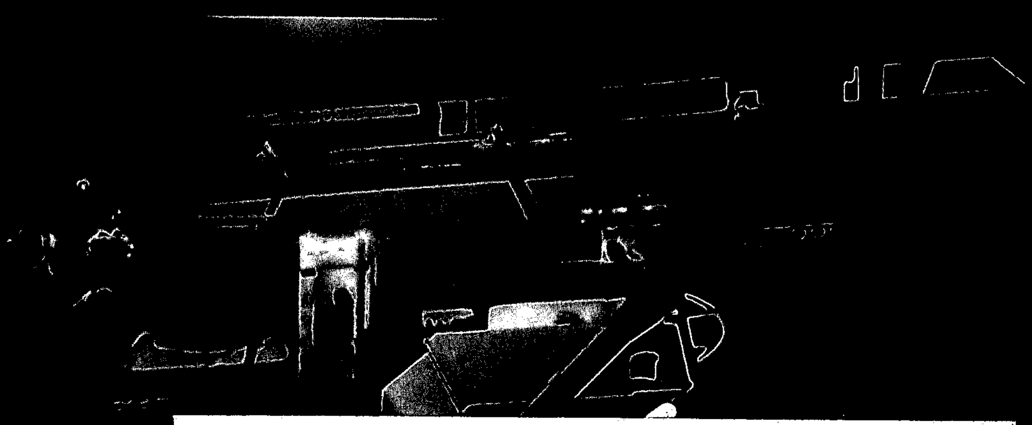
WISCONSIN PUBLIC SERVICE CORPORATION

1987 ANNUAL REPORT



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MEETING THE CHALLENGE

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The major challenge on our economic horizon is to maintain a strong business climate that preserves and expands the existing industrial and commercial base and provides opportunities for new businesses to start and flourish.

This challenge has stimulated the people of Wisconsin Public Service Corporation to create the broad array of programs we now offer in our service area. These programs integrate the needs of people and business and help develop strategies that preserve jobs and attract potential new ones through expansion or new business creation.

Some examples of the types of projects that have been successful and are currently underway to help develop a bright economic future are illustrated in this report.

ABOUT THE COVER:

The iron melting operation at Brillion Iron Works of Brillion uses massive amounts of electricity. Wisconsin Public Service's interruptible electric rate offers our customers savings on power costs in exchange for interruption of a portion of their service, should an emergency arise on the company's system.

CONTENTS

BUSINESS

WISCONSIN PUBLIC SERVICE CORPORATION is an investor-owned electric and gas utility serving a 10,000 square mile area of Northeastern Wisconsin and an adjacent part of Upper Michigan.

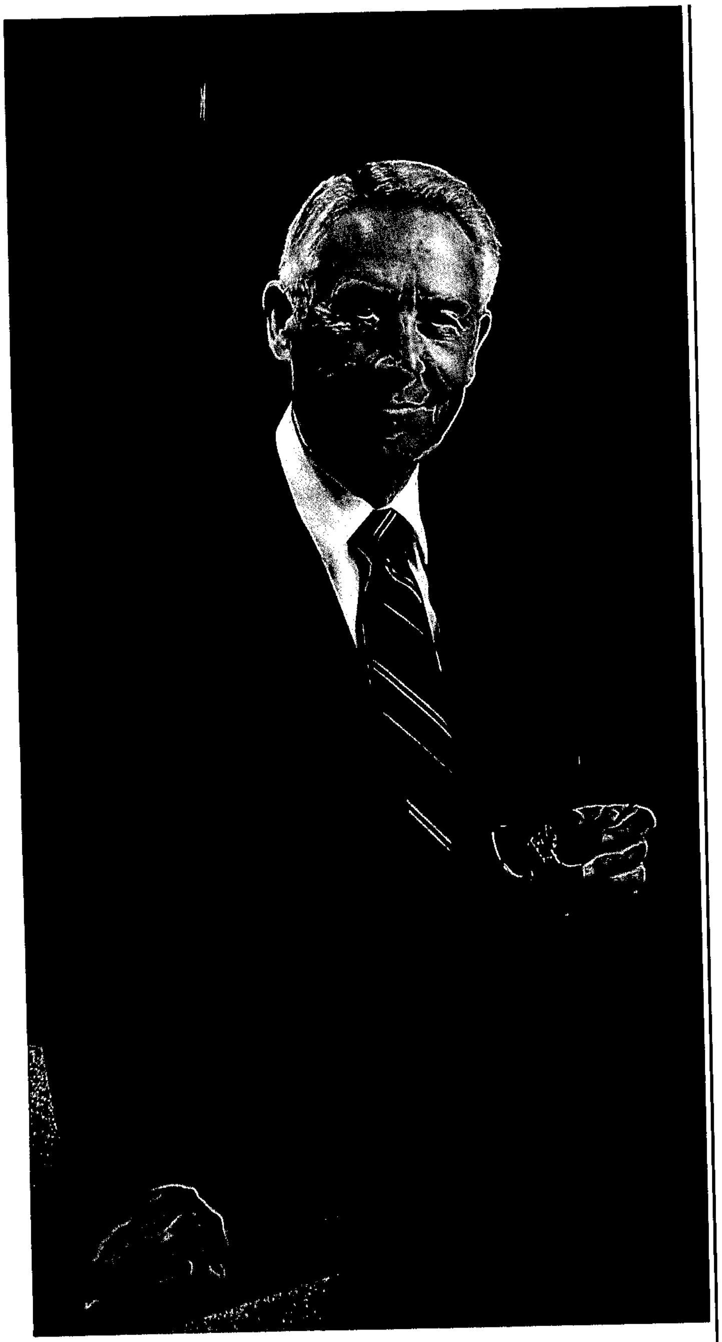
OPERATING HIGHLIGHTS

	1987	1986	Change
Revenues (Thousands)	$580,456	$592,270	– 2.0%
Net Income (Thousands)	52,771	51,541	2.4
Earnings Per Average Share of Common Stock*	2.11	2.03	3.9
Dividends Paid Per Share*	1.52	1.465	3.8
Book Value Per Share	15.52	14.94	3.9
Construction Expenditures (Thousands)	62,601	55,547	12.7
Capitalization (Thousands)	669,813	631,420	6.1
Electric Customers	312,858	307,559	1.7
Electric Sales (Kwh — Thousands)	8,351,062	7,772,905	7.4
Gas Customers	166,178	162,913	2.0
Gas Volume:			
Gas Sales (Therms — Thousands)	272,939	351,014	–22.2
Transportation (Therms — Thousands)	178,754	99,407	79.8
Total Gas Volume	451,693	450,421	.3

COMMON STOCK — TWO YEAR COMPARISON

Share Data	Dividends Per Share*	Price Range** High	Price Range** Low
1987			
1st Quarter	$ .375	53¾	49
2nd Quarter	.375	49½	42⅜
3rd Quarter	.385	25¾	21⅜
4th Quarter	.385	22¾	18⅞
Total	$1.52		
1986			
1st Quarter	$ .3575	46½	38⅜
2nd Quarter	.3575	50⅞	45⅝
3rd Quarter	.375	63	50½
4th Quarter	.375	55⅜	48¼
Total	$1.465		

*Adjusted to reflect 2 for 1 common stock split in June 1987. **Unadjusted.



TO OUR SHAREHOLDERS:

As I look back on the past 12 months and ahead to the future, it is obvious that there are many changes taking place in our business. Change is occurring more rapidly in some parts of the country than in Wisconsin, but we, nevertheless, are also being affected.

Our corporate profile, which was for so many years that of a heavily regulated monopoly, is now in transition. While we are still guided by extensive state and federal regulation, we now have a new element to deal with: competition.

Our new competitors have taken several forms. In our electric business, neighboring utilities are now bidding on contracts to sell power to our present wholesale customers. Some industrial firms are expressing interest in generating electricity and selling it to us. Independent power producers are becoming a factor in the supply of electricity. We must be prepared to deal with all these new entrants into our marketplace.

In the gas portion of our business, the recent deregulation of pipelines has created a whole new sub-industry, namely gas transportation. Many of our larger customers are buying natural gas directly from producers, instead of from us, and then contracting with us to transport the gas to their plants. In the past year, 60% of our industrial and commercial gas volume consisted of transportation gas. This is up from 35% in 1986 and 9% in 1985.

Another change in our industry is the increasing popularity of mergers and acquisitions. Some Wall Street investment bankers have speculated that our company is a prospect for acquisition by some other utility or entity. We would not favor such considerations unless clear-cut advantages for our shareholders, customers and employees became evident.

We are convinced that the keys to our future success are maintaining competitive energy rates and providing good service to our customers.

To forge those keys, our strategy is to control our costs and increase customer satisfaction. Our electric and gas rates are well below the national average and among the lowest in Wisconsin, and we fully intend to maintain this competitive posture.

Our cost control efforts have brought about a modest decrease in personnel levels this year with further decreases planned in 1988. We also are paying very close attention to our operating and maintenance costs.

Customer satisfaction is our other focus, and our surveys show that most of our customers are pleased with what we're doing for them. However, there is always room for improvement, and we will strive to achieve that improvement consistent with reasonable cost considerations.

We are fortunate to have a very capable and dedicated work force which has been a key factor in making Wisconsin Public Service Corporation the financially strong company it is today. I want to take this opportunity to publicly thank all employees for working very diligently to reach our objectives this past year. We are also appreciative of the support we have received from our shareholders.

Critical to the long-term health of this company is the strength of industry and the job market in our service area. To give you more specifics on this, we have featured it as the theme of this year's report.

Our story is also evident in our financial results which reflect our June 1987 two-for-one stock split:

- Earnings in 1987 were $2.11 per share, up from $2.03 per share the prior year.
- Quarterly dividends on common stock were increased to 38½ cents with the September payment. This is up from 37½ cents a year ago and marks the 29th consecutive year in which we have increased dividends paid per share.
- Electricity sales were 7.4% higher than last year.
- Gas sales and transportation volumes increased .3% compared to last year.

As I begin my first year as this company's chief executive officer, my efforts will be directed primarily to those new challenges we've already discussed.

I do not propose to tamper with the successful management format designed by Paul Ziemer during his 17-year tenure as chief executive officer. On December 31, 1987, Mr. Ziemer retired from the day-to-day management of the company, retaining his position as chairman of the board.

During his nearly 40 years here, Mr. Ziemer has etched an indelible signature on Wisconsin Public Service by melding human and financial resources into a strong, nationally recognized public utility.

On behalf of all the shareholders, employees and customers whose lives he has touched, I thank Paul Ziemer for that part of himself that he has generously given to this company.

Linus M. Stoll

Linus M. Stoll
President and
Chief Executive Officer

February 25, 1988

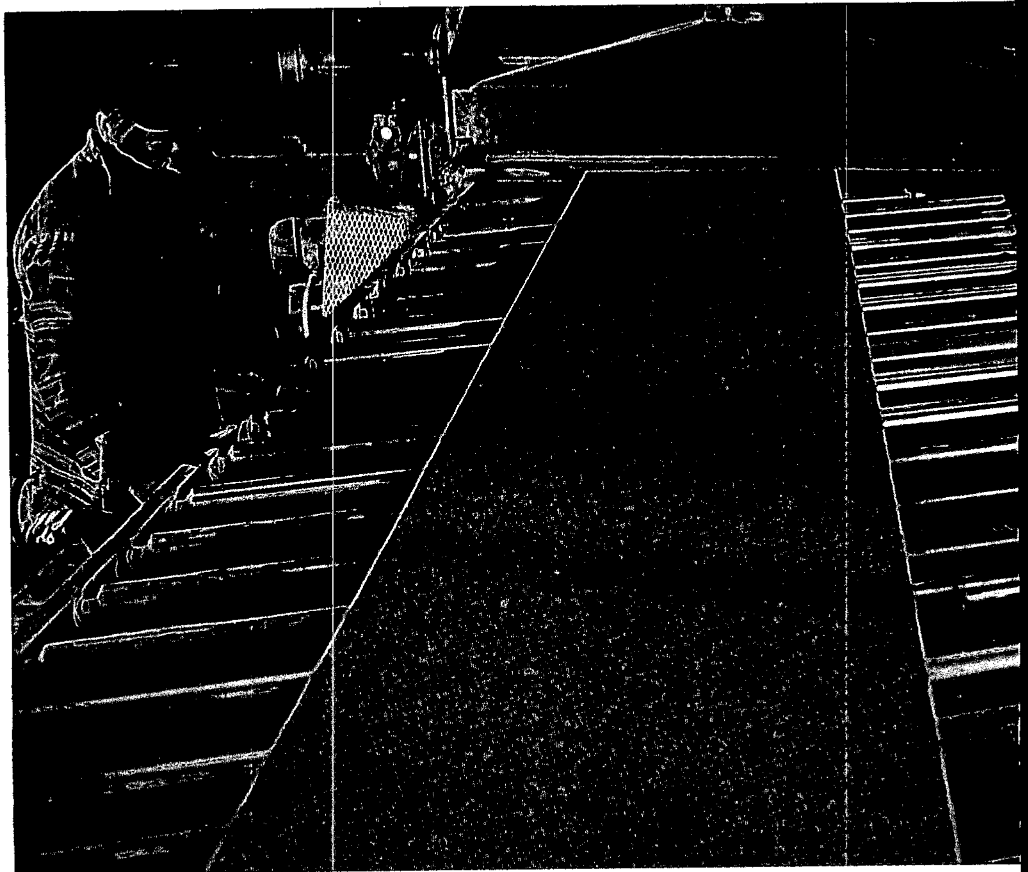
KEEPING BUSINESSES AND JOBS

The 1980s have been years of progress for Wisconsin Public Service and are highlighted by the introduction of programs that assist business growth and the development of new customers.

