1994 Annual Report

Madison Gas and Electric Company

Setting the **P a c e**

Madison Gas and Electric Company

- Produced record earnings in 1994.
- Ranks high for business position and financial strength.
- Provides low-cost, reliable power.
- Drives a strong, local economy.
- Opened a new Crawford County Gas Division.
- Aggressively pursues new energy businesses.

MGE is an investor-owned public utility headquartered in Madison, Wis. with assets of $1/2 billion and annual revenues of $245 million. The company generates, transmits and distributes electricity to nearly 119,000 customers in a 250-square-mile area of Dane County. MGE transports and distributes natural gas to more than 100,000 customers in 1,325 square miles of service areas in seven counties.

CENTRAL WISCONSIN DEVELOPMENT CORP.

Central Wisconsin Development Corporation provides economic development assistance and financing to new expanding businesses in MGE's service area.

SUPERIOR Lamp Recycling, Inc.

Superior Lamp Recycling, Inc. is an award-winning company that recycles fluorescent bulbs.

American Energy Management Inc.

American Energy Management, Inc. markets energy services to small and medium size customers in 10 states. It is poised for major growth.

A Value-Added Energy Company

GLENCO

Great Lakes Energy Corp.

Great Lakes Energy Corp. delivers low-cost, reliable energy products to large customers, tailors service to their needs and offers consulting to help cut costs.

Viroqua Gas Company

A Division of Madison Gas and Electric

Viroqua Gas Company completed an ambitious expansion project that helped double growth in southwest Wisconsin.

Elroy Gas Company

A Division of Madison Gas and Electric

Elroy Gas Company expanded service to two more communities. MGE acquired the Elroy Gas Company and the Viroqua Gas Company in 1993.

MGE®

Contents

Cover photo: *Roy Vieth (left), pipefitter and repairman, MGE; John Blackmon (right), lineman, MGE.*

results

Year at a Glance

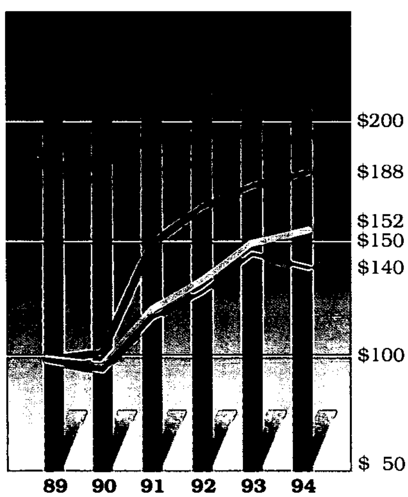
	1994	1993	Percent increase (decrease) 1994-1993
(Per Common Share)			
Earnings	**$ 2.29**	$ 2.26	1.3%
Dividends	**$ 1.87**	$ 1.84	1.6
Stock price closing	**$ 32½**	$ 33¾	(3.7)
Book value – year end	**$ 17.68**	$ 17.26	2.4
Return on common equity	**13.04%**	13.20%	(1.2)
(Thousands of dollars)			
Operating revenues	**$ 244,972**	$ 244,133	0.3
Earnings on common stock	**$ 24,540**	$ 24,186	1.5
Total assets – year end	**$ 487,759**	$ 465,364	4.8
Electric sales to consumers (mwh)	**2,519,000**	2,423,000	4.0
Peak electric demand (kw)	**551,000**	541,000	1.8
Electric customers – year end	**118,693**	117,043	1.4
Gas deliveries (therms)	**207,230,000**	194,928,000	6.3
Gas customers – year end	**100,128**	97,080	3.1
Employees	**683**	721	(5.3)

MGE Performance. These graphs illustrate our strong financial performance with a five year cumulative total return comparison* and market to book comparison.

*The Peer Group selected by the Company is composed of 19 Upper Midwest combination utilities. The companies included in the Peer Group are as follows:

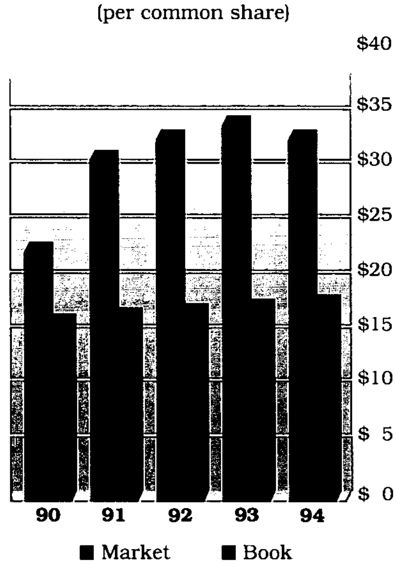
Cilcorp Inc.
Cinergy Corp.
Cipsco Inc.
CMS Energy Corp.
DPL Inc.
IES Industries Inc.
Illinova Corp.
Interstate Power Co.
Iowa-Illinois Gas & Elec.
Midwest Resources
Minnesota Power & Light
Nipsco Industries Inc.
Northern States Power-MN
Southern Indiana Gas & Elec.
St. Joseph Light & Power
Utilicorp United Inc.
Wisconsin Energy Corp.
WPL Holdings Inc.
WPS Resources Corp.

5 Year Cumulative Returns*



Assumes $100 invested on Dec. 31, 1989, in each of the Company's Common Stock, S&P 500, and the Peer Group
*Total return assumes reinvestment of dividends

Market vs. Book
(per common share)



MGE

to our

MGE sets the pace.

In 1994, we set new record earnings, substantially expanded our unregulated business, negotiated the purchase of a national energy marketing firm, nearly doubled natural gas customers in southwestern Wisconsin and took a major step toward competitive, market-based prices for electricity.

Aggressive business planning and cost-saving measures have resulted in four consecutive years of the highest earnings in MGE's history.

Record Earnings. 1994 earnings reached an all-time high of $2.29 per share, compared to $2.26 per share in 1993. MGE's previous record of $2.28 per share was set in 1991.

We have achieved outstanding financial results while voluntarily reducing or freezing electric and natural gas rates. That trend will continue in 1995 as we set the pace for competition.

MGE's request to reduce electric rates by $5.1 million and freeze natural gas rates was approved by the Public Service Commission of Wisconsin (PSCW). In 1995, our electric rates will drop to 1984 levels.

Firm Stock Price. The price of MGE common stock held firm during 1994, while the Dow Jones Utilities Average plunged to a six-year low in June. Our stock closed at $32.50 on Dec. 31.

MGE stock has been trading at nearly twice book value. National studies have cited MGE's market-to-book value as one of the best in the nation among combination utilities.

Dividend Growth. Your board of directors increased the quarterly dividend paid on common stock to 47 cents per share effective Sept. 1, 1994. The new annual rate is $1.88 per share compared to $1.86 previously.

MGE was named a Dividend Champion by *Equities* magazine for increasing cash dividends each year for at least 10 years. Only 92 of the 3,500 firms traded on the Nasdaq national stock market qualified for this list. MGE has increased dividends annually for the past 14 years and paid cash dividends each year since 1909.

Total Return. The total return on your investment, which includes MGE dividends and stock price appreciation, has outperformed other utilities over the past five years.

MGE's five-year compounded total return of 13.25% is significantly higher than all other Wisconsin utilities and more than double the Edison Electric Institute Index of 6.5% for 42 combination gas and electric utilities.

Unregulated Business. The rapid growth of Great Lakes Energy Corp. (GLENCO) exceeded expectations for its first year of operation. GLENCO contributed four cents to earnings per share in 1994, achieving projections for its fourth year in business.

Our management team negotiated the purchase of American Energy Management, Inc. (AEM), a national energy marketing firm located in the Chicago area. The transaction closed on Jan. 3, 1995. AEM will operate as a subsidiary of GLENCO.

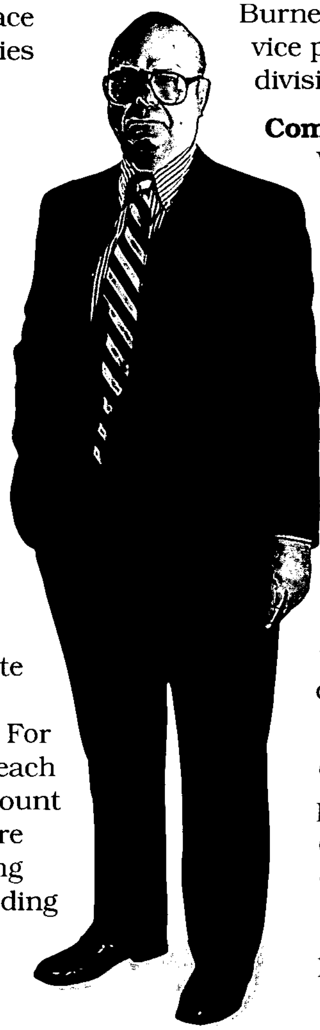
AEM provides gas marketing, energy management, auditing and conservation services to customers in 10 states. AEM serves small- to medium-sized companies, a market that offers significant potential for future growth.

Electrie Competition. We submitted position papers to the PSCW last fall regarding the future of the electric industry. MGE favors competition wherever it benefits customers and shareholders. We believe the transition to a more competitive marketplace should ensure equal opportunities for everyone.

The PSCW plans to issue policy guidelines in 1995 that will set the stage for restructuring the industry. We believe generation will be the first area opened for more competition.

MGE is the first utility in Wisconsin and one of the first in the nation to have an approved rate that separates generating costs from distribution and transmission. Our costs are very competitive with other utilities in the region.

Plant Performance. MGE cut generation costs last year in spite of market conditions that could have easily increased expenses. For example, the cost of producing each kilowatt-hour of electricity at Blount Generating Station dropped more than 45%. Aggressive purchasing strategies and creative fuel blending reduced costs while generation increased nearly 225%.



Eleetric Territory. MGE's bid for the Elroy Municipal Electric Utility won approval from the Elroy City Council. Area residents will vote on selling the utility in a public referendum in 1995. The PSCW will have final authority over the sale.

New Officers. The board of directors elected two new officers: Deborah Burgess, assistant vice president - gas rates and fuels and Lynn Hobbie, assistant vice president - marketing. Burnett Adams was also elected vice president - procurement and division operations.

Competitive Strength. We are proud of our outstanding performance. We are achieving goals to expand operations, serve customers, sell energy services and perform at superior levels.

MGE is a national leader. We are setting the pace for competition. We seize opportunities to grow earnings and produce results that reward our loyal investors.

Thank you for your confidence and support.

David C. Mebane

David C. Mebane
Chairman, President, and
Chief Executive Officer

February 10, 1995

More than 400,000 feet of natural gas main was installed in three counties to expand service to 1,100 new customers. An outstanding marketing blitz in eight communities signed up 90% of the customers eligible for service.

