# MADISON GAS AND ELECTRIC COMPANY 1996 ANNUAL REPORT

MGE®

Positioned for the Next Century

100 Years of Progress 1896-1996

CONTENTS



## THE AREA WE SERVE

MGE is an investor-owned public utility headquartered in Madison, Wis. The company generates, transmits and distributes electricity to 122,000 customers in a 250-square-mile area of Dane County. MGE also transports and distributes natural gas to 105,000 customers in 1,325 square miles of service territory in seven counties.

MGE's diversified operations include:

- National Energy Management, L.L.C., a joint venture of National Gas and Electric L.P. and MGE's subsidiaries American Energy Management Inc. and Great Lakes Energy Corp.
- Central Wisconsin Development Corp.
- Crawford Gas Division
- Elroy Gas Division
- Viroqua Gas Division

## ELECTRIC SERVICE

MGE provides electric service in Madison, Monona, Fitchburg, Middleton, Cross Plains and other Dane County communities. The population totals 259,000. Generating facilities include the Blount Generating Station and several combustion turbines at Madison, the Columbia Energy Center at Portage and the Kewaunee Nuclear Power Plant at Kewaunee.

## NATURAL GAS SERVICE

MGE provides natural gas service in Columbia, Crawford, Dane, Iowa, Juneau, Monroe and Vernon counties. The population is 342,000. Gas is transported via ANR Pipeline Co., Northern Natural Gas Co. and others.

## ABOUT THE COVER

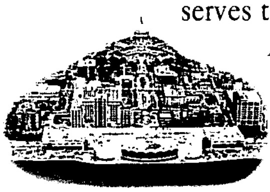
MGE began serving the Madison area in 1896. We have changed our fleet of trucks over the years, but not our forward-looking approach to business. Today, MGE is ***Positioned for the Next Century,*** just as we were 100 years ago.

## *To our shareholders.*

MGE marked 100 years of outstanding service to our customers, investors and communities in 1996.

MGE is well-positioned for the next century. We will continue our rich tradition of superior service and solid results. We will build on our strengths.

THRIVING ECONOMY. MGE proudly serves the #1 city in the country. *Money* magazine named Madison the best place to live in July 1996 based on a strong economy, excellent job opportunities and superb health care and cultural activities.



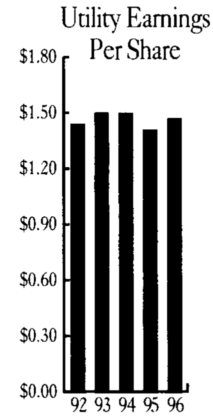
COMPETITIVE RATES. A Dillon Read study shows that MGE's commercial and industrial rates rank second lowest among nine Midwestern utilities, including all other investor-owned Wisconsin utilities.

FINANCIAL STRENGTH. MGE ranks as one of the top four utilities in the nation for credit quality, according to Bear Stearns.

INVESTOR BASE. The number of MGE shareholders increased a record 14% in 1996 with the introduction of our Investors Plus Plan. MGE was one of the first companies in the nation to offer a direct purchase stock plan.

COMMUNITY SUPPORT. MGE ranks among the country's 100 best corporate citizens according to the national magazine, *Business Ethics*. MGE was recognized for demonstrating "a true devotion to social responsibility."

PERSONAL SERVICE. Our employees are committed to exceed customers' expectations and provide exceptional service.




FINANCIAL RESULTS

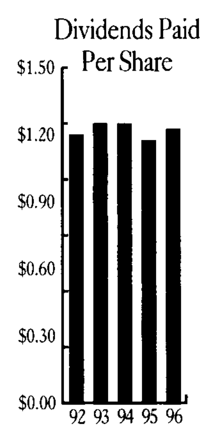
MGE's core utility business produced strong results last year. Earnings from our core utility operations were $1.48 per share in 1996 compared to $1.42 per share in 1995. Utility earnings were higher despite a $900,000 after-tax charge for added costs due to an extended outage at the Kewaunee Nuclear Power Plant.

The fourth quarter, however, included the following extraordinary after-tax charges: 1) a one-time $10.4 million charge for restructuring our unregulated gas marketing subsidiaries and 2) a one-time $1.6 million charge for a gas customer refund.

The combined impact of one-time expenses significantly reduced earnings for the year. MGE earned $0.40 per share in 1996 compared to $1.49 per share in 1995.

DIVIDEND GROWTH

Your board of directors increased the quarterly dividend paid on common stock to 32 cents per share in September. MGE has increased dividends each year since 1980 and paid cash dividends annually since 1909. Our financial strength and excellent market position allow us to continue producing solid financial results and strong dividends.