The needs of large industrial and commercial customers have been addressed as part of our work to keep businesses and jobs in the company's service territory.

In the electric service area, we have instituted innovative programs to assist industrial customers. Some of these programs are:

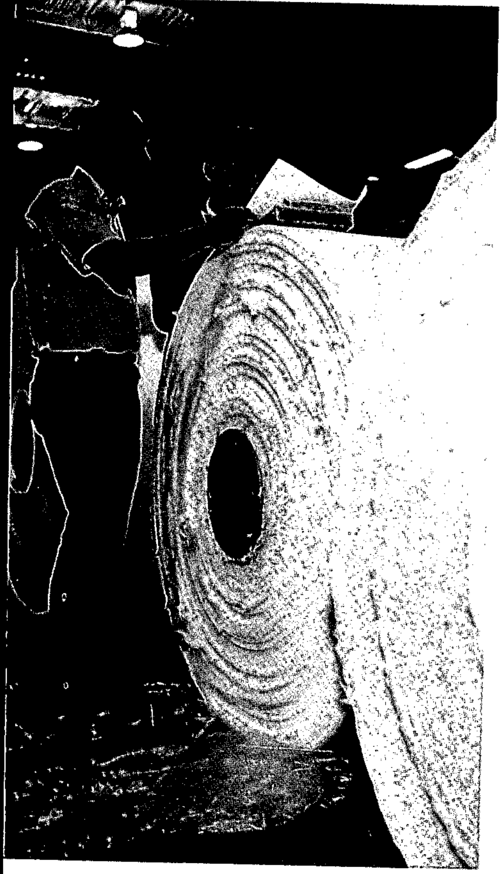
- Time of use rates — We pioneered in implementing these rates which price energy according to the change in our costs during the day. This rate structure permits large industrial customers more flexibility to control their costs.
- Interruptible rates — This program interrupts service only when there is a system emergency. Large industrial customers receive lower rates under this service, thus helping their profitability.
- Generation displacement rate — This rate is for customers who have their own power generation facilities. A price quote is provided for each upcoming week permitting the customer to evaluate the cost of their own production to decide if they want to buy power or generate their own.



Adjusting operating schedules to utilize the time of use features of our industrial electric rates and save on operating costs is exemplified here by Rodman Industries in Marinette. Rodman Industries, a fiber board manufacturer, has adjusted its schedule so that they use their large sander only at off-peak electric times to put the finishing touches on their product.

Rapid developments and growing competition in the natural gas industry have brought about a variety of new approaches in the natural gas portion of our business, such as:

- Direct purchase of natural gas from the producer — Purchasing directly from the producer may save customers money in energy expenses and improve the competitive situation. If customers desire to do so, we offer assistance with making the change. In that case, we transport the gas from the pipeline company to the customer and receive a transportation fee.
- Lower transportation rates — We decreased our firm and interruptible gas transportation rates in our last two rate cases to reflect costs, making our rates more competitive with alternate fuels.
- Expansion of interruptible rates — In a rate order received November 1987, we expanded our interruptible rates so as to qualify a greater number of customers.



When International Paper Company built its new formed fabrics plant in Green Bay, the ability of Wisconsin Public Service to arrange for direct purchase of natural gas at very competitive rates ranked among the deciding factors in choosing their new location. The fabric this plant manufactures is used in a product produced by another area paper mill.

FINANCIAL

At the Annual Meeting in May, shareholders approved an increase in the number of authorized shares of common stock from 16,000,000 shares with a par value of $8 per share, to 32,000,000 shares with a par value of $4 per share and a two-for-one stock split. Certificates evidencing such additional shares were mailed on July 15 to shareholders of record June 22.

A negotiated sale of $45 million of First Mortgage Bonds, 9.50% Series Due December 1, 1994, was completed on November 30. The proceeds were used to pay short-term borrowings incurred for construction purposes and funding toward the eventual decommissioning of the Kewaunee nuclear plant.

Construction expenditures for the five-year period 1988 through 1992 are estimated to be $312 million. This compares with $278 million for the previous five-year period. Included is about $5 million for sulfur dioxide controls at our generating stations.

RATE PROCEEDINGS

In April 1986, an application was filed with the Public Service Commission of Wisconsin (PSCW) for a general rate increase. In an order issued in July 1987, the Commission determined that electric rates should be decreased by $1.3 million, and that gas rates be increased by $1.5 million. The amounts were significantly lower than originally requested because of lower return on equity authorized, deferral of some programs, lower expenses being accepted by the Commission, and the implementation of the 1986 Tax Act.

In 1987, a new request was filed in Wisconsin to increase rates by $1.1 million for electric and $3.4 million for gas to be effective January 1, 1988. In an order effective January 30, 1988, the Commission set out a reduction of $13.9 million in electric and an increase of $989,000 in gas rates. The reduction in electric rates results from lower fuel expenses than originally estimated, adjustments in certain operating expenses, and the deferral of some programs. Requested gas rates were reduced because of lower estimates of operating expenses.

In 1986, we filed for a reduction in wholesale electric rates which are subject to Federal Energy Regulatory Commission (FERC) jurisdiction. Following settlement negotiations, reductions totaling $3.8 million were made effective in 1987.

Negotiations were conducted with the Michigan Public Service Commission to adjust electric and gas rates as a result of federal corporate income tax changes. In an order effective July 1, 1987, electric rates were reduced $205,000 and gas rates were reduced $25,000.

MANAGEMENT CHANGES

Linus M. Stoll, president and chief executive officer, was named to the board of directors in May, replacing John M. Rose who had served the company well as a director since 1961.

Kathryn M. Hasselblad-Pascale, partner and general manager of Hasselblad Machine Company, Green Bay, was elected to the board in July to replace Neil J. Webb, who resigned from our board of directors to take the position of president of Dominican College of San Rafael in San Rafael, California.

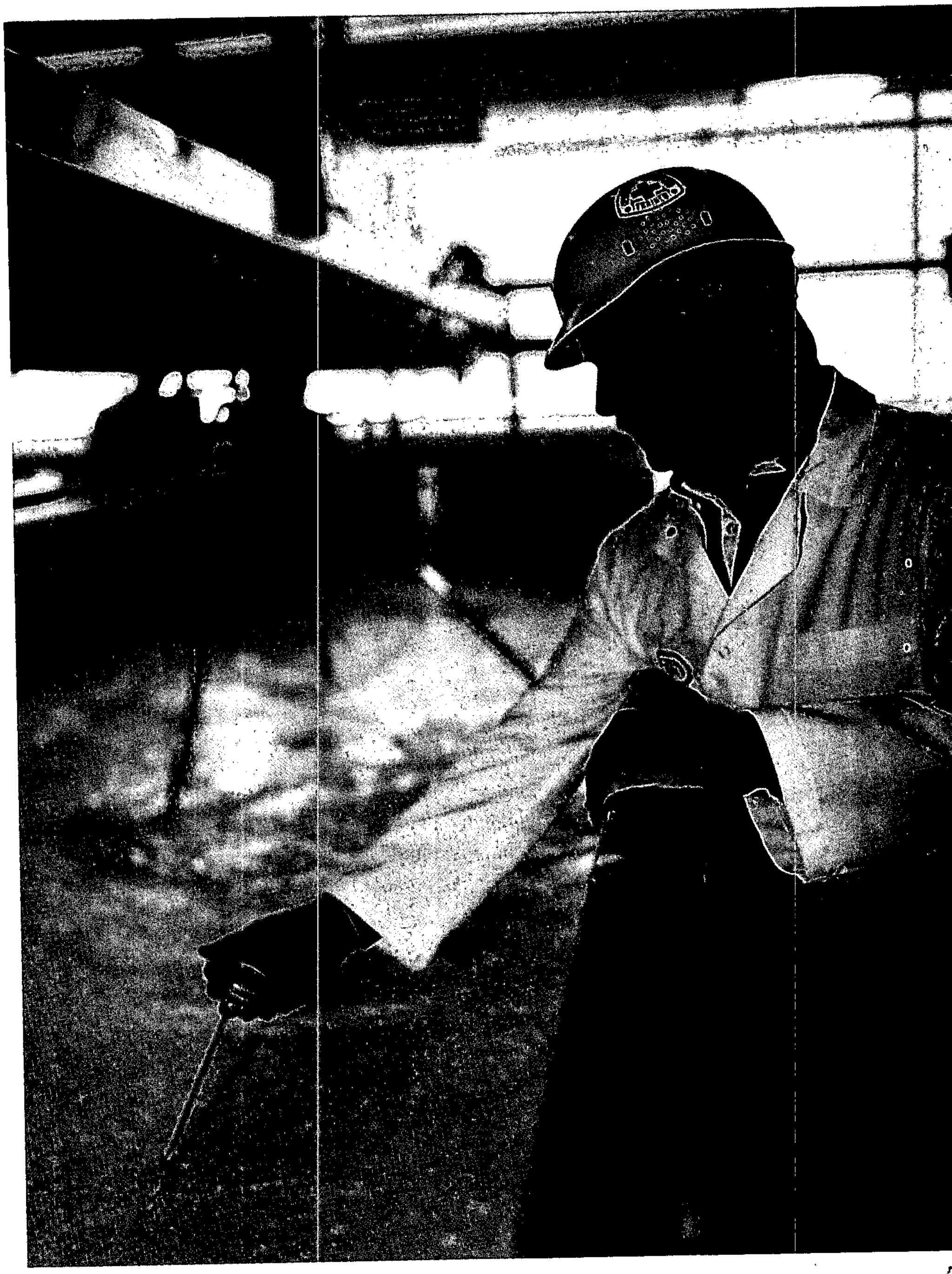
It was with great sorrow that we learned of the death of Mr. Webb and his wife, Mary, in a California plane crash in December.

Annually, large commercial and industrial natural gas users are invited to hear of the latest developments in the rapidly changing gas industry from officials from Wisconsin Public Service and ANR Pipeline which serves our company.

- Gas update meetings — Because of the continuing volatility of the gas market, we regularly update our high-use customers about changes in federal and state rules and inform them of the implications of gas supply and price forecasts, gas transportation and other timely issues.
- Coal displacement rate — Customers can contract for this rate in those cases where coal use is displaced with natural gas for economic or environmental reasons.

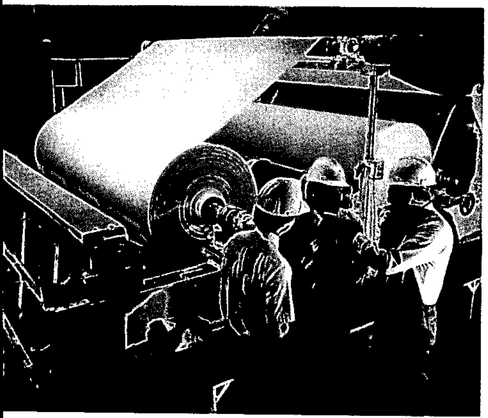
Customers who participate in these special rates preserve their eligibility for standard rates by making separate arrangements with us.

Energy conservation is another avenue we have taken to guide major employers in their energy planning and cost-effective energy use. Key programs include:



- Business energy analysis program — Our industrial application engineers have been trained to give each business expert advice and cost estimates on energy improvements so business owners can make wise energy use decisions.

Kasson Cheese of Brillion was one of several Wisconsin Public Service business customers who applied one of our commercial/industrial energy improvement loans for work aimed at upgrading the energy efficiency of their cheesemaking operation.



The Scott Paper Company plant in Marinette switched from coal to natural gas after a special transportation gas rate was filed with the Public Service Commission of Wisconsin.

- Energy improvement loans — In cases where lack of financing could stop or delay energy improvements, loans are offered to industrial and commercial businesses. So far, more than $1.4 million has been made available.

Sales to commercial, industrial and municipal customers represent almost three-quarters of our revenues. Although the residential sector produces only one-fourth of total revenues, it makes up almost 90% of our total number of customers. So when it comes to service, the needs of individual people are also conscientiously addressed.

It is important that residential customers know they can rely upon us for expert energy advice, and we make every effort to make them feel comfortable doing business with Wisconsin Public Service.

ELECTRICAL SYSTEM

In Advance Plan 5 we submitted to the PSCW our 20-year projection to meet our electric demand. This is a plan that prioritizes, based on economic benefits, various methods of meeting future energy demands. The Plan does not project the construction of the next company power plant until after the 20-year period.