Photo: *Brad Gordon, welder, InterCon Construction.*

setting the pace in expanding

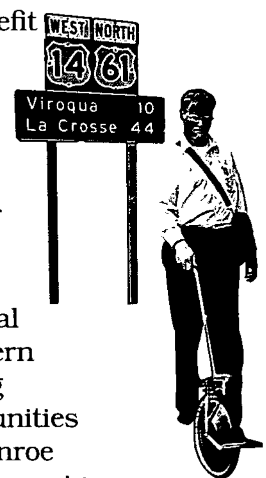
expand

Unregulated Activity. Great Lakes Energy Corp. (GLENCO) is a leader in marketing energy services outside MGE's franchised territory. This MGE subsidiary provides fuel and energy services to more than 30 facilities in Wisconsin. It is expanding throughout the Upper Midwest.

GLENCO's first-year performance exceeded expectations. 1994 results equaled GLENCO's fourth-year projections. The combined operations of MGE and GLENCO also reduced the cost of the company's pipeline contracts by more than 13%.

National Expansion. MGE purchased a Chicago-based energy marketing firm to accelerate growth into national markets. American Energy Management, Inc. (AEM) provides gas marketing, energy management, auditing and conservation services to more than 3,000 facilities in 10 states. AEM will operate as a subsidiary of GLENCO.

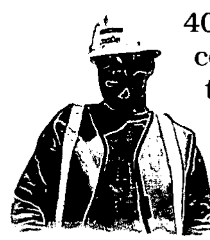
AEM offers the benefits of open access gas supplies to small- and medium-sized customers. The combined gas volume of MGE, GLENCO and AEM will nearly triple gas purchases in 1995. All customers will benefit from greater purchasing and negotiating power.



AEM will promptly expand services into new areas as electric deregulation unfolds.

Natural Gas Territory. An aggressive expansion project nearly doubled MGE's natural gas customers in southwestern Wisconsin. MGE's marketing team blanketed eight communities in Crawford, Vernon and Monroe counties in a door-to-door campaign that signed up 1,100 new customers. The outstanding marketing effort helped MGE achieve its five-year goal for customers in the very first year.

MGE employees and contract crews worked diligently to install more than 400,000 feet of gas main and connect new customers before the winter heating season. MGE's gas customers in southwestern Wisconsin add about $3.4 million to revenues each year.

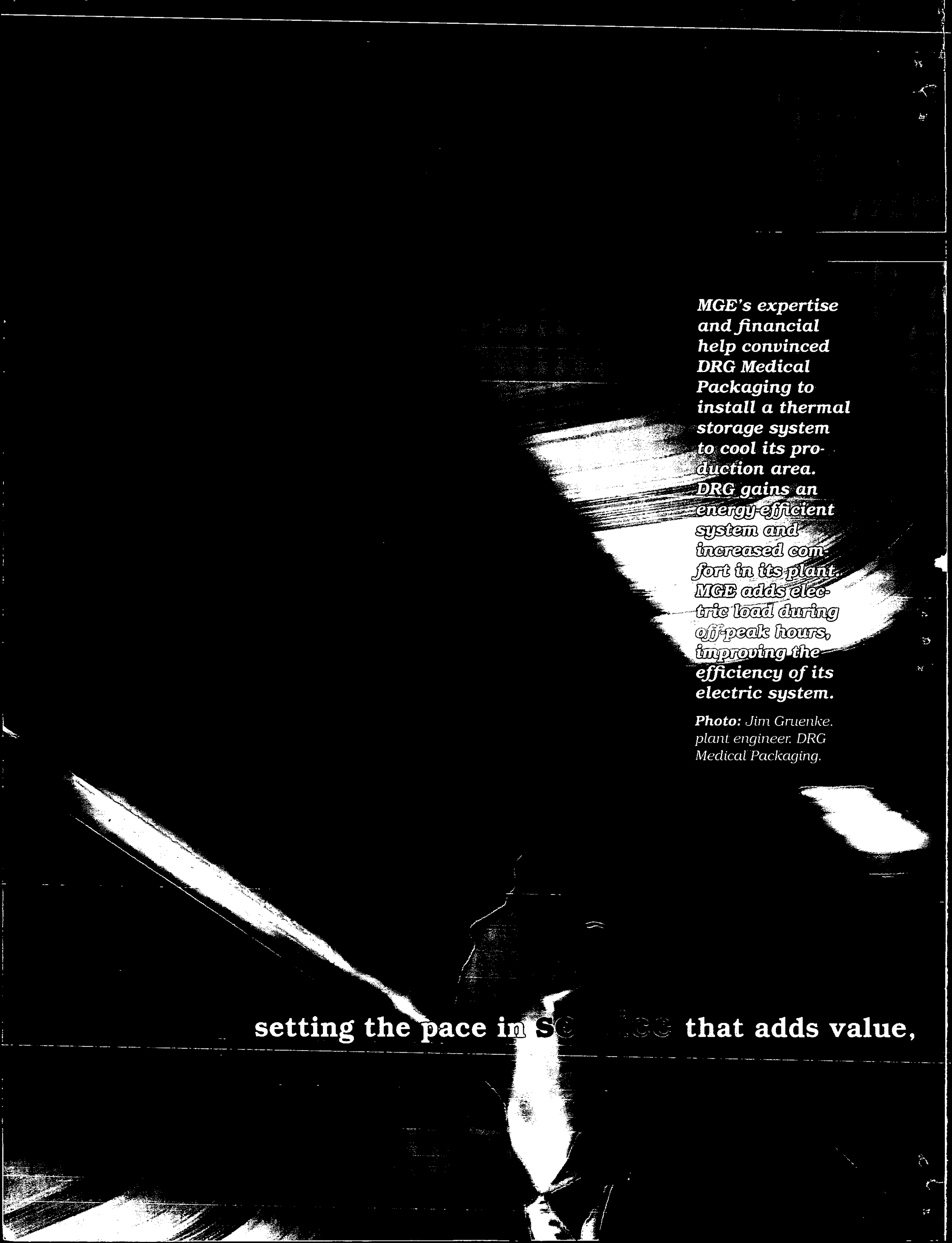


Electric Utility. MGE's competitive bid for the Elroy Municipal Electric Utility won approval from the Elroy City Council in 1994. If final approvals are received, MGE will add about 825 electric customers and $850,000 in annual revenues.

utility territory and unregulated business activities

Above: *Steve Krause, plant engineer, Mirro Company, a GLENCO customer located in Manitowoc, Wis., and Valerie Frey, assistant vice president of gas marketing, GLENCO.*

Above: *Steve Dykstra (top), MGE coordinator of sales and marketing, and Dennis Thompson, MGE inspector, for Crawford County gas expansion project.*



MGE's expertise and financial help convinced DRG Medical Packaging to install a thermal storage system to cool its production area. DRG gains an energy-efficient system and increased comfort in its plant. MGE adds electric load during off-peak hours, improving the efficiency of its electric system.

Photo: *Jim Gruenke, plant engineer, DRG Medical Packaging.*

setting the pace in service that adds value,

Customized Services. MGE is a valuable partner. The company assesses customers' needs and responds with tailor-made services that save money, improve efficiency and add value.

MGE's energy expertise and financial incentive helped DRG Medical Packaging, Madison, install a large thermal storage system that is environmentally safe and energy-efficient. The new unit adds sales for MGE during off-peak hours, better using its existing generating capacity.

More than 130 companies are leasing $1.5 million in equipment from MGE. Leasing makes it possible for many businesses to install new equipment that will improve efficiency.

The shared savings program offers another cost-effective way for firms to improve operations. MGE has invested more than $1.1 million in energy-efficient projects for about a dozen companies. Customers repay MGE based on their monthly energy savings.

Computerized Maps. MGE is the first utility in the nation to computerize detailed maps for gas and electric service right up to a customer's meter. MGE employees use laptop computers in the field to locate and mark underground services. Thc portable computers have improved efficiency and accuracy. The company no longer prints 300 maps every day to meet customers' requests.

Efficient Response. MGE is finding more efficient ways to serve customers.

A new centralized computer system provides MGE dispatchers with detailed customer information based on a phone number. MGE can respond more quickly to customers' requests and better coordinate projects for the same location.

The company also works with customers up to one month in advance to schedule the installation of new gas and electric services. Customers can pick a time that fits their schedule.

Customer Council. MGE knows the best way to serve customers is to listen to them. The Major Customer Council, which includes decision-makers from its 30 largest customers, meets quarterly at area businesses. MGE shares its expertise and listens to customers. With their input, MGE develops creative ways to help solve problems and define value on customers' terms.

Above: *Tim Welsch, field technician, MGE.*

Above: *Leslie Paynter, dispatcher, MGE.*

MGE worked with the village of Mazomanie to provide electric service to Sunny Industries, a new $40-million printing plant. The company is also expected to be one of MGE's top 10 gas customers.

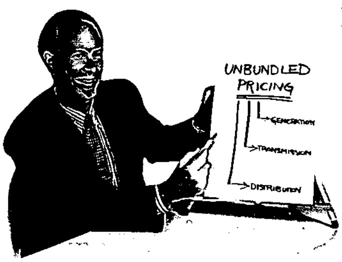
Photo: *Donald Bell, lineman, MGE.*

setting the pace in new services

sell

New Pricing. MGE is well-positioned to sell electric services in the future.

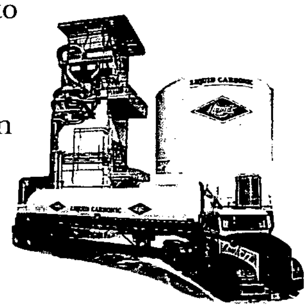
The electric industry is on the verge of major regulatory changes. The Public Service Commission of Wisconsin will announce its policy in 1995 for guiding the transition of electric utilities into a market-driven industry. Generation will likely be the first area targeted for increased competition.



MGE is the first utility in Wisconsin and one of the first in the nation to separate electric generation costs from its transmission and distribution costs. MGE will lead the way in showing customers that its costs are very competitive with other utilities in the Midwest.

Promoting Growth. MGE sells the benefits of its territory to promote business growth. It serves the fastest-growing area in the state of Wisconsin. More than $1 billion has been invested in commercial and industrial projects in the past five years.

A $67 million convention center is being built in downtown Madison. The new center, based on a Frank Lloyd Wright design, will attract more national attention to the area.



Liquid Carbonic built a $28 million air separation plant in Madison last year. Electricity started flowing to the plant in July. Liquid Carbonic is MGE's second largest electric customer.

MGE's ability to meet a tight deadline for electric facilities helped the village of Mazomanie attract a new $40 million printing plant. Sunny Industries will create up to 125 jobs. Based on projections, the company also will rank among MGE's top 10 gas customers.

"For sale" signs went up on more than 300 acres of land MGE owns but doesn't currently need for utility expansion. Selling this land will create new opportunities for high-quality development in MGE's territory. Business growth and expansion will lead to more gas and electric sales.

