University of Wisconsin-Madison
Age 57
Director since 1998

H. Lee Swanson
Chief Executive Officer,
President and Director
State Bank of Cross Plains
Age 61
Director since 1988



Gary J. Wolter
President and Chief Executive Officer
Age 45
Director since February 2000

Audit Committee
Directors Biddick, Blaney, Hastings,
Millner, Mohs, Nevin and Swanson.

Compensation Committee
Directors Biddick, Blaney and Mohs.

Executive Committee
Directors Biddick, Blaney, Mebane, Mohs
and Swanson.

Personnel Committee
Directors Hastings, Mebane, Millner, Mohs,
Nevin and Swanson.

*Note: Ages as of Feb. 1, 2000.*

# Officers of the Company

David C. Mebane
Chairman of the Board
Age 66
Years of Service, 22

Gary J. Wolter
President and Chief Executive Officer
Age 45
Years of Service, 15

Mark C. Williamson
Executive Vice President
and Chief Strategic Officer
Age 46
Years of Service, 13

Ronald L. Semmann
Executive Vice President
Age 64
Years of Service, 2

Lynn K. Hobbie
Senior Vice President
Age 41
Years of Service, 14

Thomas R. Krull
Group Vice President
Age 51
Years of Service, 28

James G. Bidlingmaier
Vice President - Administration
and Chief Information Officer
Age 53
Years of Service, 28

Mark A. Frankel
Vice President, General Counsel
and Secretary
Age 51
Joined MGE in August 1999

Terry A. Hanson
Vice President - Finance
Age 48
Years of Service, 18

Scott A. Neitzel
Vice President - Gas Rates and Fuels
Age 39
Years of Service, 2

Peter J. Waldron
Vice President - Power Supply
Age 42
Years of Service, 19

Jeffrey C. Newman
Treasurer
Age 37
Years of Service, 16

Gregory A. Bollom
Assistant Vice President -
Electric Marketing
Age 39
Years of Service, 17

Joseph P. Pellitteri
Assistant Vice President -
Human Resources
Age 51
Joined MGE in June 1999

Carol A. Wiskowski
Assistant Vice President -
Administration and
Assistant Secretary
Age 60
Years of Service, 33

John M. Yogerst
Assistant Vice President -
Gas Operations
Age 42
Years of Service, 20

*Note: Ages, years of service and positions as of Feb. 1, 2000.*

# MGE Shareholder Information

## 2000 Annual Shareholder Meeting
Tuesday, May 9, 2000
Exhibition Hall
Dane County Expo Center
1919 Expo Way
Madison, Wisconsin

## Stock Listing
MGE stock trades on the:
- Nasdaq National Stock Market under the ticker symbol MDSN.

MGE stock listing in newspapers:
- MadsnGas or MadGE.

## Shareholder Services
We welcome calls from shareholders.
Please notify us promptly if:
- a stock certificate is lost or stolen.
- a dividend check or statement is not received within 10 days of the scheduled payment date.
- your name or address changes.

## Reports Available
More financial information is available upon request, including:
- Form 10-K *(filed with the Securities and Exchange Commission);* and
- A Statistical Supplement to this annual report.

## Dividend Reinvestment and Direct Stock Purchase Plan
MGE's Dividend Reinvestment and Direct Stock Purchase Plan *(Investors Plus Plan)* allows investors to:
- Buy MGE stock directly from the company.
- Reinvest dividends or receive cash payments.
- Deposit MGE certificates for safekeeping.

## 2000 Dividend Payment Dates
Quarterly dividends on MGE common stock are expected to be paid on:
- March 15
- June 15
- September 15
- December 15

The record date for dividend payments is the first day of the payment month.

## Transfer Agent & Registrar
Harris Trust and Savings Bank
P. O. Box 755
Chicago, IL 60690

## For Assistance
Contact MGE Shareholder Services by phone, mail or e-mail.

| | |
|---|---|
| Madison Area: | 608-252-4744 |
| Continental U.S.: | 1-800-356-6423 |
| Mailing Address: | MGE Shareholder Services<br>P.O. Box 1231<br>Madison, WI 53701-1231 |
| E-mail: | shareservices@mge.com |
| Business Office: | 608-252-7000<br>8:00 a.m. to 4:30 p.m.<br>*(Central Time)*<br>Monday through Friday |
| MGE Location: | 133 South Blair Street<br>Madison, WI 53703 |
| Web Address: | www.mge.com |