Advance Plan 5 anticipates options such as extending the life of our power plants, converting mercury vapor street lighting to sodium, reducing losses on transmission lines, implementing customer energy conservation, and cogeneration. Because of the interest in cogeneration, we have already begun discussing this option with area industries who could have the capability of generating electricity at their facilities.

We installed a data exchange network with three other major Wisconsin utilities providing continuous quotations of energy prices for purchase and sale considerations.

In an effort to maintain low-priced electricity for our customers, we signed a contract with Commonwealth Edison and will receive power via transmission lines owned by another utility.

To assure continued reliable service in the Stevens Point area, a major transformer addition was made, and we completed a new transmission tie to Consolidated Water Power, our largest customer.

The city of Marshfield, a customer for decades, and one of our larger municipal wholesale customers, requested bids for electric supply from three utilities. This is an example of the increased competition occurring in the industry. We are pleased to report that we won the extension of our contract.

Seeking the renewal of the operating licenses for eight of our 15 hydroelectric plants will be our focus for the next several years. This year we began the relicensing process for our Otter Rapids plant.

As part of an expanded quality assurance program, we are buying only those brands of transformers which hold up best and reduce our overall costs. This should mean fewer outages due to transformer failure and should provide even more reliable service to customers.

We also have adopted a sample test plan for in-service electric meters. It identifies the meter types and parts requiring corrective efforts to enhance their reliability. In 1988, this will reduce the number of meters tested and should provide customers with improved service at a lower cost.

In our truck fleet, we are reducing our expenses by $2 million over a three-year period by transferring older line-truck bodies and equipment to new chassis with diesel engines. This is the culmination of our earlier program of buying long-lasting fiberglass truck bodies. We are saving about $100,000 per truck, compared with the purchase of a new digger/derrick truck. Also, the cost of using diesel fuel is much lower than gasoline.

Several new records of electrical usage were reached this past summer, including an all-time high hourly gross demand of 1,433,000 kilowatt-hours reached on August 3. This exceeded the previous year's record of 1,341,000 kilowatt-hours on July 18, 1986.

Annual kilowatt-hour firm sales growth through 1997 is projected at 1.7% and annual growth in peak load is now projected at .8%, both down slightly from last year's estimates.

This concern for the residential customer is the impetus behind an array of energy services directed at satisfying these important people's needs, including:

- Prompt service restoration after storms and emergencies.
- Fewer estimated bills.
- Prompt installation of new service.
- Courteous handling of customer calls.

Many residential programs are small-scale versions of the programs offered to businesses, such as energy check-ups, loans, budget billing, experimental rate structures and financial counseling.

The attitude of customers is seen as a measure of our success. The continuing partnership that has been established with customers has resulted in high-quality service and customer satisfaction in our service area.

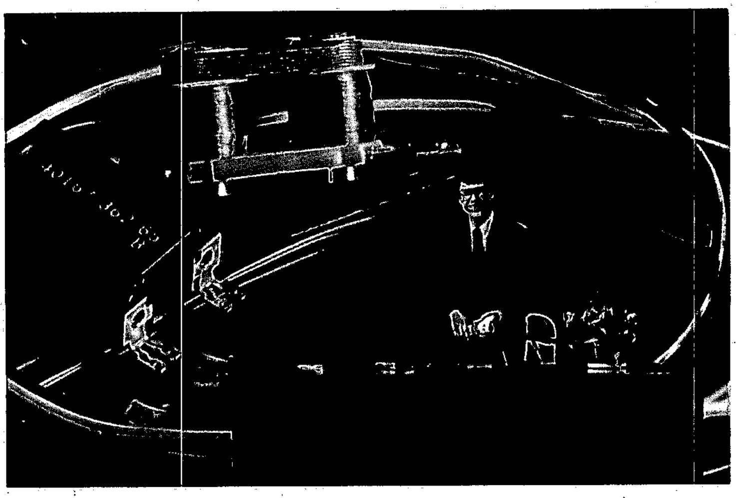
NEW BUSINESS AND JOBS

In addition to partnership with existing businesses, we participate in the encouragement of future growth through business development. This growth comes when prospective companies consider and then decide to move into Northeastern Wisconsin. These new endeavors add economic strength and job diversification to our service area.

Our major effort to provide business information and related economic development services is coordinated through the PRIDE Program, Partners in Regional Industrial Development, an institution in our area for more than 30 years.

#5 in a series of Northeastern Wisconsin business success profiles

In Northeastern Wisconsin, they're transforming vision into success



They're the SNC Manufacturing Company, Inc. of Oshkosh, Wisconsin and they are internationally recognized for their production of specialized transformers. John L. Vette, III, President.

If you had just purchased an electrical transformer firm located in Illinois, what would you do first to turn the corner to profit? SNC Manufacturing Company moved to Northeastern Wisconsin.

Now nearly forty years later, SNC is a multi-million dollar operation with thousands of special transformer designs to its credit. What they found here was a willing, capable work force and a receptive market — two traits basic to business success and characteristic of Northeastern Wisconsin.

The father of the current president, John L. Vette, Jr., possessed another ingredient of success: Vision. He had the courage to shuck what was considered a prime business location outside of Chicago to forge a future elsewhere — Oshkosh, Wisconsin.

Pioneers have never been foreign to Oshkosh. They founded it. And, in Oshkosh, modern day pioneers are still blazing trails.

They may be scouting high tech to provide the specialized transformers required by international business. They may be pushing back the boundaries of flight during the Experimental Aircraft Association's annual convention. They may be starting businesses that will prosper. Workers or visionaries, the people take pride in meeting a challenge in Oshkosh. A city that breeds innovation.

A place where success can be part of anyone's future.

Business prospers in Northeastern Wisconsin. So can you. Call or write today for the information necessary to make your growing business even more successful.

Theodore J. Penn
Director-Economic Development
PRIDE
Wisconsin Public Service Corp.
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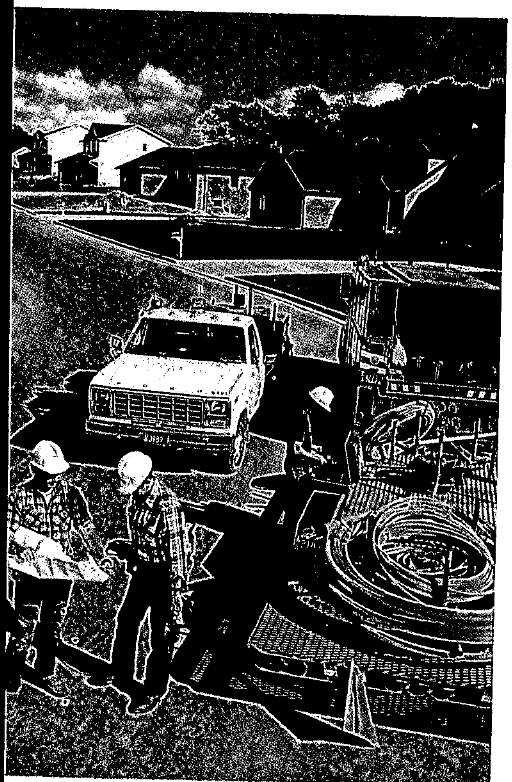
PRIDE®
PARTNERS IN REGIONAL INDUSTRIAL DEVELOPMENT
WISCONSIN PUBLIC SERVICE CORPORATION

Magazine ads carrying business success stories, like this one at SNC Manufacturing Company, Inc. of Oshkosh, carry the message of economic progress in Wisconsin Public Service's territory to readers throughout the nation.



In addressing the needs of residential customers, Wisconsin Public Service has implemented aggressive gas extension programs.

■ NATURAL GAS

As of November 1, 1987 our minimum bill requirements were eliminated for natural gas purchases from our supplier ANR Pipeline. That means we can now either buy gas on the open market or from ANR, depending on cost and reliability. This is a result of a FERC ruling earlier in the year.

Under present circumstances, and provided they have the capacity, ANR will transport gas to any user on its system for any use.

Transportation gas allows our customers to obtain cheaper spot market prices at times, and we retain our sales margin by charging them for the use of our pipeline system.

■ COAL POWER

In 1987, we spent $133 million for coal. While the quantity of coal being purchased remains about the same, reduction in the price and our purchasing strategies have enabled us to reduce that budget to $126 million in 1988. Lower coal prices result in cheaper electricity which helps both us and our commercial, industrial and wholesale customers compete more effectively.

Our purchasing strategies include renegotiating higher priced long-term coal contracts, increasing the level of purchases at current market prices, negotiating new rates in rail and lake carrier transportation agreements and matching lower priced coal from various parts of the country with the rail or lake shippers who offer the most competitive prices.

At our Pulliam plant in Green Bay, we are refurbishing the Unit 5 turbine generator which, along with other improvements, will extend the Unit's service until 2008. We continue to review what can be done to extend the life and operating efficiency of our coal-burning units.

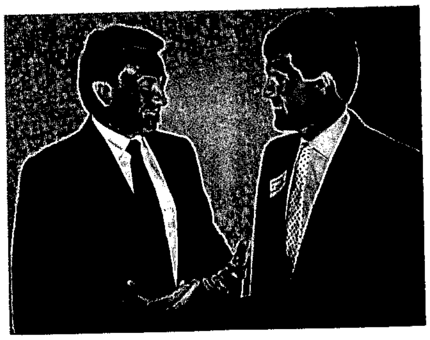
■ NUCLEAR POWER

The Nuclear Regulatory Commission (NRC) gave the Kewaunee nuclear plant the highest rating ever given a plant in Region 3 and in the nation for its 1987 "Systematic Assessment of Licensee Performance" study. Also, the Institute of Nuclear Power Operations (INPO), gave Kewaunee its second "Award of Excellence."

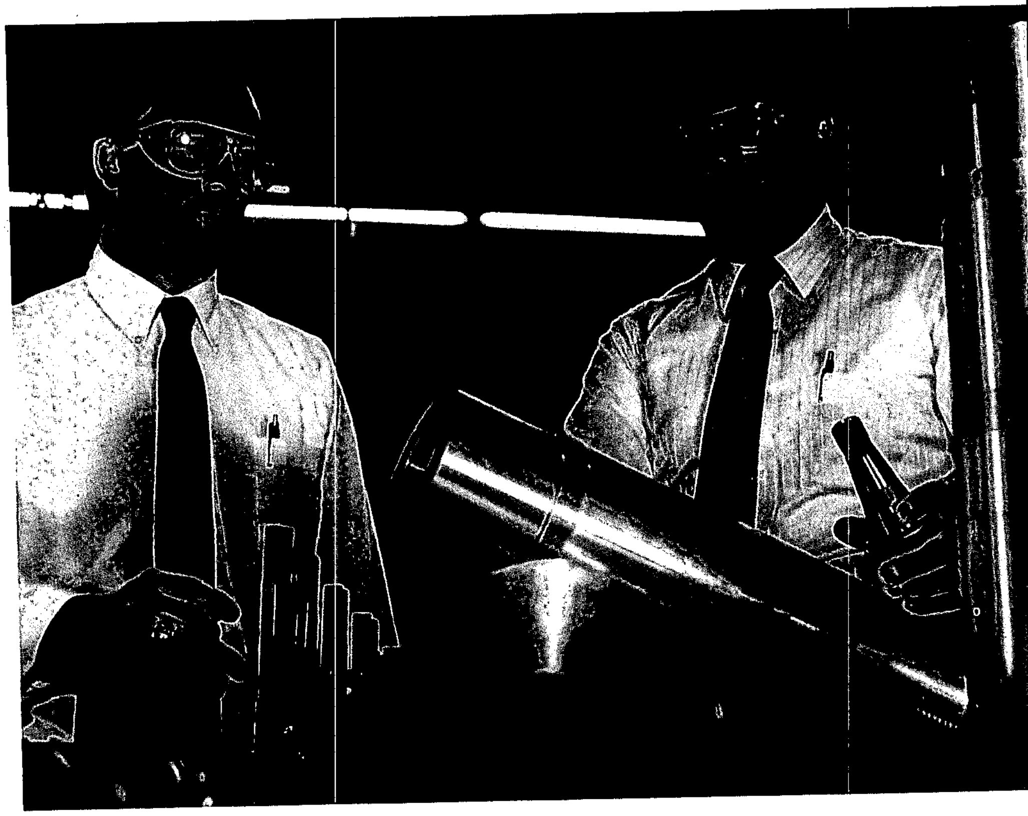
Six of our 10 training programs at Kewaunee have now been accredited by INPO, and we expect the other four to be accredited in 1988. This is part of our commitment to the NRC to standardize nuclear training with other U.S. nuclear plants.

We bought out of a uranium milling contract and secured our 1988 uranium needs at the spot market price which was cheaper than entering into a long-term contract or operating the company's mining property.

For nuclear fuel enrichment services we have also turned to the spot market, which was cheaper. Similarly, we realized additional savings by securing an extended contract for absorber rods needed to control the nuclear reaction process.



Wisconsin Governor Tommy Thompson, left, and Wisconsin Public Service Director-Economic Development, Ted Penn, talk after a media conference announcing the success of a joint public and private funding project which created new jobs at a local company.