Growing Sales Force. An employee team is spearheading an initiative called the "700 Marketers." Its goal is to motivate each employee to see the company through customers' eyes. Employees will discuss and address customers' concerns – and find new opportunities to sell MGE's services.

beyond traditional boundaries to increase revenues

Above: *Greg Bollom, director - market planning and electric pricing, MGE.*

Above: *Liquid Carbonic's new facility in Madison.*

MGE burned more than 4,200 tons of alternate fuels at Blount Generating Station in 1994. Burning a blend of coal, natural gas and waste products cuts fuel costs, reduces emissions, and prevents waste from going to a landfill.

Photo: *Rick Volk, assistant boiler operator, MGE.*

setting the pace in performance

perform

Generating Costs. MGE is an excellent performer. It anticipates market conditions, makes decisions and takes action.

MGE's innovative approach to blending fuels at Blount Generating Station in Madison has lowered costs. The Blount team cut the cost of producing each kilowatt-hour of electricity nearly in half while increasing generation about 225% compared to the previous year.

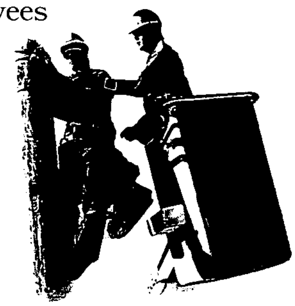
Burning a blend of alternate fuels, natural gas and coal has also helped MGE reduce emissions at Blount with no significant capital investment.

MGE's jointly owned power plants also improved performance in 1994. Production costs were down about 10% at the Kewaunee Nuclear Power Plant and about 4% at the Columbia Energy Center.

The combined savings from all plants resulted in a credit of $300,000 for MGE's electric customers in the last four months of 1994.

Fuel costs will continue to go down in the future. New coal contracts and freight tariffs will save MGE nearly $3 million dollars each year for the next five years.

Training. A new training facility in Madison gives employees fleld experience in a controlled setting. MGE's new program offers first-class training to help employees perform their work more safely and efficiently every day.



Competitive Advantage. MGE's solid performance has received national recognition.

- MGE is one of only 21 utilities in the nation with an above-average business position, based on Standard & Poor's comparison of 124 electric utilities.
- A.G. Edwards and Sons ranked MGE number one for competitive position in its Midwestern utility network in 1994.
- Edward D. Jones and Co. and Kidder Peabody and Co. have ranked MGE's market-to-book value among the top three combination utilities in the country.

MGE's performance reflects its ability to operate efficiently, cut costs and maintain a strong bottom line. These high standards are setting the pace in a competitive industry.

that improves efficiency and enhances MGE earnings

Above: *Wendell Rockwell, turbine operator, MGE.*

Above: *MGE linemen Matthew Van Beek (left) and Leonard Moe.*

Management's Discussion and Analysis of Financial Condition and Operations

Results of Operations

Earnings Overview

In 1994, earnings per share of Madison Gas and Electric Company's (the Company) common stock were $2.29, an increase of 1.3 percent compared to the $2.26 earned in 1993. The colder weather conditions during the first quarter of 1994 contributed to increases in natural gas deliveries. Gas and electric sales were positively impacted by an incrcase in customer base. Other factors that led to improved earnings were holding operating expenses to 1993 levels and a reduction in interest costs from 1993.

Eleetric Sales and Revenues

Electric retail sales for 1994 increased 4.0 percent from 1993. The electric sales breakdown by customer class is shown in the graph below. The increase in electric sales for 1994 over 1993 is attributable to a 1.4 percent increase in electric retail customers. Also, the addition of a large, base-load industrial customer helped increase sales. As a result, revenues increased 1.7 percent in 1994 as compared to 1993. Electric base rates were reduced in June 1993 by 2.9 percent on an annual basis.

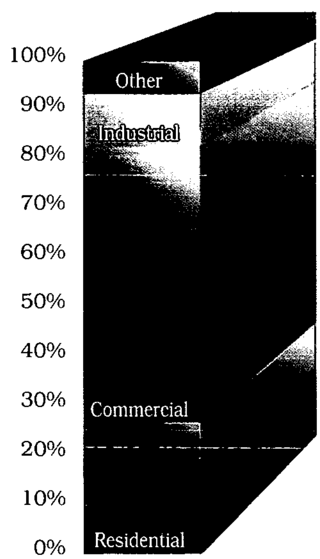
In 1993, electric retail sales increased 5.2 percent from 1992, due in part to warmer weather expcrienced in the third quarter of 1993. Total electric revenues increased 3.2 percent in 1993 versus 1992, which reflects the June 1993 rate decrease.

Gas Sales and Revenues

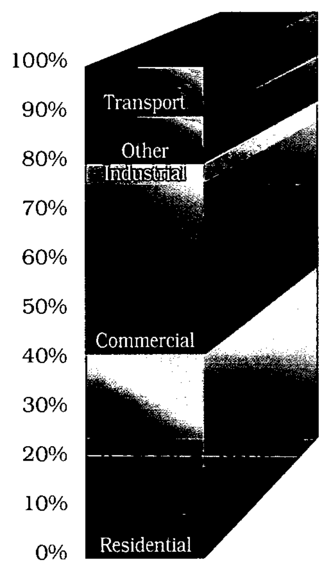
Gas delivered to the customers for 1994 increased 6.3 percent from 1993. The breakdown of gas deliveries by customer class is shown in the graph below. The extremely cold first quarter of 1994 helped bolster gas deliveries. The average temperature for the first quarter of 1994 was 5 degrees (Fahrenheit) colder than the first quarter of 1993, and 4 degrees colder than normal. Also contributing to the increase in gas deliveries is thc increase in the gas customer base, due in part to the Company's expansion of its gas service territory in western Wisconsin. The customer base increased 3.1 percent in 1994 when compared to 1993. Gas base rates were reduced in June 1993 by 1.6 percent on an annual basis.

In 1993, both gas deliveries and revenues increased from 1992, due to cooler weather conditions, a shift in a major customer from transportation rates (which is not counted as a system sale) to system rates, and an increase in customers as a result of the acquisition of two gas utilities in western Wisconsin.

Electric Sales by Customer Class
(per kwh, by percent)



Gas Deliveries by Customer Class
(per therm, by percent)



Electrie Fuel and Natural Gas Costs

The Company relied more on its generating units and purchased less energy in 1994 versus 1993 due to lower fuel costs. This resulted in an increase of 13.2 percent in fuel used for 1994 when compared to 1993 and a decrease in purchased energy of 10.5 percent for the same period (see net generation graph below). During June 1994, the Company set a record for peak demand at 551 megawatts for one hour.

Natural gas costs decreased 4.5 percent in 1994 as compared to 1993. The decrease is mainly attributed to lower natural gas costs per therm in the fourth quarter of 1994, resulting from the unseasonably warm weather experienced. A shift in a major customer from system service to transportation service, which is only recorded on a margin basis, also contributed to the decrease in natural gas costs.

Other Items

Operations and maintenance expenses for 1994, in aggregate, remained at the same approximate level as last year, while depreciation expense increased 2.7 percent in 1994 from 1993. The increase in depreciation expense is mainly due to additional plant-in-service.

Income taxes charged to operations increased 6.1 percent in 1994 from 1993 because of higher taxable income combined with decreased income statement benefits from amortization of excess deferred taxes, previously collected from customers, at tax rates higher than the current statutory rate (35 percent).

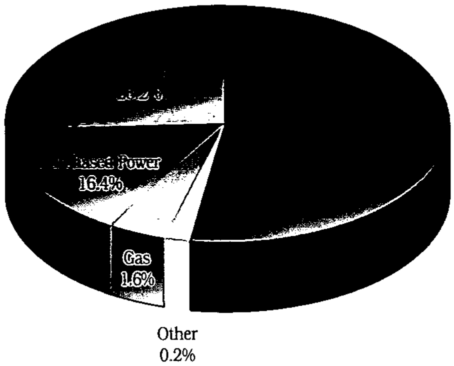
Interest on long-term debt decreased 5.7 percent in 1994 from 1993, which is attributable to the Company's repurchase of its 8%, 1999 series, First Mortgage Bonds in October 1993. Other interest increased in 1994 when compared to 1993 due to a higher level of commercial paper outstanding throughout 1994 (see Notes 1i and 2c).

Electric and Gas Operations Outlook

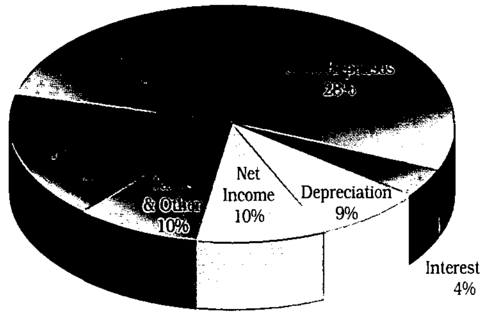
Over the next five-year period ending December 31, 1999, the Company anticipates electric sales to grow at a compound annual rate of approximately 1.5 percent assuming moderate growth in the service territory and normal weather. The Company is in a favorable position for a deregulated market because of its competitive electric rates and its low percentage of industrial customers.

Natural gas deliveries are estimated to grow at a compound annual rate of 2.0 percent, subject to variables such as weather and the economy. The Company will continue efforts to expand its gas service territory and its unregulated gas marketing activities.

Net Generation
(in percent)



Distribution of Revenues
(in percent)



Liquidity and Capital Resources

Capital Resourees

The Company's liquidity is primarily affected by the requirements of its ongoing construction program. During 1994, all of the Company's construction and nuclear fuel expenditures were provided for by internally generated cash. A portion of the electric construction program during 1994 was satisfied through construction fund draw-downs. For the five-year period ending December 31, 1999, the Company estimates that internally generated cash will provide, on average, over 100 percent of the utilities plant and nuclear fuel expenditures.

Capital Requirements

In 1994, capital expenditures increased approximately $3 million as compared to 1993. This is due in part to the significant increased capital expenditures for the new gas service territories in western Wisconsin. It is anticipated that 1995 construction and nuclear fuel expenditures will be $25 million, and the expenditures for the years 1996 through 1999 are expected to remain at similar levels. Through these expenditures, the Company will have efficient, up-to-date facilities for providing reliable service to customers and for meeting their future energy needs.

The Company has been able to delay building any new generating facilities through efficient Demand-Side Management Programs and aggressively pursuing purchase power contracts to meet future energy demands. The Company negotiated a purchased power agreement with Dairyland Power Cooperative that provides for the purchase of 40 megawatts of electric capacity during the years 1996 to 2000.