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Madison Gas and Electric Company

MGE

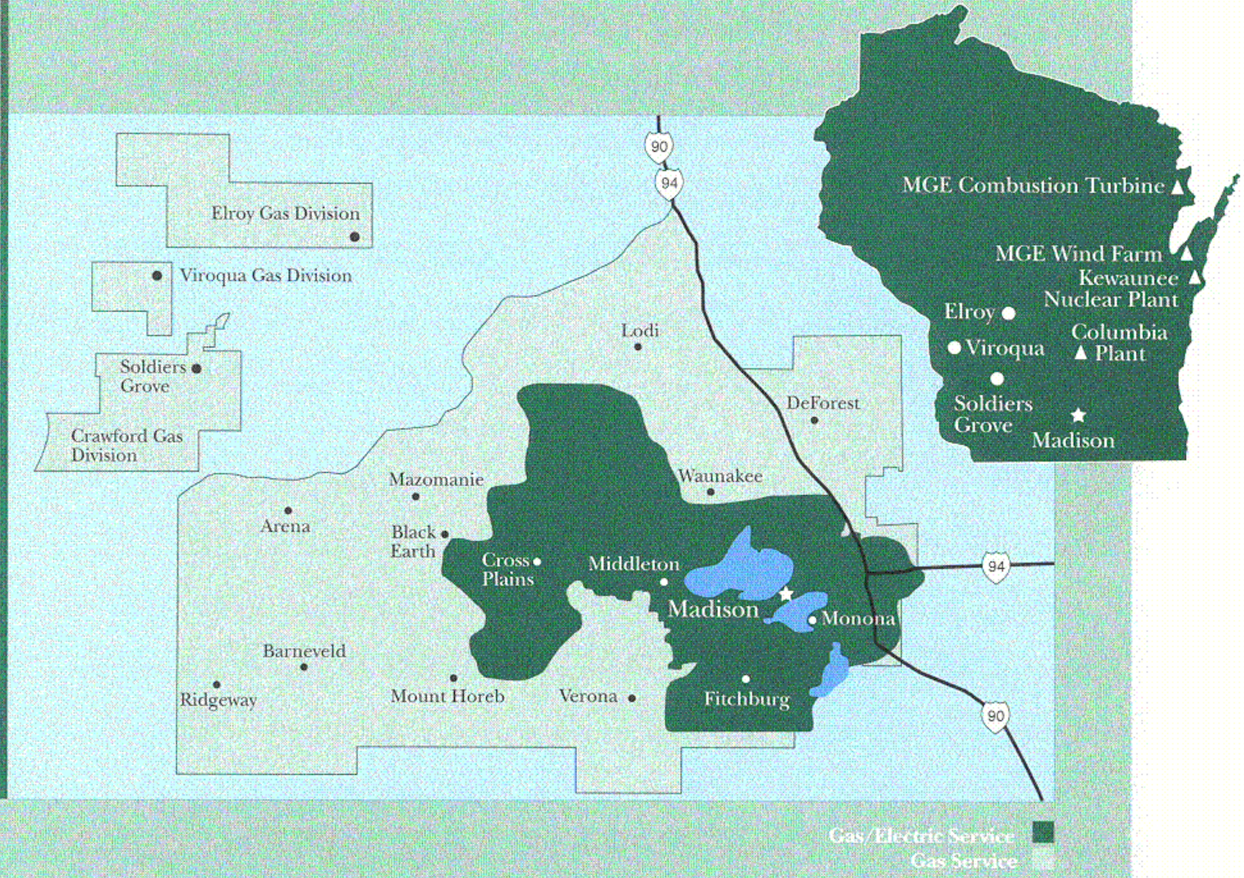
# The Area We Serve

## Electric Service

MGE provides electric service in Madison, Monona, Fitchburg, Middleton, Cross Plains and other Dane County communities, with a total population of 265,000. Generating facilities include the Blount Generating Station and several combustion turbines at Madison, the Columbia Energy Center at Portage, a natural gas combustion turbine at Marinette and the Kewaunee Nuclear Power Plant and MGE Wind Farm in Kewaunee County.

## Natural Gas Service

MGE provides natural gas service in Columbia, Crawford, Dane, Iowa, Juneau, Monroe and Vernon counties, with a total population of 353,000.

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