There are many keys to successful regional economic development, and they involve not only our programs, but a network of interacting government and private bodies. PRIDE Program's mission is to act as a regional clearinghouse among these groups so that a coordinated effort can be put forth to attract new business and help existing businesses expand. We also encourage conservation and off-peak energy usage.

Our economic development director and his staff coordinate leads obtained from the state level, particularly the Wisconsin Department of Development, the privately administered Forward Wisconsin group and communities in Wisconsin Public Service territory.

This has proven to be an important link in the economic development chain because neither the state nor individual communities are organized regionally. With a territory serving 19 counties in Northeastern Wisconsin and a small area of Michigan's Upper Peninsula, we have the advantage of being able to call upon our own regional management people for added backup on local economic development.

This pro-active economic development stance is enhanced by wide reaching written and person-to-person communications, such as:

- The PRIDE Newsletter circulated to local business leaders.
- Targeted advertising in business journals.
- Seminars to train existing businesses in how to obtain government contracts.
- Prospect call trips.
- Participation in trade shows related to the types of industries which have been identified as appropriate to our territory.
- Support for incubator business programs.

Business incubator projects, such as the Green Bay Area Chamber of Commerce ADVANCE Business Development center, help tenants pictured here, Integrated Design Corporation, get a head-start before venturing into their own facility. Wisconsin Public Service's PRIDE program supports community agencies that operate incubator projects.

Helping solve financial difficulties of service area businesses is another aspect of economic development. The PRIDE Building Loan Program has made $1.1 million of loans for plant expansions at five major employers.

We believe that by serving area businesses in their expansion plans and by helping new ones locate here, we are helping all our customers.

A plant expansion project at Advance Transportation Company's Wausau facility received partial funding through Wisconsin Public Service's PRIDE building loan program. Working through local economic development organizations, loans totaling $1.1 million have been made for improvements at five major area employers.

RESULTS AND PROJECTIONS

The results of these programs are varied and ongoing. They affect the profitability of large and small businesses, encourage the continuity of a devoted work force, help provide a strong tax base and living standard, plus establish activities for the continued development of growth potential in Wisconsin Public Service territory. We are proud of our role as a contributor to the present and future prosperity of our area.

■ FUEL COSTS AND GENERATION MIX

Fuel costs in 1987 compared with 1986, expressed in dollars per million Btu, were:

Nuclear, $.47, down from $.50; coal, $1.89, down from $1.90; natural gas, $3.32, down from $3.51; and No. 2 fuel oil, $3.75, down from $3.92.

The generation mix of fuels needed to operate our power plants in 1987 compared with 1986 was:

Coal, 67.8%, down from 71.0%; nuclear, 18.5%, down from 19.1%; hydro, 2.8%, down from 5.0%; combined natural gas and fuel oil, .4%, up from .3%; and power purchased from other utilities, 10.5%, up from 4.6%.

■ ENVIRONMENTAL ISSUES

We've taken major steps to further decrease particulate emissions from the Pulliam plant in Green Bay. We installed a new system on our Units 6 and 7 boilers to better collect fly ash before it goes up the chimney. A new natural gas ignition system replacing fuel oil now starts up the coal boilers for Units 3 through 6 and has done much to reduce emissions.

Fly ash collected at Pulliam was put to beneficial use this year when the Wisconsin Department of Transportation ordered 55,000 tons of it for a highway construction project. This and other uses for fly ash greatly reduce disposal expenses.

■ GOVERNMENT AFFAIRS

The inauguration of Wisconsin Governor Tommy Thompson in January 1987 brought a new spirit of optimism to our state's business community.

One of his first appointments was a new chairman of the PSCW, Charles Thompson, a businessman.

We continue to object to a state property tax relief proposal that would expand state sales taxes to currently untaxed goods and services.

Congress did not pass any of the many acid rain bills now pending. We and other Wisconsin utilities continue to support only federal legislation that properly credits Wisconsin for the significant emission reductions already achieved. Our state residents should not be forced to subsidize electric customers living in other states where emission rules are not as strict.

We are also monitoring Congressional debates on nuclear power plant issues including emergency preparedness, high-level radioactive waste siting and reauthorization of the Price-Anderson Act which regulates plant liability insurance.

■ BUSINESS VENTURES

WPS Development, Inc., one of our nonregulated subsidiaries, sells our Integrated Facilities Model software package which provides facilities and mapping information management, data conversion services and custom system development for industry and government. Although not yet profitable, it has been progressing as anticipated. We doubled our 1986 sales and signed new contracts that hold promise for future long-term sales. This is an exciting new business opportunity that holds good promise for the future.

BUSINESS VENTURES (con.)

Another subsidiary, WPS Communications, Inc., is involved with the NorLight fiberoptics system in Illinois, Wisconsin and Minnesota. Progress here has been mixed as revenues are about a year behind our original projections due to regulatory delays during the construction phase and because the market has not developed as strongly as predicted. Customers have also been splitting their orders with other companies for route diversity. Nevertheless, revenues improved in the last few months of 1987, and it appears we may hit a cash break-even point by the last quarter of 1988. Also, we are looking to further extend our fiber into another Minnesota Local Access Transport Area (LATA) so we can fill a potentially large fiberoptics demand there.

Our $2.5 million investment in Utech Venture Capital Corporation continues to be placed in ventures that can provide goods or services that will benefit the utility industry.

CUSTOMER RELATIONS

Customers' requests for service repairs or installations can now be followed up much easier thanks to company-wide computerization of customer-related job orders. Also, more employees can answer customers' questions about such work because of their access to this data through terminals.

Answering a need to provide home furnace safety and energy use check-ups, we are continuing to offer our natural gas furnace inspection program to residents. We have checked 7,000 furnaces so far and expect to continue to serve customers with this program as long as they request it.

Our consumer consultants sponsored a roundtable discussion, inviting representatives of fixed income and senior citizen customers. The purpose was to elicit from them what we can do to meet the special needs of these customers.

CUSTOMER SAVINGS

We're looking to our customers to learn which energy-saving ideas may appeal to them in the future. Our Marketing Department has developed several pilot programs which will be conducted in selected regions:

- Industrial customers: Cash back for energy-efficient motors and lighting systems, and financial incentives for programs implemented as a result of energy audits, to promote more efficient electrical use.
- Commercial: Rebates for upgrading outdoor lighting to high-pressure sodium lamps.
- Farm: Company rebates and loans for the installation of heat reclamation units in milkhouses and high-efficiency lighting in barns.
- Residential: Rebates or "zero percent" financing of new high-efficiency electric water heaters.

Another way we stay in touch with customers about energy savings is through the trade allies who sell, service and install plumbing, heating, ventilating, air conditioning and other energy-use equipment for our customers. Some 2,000 dealers and their employees attended seminars at which we featured speakers skilled in this field and displays of innovative energy equipment. Our aim is to help keep our employees and trade allies on the leading edge of technological change, so, ultimately, all our customers will benefit.

EMPLOYEE RELATIONS

To encourage our employees to become better shoppers for the quality and cost of medical care they receive, we revised our medical coverage for all nonunion employees. Features include precertification and obtaining second opinions for certain types of hospital admissions, extension of the maximum of coverage on catastrophic illness, and the establishment of a company/employee co-payment provision for covered medical expenses.

We revised and expanded our drug and alcohol policy and began testing certain groups of employees. Our program is in response to recent requirements by the NRC and state transportation authorities. The program also provides safe, reliable service to our customers and maintains a safe workplace and a workforce that is fit for duty.

We also offered our employees informational seminars about AIDS (acquired immune deficiency syndrome) and sexual harassment, and we intend to keep employees updated about the developments regarding these important issues.

RESULTS OF OPERATIONS

■ 1987 COMPARED TO 1986

Electric operating revenues increased approximately 4.5% in 1987 due to a 7% overall increase in kilowatt-hour sales primarily in the commercial, industrial and wholesale markets. During 1987 the company experienced several rate decreases including FERC wholesale electric rates in January and June, and PSCW and Michigan Public Service Commission retail rate decreases in July. A substantial cause of these decreases was lower taxes as a result of the Tax Reform Act of 1986. Heating degree days decreased approximately 11% in 1987 while calendar month cooling degree days for the same period increased 66%. Residential kilowatt-hour sales increased at an annual rate of less than 2% primarily due to customer growth. Kilowatt-hour sales increased 5% to our small commercial and industrial customers and approximately 7% to our large commercial and industrial customers. Kilowatt-hour sales to our wholesale electric customers rose a significant 21% in 1987 primarily due to the addition of a paper machine by our largest wholesale customer in late 1986.

Gas operating revenues decreased approximately 17% in 1987 due primarily to the unusually mild winter weather experienced during the year and also the continuation of transportation gas to our industrial customers. Because of the mild winter weather noted above, residential gas therm sales decreased approximately 7% in 1987.

Sales to our firm commercial and industrial customers decreased 26% in 1987 as a result of mild winter weather and increased use of transportation gas.

Gas therm sales to our large interruptible customers decreased 89% due almost entirely to transportation gas.

Transportation gas is expected to continue throughout 1988 but at a slightly lower level than 1987 due to an increase in spot market prices and an increase in transportation rates. The company plans to purchase approximately 50% of its system requirements from suppliers other than ANR, our pipeline supplier, for resale within our service territory.

Operating expenses showed a net decrease of 3% in 1987, primarily in gas purchases because of transportation gas mentioned above, a lower average price per therm from our normal pipeline supplier and purchases of cheaper gas made in the spot market. Federal income tax also decreased in 1987 due to the lower statutory tax rates that took effect this year as enacted in the Tax Reform Act of 1986. Investment tax credit deferral decreased significantly because of its elimination in that same tax legislation and adjustments resulting from two IRS investment tax credit audits for the years 1974-1979 and 1980-1981. The amount shown for 1987 primarily reflects restored investment tax credits. There was a significant increase in purchased power because the company was able to obtain energy from other sources at favorable rates. Adjustments caused by settling an IRS depreciation audit for the years 1980-1981, and filing the company's 1986 tax return as well as higher tax depreciation rates for nuclear fuel, and the normalization of a portion of the payments being made to the nuclear decommissioning trusts which are now deductible as the result of a ruling received from the IRS this year, caused a major increase in additional depreciation. Higher short-term borrowing, the majority of which was used to finance the initial payments to the nuclear decommissioning trusts made in July, caused other interest expense to increase. The company also issued $45 million in first mortgage bonds in December, with a portion of the proceeds being used to reduce short-term borrowing.

■ 1986 COMPARED TO 1985

Electric operating revenues increased approximately 2% in 1986. The primary factor causing this increase was an increase in kilowatt-hour sales of 4%. The most noteworthy sales increases were experienced in the commercial, industrial and wholesale markets. Heating degree days decreased 6% in 1986 while calendar month cooling degree days increased 5%.

Residential kilowatt-hour sales remained steady. A growth rate of approximately 2% was experienced in 1986. Sales to our small commercial and industrial customers increased 4% during 1986 while a more significant increase of 6% was experienced in the large commercial and industrial market.

Gas operating revenues continued to decrease during 1986. A significant decrease of 24% was experienced in 1986. The decrease is the result of two major factors. Gas therm sales declined 22% due to warmer weather experienced during 1986 and the effect of transportation gas by our firm and interruptible commercial and industrial customers.

Gas residential therm sales decreased approximately 4% due mainly to the reduction in heating degree days as noted above.

Firm commercial and industrial gas therm sales decreased 23% due to a combination of warmer weather and transportation gas.

Gas therm sales to our interruptible commercial and industrial customers dropped by 61%. The majority of this decrease can be attributed to transportation gas.

Operating expenses showed a net decrease of 8% in 1986, primarily in gas purchases because of fewer sales as explained above and a lower average price per therm from our pipeline supplier. With no new major additions of plant recently, additional depreciation was lower because the existing plant is further into the cycle of using the declining balance method and also decreased due to recording a negative tax savings adjustment based on the settlement of the 1974-1979 IRS audit, taking the maximum amount of repair allowance in 1986, and changing removal rates. Investment credit deferral decreased significantly due to the 1986 tax law eliminating most earned investment tax credits. The amount shown for 1986 primarily reflects restored investment tax credits. Fewer repairs to the company's primary coal generating plants accounted for the decrease in maintenance. A major increase occurred in other taxes because Wisconsin gross receipts tax was recorded at the full rate in 1986 versus the half rate in the initial year, 1985, as prescribed by the PSCW. Electric production fuels rose significantly due to increased generation at the company's coal-fired plants. Other expenses increased primarily due to recording the coal contract settlement; for more information, refer to Note 1(e) in "Notes to Financial Statements."

The company issued $45 million of first mortgage bonds in October 1985, resulting in higher interest on long-term debt in 1986. However, the company was able to lower its commercial paper borrowing in 1986 which offset much of that increase. In addition, preferred dividend requirements decreased because of the redemption of the 10.75% preferred stock.