Expenditures for construction and nuclear fuel estimated for 1995, actual for 1994, and the average for the three-year period 1991 to 1993 are shown below:

Expenditures for Construction and Nuclear Fuel

For the years ended December 31:	1995 Estimated		**1994**		Annual Average 1991-1993	
(Thousands of dollars)						
Electric						
Production	$ 3,446	13.8%	**$ 1,777**	**6.7%**	$ 3,018	15.1%
Transmission	1,078	4.3	**2,045**	**7.7**	1,726	8.7
Distribution and General	9,284	37.1	**8,680**	**32.9**	7,316	36.7
Nuclear fuel	3,616	14.5	**3,427**	**13.0**	2,550	12.8
Total Electric	17,424	69.7	**15,929**	**60.3**	14,610	73.3
Gas	4,382	17.5	**9,072**	**34.3**	3,737	18.7
Common	3,194	12.8	**1,428**	**5.4**	1,602	8.0
Total	$ 25,000	100.0%	**$ 26,429**	**100.0%**	$ 19,949	100.0%

Inflation

The current financial statements report operating results in terms of historical cost. Even though the statements provide a reasonable, objective, quantifiable statement of financial results, they do not evaluate the impact of inflation. For ratemaking purposes, projected normal operating costs include impacts of inflation which are recoverable in revenues. However, electric and gas utilities, in general, are adversely impacted by inflation because depreciation of utility plant is limited to the recovery of historical costs. Thus, cash flows from the recovery of existing utility plant may, to a certain extent, not be adequate to provide replacement of plant investment.

Environmental and Legislative Issues

The Federal Clean Air Act as amended in 1990 will have a major impact on many electric utilities. However, the Company does not anticipate that Phase I of the Act, effective in 1995, will have any major impact on operations. The Company is also confident that if capital investments are required at some future date, the Company will receive timely recovery of such costs. The Company believes that fuel switching will be the effective strategy to follow to meet Phase II of the Act.

In 1992, the National Energy Policy Act (Act) was enacted. Generally, the Act promotes energy efficiency, a clean environment, and increased competition in the electric generation and bulk transmission areas. The Company is actively engaged in each of these areas. Wisconsin is a world leader in promoting energy efficiency, adherence to strict environmental principles, and competition for both generation and transmission. The utilities industry is expected to see changes through increased competition. New regulations have encouraged competition and are leading the way toward a deregulated market. This competition could have a significant impact on the Company. The Company is positioning itself to succeed in such an environment.

On April 8, 1992, the Federal Energy Regulatory Commission (FERC) issued Order 636. Order 636 requires all companies with natural gas pipelines to separate natural gas sales service from transmission service. It also requires these pipelines to offer flexibility to parties contracting for service.

Following the issuance of Order 636, ANR Pipeline Company (ANR) and Northern Natural Gas Company (NNG), the Company's pipeline suppliers, made filings at FERC to comply with Order 636. The Company played an active role negotiating with both pipelines to achieve the greatest benefit for its customers. Effective November 1, 1993, ANR and NNG's services that comply with Order 636 went into effect. The services that the Company has contracted for have met the needs of its customers reliably and economically.

Capitalization Matters

At December 31, 1994, bank lines of credit available to the Company were $32 million. The bank lines are generally used to support commercial paper issued, which represents a primary source of short-term financing. The Company's dealer-issued commercial paper carries the highest ratings assigned by Moody's Investors Service and Standard & Poor's Corporation.

The Company's existing bonds are rated AA by Standard & Poor's and Aa2 by Moody's Investors Service.

Capitalization ratios are shown in the Summary of Selected Financial and Operating Data on page 29. Under the Company's Automatic Dividend Reinvestment and Stock Purchase Plan, in 1993 and 1994, the Company has purchased all of its shares of common stock on the open market. The Company anticipates it will be able to meet its construction requirements, reduce short-term debt, and meet sinking fund debt requirements with internally generated funds and construction fund draw-downs over the next three years.

Acquisition of American Energy Management, Inc.

On January 3, 1995, the Company purchased American Energy Management, Inc. (AEM), a national energy marketing firm that provides gas marketing, energy management, energy auditing, and conservation services to customers in ten states. AEM, a subsidiary of Great Lakes Energy Corp. (GLENCO), serves mostly small- to medium-sized companies. GLENCO, a wholly owned subsidiary of the Company, markets excess gas supplies and pipeline capacity to commercial and industrial customers.

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Consolidated Statements of Income

For the years ended December 31	**1994**	1993	1992
(Thousands of dollars, except per-share amounts)			
Operating Revenues (Notes 1b and 3)			
Electric	**$149,665**	$147,201	$142,646
Gas	**95,307**	96,932	85,356
Total Operating Revenues	**244,972**	244,133	228,002
Operating Expenses			
Fuel used for electric generation (Note 1d)	**26,167**	23,125	26,062
Purchased power	**10,015**	11,190	6,378
Natural gas purchased	**59,693**	62,479	53,169
Other operations	**56,795**	56,103	52,469
Maintenance	**12,416**	13,029	12,544
Depreciation and amortization (Note 1g)	**22,383**	21,791	21,427
Other general taxes	**8,619**	8,222	8,107
Income taxes (Note 1h)	**14,822**	13,964	12,784
Total Operating Expenses	**210,910**	209,903	192,940
Net Operating Income	**34,062**	34,230	35,062
Allowance for funds used during construction - equity funds (Note 1c)	**132**	81	42
Other income, net	**1,939**	1,988	2,139
Income Before Interest Expense	**36,133**	36,299	37,243
Interest Expense			
Interest on long-term debt	**10,558**	11,195	13,249
Other interest (Note 2c)	**639**	478	216
Allowance for funds used during construction - borrowed funds (Note 1c)	**(75)**	(49)	(29)
Net Interest Expense	**11,122**	11,624	13,436
Net Income	**25,011**	24,675	23,807
Preferred stock dividend requirements	**471**	489	506
Earnings on Common Stock	**$ 24,540**	$ 24,186	$ 23,301
Earnings Per Share of Common Stock (Average shares outstanding – 10,719,812, 10,703,558, and 10,697,218, respectively)	**$2.29**	$2.26	$2.18

Consolidated Statements of Retained Income

For the years ended December 31	**1994**	1993	1992
(Thousands of dollars)			
Balance—Beginning of Year	**$ 72,865**	$ 68,380	$ 64,226
Add—Net income	**25,011**	24,675	23,807
Deduct—Cash dividends on common stock	**(20,046)**	(19,701)	(19,147)
Preferred stock dividend	**(471)**	(489)	(506)
Balance—End of Year	**$ 77,359**	$ 72,865	$ 68,380

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

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Consolidated Statements of Cash Flows

For the years ended December 31 *(Thousands of dollars)*	**1994**	1993	1992
Operating Activities			
Net income	**$ 25,011**	$24,675	$23,807
Income items not affecting working capital			
Depreciation and amortization	**22,383**	21,791	21,427
Deferred income taxes	**2,428**	3,255	2,563
Amortization of nuclear fuel	**2,803**	2,486	2,997
Amortization of investment tax credits	**(783)**	(803)	(759)
Allowance for funds used during construction – equity funds	**(132)**	(81)	(42)
Other	**994**	(462)	303
Net Funds Provided from Operations	**52,704**	50,861	50,296
Changes in working capital, excluding cash equivalents, sinking funds, maturities, and interim loans –			
(Increase)/decrease in current assets	**(10,789)**	(4,647)	3,380
Decrease in current liabilities	**(2,127)**	(2,941)	(2,738)
Other noncurrent items, net	**1,171**	(1,878)	(11,358)
Cash Provided by Operating Activities	**40,959**	41,395	39,580
Financing Activities			
Common stock issued	—	143	—
Cash dividends on common and preferred stock	**(20,517)**	(20,190)	(19,653)
Sale of First Mortgage Bonds	—	25,000	59,300
Maturities/redemptions of First Mortgage Bonds	—	(33,788)	(74,464)
Other decreases in First Mortgage Bonds	**(58)**	(122)	(858)
Decrease in preferred stock	**(200)**	(200)	(200)
Decrease in bond construction funds, net	**10,892**	6,943	3,526
Increase in interim loans	**5,100**	6,500	11,400
Cash Used for Financing Activities	**(4,783)**	(15,714)	(20,949)
Investing Activities			
Additions to utility plant and nuclear fuel	**(26,429)**	(23,648)	(16,364)
Allowance for funds used during construction – borrowed funds	**(75)**	(49)	(29)
Increase in decommissioning fund	**(2,316)**	(2,399)	(2,273)
Cash Used for Investing Activities	**(28,820)**	(26,096)	(18,666)
Change in Cash and Cash Equivalents (Note 6)	**7,356**	(415)	(35)
Beginning of Period	**4,178**	4,593	4,628
Cash and cash equivalents – end of period (Note 1f)	**$ 11,534**	$ 4,178	$ 4,593

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

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Consolidated Balance Sheets

At December 31 *(Thousands of dollars)*	**1994**	1993
Assets		
Utility Plant, at original cost (Note 1c)		
In service–Electric (Note 1e)	**$479,346**	$466,984
–Gas	**167,710**	158,458
Gross Plant in Service	**647,056**	625,442
Less–Accumulated provision for depreciation (Note 1g)	**(323,511)**	(302,904)
Net Plant in Service	**323,545**	322,538
Construction work in progress	**11,920**	12,251
Nuclear decommissioning fund (Note 1g)	**27,815**	25,499
Nuclear fuel, net (Note 1d)	**8,386**	8,305
Total Utility Plant	**371,666**	368,593
Other Property and Investments	**9,843**	9,822
Current Assets		
Cash and cash equivalents (Note 1f)	**11,534**	4,178
Accounts receivable, less reserves of $921 and $973, respectively (Note 1i)	**25,998**	10,593
Unbilled revenue (Note 1b)	**10,411**	11,458
Materials and supplies, at average cost	**6,424**	7,254
Fossil fuel, at average cost	**2,130**	3,333
Stored natural gas, at average cost	**8,551**	10,562
Prepaid taxes	**5,838**	5,693
Other prepayments	**1,456**	1,126
Total Current Assets	**72,342**	54,197
Deferred Charges	**33,908**	32,752
Total Assets	**$487,759**	$465,364
Capitalization and Liabilities		
Capitalization (see statement) (Notc 2)	**$325,389**	$310,791
Current Liabilities		
Long-term debt sinking fund requirements (Note 2b)	**430**	—
Preferred stock sinking fund requirements	**200**	100
Interim loans – commercial paper outstanding (Note 2c)	**28,600**	23,500
Accounts payable	**18,360**	17,890
Accrued taxes	**1,143**	2,056
Accrued interest	**2,803**	2,810
Other	**4,327**	5,998
Total Current Liabilities	**55,863**	52,354
Other Credits		
Accumulated deferred income taxes (Note 1h)	**56,595**	54,167
Regulatory liability (Note 1h)	**25,204**	25,264
Investment tax credit deferred (Note 1h)	**12,998**	13,781
Other	**11,710**	9,007
Total Other Credits	**106,507**	102,219
Commitments (Note 4)	—	—
Total Capitalization and Liabilities	**$487,759**	$465,364

The accompanying notes are an integral part of the above balance sheets.