FINANCIAL CONDITION

The company has maintained good liquidity levels and follows conservative accounting practices. The company's financial position is considered to be strong by utility analysts and rating services. No funding difficulties are anticipated in the near or long-term future. Commercial paper ratings of A-1+ (Standard & Poor's) and P-1 (Moody's) have resulted in a low cost for short-term debt. The company has also maintained bank credit agreements which, although seldom used, are available to back the issuance of commercial paper. Management expects a very low level of short-term debt during most of 1988 with excess funds invested in short-term securities.

In recent years the company has used short-term debt and internal funds to finance construction and to fund external nuclear plant decommissioning trusts, as well as to retire common and preferred stocks and long-term debt. Internal funds exceeded construction and other capital expenditures during 1986 and 1987. During 1988, however, internal funds generation is expected to be lower than normal and therefore will not exceed increased construction expenditures. For the period 1989-1992 internal funds generation is expected to exceed construction and other capital expenditures. Another major power plant is not expected to be needed during the next 20 years.

The company received approval from the PSCW to refund certain long-term debt issues if interest rates were expected to be low enough to make the transactions economical. In 1986 and 1987, the company purchased in the open market and retired about $30 million of bonds of the 11.50% Series Due 2015. In late 1987, the company sold $45 million of bonds (9.50% Series Due 1994) to reduce short-term borrowing incurred for security repurchases, construction and nuclear decommissioning trusts. No additional financings are anticipated through 1992. Several contingencies could change this, including major federal acid rain legislation, the repurchase of additional company securities and changes in rate treatment.

Standard & Poor's Corporation has assigned a rating of AA+ to the company's first mortgage bonds. Moody's rating is Aaa. These excellent ratings are due in part to strong pretax interest coverage. This coverage was 5.1 times for the 12 months ended December 31, 1987. This favorable ratio resulted from moderate construction requirements, low allowance for funds used during construction (AFUDC), low embedded cost of debt, and strong equity ratios.

Common and preferred shareholders' equity was 62% of long-term capitalization at December 31, 1987. Company management has been taking action to stabilize the total equity ratio. Accordingly, the dividend reinvestment plan was discontinued in 1984. In 1985, the company conducted a program to purchase and retire common stock. Although there are currently no firm plans, the company may purchase and retire additional common stock in later years. The company has exercised its right to call, for sinking fund purposes, 10% of the original 10.50% preferred stock each year since 1984. In 1984, part of the 10.75% preferred stock series was purchased. The company called the remainder in 1986.

Recent rate decisions in each jurisdiction have resulted in decreases because of lower returns authorized on common equity, the new tax law, and changes in accounting practices.

These actions are having some adverse impact on revenues and financial strength. New tax laws have also had some negative impact on revenues, internal cash generation, and interest coverages due to elimination of investment tax credits, changes in depreciation and reduction of tax rates.

A July 1987 rate order from the PSCW imposed restrictions on additional investment in nonutility diversification based on common equity levels. In November, the company presented rate case testimony requesting more flexibility. A rate order was received in January 1988 which allows $2.9 million of investment in nonutility projects for the year 1988. Indications are that the PSCW may permit additional minor investments in existing nonutility operations in the next few years if it feels the utility's financial integrity permits. For more information on rate matters, see "Rate Proceedings" in the "Year in Review" section.

■ IMPACT OF INFLATION

Current financial statements are prepared in accordance with generally accepted accounting principles and report operating results in terms of historic cost. They provide a reasonable, objective, quantifiable statement of financial results but do not evaluate the impact of inflation. Under ratemaking prescribed by the commissions regulating the company, projected operating costs are recoverable in revenues. Because forecasts are prepared assuming inflation, the majority of inflationary effects on normal operating costs are recoverable in rates. However, the company is only allowed to recover the historical cost of plant via depreciation in these forecasts. Any effects of inflation on utility plant are generally offset by the holding gain resulting from the use of debt to finance utility construction.

EXECUTIVE OFFICE

700 North Adams Street, P.O. Box 19001, Green Bay, Wisconsin 54307. Telephone (414) 433-1598 for general information or (414) 433-1050 for shareholder information.

COMMON STOCK

Listed on New York and Midwest Stock Exchanges. Ticker Symbol: WPS. Transfer Agent and Registrar: First Wisconsin Trust Company, P.O. Box 2054, Milwaukee, Wisconsin 53201. As of December 31, 1987, there were 27,243 common stock shareholders of record.

ANNUAL SHAREHOLDERS' MEETING

Midway Motor Lodge, 780 Packer Drive, Green Bay, Wisconsin, Thursday, May 5, 1988 at 10:30 a.m.

ANNUAL SEC REPORT FORM 10-K

This report (not including exhibits thereto) will be available without charge about April 1, 1988 to shareholders who make requests to Robert H. Knuth, Secretary, 700 North Adams Street, P.O. Box 19001, Green Bay, Wisconsin 54307.

PREFERRED STOCK

Over-the-counter markets. Transfer Agent and Registrar: First Wisconsin Trust Company, Milwaukee.

WISCONSIN UTILITY INVESTORS

WUI is an independent, non-profit organization representing the collective voice of utility shareholders before regulators, legislators and the general public. WUI invites the participation of all utility investors. For information write: Wisconsin Utility Investors, Inc., 161 W. Wisconsin Avenue, Suite 6058, Milwaukee, Wisconsin 53203.

STATEMENTS OF INCOME

WISCONSIN PUBLIC SERVICE CORPORATION

	Years Ended December 31		
	1987	1986	1985
		(Thousands)	
Operating Revenues:			
Electric	$429,443	$410,514	$403,801
Gas	151,013	181,756	234,703
	580,456	592,270	638,504
Operating Expenses:			
Operation —			
Electric production fuels	132,430	132,028	125,179
Gas purchased for resale	109,447	141,656	190,195
Purchased power, net	19,109	9,015	10,070
Other	100,305	95,258	89,399
Maintenance	35,142	32,927	36,166
Depreciation —			
Straight-line provision	49,170	47,271	47,486
Additional depreciation	8,491	4,681	8,843
Taxes —			
Current federal income	28,604	31,825	32,198
Investment credit deferral, net	(4,040)	(2,122)	1,325
Current state income	6,603	5,958	6,696
Other	21,309	21,293	14,908
	506,570	519,790	562,465
Operating Income	73,886	72,480	76,039
Other Income and Deductions:			
AFUDC, other funds	456	595	717
Other, net	(2,815)	(306)	(80)
Income taxes	1,912	(182)	125
	(447)	107	762
Income Before Interest Expense	73,439	72,587	76,801
Interest Expense:			
Interest on long-term debt	18,309	19,914	16,834
AFUDC, borrowed funds	(275)	(277)	(350)
Other interest	2,634	1,409	2,902
	20,668	21,046	19,386
Net Income	52,771	51,541	57,415
Preferred Stock Dividend Requirements	3,751	4,392	5,519
Earnings On Common Stock	$ 49,020	$ 47,149	$ 51,896
Earnings Per Share On Common Stock*	$2.11	$2.03	$2.22
Dividends Per Share On Common Stock*	$1.52	$1.465	$1.355

*Adjusted to reflect 2 for 1 common stock split in June 1987.

The accompanying notes to financial statements are an integral part of these statements.

BALANCE SHEETS

WISCONSIN PUBLIC SERVICE CORPORATION

	December 31 1987	1986	1985
		(Thousands)	
Assets			
Utility Plant (at original cost):			
In service — Electric	$1,101,697	$1,072,214	$1,032,632
Gas	135,044	131,363	126,361
	1,236,741	1,203,577	1,158,993
Less — Accumulated provision for depreciation	635,454	591,727	544,319
	601,287	611,850	614,674
Nuclear decommissioning trusts, at cost	25,502	—	—
Construction in progress	10,776	4,379	6,590
Nuclear fuel	108,028	100,756	93,689
Less — Accumulated provision for amortization	89,142	80,976	73,832
	18,886	19,780	19,857
Net utility plant	656,451	636,009	641,121
Investments	20,367	19,573	13,464
Current Assets:			
Cash and special deposits	(9,174)	(1,339)	5,604
Customer and other receivables (net of uncollectible reserves)	54,882	51,754	57,505
Accrued utility revenues	27,225	27,425	33,177
Fossil fuel, at average cost	27,936	36,634	43,063
Materials and supplies, at average cost	12,210	11,692	12,444
Prepayments and other	17,591	15,864	15,218
Total current assets	130,670	142,030	167,011
Deferred Charges	17,141	16,415	13,875
	$ 824,629	$ 814,027	$ 835,471
Capitalization and Liabilities			
Capitalization:			
Common stock equity	$ 360,101	$ 346,445	$ 334,278
Preferred stock with no mandatory redemption	51,200	51,200	51,200
Preferred stock with mandatory redemption	3,645	5,144	20,147
Long-term debt	254,867	228,631	244,362
Total capitalization	669,813	631,420	649,987
Current Liabilities:			
Note payable	10,000	10,000	10,000
Commercial paper	3,000	23,400	18,995
Maturing first mortgage bonds, not to be refinanced	—	5,062	—
Accounts payable	49,640	44,577	52,898
Accrued taxes	(76)	5,826	6,105
Accrued interest	5,427	5,212	5,827
Accrued contributions to benefit plans	4,036	4,520	6,960
Other	2,480	3,475	3,586
Total current liabilities	74,507	102,072	104,371
Other Credits:			
Accumulated deferred investment credit	47,551	51,313	53,188
Other	32,758	29,222	27,925
	80,309	80,535	81,113
	$ 824,629	$ 814,027	$ 835,471

The accompanying notes to financial statements are an integral part of these balance sheets.

STATEMENTS OF CAPITALIZATION

WISCONSIN PUBLIC SERVICE CORPORATION

			December 31 1987	1986	1985
				(Thousands)	
COMMON STOCK EQUITY:					
Common stock, $4 par value, 32,000,000 shares authorized; 23,200,552 shares outstanding*			$ 92,802	$ 92,802	$ 92,802
Premium on capital stock			50,385	50,385	50,385
Retained earnings			216,914	203,258	191,091
Total common stock equity			360,101	346,445	334,278
PREFERRED STOCK:					
Cumulative, $100 par value, 1,000,000 shares authorized:					
With no mandatory redemption —	Series	Shares outstanding			
	5.00%	132,000	13,200	13,200	13,200
	5.04%	30,000	3,000	3,000	3,000
	5.08%	50,000	5,000	5,000	5,000
	6.76%	150,000	15,000	15,000	15,000
	7.72%	150,000	15,000	15,000	15,000
			51,200	51,200	51,200
With mandatory redemption —					
10.50% Series, 36,445, 51,445 and 66,468 shares outstanding, respectively			3,645	5,144	6,647
10.75% Series, 135,000 shares outstanding in 1985			—	—	13,500
			3,645	5,144	20,147
LONG-TERM DEBT:					
First mortgage bonds —	Series	Year due			
	4⅜%	1987	—	5,062	5,062
	4⅜%	1993	8,726	8,726	8,726
	4½%	1994	10,944	10,944	10,944
	9.50%	1994	45,000	—	—
	6⅜%	1997	23,482	23,482	23,482
	7¼%	1999	24,039	24,039	24,039
	8¼%	2001	25,000	25,000	25,000
	8⅛%	2003	25,000	25,000	25,000
	7⅞%	2005	11,000	11,000	11,000
	8.20%	2012	45,000	45,000	45,000
	9.70%	2014	22,000	22,000	22,000
	10⅛%	2014	1,000	1,000	1,000
	11.50%	2015	15,450	21,450	45,000
			256,641	222,703	246,253
Maturing first mortgage bonds			—	(5,062)	—
Unamortized discount and premium on bonds, net			(1,774)	(1,610)	(1,891)
Total first mortgage bonds			254,867	216,031	244,362
Other long-term debt			—	12,600	—
Total long-term debt			254,867	228,631	244,362
Total capitalization			$669,813	$631,420	$649,987

*Adjusted to reflect 2 for 1 common stock split in June 1987.

The accompanying notes to financial statements are an integral part of these statements.