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Consolidated Statements of Capitalization

At December 31 *(Thousands of dollars)*	**1994**	1993
Common Shareholders' Equity		
Common stock — Par value $8 per share		
Authorized: 28,000,000 shares		
Outstanding: 10,719,812 shares	**$ 85,758**	$ 85,758
Amount received in excess of par value	**26,372**	26,372
Retained income	**77,359**	72,865
Total Common Shareholders' Equity	**189,489**	184,995
Redeemable Preferred Stock, cumulative, $25 par value, authorized 1,191,000 and 1,199,000 shares, respectively (Note 2a)		
Series E, 8.70%, 212,000 and 220,000 shares outstanding, respectively, less current sinking fund requirements of $200 and $100, respectively	**5,100**	5,400
First Mortgage Bonds		
5.45%, 1996 Series	**7,920**	8,000
7¾%, 2001 Series	**11,478**	11,482
6½%, 2006 Series, Pollution Control Revenue Bonds, principal amount $8,780, less construction fund of $1,618 and $1,556, respectively	**7,162**	7,224
8.50%, 2022 Series	**40,000**	40,000
6.75%, 2027A Series, Industrial Development Revenue Bonds, principal amount $28,000, less construction fund of $6,472 and $17,426, respectively	**21,528**	10,574
6.70%, 2027B Series, Industrial Development Revenue Bonds	**19,300**	19,300
7.70%, 2028 Series	**25,000**	25,000
First Mortgage Bonds Outstanding	**132,388**	121,580
Unamortized discount and premium on bonds, net	**(1,158)**	(1,184)
Long-term debt sinking fund requirement (Note 2b)	**(430)**	—
Total First Mortgage Bonds	**130,800**	120,396
Total Capitalization	**$325,389**	$310,791

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

December 31, 1994, 1993, and 1992

1. Summary of Significant Accounting Policies

The consolidated financial statements reflect the application of certain accounting policies described in this note. Certain reclassifications, not affecting income, have been made to amounts reported in prior years to conform with presentations used in 1994.

a. Basis of consolidation

The financial statements include the accounts of Madison Gas and Electric Company and its subsidiaries (the Company). All significant intercompany accounts and transactions have been eliminated in consolidation.

b. Revenue recognition

The Company records unbilled revenue on the basis of service rendered. Gas revenues are subject to adjustment clauses related to periodic changes in the cost of gas.

c. Utility plant

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

AFUDC represents the approximate cost of debt and equity capital devoted to plant under construction. The Company presently capitalizes AFUDC at a rate of 10.62 percent on 50 percent of construction work in progress. The AFUDC rate approximates the Company's cost of capital. The portion of the allowance applicable to borrowed funds is presented in the Consolidated Statements of Income as a reduction of interest expense, while the portion of the allowance applicable to equity funds is presented as other income. Although the allowance does not represent current cash income, it is recovered under the ratemaking process over the service lives of the related properties.

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

d. Nuclear fuel

The cost of nuclear fuel used for electric generation is being amortized to fuel expense and recovered in rates based on the quantity of heat produced for the generation of electric energy by the Kewaunee Nuclear Plant (Kewaunee). Such cost includes a provision for estimated future disposal costs of spent nuclear fuel. The Company currently pays disposal fees to the Department of Energy based on net nuclear generation. The Company has recovered through rates and satisfied its known fuel disposal liability for past nuclear generation.

The National Energy Policy Act enacted in 1992 contains a provision for all utilities that have used federal enrichment facilities to pay a special assessment for decontamination and decommissioning for these facilities. This special assessment will be based on past enrichment, and the Company has accrued and deferred an estimate of $2.7 million for the Company's portion of the special assessment. The Company believes all costs will be recovered in future rates.

e. Joint plant ownership

The Company and two other Wisconsin investor-owned utilities jointly own two electric generating facilities, which account for 54 percent (325 mw) of the Company's net generating capability. Power from the facilities is shared in proportion to the companies' ownership interests. The Company's interests are 22 percent (232 mw) of the coal-fired Columbia Energy Center (Columbia) and 17.8 percent (93 mw) of Kewaunee. Each owner provides its own financing and reflects its respective portion of facilities and operating costs in its financial statements. The Company's portions of these facilities, included in its gross utility plant in service, and the related accumulated depreciation reserves at December 31, were as follows:

	Columbia		Kewaunee	
(Thousands of dollars)	**1994**	1993	**1994**	1993
Utility plant	**$85,092**	$84,620	**$57,534**	$56,872
Accumulated depreciation	**(44,238)**	(41,550)	**(32,793)**	(31,405)
Net Plant	**$40,854**	$43,070	**$24,741**	$25,467

f. Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents. The carrying amount approximates fair value because of the short maturity of these items.

g. Depreciation

Provisions at composite straight-line depreciation rates, excluding decommissioning costs as discussed as follows, approximate the following percentages of the cost of depreciable property: electric, 3.3 percent in 1994, 3.5 percent in 1993, and 3.3 percent in 1992; gas, 3.5 percent in 1994 through 1992, respectively. Depreciation rates are approved by the Public Service Commission of Wisconsin (PSCW) and are generally based on the estimated economic lives of property.

External trust funds have been established for costs associated with the future decommissioning of Kewaunee. It is estimated that the Company's share of decommissioning, which includes the cost of decontamination, dismantling, and site restoration, will be $57 million (1992 dollars) based on a site-specific study completed in 1992. Decommissioning costs (net of trust fund income), recovered through rates, are $3.1 million annually starting in January 1995. The Company's costs accrued to date, which are recorded in accumulated depreciation, are $28 million.

h. Income taxes

The Company has adopted Statement of Financial Accounting Standard No. 109 (SFAS 109), "Accounting for Income Taxes," effective January 1, 1993. This statement replaced the deferred method of income tax accounting with the liability method. The liability method requires the recognition of deferred tax assets and liabilities for the expected tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts. The statement was adopted prospectively and the cumulative effect of implementation on 1993 net income was insignificant. The principal effects on the Company's 1993 financial statements of adoption were a decrease in accumulated deferred income taxes and the establishment of a corresponding regulatory liability in the amount of $25,264,000.

In 1993, accumulated deferred income taxes were increased by approximately $2.6 million as the result of the increase in the federal statutory income tax rate from 34 to 35 percent effective January 1, 1993.

Investment tax credits from regulated operations are amortized over the service lives of the property to which they relate.

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

(Thousands of dollars)	**1994**	1993	1992
Income taxes charged to operations	**$14,822**	$13,964	$12,784
Income taxes charged to other income	**612**	491	602
Total income taxes	**$15,434**	$14,455	$13,386

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

(Thousands of dollars)	**1994**	1993	1992
Currently payable			
Federal	**$10,985**	$ 9,485	$ 9,126
State	**2,804**	2,518	2,456
Net deferred			
Federal	**1,756**	2,432	1,826
State	**672**	823	737
Amortized investment tax credits	**(783)**	(803)	(759)
Total income taxes	**$15,434**	$14,455	$13,386

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

	1994	1993	1992
Statutory federal income tax rate	**35.0%**	35.0%	34.0%
Restoration of investment tax credit	**(1.9)**	(2.1)	(2.0)
State income taxes, net of federal benefit	**5.6**	6.3	6.3
Amortization of excess deferred taxes	**(1.1)**	(1.3)	(1.2)
Other, individually insignificant	**0.6**	(1.0)	(1.1)
Effective income tax rate	**38.2%**	36.9%	36.0%

The significant components of deferred tax liabilities (assets) that appear on the Consolidated Balance Sheets as of December 31, 1994 and 1993, are as follows:

(Thousands of dollars)	**1994**	1993
Property-related	**$60,295**	$58,914
Energy conservation expenses	**6,168**	5,262
Automated mapping and facilities management system	**860**	1,262
Bond transactions	**2,131**	1,027
Nuclear fuel	**412**	958
Other, individually insignificant	**25**	305
Gross deferred income tax liabilities	**$69,891**	$67,728
Allowance for bad debts	**(370)**	(393)
Deferred compensation	**(1,061)**	(1,030)
Vacation pay	**(772)**	(718)
Stored natural gas	**(977)**	(1,280)
Deferred tax regulatory account	**(10,116)**	(10,140)
Gross deferred income tax assets	**(13,296)**	(13,561)
Accumulated deferred income taxes	**$56,595**	$54,167

Valuation allowances for deferred tax assets as of December 31, 1994 and 1993, were deemed unnecessary. Deferred income tax expense for 1992 results principally from property-related timing differences due to different depreciation methods and lives used for income tax and financial reporting purposes.

i. Accounts receivable

On June 30, 1994, the Company bought back $15 million of its accounts receivable from a wholly owned subsidiary of The First National Bank of Chicago. The Company sold $15 million of its accounts receivable in December 1990. The Company used short-term borrowings for the buy-back of its receivables.

j. Pension plans

The Company maintains two defined benefit plans for its employees. The pension benefit formula used in the determination of pension costs is based upon the average compensation earned during the last five years of employment for the salaried plan and career earnings for the nonsalaried plan subject to a monthly maximum.

The Company's funding policy is to make such contributions as are necessary to finance the benefits provided under the plans. The Company's contributions meet the funding standards set forth in the Employee Retirement Income Security Act of 1974. Ratemaking practice has historically allowed the accrued pension funding amount in rates. The Company has recorded 1994 pension costs equal to the funding amount. The funding amounts were $1,094,000 in 1994, $1,075,000 in 1993, and $988,000 in 1992. Of these amounts, $810,000, $861,000, and $805,000 were charged to operating expenses for the years 1994 through 1992, respectively. The plans' assets consist primarily of pooled funds invested with the Prudential Asset Management Group.

The funded status of the plans at December 31 is as follows:

(Thousands of dollars)	**1994**	1993
Fair value of plan assets	**$41,230**	$41,905
Actuarial present value of benefits rendered to date – Accumulated benefits based on compensation to date, including vested benefits of $36,066 and $36,322, respectively	**36,895**	37,376
Additional benefits based on estimated future salary levels	**7,010**	7,693
Projected benefit obligation	**$43,905**	$45,069
Plan assets less than projected benefit obligation	**(2,675)**	(3,164)
Unrecognized net asset at date of initial application	**(40)**	(79)
Unrecognized net (gain)/loss	**(156)**	295
Unrecognized prior service cost	**1,256**	1,340
Net liability	**$ (1,615)**	$ (1,608)

Components of net pension costs for the years ended December 31 are as follows:

(Thousands of dollars)	**1994**	1993	1992
Service costs (benefits earned during the period)	**$1,462**	$1,596	$1,381
Interest costs on projected benefit obligation	**3,462**	3,196	2,867
Actual loss/(return) on plan assets	**412**	(3,663)	(2,933)
Net amortization and deferral	**(4,056)**	347	(168)
Regulatory effect based on funding	**(186)**	(401)	(159)
Net pension costs	**$1,094**	$1,075	$ 988

The net pension costs at December 31, 1994 through 1992, respectively, were based on an assumed long-term rate of return on plan assets of 9.0 percent. The weighted average discount rate was 8.25 percent in 1994 and 7.50 percent for1993 and 1992, while the assumed rate of increase in future compensation levels is 5 percent for 1994 through 1992, respectively.

In addition to the noted plans, the Company also maintains two defined contribution 401(k) benefit plans for its employees. The Company's costs of the 401(k) plan for the years 1994, 1993, and 1992 were $199,000, $186,000, and $180,000, respectively.

k. Postretirement benefits other than pensions

The Company adopted SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," effective January 1, 1993. This statement requires that postretirement benefits be accrued over the period in which employees provide services to the Company. The Company provides health care and life insurance benefits for its retired employees and substantially all of the Company's employees may become eligible for these benefits upon retirement. Prior to adoption of SFAS 106, the Company recognized the costs of these benefits by expensing the benefits as paid.

The Company has elected to recognize the cost of its transition obligation (the accumulated postretirement benefit obligation as of January 1, 1993) by amortizing it on a straight-line basis over 20 years. The Company's SFAS 106 obligation and costs are based on a discount rate of 8.25 percent in 1994 and 7.50 percent in 1993. The assumed rate of increase in health care costs (health care cost trend rate) is 13 percent in 1994 and 1993, decreasing gradually to 5 percent in 2003, and remaining constant thereafter. Increasing the health care cost trend rates of future years by one percentage point would increase the accumulated postretirement benefit obligation by $1.8 million and would increase annual aggregate service and interest costs by $262,000.

The PSCW ruled that Wisconsin utilities are required to implement SFAS 106 for ratemaking purposes. The Company is phasing in, over a four-year period, the effect of implementing SFAS 106, which resulted in a regulatory asset of $497,000 at December 31, 1994, and $382,000 at December 31, 1993.

The Company's policy is to fund the SFAS 106 obligation through tax-advantaged vehicles. The plan's assets consist primarily of funds on reserve with an insurance company.

The funded status of the plans at December 31 is as follows:

(Thousands of dollars)	**1994**	1993
Accumulated postretirement benefit obligation (APBO):		
Retirees	**$ (4,064)**	$ (3,208)
Fully eligible active plan participants	**(1,399)**	(1,287)
Other active plan participants	**(6,562)**	(6,047)
Total	**(12,025)**	(10,542)
Plan assets at fair value	**1,465**	1,338
APBO in excess of plan assets	**(10,560)**	(9,204)
Unrecognized transition obligation	**7,813**	8,248
Unrecognized loss/(gain)	**605**	(86)
Accrued postretirement benefit liability	**$ (2,142)**	$ (1,042)

Components of net periodic benefit costs for the years ended December 31 are as follows:

(Thousands of dollars)	**1994**	1993
Service cost	**$ 402**	$ 413
Interest cost on APBO	**772**	747
Actual return on plan assets	**(91)**	(131)
Amortization of transition obligation over 20 years	**434**	434
Net amortization and deferral	**(7)**	56
Regulatory effect based on phase-in	**(497)**	(382)
Net periodic benefit cost	**$ 1,013**	$ 1,137

l. Fair value of financial instruments

At December 31, 1994, the carrying amount of cash and cash equivalents approximates fair value. The estimated fair market value of the Nuclear Decommissioning Fund is $28 million, and the estimated fair market value of the Company's First Mortgage Bonds, based on quoted market prices at December 31, is as follows:

(Thousands of dollars)	**1994**	1993
Carrying amount (includes sinking funds)	**$132,388**	$121,580
Fair market value	**$124,677**	$133,592

2. Capitalization Matters

a. Redeemable preferred stock

The Company repurchased all 212,000 shares outstanding of its Series E, 8.70%, preferred stock on February 21, 1995. The total amount of approximately $5.5 million was financed with short-term borrowings.

b. First mortgage bonds

The annual sinking fund requirements of the outstanding first mortgage bonds is $430,000 in 1995 and $350,000 in 1996 through 1999. In addition, approximately $8 million will be required in 1996, to retire at maturity, the 5.45 percent, 1996 Series, First Mortgage Bonds.

c. Notes payablc to banks, commercial paper, and lines of crcdit

For short-term borrowings, the Company generally issues commercial paper (issued at the prevailing discount rate at the time of issuance) which is supported by unused bank lines of credit. Through negotiations with several banks, the Company has $32 million in bank lines of credit.

Information concerning short-term borrowings is set forth below as of December 31:

(Thousands of dollars)	**1994**	1993	1992
Available lines of credit	**$32,000**	$25,000	$20,000
Commercial paper outstanding	**$28,600**	$23,500	$17,000
Weighted average interest rate	**6.06%**	3.45%	3.94%
During the year:			
Maximum short-term borrowings	**$29,500**	$26,000	$17,500
Average short-term borrowings	**$16,549**	$14,056	$ 3,448
Weighted average interest rate	**4.57%**	3.31%	3.70%

3. Rate Matters

In September 1994, the Company reduced electric rates by $0.9 million on an annual basis due to lower fuel costs. In December 1994, the PSCW issued its rate order that further reduced electric rates by $4.2 million and froze gas rates for the test period ending December 31, 1995. These rates will remain in place until the next test year, which is scheduled to begin January 1, 1997. The current rates are based on a return on common equity of 11.7 percent.

4. Commitments

Utility plant construction expenditures for 1995, including the Company's proportional share of jointly-owned electric power production facilities and purchases of fuel for Kewaunee, are estimated to be $25 million, and substantial commitments have been incurred in connection with such expenditures. Significant commitments have also been made for fuel for Columbia.

5. Segments of Business

The table below presents information pertaining to the Company's segments of business for the years ended December 31:

Information regarding the distribution of net assets between electric and gas is set forth on page 29.

(Thousands of dollars)	**1994**	1993	1992
Electric Operations			
Total revenues	**$149,665**	$147,201	$142,646
Operation and maintenance expenses	**87,748**	86,060	82,439
Depreciation and amortization	**17,337**	16,948	16,573
Other general taxes	**6,907**	6,651	6,614
Pre-tax Operating Income	**37,673**	37,542	37,020
Income taxes	**11,717**	11,104	9,988
Net Operating Income	**$ 25,956**	$ 26,438	$ 27,032
Construction and Nuclear Fuel Expenditures (Electric)	**$ 16,804**	$ 18,064	$ 12,548
Gas Operations			
Operating revenues	**$ 95,307**	$ 96,932	$ 85,356
Revenues from sales to electric utility	**1,671**	2,861	860
Total Revenues	**96,978**	99,793	86,216
Operation and maintenance expenses	**79,009**	82,727	69,043
Depreciation and amortization	**5,046**	4,843	4,854
Other general taxes	**1,712**	1,571	1,493
Pre-tax Operating Income	**11,211**	10,652	10,826
Income taxes	**3,105**	2,860	2,796
Net Operating Income	**$ 8,106**	$ 7,792	$ 8,030
Construction Expenditures (Gas)	**$ 9,625**	$ 5,584	$ 3,816

6. Supplemental Cash Flow Information

For purposes of the Consolidated Statements of Cash Flows, the Company considers cash equivalents to be those investments that are highly liquid with maturity dates of less than three months.

Cash payments for interest and income taxes were as follows for the years ended December 31:

(Thousands of dollars)	**1994**	1993	1992
Interest paid, net of amounts capitalized	**$11,235**	$11,704	$13,103
Income taxes paid	**$13,602**	$10,954	$12,968

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Responsibility for Financial Statements

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

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

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

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

David C. Mebane

David C. Mebane
Chairman, President and
Chief Executive Officer

Joseph T. Krzos

Joseph T. Krzos
Vice President - Finance

Report of Independent Accountants

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

We have audited the accompanying consolidated balance sheets and statements of capitalization of MADISON GAS AND ELECTRIC COMPANY and subsidiaries as of December 31, 1994 and 1993, and the related consolidated statements of income and retained income and cash flows for the years ended December 31, 1994 and 1993. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Madison Gas and Electric Company for the year ended December 31, 1992, were audited by other auditors, whose report dated February 12, 1993, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Madison Gas and Electric Company and subsidiaries as of December 31, 1994 and 1993, and the consolidated results of their operations and their cash flows for the years ended December 31, 1994 and 1993, in conformity with generally accepted accounting principles.

Coopers & Lybrand LLP

Milwaukee, Wisconsin
February 10, 1995

MGE

Quarterly Summary of Operations and Stock Prices

	Quarters Ended (Unaudited) (1)			
	March 31	June 30	Sept. 30	Dec. 31
	(Thousands of dollars, except per share amounts)			
1994				
Operating Revenues:				
Electric	**$35,262**	**$ 36,434**	**$ 43,577**	**$ 34,392**
Gas	**46,871**	**13,938**	**8,615**	**25,883**
Total	**82,133**	**50,372**	**52,192**	**60,275**
Operating Expenses	**70,479**	**45,504**	**43,405**	**51,522**
Net Operating Income	**11,654**	**4,868**	**8,787**	**8,753**
Interest, Preferred Dividends, and Other	**2,249**	**2,206**	**2,439**	**2,628**
Earnings on Common Stock	**$ 9,405**	**$ 2,662**	**$ 6,348**	**$ 6,125**
Earnings per Common Share (2)	**88¢**	**25¢**	**59¢**	**57¢**
Dividends Paid per Common Share (3)	**46.5¢**	**46.5¢**	**47¢**	**47¢**
Price per Common Share (4)—High	**$ 34¼**	**$ 33¾**	**$ 35**	**$ 33¾**
—Low	**$ 31**	**$ 31¾**	**$ 31¾**	**$ 31¾**
1993				
Operating Revenues:				
Electric	$ 34,771	$ 35,106	$ 43,066	$ 34,258
Gas	38,180	15,199	10,446	33,107
Total	72,951	50,305	53,512	67,365
Operating Expenses	62,230	43,967	44,866	58,840
Net Operating Income	10,721	6,338	8,646	8,525
Interest, Preferred Dividends, and Other	2,677	2,479	2,451	2,437
Earnings on Common Stock	$ 8,044	$ 3,859	$ 6,195	$ 6,088
Earnings per Common Share (2)	75¢	36¢	58¢	57¢
Dividends Paid per Common Share (3)	45.5¢	45.5¢	46.5¢	46.5¢
Price per Common Share (4)—High	$ 35½	$ 35¼	$ 36¾	$ 36½
—Low	$ 30¼	$ 32¾	$ 32¾	$ 32¾

Notes:

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

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

(3) There were 16,238 shareholders as of February 1, 1995. Currently, there are no restrictions on the Company's ability to pay dividends and none are expected in the foreseeable future. The Company has regularly paid dividends to its shareholders and expects that it will continue to do so in the future.