STATEMENTS OF SOURCES OF CONSTRUCTION FUNDS

WISCONSIN PUBLIC SERVICE CORPORATION

	Years Ended December 31		
	1987	1986	1985
		(Thousands)	
Funds Generated Internally:			
Net income	$ 52,771	$ 51,541	$ 57,415
Depreciation	57,661	51,952	56,329
Amortization of nuclear fuel	8,392	8,436	9,679
Investment credit deferral, net	(4,040)	(2,122)	1,325
AFUDC	(731)	(872)	(1,067)
Other	11,035	6,000	9,382
Funds provided from operations	125,088	114,935	133,063
Less – Cash dividends on common and preferred stock	39,042	38,649	37,174
Net funds generated internally	86,046	76,286	95,889
External Funds:			
Sale of first mortgage bonds and other long-term debt	45,000	12,600	45,000
Redemption and maturities of first mortgage bonds and other long-term debt	(23,662)	(23,550)	(10,000)
Bond sinking fund retirements	—	—	(800)
Redemption of preferred stock	(1,500)	(15,003)	(1,537)
Repurchase of common stock	—	—	(7,572)
Net change in commercial paper	(20,400)	4,405	(7,475)
Total external funds	(562)	(21,548)	17,616
Changes In Net Current Assets:			
Cash and special deposits	7,835	6,943	(9,903)
Customer and other receivables	(3,128)	5,751	(1,661)
Accrued utility revenues	200	5,752	(3,757)
Fossil fuel	8,698	6,429	1,353
Prepayments and other	(1,727)	(646)	(13,907)
Accounts payable	5,063	(8,321)	(1,600)
Accrued taxes	(5,902)	(279)	1,727
Other, net	(4,008)	(2,266)	1,863
Total changes in net current assets	7,031	13,363	(25,885)
Changes In Other Assets:			
Decommissioning funding	(22,314)	(3,188)	—
Nuclear fuel disposal payment	—	—	(10,961)
Contract settlement	(1,994)	—	(16,218)
Other, net	(6,337)	(10,238)	(5,799)
Total changes in other assets	(30,645)	(13,426)	(32,978)
Total funds used for construction expenditures and nuclear fuel, excluding AFUDC	61,870	54,675	54,642
AFUDC	731	872	1,067
Total funds used for construction expenditures and nuclear fuel, including AFUDC	$ 62,601	$ 55,547	$ 55,709

The accompanying notes to financial statements are an integral part of these statements.

STATEMENTS OF RETAINED EARNINGS

WISCONSIN PUBLIC SERVICE CORPORATION

	Years Ended December 31		
	1987	1986	1985
		(Thousands)	
Balance at Beginning of Year	$203,258	$191,091	$175,686
Add — Net income	52,771	51,541	57,415
	256,029	242,632	233,101
Deduct —			
Cash dividends declared on preferred stock:			
5.00% Series ($5.00 per share)	660	660	660
5.04% Series ($5.04 per share)	151	151	151
5.08% Series ($5.08 per share)	254	254	254
6.76% Series ($6.76 per share)	1,014	1,014	1,014
7.72% Series ($7.72 per share)	1,158	1,158	1,158
10.50% Series ($10.50 per share)	540	698	858
10.75% Series ($10.75 per share)	—	725	1,451
Cash dividends declared on common stock	35,265	33,989	31,628
Premium paid for repurchase of common stock	—	—	4,836
Premium paid for repurchase of preferred stock	—	725	—
Other	73	—	—
	39,115	39,374	42,010
Balance at End of Year	$216,914	$203,258	$191,091

The accompanying notes to financial statements are an integral part of these statements.

AUDITORS' REPORT

To the Board of Directors and Shareholders, Wisconsin Public Service Corporation:

We have examined the balance sheets and statements of capitalization of WISCONSIN PUBLIC SERVICE CORPORATION (a Wisconsin corporation) as of December 31, 1987, 1986 and 1985, and the related statements of income, retained earnings and sources of construction funds for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Wisconsin Public Service Corporation as of December 31, 1987, 1986 and 1985, and the results of its operations and the sources of its construction funds for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

ARTHUR ANDERSEN & CO.

Milwaukee, Wisconsin,
January 28, 1988.

WISCONSIN PUBLIC SERVICE CORPORATION

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: The financial statements reflect the application of certain accounting policies which are described in this note.

(a) Jurisdictional Accounting — The company uses jurisdictional accounting which reflects the effects of the different ratemaking principles followed by the various jurisdictions regulating the company. These include the Public Service Commission of Wisconsin (PSCW), the Michigan Public Service Commission (MPSC) and the Federal Energy Regulatory Commission (FERC).

The retail portion of the business is regulated by the PSCW and MPSC which comprise approximately 87% and 2%, respectively, of the company's revenues. The FERC regulates the electric wholesale portion which is approximately 11% of the revenues.

(b) Utility Plant — Utility plant is stated at the original cost of construction, which includes an allowance for funds used during construction (AFUDC). All retail jurisdictional construction work in progress (CWIP) is subject to AFUDC using a rate based on the company's overall cost of capital (approximately 11%).

AFUDC is recorded on wholesale jurisdictional electric construction work in progress at debt and equity percentages specified in the FERC Uniform System of Accounts. For 1987, the rate was approximately 7%.

Substantially all of the company's utility plant is subject to a first mortgage lien.

(c) Property Additions, Maintenance and Retirements — The cost of renewals and betterments of units of property (as distinguished from minor items of property) is charged to utility plant accounts. The cost of units of property retired, sold or otherwise disposed of, plus removal costs, less salvage, is charged to accumulated provision for depreciation. No profit or loss is recognized in connection with ordinary retirements of property units. Maintenance and repair costs and replacement and renewal of items less than units of property are generally charged to operating expenses.

(d) Nuclear Fuel — The cost of nuclear fuel is being amortized to fuel expense based on the quantity of heat produced for the generation of electric energy by the Kewaunee plant. The tax effect of using a liberalized method of depreciating the fuel for income tax purposes is recorded as additional depreciation as discussed in Note 1(j). Amortization and additional depreciation are included in the accumulated provision for amortization of nuclear fuel. The costs amortized to fuel expense (which assume no salvage values for uranium or plutonium) include an amount for ultimate disposal which is being recovered through current rates. As required by the Nuclear Waste Policy Act of 1982, a contract with the Department of Energy (DOE) has been signed and quarterly payments are being made to the DOE for the fee related to generation. Interim storage space for spent nuclear fuel is provided at the Kewaunee plant, and expenses associated with this storage are recognized as current operating costs.

The company has a wholly-owned subsidiary which engages in various mining operations relating to procuring a reliable supply of uranium for the Kewaunee plant. The investment in this subsidiary is carried on the equity basis of accounting. The uranium obtained through this subsidiary is carried at cost, including the operation costs of the subsidiary.

	December 31		
	1987	1986	1985
		(Thousands)	
Accumulated amortization	$91,922	$85,182	$78,123
Accumulated additional depreciation	(2,780)	(4,206)	(4,291)
Accumulated provision for amortization of nuclear fuel	$89,142	$80,976	$73,832
Investment in subsidiary	$2,193	$2,096	$3,011

(e) Deferred Charges — In 1985, the company bought out of a partial requirements coal contract which had an unexpired term of 17 years. A payment was made in exchange for releases with all interested parties. In a related transaction, the mines, leases and certain equipment of the terminated contractor were purchased by another contractor with whom the company has contracted for a long-term coal supply. The company also agreed to indemnify the new contractor in certain respects for liabilities or costs that could result due to the condition of the assets. A $1,250,000 reserve was established for this indemnification. The total cost of the buy out and indemnification ($16,218,000) was recorded as a deferred charge net of tax.

As a result of a PSCW review during 1986 of the company's fuel procurement practices, an accounting directive was issued in January 1987 which required the company to charge to operating expense $4,546,000 of the deferred charge in December 1986 without recovery in rates. The directive also provided that the remaining amount of the deferred charge will be amortized as cost of service over two years concurrent with rate relief. In a rate order dated July 1987 the PSCW reaffirmed this recovery which began in July 1987. In 1987, the indemnification was settled for a one-time payment of $775,000 with a contingent payment of up to $450,000 which would be recoverable in rates.

The PSCW's review also indicated that in regard to existing fuel contracts, $2,131,500 of expense will be excluded from rate recovery for each of the calendar years 1987 and 1988.

(f) Revenue — The company accrues revenues related to electric and gas service through the end of the month.

Automatic fuel adjustment clauses are used for the FERC wholesale electric and MPSC retail electric portions of the company's business. The PSCW retail electric portion of the business uses a "cost variance range approach." This range is based on a specific estimated fuel cost for the upcoming year. If the company's actual fuel costs vary outside this range, a hearing may be held and a rate increase or decrease may result.

Some of the company's larger gas customers purchase gas directly from the pipeline supplier. This gas continues to be transported over the company's distribution facilities for which the company earns a transportation fee. This transport fee is designed to recover approximately the same profit margin as if the gas had been purchased and resold by the company; therefore, there is a minimal effect on net income. It is estimated that gas revenues are lower by approximately $59,000,000 in 1987, $33,000,000 in 1986 and $10,000,000 in 1985 because of such transportation gas.

(g) Employee Benefit Plans — The company has non-contributory retirement plans covering substantially all employees under which annual contributions are made to an irrevocable trust established to provide retired employees with a monthly payment if conditions relating to age and length of service have been met. It is the company's policy to fund retirement contributions to meet current costs of the plans as determined using the entry-age normal, frozen initial liability actuarial method. The unfunded prior service costs are amortized over approximately ten years. Funding is based on the amount deductible for tax purposes. Because the plans are fully funded, the 1987 tax deductible amount was lower than the last few years. The weighted average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 5½% in all years presented.

	1987	1986	1985
		(Thousands)	
Retirement Plans:			
Retirement plans funding (for the year)	$3,972	$4,446	$6,886
Capitalized retirement plan costs	(432)	(412)	(616)
Retirement plan costs expensed	$3,540	$4,034	$6,270
Actuarially computed value of vested benefits*	$119,055	$109,194	$98,667
Actuarially computed value of non-vested benefits*	$12,210	$11,079	$9,687
Net assets available for benefits*	$195,326	$170,013	$129,512

*As of January 1 of each year.

In December 1985, the Financial Accounting Standards Board issued Statement No. 87 (SFAS No. 87), Employers' Accounting for Pensions. The company adopted SFAS No. 87 in 1986. However, the PSCW requires the recognition of the funded amount for ratemaking. Therefore, retirement plans costs reflected in the financial statements are the funded amounts. SFAS No. 87 provides for the use of the projected unit credit actuarial cost method.

The following tables, in compliance with SFAS No. 87, disclose the plans' funded status and amounts using the provisions of that statement:

	As of December 31 (Thousands) 1987	1986
Vested benefit obligation	$ 90,435	$ 82,498
Non-vested benefit obligation	8,462	8,374
Total actuarial present value of accumulated benefit obligation	$ 98,897	$ 90,872
Projected benefit obligation for service rendered to date	$(128,835)	$(119,322)
Plan assets at fair value	199,760	190,879
Plan assets in excess of projected benefit obligation	$ 70,925	$ 71,557
Unrecognized net gain from past experience different from that assumed in the effects of changes in assumptions	(10,668)	(14,615)
Prior service cost not yet recognized	(161)	—
Unrecognized net asset at January 1, being recognized over 17 years	(51,171)	(54,635)
Prepaid retirement plan cost	$ 8,925	$ 2,307

The assumed rates for calculations under SFAS No. 87 used in the above table were:

	1987	1986
Expected long-term rate of return	7.00%	7.00%
Average rate for future salary increases	6.25%	7.00%
Discount rate to compute projected benefit obligation	8.50%	8.50%

The net retirement plan expense under SFAS No. 87 provisions includes the following components:

	1987 (Thousands)	1986
Service cost — benefits earned during the year	$ 3,440	$ 3,102
Interest cost on projected benefit obligation	10,020	9,291
Actual return on plan assets	(11,026)	(26,167)
Net amortization and deferral	(1,132)	11,467
Adjustment to funded amount	2,238	6,341
Net retirement plan expense	$ 3,540	$ 4,034

The company also has self-insured health care plans which provide medical and dental benefits to employees, retirees and their dependents. The health care expenses for active employees are expensed as incurred. Anticipated post-retirement medical benefits are funded to irrevocable trusts within the limits of the current deduction for tax purposes. The 1986 funded amounts reflect new limitations imposed by the Tax Reform Act of 1986. These funded amounts are recognized in the financial statements currently. The unfunded past service costs associated with post-retirement medical benefits are currently amortized over approximately 17½ years.

The company also has a survivor benefits plan for its employees and retirees. This plan includes a Survivor Income Benefits (SIB) Plan, which provides benefits to survivors of employees and retirees over a period of time, and a Group Life Insurance Plan for those not covered by SIB. The SIB benefits are paid partially through an insurance contract and partially from a trust. All of the Group Life Insurance benefits are paid through the insurance contract. The insurance contract which covers both plans provides that the company will reimburse the insurance company for all claims up to a specific threshold and an administrative fee. The company is funding expected SIB benefits to an irrevocable trust. This funded amount is recognized currently until 1987. Group Life Insurance costs other than those covered by the SIB plan were expensed as benefit claims were paid. Effective in 1987, the company began funding Group Life Insurance costs out of the trust. Because of the trust's current funded position, no provisions were made to it for 1987.

	1987	1986	1985
		(Thousands)	
Health Care Plans:			
Post-retirement medical plan funding	$3,143	$2,461	$4,559
Capitalized post-retirement medical costs	(341)	(225)	–
Post-retirement medical plan costs expensed	$2,802	$2,236	$4,559
Active employee health care costs	$4,002	$3,429	$2,744
Capitalized active employee health care costs	(374)	(290)	–
Active employee health care costs expensed	$3,628	$3,139	$2,744
Survivor Benefits:			
SIB plan funding and group life insurance expense	–	$1,234	$1,272
Capitalized SIB and group life insurance costs	–	(120)	–
SIB plan and group life insurance expensed	–	$1,114	$1,272
Number of active participants	2,336	2,305	2,271
Number of retired participants	558	545	528

(h) Investments — Included in investments are various immaterial subsidiaries and affiliates, all of which are accounted for using the equity method of accounting.