(4) The Company's common stock trades on The Nasdaq Stock Market under the symbol MDSN.

Summary of Selected Financial and Operating Data

	1994	1993	1992	1991	1990	1984
Eleetric						
Operating Revenues ($000s)						
Residential	$ 51,751	$ 51,718	$ 49,479	$ 53,216	$ 49,338	$ 39,689
Commercial power and lighting	79,295	78,085	76,042	75,946	72,984	61,252
Industrial power and lighting	9,022	7,999	7,930	7,583	7,464	5,768
Street and highway lighting and public authorities	7,684	8,076	7,692	8,478	8,848	9,494
Other utilities	1,684	367	602	620	354	6,828
Miscellaneous	329	956	901	535	1,505	2,309
Total Operating Revenues	$ 149,685	$ 147,201	$ 142,646	$ 146,378	$ 140,493	$125,340
Kilowatt-hour Sales (000s)						
Residential	679,211	666,991	625,231	675,563	628,129	542,426
Commercial power and lighting	1,448,474	1,405,857	1,345,730	1,345,954	1,289,042	981,135
Industrial power and lighting	221,384	173,266	166,807	160,589	157,691	194,830
Street and highway lighting and public authorities	169,755	176,389	166,419	185,337	192,528	188,076
Other utilities	34,990	12,510	30,765	18,566	11,585	230,429
Total Sales	2,553,814	2,435,013	2,334,952	2,386,009	2,278,975	2,046,896
Average Number of Customers						
Residential	102,255	100,721	99,244	98,089	97,063	89,149
Commercial power and lighting	15,348	15,037	14,840	14,637	14,402	12,963
Industrial power and lighting	75	77	80	80	79	96
Street and highway lighting and public authorities	51	53	51	51	50	53
Other utilities	4	3	3	2	2	4
Total Average Customers	117,733	115,891	114,218	112,859	111,596	102,109
Gas						
Operating Revenues ($000s)						
Residential	$ 51,812	$ 52,598	$ 48,263	$ 48,856	$ 44,913	$ 46,808
Commercial	33,436	35,757	29,730	29,614	28,487	37,990
Industrial	2,547	2,088	1,900	1,781	1,599	3,695
Best efforts (includes Interruptible boiler fuel)	5,782	5,723	4,949	4,723	4,621	6,627
Gas transport, net	968	151	488	624	397	—
Miscellaneous	762	615	26	224	58	302
Total Operating Revenues	$ 95,307	$ 96,932	$ 85,356	$ 85,822	$ 80,075	$ 94,522
Therms Sold and Transported (000s)						
Residential	84,326	84,713	79,031	79,790	72,080	70,587
Commercial	73,752	83,807	65,285	64,588	59,337	66,561
Industrial	8,056	6,651	4,587	4,313	3,461	7,375
Best efforts (includes Interruptible boiler fuel)	18,633	18,079	15,860	15,703	14,492	16,093
Gas transport, net	22,463	1,678	10,104	9,232	6,424	—
Total Sold and Transported	207,230	194,928	174,867	173,626	155,794	180,526
Average Number of Customers						
Residential	87,194	83,129	80,508	78,481	76,103	68,354
Commercial	11,053	10,477	10,184	9,950	9,547	7,493
Industrial	68	71	71	70	70	72
Best efforts (includes Interruptible boiler fuel)	84	53	49	46	45	4
Total Average Customers	98,379	93,730	90,812	88,547	85,765	70,923

Summary of Selected Financial and Operating Data

	1994	1993	1992	1991	1990	**1984**
		(Thousands of dollars, except per-share amounts)				
Incomc, Earnings, and Dividends						
Net income	**$ 25,011**	$ 24,675	$ 23,807	$ 24,880	$ 22,029	**$ 20,382**
Earnings on common stock	**$ 24,540**	$ 24,186	$ 23,301	$ 24,356	$ 21,488	**$ 17,914**
Earnings per average common share	**$2.29**	$2.26	$2.18	$2.28	$2.04	**$1.91**
Cash dividends paid per common share	**$1.87**	$1.84	$1.79	$1.75	$1.72	**$1.43**
Assets (year end)						
Electric	**$323,870**	$328,048	$325,510	$330,136	$331,609	**$242,381**
Gas	**118,210**	114,626	106,837	104,381	104,270	**84,459**
Assets not allocated	**45,679**	22,690	20,390	20,548	14,455	**40,393**
Total	**$487,759**	$465,364	$452,737	$455,065	$450,334	**$367,213**
Intcrnal Generation of Cash						
Total cash used for construction expenditures and nuclear fuel	**$ 26,429**	$ 23,648	$ 16,364	$ 19,836	$ 22,955	**$ 36,975**
Percent generated internally	**120.8%**	128.3%	180.6%	157.1%	127.7%	**85.5%**
Long-term Debt and Redeemablc Prefcrred Stock, Net (year end)	**$135,900**	$125,796	$127,963	$130,659	$141,813	**$131,762**
Capitalization Ratios (year end)						
Common shareholders' equity	**53.4%**	55.3%	55.4%	54.6%	53.5%	**48.3%**
Redeemable preferred stock	**1.5**	1.7	1.8	1.8	1.9	**10.1**
Long-term debt	**37.0**	36.0	37.6	41.8	43.9	**41.6**
Short-term debt (interim loans)	**8.1**	7.0	5.2	1.8	0.7	**—**
Common Stock Data (year end)						
Per share – Close	**$ 32½**	$ 33¾	$ 32½	$ 30⅝	$ 22⅜	**$ 15**
– Book value	**$ 17.68**	$ 17.26	$ 16.86	$ 16.47	$ 15.93	**$ 13.03**
Shares (000s) – Outstanding	**10,720**	10,720	10,697	10,697	10,680	**9,528**
– Authorized*	**28,000**	28,000	28,000	14,000	14,000	**7,000**
Price/earnings ratio	**14.2**	14.9	15.0	13.5	10.9	**7.9**
Yield on common stock	**5.8%**	5.5%	5.6%	5.7%	7.8%	**9.8%**
Dividend payout ratio	**81.7%**	81.5%	82.2%	76.7%	84.3%	**74.6%**
Interest Covcrages (excludes AFUDC)						
Pre-tax	**4.54**	4.30	3.72	4.08	3.38	**4.67**
After-tax	**3.22**	3.10	2.77	2.94	2.53	**2.82**
Sources of Energy Generated and Purchascd Power						
Coal	**55.6%**	47.1%	56.1%	57.1%	59.6%	**61.5%**
Nuclear	**26.2**	26.6	27.4	26.2	29.0	**31.1**
Purchased Power	**16.4**	23.1	12.5	14.8	10.0	**4.1**
Gas	**1.6**	3.2	3.6	1.5	0.9	**2.8**
Other	**0.2**	—	0.4	0.4	0.5	**0.5**
Cooling Degree Days (Normal – 597)	**637**	630	342	858	629	**559**
Heating Degrec Days (Normal – 7,455)	**7,170**	7,351	7,050	7,055	6,688	**7,450**

**Due to the three-for-two stock split in January 1992, outstanding shares for 1984 appear higher than authorized shares because authorized shares cannot be restated.*

board of directors

Jean Manchester Biddick
Retired Chief Executive Officer,
Neesvig's Inc.
Age 68
Director Since 1982

Richard E. Blaney
President,
Richard Blaney Seeds Inc.
Age 58
Director Since 1974

Robert M. Bolz
Retired Vice Chairman,
Oscar Mayer Foods Corp.
Age 72
Director Since 1972

Donald J. Helfrecht
Chairman Emeritus
Age 72
Director Since 1972

David C. Mebane
Chairman, President and
Chief Executive Officer
Age 61
Director Since 1984

Frederic E. Mohs
Partner,
Mohs, MacDonald & Widder,
Attorneys at Law
Age 57
Director Since 1975

Robert B. Rennebohm
President Emeritus
and Consultant,
University of Wisconsin Foundation
Age 71
Director Since 1983

Phillip C. Stark
Chairman of the Board,
The Stark Company
Age 69
Director Since 1985

H. Lee Swanson
Chief Executive Officer,
President and Director,
State Bank of Cross Plains
Age 56
Director Since 1988

Frank C. Vondrasek
Vice Chairman
Age 66
Director Since 1982

Audit Committee
Directors Biddick, Blaney,
Bolz, Helfrecht, Mohs, Rennebohm,
Stark, Swanson and Vondrasek

Compensation Committee
Directors Blaney, Bolz
and Mohs

Executive Committee
Directors Biddick, Blaney,
Helfrecht, Mebane, Mohs
and Vondrasek

Personnel Committee
Directors Biddick, Mebane,
Mohs, Swanson and Vondrasek

officers of the company

David C. Mebane
Chairman, President and Chief Executive Officer
Age 61
Years of Service, 17

Robert E. Domek
Senior Vice President - Human Resources
Age 64
Years of Service, 25

Burnett F. Adams
Vice President - Procurement and Division Operations
Age 42
Years of Service, 13

Joseph T. Krzos
Vice President - Finance
Age 50
Years of Service, 12

Richard H. Thies
Vice President - Gas Systems Operation
Age 53
Years of Service, 31

Mark C. Williamson
Vice President - Energy Services
Age 41
Years of Service, 8

Gary J. Wolter
Vice President - Administration and Secretary
Age 40
Years of Service, 10

James C. Boll
Assistant Vice President - Law and Corporate Communications
Age 59
Years of Service, 4

Deborah L. Burgess
Assistant Vice President - Gas Rates and Fuels
Age 35
Years of Service, 6

Lynn K. Hobbie
Assistant Vice President - Marketing
Age 36
Years of Service, 9

Thomas R. Krull
Assistant Vice President - Electric Transmission and Distribution
Age 45
Years of Service, 22

Carol A. Wiskowski
Assistant Vice President - Administration and Assistant Secretary
Age 55
Years of Service, 28

Terry A. Hanson
Treasurer
Age 43
Years of Service, 13

Note: Ages and years of service as of Dec. 31, 1994.

shareholder information

Shareholder Services
We welcome calls from shareholders. Please use the toll-free telephone numbers below for questions about your account, dividend payments, dividend reinvestment, lost certificates and stock transfers:

Madison calling area, (608) 252-4744
Other Wisconsin areas, 1-800-362-6423
Outside Wisconsin, 1-800-356-6423
(Continental U.S.)

If you prefer to write to us, address correspondence to:

MGE Shareholder Services
Post Office Box 1231
Madison, WI 53701-1231

Be sure to notify us in writing when a stock certificate is lost or stolen. Also notify us if you do not receive a dividend check within 10 days of the scheduled payment date. Please report name and address changes to us promptly.