(i) Depreciation — The company reports depreciation expense on the income statement as a current cost of doing business to reflect an allocation for the use of property. Straight-line depreciation expense is reported in equal amounts over the estimated useful life of the property as approved by the PSCW. Based on an order of the PSCW, the company also reports the deferred taxes applicable to plant and nuclear fuel as additional depreciation expense. For a more complete explanation of additional depreciation, see Note 1(j).

The PSCW issued an accounting order in 1985 requiring an external fund for all prior and future expensed decommissioning costs. Through 1987, nuclear depreciation rates for the retail portion of the company business reflected a negative salvage factor to recover expected decommissioning costs resulting in an accumulated provision of $25,500,000 at December 31, 1987. Accumulated revenues from retail customers to cover future decommissioning costs were transferred to an external trust in July 1987 after receipt of a ruling from the IRS. Annual retail payments of approximately $2,659,000 are expected to be made to the trust through the year 2008. For the company's wholesale customers, the company agreed as part of the settlement of its 1987 rate filing to adopt an external funding method for decommissioning costs. Subject to a revised ruling from the IRS, the company will transfer to the trust the related accumulated decommissioning provision ($2,179,000 at December 31, 1987). The company's 41.2% ownership share of future decommissioning costs of the Kewaunee nuclear plant is estimated to be $171,460,000.

	1987	1986	1985
Composite depreciation rates (for the year)			
Electric	4.12%	4.09%	4.38%
Gas	4.80%	4.85%	4.19%
		(Thousands)	
Additional depreciation (benefit) expense (for the year)			
Federal	$9,007	$5,070	$9,538
State	$(516)	$(389)	$(695)
Accumulated additional depreciation (end of year)	$146,657	$139,591	$134,996

(j) Income Taxes — Depreciation expense used for federal and state income tax purposes is different from the amounts recorded on the books as straight-line depreciation. There are two major reasons for the differences. First, the period of time over which the taxing authorities allow the cost of assets to be depreciated is generally shorter than the lives used for straight-line depreciation purposes. Second, the IRS allows some of the depreciation the company would be entitled to in later years to be deducted earlier, a practice known as accelerated depreciation. The estimated changes in current federal income taxes paid as a result of these differences are recorded as additional depreciation. The deferral of additional depreciation and the related allocation of such tax benefits over plant life is referred to as normalization. Beginning in 1985, as a result of a PSCW order, the estimated reduction in state income taxes resulting from the utilization of accelerated depreciation for state income tax purposes is no longer being normalized for retail jurisdictional purposes. These benefits are now being flowed through to the current retail customers. The accumulated additional depreciation related to state income taxes as of December 31, 1984, which amounted to $8,155,000, is being amortized to income over 17 years for the retail jurisdiction.

Certain book-tax depreciation differences have not been normalized; the cumulative tax effect of such differences as of December 31, 1987 is $18,366,000. The ratemaking policies of the jurisdictions which regulate the company provide for recovery of the related future taxes that have not been normalized.

Prior to 1986, when plant was added, the IRS allowed a credit (known as investment tax credit) against income tax due for 10% of the cost of the asset. The company recognized the tax benefit from this credit over the life of the property involved through normalization. The Tax Reform Act of 1986 discontinued this provision effective with 1986 but allowed some transition rules. The impact of other changes due to the 1986 tax law has been fully recognized in the company's rate proceedings.

The effective income tax rates are computed by dividing total income tax expense, including net investment credit deferral and additional depreciation, by the sum of such expense and net income.

	1987		1986 (Thousands except for percentages)		1985	
	Amount	Rate	Amount	Rate	Amount	Rate
Statutory federal income tax	$36,162	40.0%	$42,350	46.0%	$48,922	46.0%
State income taxes and state additional depreciation, net	3,463	3.8	2,832	3.1	3,214	3.0
Investment credit restored	(3,093)	(3.4)	(3,483)	(3.8)	(3,323)	(3.1)
Other differences, net	1,214	1.3	(1,175)	(1.3)	124	.1
Effective income tax	$37,746	41.7%	$40,524	44.0%	$48,937	46.0%

In December 1987, the Financial Accounting Standards Board issued a new standard on accounting for income taxes which must be adopted by the company not later than January 1989. The company has not determined whether it will reflect the initial application of the standard as a cumulative effect in the year of adoption or as a restatement of prior year's financial statements.

This new standard requires adjustments of previously recorded deferred taxes to reflect income tax rate changes, recognition of previously unrecorded deferred taxes and reclassification of deferred taxes previously netted against certain assets and liabilities. Although the company has not yet determined the amounts of such adjustments, management believes that any additional assets and liabilities resulting from adoption of the standard will be offset by regulatory assets and liabilities representing the expected future rate treatment of these adjustments. As such, management does not expect the new standard to have a significant impact on future operations.

(k) Leases — Leases are not material in the aggregate.

(l) Earnings Per Share — Earnings per share on common stock are computed on the basis of the weighted average number of shares outstanding adjusted to reflect 2 for 1 common stock split in June 1987 (23,200,552, 23,200,552 and 23,347,514 shares for 1987, 1986 and 1985, respectively).

(2) JOINTLY-OWNED FACILITIES AND CONSTRUCTION COMMITMENTS:
Information with respect to the company's share of jointly-owned electric generating facilities in service at December 31, 1987 is as follows:

	Columbia Energy Center	Edgewater Unit No. 4 (Thousands except for percentages)	Kewaunee
Ownership	31.8%	31.8%	41.2%
Utility plant in service	$105,694	$17,586	$115,623
Accumulated provision for depreciation	$55,649	$10,081	$86,529

The company's share of direct expenses for these plants is included in the corresponding operating expenses in the income statements and the company supplies its own financing for all jointly-owned projects.

The company is not currently engaged in any major construction projects. Utility plant construction expenditures for 1988 are estimated to be approximately $73,236,000.

(3) OTHER DEBT AND LINES OF CREDIT: To support outstanding commercial paper, the company maintains unused bank lines of credit. Most of these lines of credit require payment of fees. Some lines of credit are supported by compensating balances. Many of these lines may be withdrawn at the discretion of the lenders. While certain cash balances represent compensating balances for credit lines and bank services, there are no legal restrictions as to withdrawal of these funds. The majority of the lines of credit require a fee based on the unused balance.

The following information relates to short-term borrowings and lines of credit for the years indicated:

	1987	1986	1985
	(Thousands except for percentages)		
As of end of year —			
Discount rate on outstanding commercial paper	7.9%	6.5%	7.9%
Interest rate on note payable	7.0%	6.0%	7.5%
Unused lines of credit	$50,365	$48,675	$49,365
Compensating balance requirements	$321	$418	$418
For the year —			
Maximum amount of borrowings	$51,500	$46,100	$52,000
Average amount of borrowings	$33,449	$19,195	$33,106
Weighted average interest rate on borrowings	6.8%	6.6%	8.1%

Included in the above lines of credit are agreements with commercial banks that permit the company to borrow up to $28,600,000 at any time provided compliance with certain financial covenants is maintained. These agreements extend for 13 months or more. As of December 31, 1987, no amounts were outstanding under these agreements.

(4) FIRST MORTGAGE BONDS: Sinking fund requirements on first mortgage bonds may be satisfied by the deposit of cash or reacquired bonds with the trustee and for certain series by the application of net expenditures for bondable property in an amount equal to 166⅔% of the annual requirements.

All series requiring cash or reacquired bonds for sinking funds purposes have been satisfied to maturity. The company has adequate unpledged property to satisfy the remaining series for at least ten years.

In 1986, the company repurchased $23,550,000 of its 11.50% Bonds Series Due 2015. Because of the significant cost to reacquire these bonds ($2,455,000 net of tax), the company received approval from the PSCW to defer and amortize these costs to expense over a ten-year period beginning July 1, 1987 and concurrent with recovery of these costs in rates. An additional $6,000,000 of these bonds were repurchased in 1987 and the costs associated with the repurchase ($369,000 net of tax) are also being deferred and amortized.

(5) PREFERRED STOCK: The 10.50% Series Preferred Stock has a mandatory 5% annual sinking fund requirement and an additional 5% is redeemable annually at the company's option at a price of $100 per share plus accrued dividends. In each of the years 1987, 1986 and 1985, the company redeemed 15,000 shares to meet the sinking fund requirements, as well as 23 shares in 1986 and 373 shares in 1985, to meet future sinking fund requirements.

(6) COMMON EQUITY: Shareholders authorized a 2 for 1 common stock split in May 1987. This action reduced the par value of common stock from $8 per share to $4 per share and increased the number of authorized common stock shares from 16,000,000 to 32,000,000.

In 1985, the company repurchased 443,860 shares of common stock (adjusted to reflect stock split) for $7,572,000. The stock was retired using the average issuance price method which reduces the common stock balance by the par value ($4 per share) and reduces premium on capital stock by the average premium ($2.17 per share). For the shares repurchased in 1985, this amounted to $1,776,000 and $960,000, respectively. The difference between the purchase price and the average price was charged to retained earnings as premium paid for repurchase of common stock. The company has no firm plans to repurchase any additional common stock.

In a rate order dated January 26, 1988, the PSCW authorized the company to invest up to $2,900,000 in nonutility operations during 1988 and stated that additional funds could be used for nonutility operations without prior PSCW approval as long as the company's common equity exceeds 50.8% of the company's total capitalization.

(7) COMMITMENTS AND CONTINGENT LIABILITIES:
To ensure a long-term, reliable, low-cost supply of coal for the jointly-owned Edgewater 4 unit, the company is a party to a coal contract that contains demand charges totalling approximately $36,000,000 for the company's share through 1994, of which approximately $9,000,000 has been paid to date. The company is required to pay these demand charges in future years, even if it is unable to fully utilize all contracted quantities of coal under future emission limits and acid rain legislation. In the opinion of management, any such costs incurred to meet mandatory emission limits would be considered a legitimate cost of service expense subject to recovery in rates.

(8) SEGMENTS OF BUSINESS:

The following table presents information for the respective years pertaining to the company's operations segmented by lines of business. The information does not represent ratemaking treatment since the company is regulated by three jurisdictions with differing ratemaking practices.

	1987			1986 (Thousands)			1985		
	Electric	Gas	Total	Electric	Gas	Total	Electric	Gas	Total
Operating revenues	$429,443	$151,013	$580,456	$410,514	$181,756	$592,270	$403,801	$234,703	$638,504
Operating expenses—									
Operation and maintenance	263,323	133,110	396,433	244,396	166,488	410,884	235,774	215,235	451,009
Straight-line depreciation	43,006	6,164	49,170	41,275	5,996	47,271	42,541	4,945	47,486
Other taxes	18,401	2,908	21,309	19,064	2,229	21,293	12,673	2,235	14,908
	324,730	142,182	466,912	304,735	174,713	479,448	290,988	222,415	513,403
Operating income before income taxes	104,713	8,831	113,544	105,779	7,043	112,822	112,813	12,288	125,101
Total AFUDC	704	27	731	848	24	872	1,036	31	1,067
Provisions for income tax (a)	36,851	2,807	39,658	38,067	2,275	40,342	44,208	4,854	49,062
Operating income including AFUDC	$ 68,566	$ 6,051	74,617	$ 68,560	$ 4,792	73,352	$ 69,641	$ 7,465	77,106
Other income, net			(903)			(488)			45
Interest expense			20,943			21,323			19,736
Net income			$ 52,771			$ 51,541			$ 57,415
Identifiable assets (b)	$702,601	$101,748	$804,349	$691,929	$102,474	$794,403	$701,938	$114,818	$816,756
Assets not allocated (c)			20,280			19,624			18,715
Total assets			$824,629			$814,027			$835,471
Construction and nuclear fuel expenditures including AFUDC	$ 55,536	$ 7,065	$ 62,601	$ 49,811	$ 5,736	$ 55,547	$ 48,689	$ 7,020	$ 55,709

(a) Income taxes include amounts recorded as additional depreciation representing the estimated changes in income taxes due to using liberalized depreciation for income tax purposes. See Note 1(j).

(b) At December 31 and net of the respective accumulated provisions for depreciation.

(c) Primarily includes cash, investments, nonutility property and other receivables.

(9) QUARTERLY FINANCIAL INFORMATION (Unaudited):

	Three Months Ended (Thousands except for per share data)			
	1987			
	Mar.	June	Sept.	Dec.
Operating revenues	$164,351	$127,655	$130,883	$157,567
Net income	$16,423	$9,898	$11,816	$14,634
Earnings on common stock	$15,479	$8,953	$10,872	$13,716
Average number of shares of common stock outstanding*	23,201	23,201	23,201	23,201
Earnings per average share on common stock*	$.67	$.39	$.47	$.58
	1986			
	Mar.	June	Sept.	Dec.
Operating revenues	$186,251	$127,720	$120,659	$157,640
Net income	$19,199	$8,066	$10,102	$14,174
Earnings on common stock	$17,853	$6,961	$9,118	$13,217
Average number of shares of common stock outstanding*	23,201	23,201	23,201	23,201
Earnings per average share on common stock*	$.77	$.30	$.39	$.57
	1985			
	Mar.	June	Sept.	Dec.
Operating revenues	$198,276	$139,117	$130,920	$170,191
Net income	$19,452	$11,657	$10,685	$15,621
Earnings on common stock	$18,065	$10,271	$9,299	$14,261
Average number of shares of common stock outstanding*	23,636	23,360	23,201	23,201
Earnings per average share on common stock*	$.76	$.44	$.40	$.62

Because of various factors which affect the utility business, the quarterly results of operations are not necessarily comparable.