Dividend Payment Dates
Dividends on the company's common stock in 1995 are expected to be paid quarterly on the 15th of March, June, September and December. The record date for dividend payments is the first day of the payment month.

Direct Deposit of Dividends
The company now offers direct deposit of dividends into your checking or savings account. Contact the Shareholder Services Department for more information or an authorization form.

Transfer Agent & Registrar

Harris Trust and Savings Bank
Post Office Box 755
Chicago, IL 60690

Dividend Reinvestment and Stock Purchase Plan
MGE has offered an Automatic Dividend Reinvestment and Stock Purchase Plan since 1977. Quarterly dividends are automatically reinvested in shares of MGE common stock. Participants may make optional cash payments of $10 to $4,000 each quarter to purchase shares of MGE common stock.

For more information, contact MGE Shareholder Services to receive the plan prospectus. An offer to sell common stock can only be made through the prospectus.

Stock Listing
The company's common stock trades on The Nasdaq Stock Market under the symbol MDSN. It is listed in most newspaper stock tables as MadsnGas or MadGE.

1995 Annual Meeting
The annual meeting of shareholders will be held Monday, May 1, 1995, at 11 a.m.

Holiday Inn-Madison West
1313 John Q. Hammons Drive
Greenway Center, Middleton, Wis.

Reports Available
Upon request, we will provide you with a copy of Form 10-K, our 1994 Annual Report to the Securities and Exchange Commission. A Statistical Supplement to this Annual Report to shareholders also is available. It contains additional financial and operating data. Please address requests for these reports to:

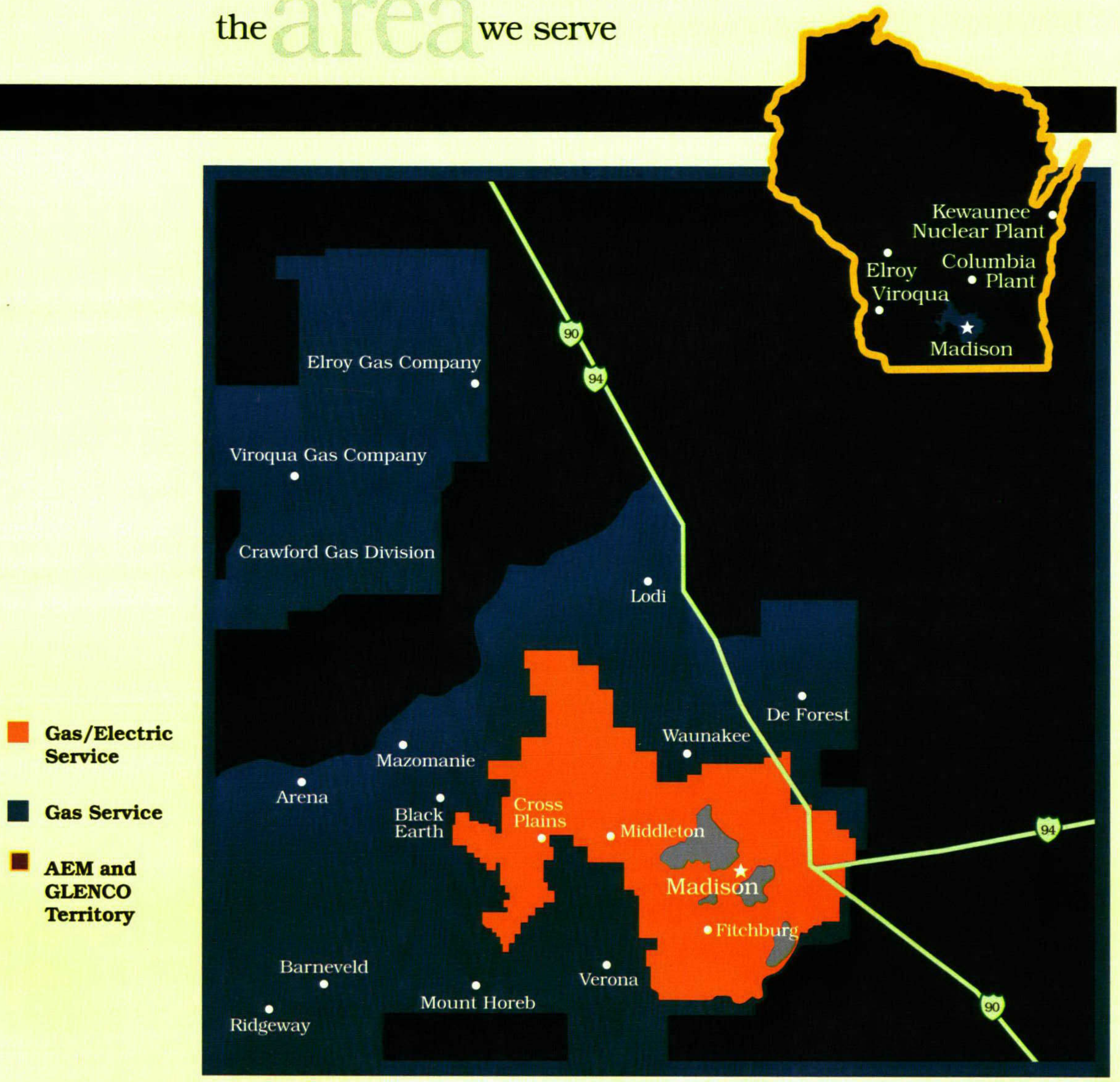
Joseph T. Krzos
Madison Gas and Electric Co.
Post Office Box 1231
Madison, WI 53701-1231

MGE General Offices
133 S. Blair St.
Post Office Box 1231
Madison, WI 53701-1231

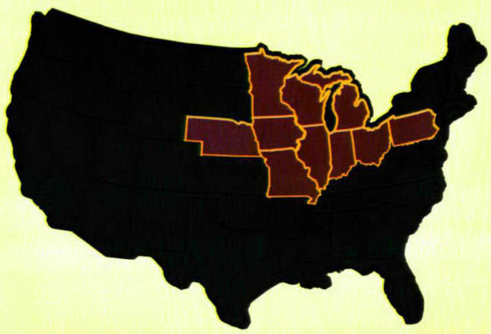
Telephone: (608) 252-7000

Business hours: 8 a.m. to 4:30 p.m., Central Time, Monday through Friday

the area we serve



Electric Service. MGE provides electric service in Madison, Monona, Fitchburg, Middleton, Cross Plains and other Dane County communities. The population totals 255,000. Generating facilities include the Kewaunee Nuclear Power Plant, the Columbia Energy Center, the Blount Generating Station and several combustion turbines.



Natural Gas Service. MGE provides natural gas service in Columbia, Crawford, Dane, Iowa, Juneau, Monroe and Vernon counties. The population in the gas service area is 336,000. Gas is transported via ANR Pipeline Co., Northern Natural Gas Co. and others.

Energy Management Service. Two MGE subsidiaries market nonregulated energy services to national, regional and local accounts in 10 states. Services include purchase and transportation of natural gas and other fuels for commercial, industrial and governmental customers.

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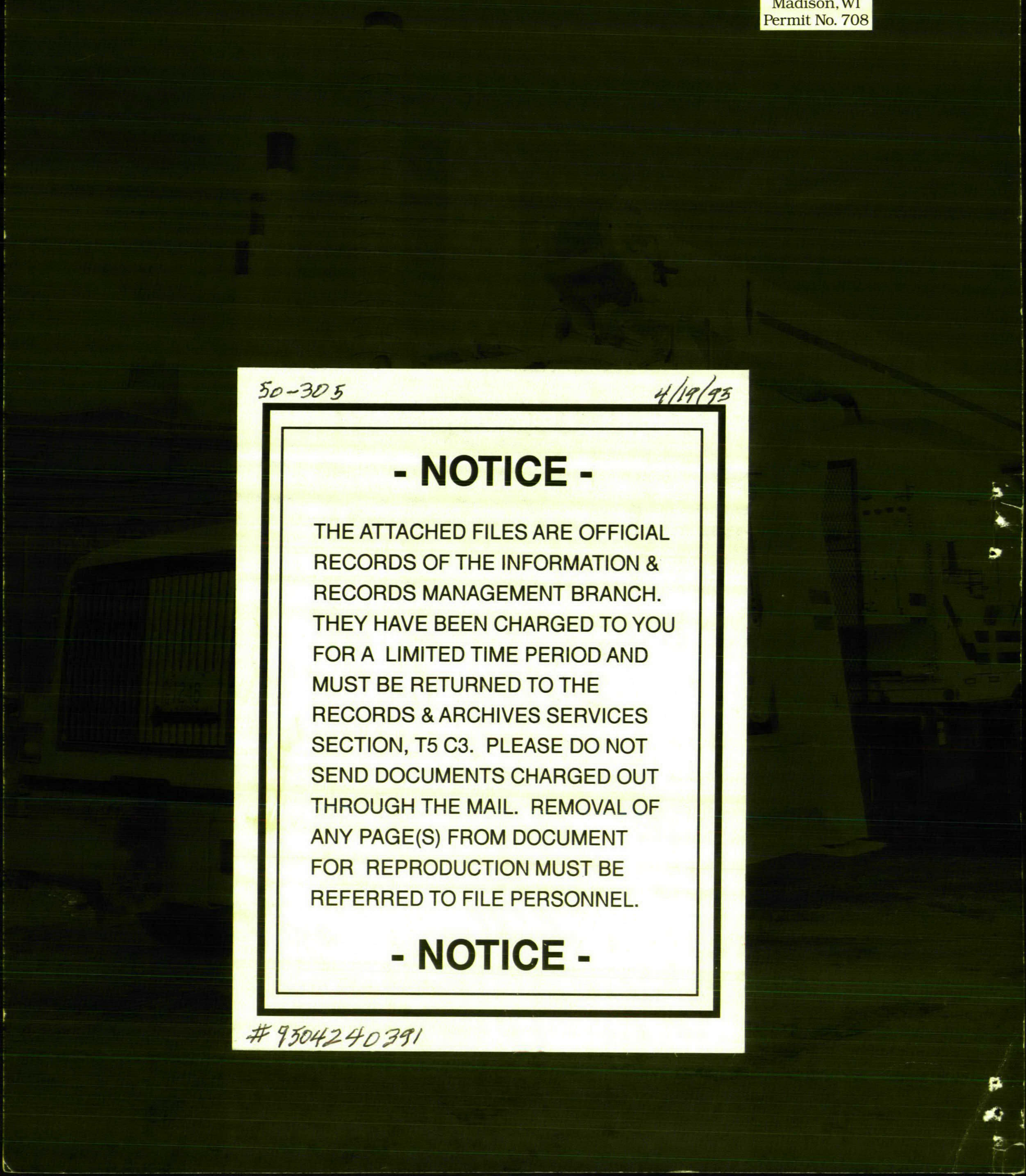
Madison, Wisconsin 53701-1231



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