*Adjusted to reflect 2 for 1 common stock split in June 1987.

WISCONSIN PUBLIC SERVICE CORPORATION

Statements Of Income (Thousands)

	1987	1986	1985	1984	1983	1982	1977
Operating Revenues:							
Electric	$429,443	$410,514	$403,801	$405,420	$389,197	$355,766	$200,023
Gas	151,013	181,756	234,703	238,771	240,694	228,681	98,106
	580,456	592,270	638,504	644,191	629,891	584,447	298,129
Operating Expenses:							
Operation —							
Electric production fuels	132,430	132,028	125,179	125,457	127,055	114,688	55,402
Gas purchased for resale	109,447	141,656	190,195	198,172	202,770	195,132	73,862
Purchased power, net	19,109	9,015	10,070	6,276	4,597	13,152	2,740
Other	100,305	95,258	89,399	83,404	78,859	69,160	33,427
Maintenance	35,142	32,927	36,166	34,634	32,112	30,755	16,728
Depreciation —							
Straight-line provision	49,170	47,271	47,486	45,634	41,873	38,138	23,569
Additional depreciation	8,491	4,681	8,843	7,933	17,322	6,090	6,737
Taxes —							
Current federal income	28,604	31,825	32,198	34,364	24,851	22,167	21,586
Net investment credit	(4,040)	(2,122)	1,325	2,966	501	2,947	3,231
Current state income	6,603	5,958	6,696	7,672	6,862	5,470	4,014
Other	21,309	21,293	14,908	20,313	18,569	17,144	13,308
	506,570	519,790	562,465	566,825	555,371	514,843	254,604
Operating Income	73,886	72,480	76,039	77,366	74,520	69,604	43,525
Other Income and Deductions:							
AFUDC, other funds*	456	595	717	—	—	—	440
Other, net	(2,815)	(306)	(275)	(2,405)	(665)	389	787
Income taxes	1,912	(182)	125	1,212	535	(195)	(356)
Gains on bonds reacquired	—	—	195	449	221	421	438
	(447)	107	762	(744)	91	615	1,309
Income Before Interest Expense	73,439	72,587	76,801	76,622	74,611	70,219	44,834
Interest Expense:							
Interest on long-term debt	18,309	19,914	16,834	16,205	19,517	22,418	14,484
AFUDC, borrowed funds*	(275)	(277)	(350)	(154)	(263)	(191)	(593)
Other interest	2,634	1,409	2,902	4,301	3,763	6,085	207
	20,668	21,046	19,386	20,352	23,017	28,312	14,098
Net Income	52,771	51,541	57,415	56,270	51,594	41,907	30,736
Preferred Stock Dividend Requirements	3,751	4,392	5,519	5,789	5,974	6,036	4,812
Earnings On Common Stock	$ 49,020	$ 47,149	$ 51,896	$ 50,481	$ 45,620	$ 35,871	$ 25,924
Income Statlstics							
Common Stock:							
Shares outstanding, Dec. 31**	23,200,552	23,200,552	23,200,552	23,644,412	23,644,412	23,272,170	21,554,856
Shares outstanding, Avg.**	23,200,552	23,200,552	23,347,514	23,644,412	23,454,062	22,838,538	21,520,732
Earnings per share† **	$2.11	$2.03	$2.22	$2.14	$1.95	$1.57	$1.21
Dividends paid per share**	$1.52	$1.465	$1.355	$1.22	$1.11	$1.02	$.75
Times Interest Earned:							
Before income taxes	5.13	5.17	6.12	6.27	5.32	3.76	5.51
After income taxes	3.41	3.34	3.77	3.74	3.22	2.47	3.09
Times Interest and Preferred Dividends Earned	2.91	2.78	2.97	2.92	2.56	2.04	2.33

*AFUDC is split between debt and equity portions beginning in 1977.
**Adjusted to reflect 2 for 1 common stock split in June 1987.
†Based on weighted average shares outstanding.

WISCONSIN PUBLIC SERVICE CORPORATION

Balance Sheets (Thousands)

	1987	1986	1985	1984	1983	1982	1977
Assets							
Utility Plant:							
Electric	$1,111,987	$1,076,400	$1,038,867	$1,000,596	$ 963,787	$ 933,052	$578,347
Gas	135,530	131,556	126,716	122,742	117,309	113,143	94,905
	1,247,517	1,207,956	1,165,583	1,123,338	1,081,096	1,046,195	673,252
Less - accumulated depreciation	635,454	591,727	544,319	494,931	445,823	395,438	226,699
	612,063	616,229	621,264	628,407	635,273	650,757	446,553
Nuclear decommissioning trusts, at cost	25,502	—	—	—	—	—	—
Nuclear fuel, net	18,886	19,780	19,857	12,805	10,694	18,115	14,048
Net utility plant	656,451	636,009	641,121	641,212	645,967	668,872	460,601
Investments	20,367	19,573	13,464	10,012	10,290	13,056	10,609
Current assets	130,670	142,030	167,011	137,905	131,776	126,068	67,913
Deferred charges	17,141	16,415	13,875	4,167	4,587	6,497	8,469
Total assets	$ 824,629	$ 814,027	$ 835,471	$ 793,296	$ 792,620	$ 814,493	$547,592
Capitalization and Liabilities							
Common stock and premium	$ 143,187	$ 143,187	$ 143,187	$ 145,923	$ 145,909	$ 141,268	$125,134
Retained earnings	216,914	203,258	191,091	175,686	154,184	134,767	71,450
Preferred stock with no mandatory redemption	51,200	51,200	51,200	51,200	51,200	51,200	51,200
Preferred stock with mandatory redemption	3,645	5,144	20,147	21,684	24,750	25,500	15,000
Long-term debt	254,867	228,631	244,362	210,481	222,092	231,601	197,765
Total capitalization	669,813	631,420	649,987	604,974	598,135	584,336	460,549
Short-term borrowings	13,000	33,400	28,995	36,470	39,500	46,000	8,800
Bond sinking fund requirements and maturing first mortgage bonds	—	5,062	—	—	9,125	40,000	2,310
Other liabilities and credits	141,816	144,145	156,489	151,852	145,860	144,157	75,933
Total capitalization and liabilities	$ 824,629	$ 814,027	$ 835,471	$ 793,296	$ 792,620	$ 814,493	$547,592

	1987	1986	1985	1984	1983	1982	1977
Book Value Per Share, Dec. 31*	$15.52	$14.94	$14.41	$13.60	$12.69	$11.86	$9.12
Return On Average Equity	14.0%	13.9%	15.9%	16.2%	15.9%	13.9%	13.8%
Capitalization Ratios							
Common stock and premium	21.4	22.7	22.0	24.1	24.4	24.2	27.2
Retained earnings	32.4	32.2	29.4	29.0	25.8	23.1	15.5
Preferred stock	8.1	8.9	11.0	12.1	12.7	13.1	14.4
Long-term debt	38.1	36.2	37.6	34.8	37.1	39.6	42.9
Percent Long-Term Debt to Net Utility Plant	38.8	35.9	39.3	32.8	34.4	34.6	42.9
Average Bond Rate	8.2	7.9	8.3	7.6	7.2	7.7	6.9
Average Preferred Stock Rate	6.6	6.7	7.5	7.6	7.8	7.8	7.3
Shareholders — Common stock	27,243	27,240	29,687	31,440	33,857	34,803	38,949
Preferred stock	5,402	5,756	6,219	6,553	6,885	7,267	9,002
Number of Employees, Dec. 31	2,495	2,497	2,485	2,390	2,267	2,204	1,801

*Adjusted to reflect 2 for 1 common stock split in June 1987.

WISCONSIN PUBLIC SERVICE CORPORATION

Electric Operations	1987	1986	1985	1984	1983	1982	1977
Operating Revenues (Thousands):							
Residential	$139,940	$138,365	$137,503	$135,833	$132,810	$121,548	$ 69,994
Commercial and industrial	223,133	212,180	207,772	209,468	201,037	179,857	102,256
All other	66,370	59,969	58,527	60,119	55,350	54,361	27,773
Total electric revenues	$429,443	$410,514	$403,802	$405,420	$389,197	$355,766	$200,023
Kwh Sales (Thousands)	8,351,062	7,772,905	7,445,019	7,469,964	7,113,304	6,809,880	5,833,370
Number of Customers, Dec. 31:							
Residential	281,111	276,407	271,407	267,461	263,362	259,769	235,400
Commercial and industrial	31,262	30,673	30,185	29,702	29,228	28,172	24,907
All other	485	479	478	475	450	1,029	936
Total electric customers	312,858	307,559	302,070	297,638	293,040	288,970	261,243
Annual Average Use (Kwh):							
Residential	7,294	7,340	7,288	7,269	7,219	7,069	6,989
Commercial and industrial	148,158	141,793	136,764	138,244	133,442	129,755	130,943
Average Kwh Price (Cents):							
Residential	6.89	6.89	7.01	7.05	7.04	6.66	4.33
Commercial and industrial	4.88	4.93	5.08	5.14	5.19	4.95	3.16
Production Data:							
System Capacity (Kw):							
Steam	1,269,240	1,269,240	1,269,240	1,269,240	1,269,240	1,269,240	837,440
Nuclear	221,000	221,000	221,000	221,000	221,000	221,000	221,000
Hydraulic	64,236	64,236	64,236	64,236	62,156	62,156	62,156
Combustion turbine	156,200	156,200	156,200	156,200	156,200	156,200	156,200
Other	4,040	4,040	4,040	4,040	4,000	4,000	4,000
Total	1,714,716	1,714,716	1,714,716	1,714,716	1,712,596	1,712,596	1,280,796
Interest in Wisconsin River Power Company	11,667	11,667	11,667	11,667	11,667	11,667	11,667
Total system capacity	1,726,383	1,726,383	1,726,383	1,726,383	1,724,263	1,724,263	1,292,463
Generation and Purchases (Thousands of Kwh):							
Steam	6,091,075	5,916,885	5,448,302	5,443,590	5,246,683	4,685,171	4,164,132
Nuclear	1,651,626	1,588,287	1,523,780	1,569,519	1,527,660	1,577,139	1,462,607
Hydraulic	206,397	340,488	352,000	307,911	348,813	319,895	227,676
Purchases	993,319	459,468	691,002	649,557	534,262	776,803	400,690
Total	8,942,417	8,305,128	8,015,084	7,970,577	7,657,418	7,359,008	6,255,105
System peak – firm (Kw)	1,381,300	1,292,600	1,219,700	1,202,900	1,166,000	1,101,000	1,007,000
Annual load factor	72.72%	71.93%	74.03%	73.57%	72.67%	74.90%	65.86%
Gas Operations							
Operating Revenues (Thousands):							
Residential	$ 84,528	$ 91,513	$100,078	$ 97,114	$ 97,053	$ 89,908	$ 40,685
Commercial and industrial	54,160	82,755	130,642	139,662	141,314	136,445	56,709
All other	12,324	7,488	3,983	1,995	2,327	2,328	712
Total gas revenues	$151,012	$181,756	$234,703	$238,771	$240,694	$228,681	$ 98,106
Therm Sales (Thousands)	272,939	351,014	451,419	470,912	460,488	482,490	484,963
Transportation (Therms-Thousands)	178,754	99,407	28,730	—	—	—	—
Total gas volume	451,693	450,421	480,149	470,912	460,488	482,490	484,963
Number of Customers, Dec. 31:							
Space heating	158,229	154,672	150,833	147,646	144,332	142,440	123,402
All other	7,949	8,241	8,788	9,376	10,423	10,701	15,743
Total gas customers	166,178	162,913	159,621	157,022	154,755	153,141	139,145

DIRECTORS

Paul D. Ziemer
Chairman of the Board

Linus M. Stoll
President and Chief Executive Officer of the Company

A. Dean Arganbright
President, Wisconsin National Life Insurance Company, Oshkosh, WI

Michael S. Ariens
President and Chief Executive Officer, Ariens Company, Brillion, WI

William V. Arvold
Retired President, Wausau Paper Mills Company, Brokaw, WI

Richard A. Bemis
President, Bemis Manufacturing Company, Sheboygan, WI

Kathryn M. Hasselblad-Pascale
Partner and General Manager, Hasselblad Machine Company, Green Bay, WI

James H. Liethen
Senior Vice President of the Company

Eugene R. Mathews
Senior Vice President of the Company

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Senior Vice President, Corporate Services

James H. Liethen*
Senior Vice President, Finance

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