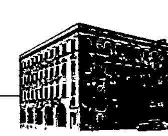



*1896*

*Madison Gas and Electric Company is formed with offices on East Main Street. It serves a population of 17,000.*

*1902*

*Blount Street Generating Station goes into service.*

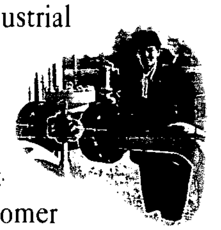


*1920's*

*New MGE office building is constructed at corner of Mifflin and Fairchild Streets.*

## JOINT VENTURE

MGE's unregulated gas marketing business has joined forces with National Gas and Electric (NG&E), a Houston-based marketing company. The new company, National Energy Management, L.L.C., serves more than 1,000 industrial and commercial customers in the Great Lakes region.



This joint venture strengthens our gas marketing team, expands our customer base and builds on our national reputation for providing highly reliable service. We are positioned for future success. NG&E is one of the few companies in the nation that has made a profit in the gas marketing business every year since the gas industry was deregulated.

## RATE INCREASE

The Public Service Commission of Wisconsin (PSCW) is expected to decide MGE's request to increase electric and natural gas rates in the second quarter of 1997.

We are seeking an electric rate increase of $7.7 million, or 5.1% annually, and a gas rate increase of $3.7 million, or 3.8% annually. The electric rate increase is primarily needed to cover accelerated costs for eventually retiring the Kewaunee Nuclear Power Plant. Higher operating and construction costs are also driving these increases.

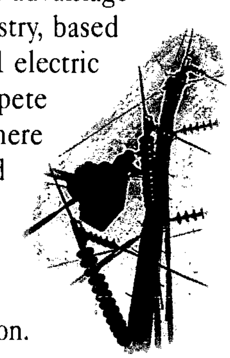
Even with the proposed increases, MGE rates will remain well below the national average – and lower than the rates our customers paid in 1990. Natural gas rates have been reduced or frozen each of the last six years. Electric rates have remained steady or decreased each year since 1991.

## KEWAUNEE REPAIRS

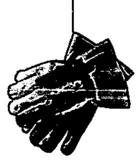
The PSCW approved a temporary electric rate surcharge of 0.507 cents per kilowatt-hour to cover higher costs in 1997 due to an extended outage at the Kewaunee Nuclear Power Plant. Steam generator tubes required repairs before the plant could return to service. The unexpected length of this outage also increased costs in the fourth quarter of 1996. MGE owns 17.8% of the plant.

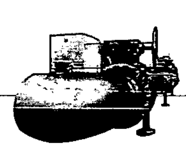
## FAIR COMPETITION

MGE will be at a competitive advantage in a deregulated electric industry, based on a Dillon Read study of 131 electric utilities. We are ready to compete in an open marketplace – if there is a fair and level playing field for all utilities.



MGE has joined forces with a broad-based statewide coalition to advocate fair competition. No utility, by virtue of its size, should be allowed to control regional power markets. We have participated in state and federal regulatory reviews of utility mergers and electric industry restructuring. Several decisions and recommendations have favored MGE's position.





*1944*

*MGE is divested from American Light and Traction and becomes publicly owned by employees and local investors.*

*1960's*

*MGE expands its gas service territory in Dane and Columbia counties.*

*1970's*

*Two new power plants go into service to meet the growing demand of MGE's customers.*

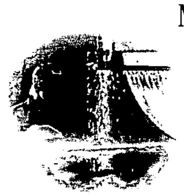
Major elements of MGE's position are:

- Transmission lines must be independently operated and open to all.
- Existing utility merger laws do not adequately protect consumers in an era of deregulation.
- Utility mergers must not violate antitrust guidelines.

MGE will continue to fight for what is right – fair access to transmission lines, fair prices for Wisconsin customers and a fair return for our investors.

BUSINESS GROWTH

In 1996, *Entrepreneur* magazine ranked Madison among the three best cities in the country for small business. Our area ranked well based on business performance, economic growth, quality of life, risk and the state's positive attitude toward small business.



MGE actively supports business growth. We are one of three utilities in the nation to receive a 1996 Economic Development Achievement Award from *Business Facilities* magazine for our successful incentive programs.

- Customers typically save up to 15% on annual energy costs after MGE analyzes their major processes and energy use through our Business Efficiency Consultation Services.
- MGE's Shared Savings Program has committed nearly $5 million in loans for energy-saving improvements at more than 80 businesses over the past four years.
- MGE subsidiary Central Wisconsin Development Corp. has committed more than $1.7 million to finance business parks, buildings and growing companies in our service territory over the past five years.

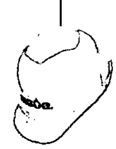
MANAGEMENT CHANGES

The board of directors elected several people to new positions: Terry A. Hanson, vice president and treasurer; Lynn K. Hobbie, vice president – marketing; Thomas R. Krull, vice president – electric transmission and distribution; and Peter J. Waldron, assistant vice president – power supply operations and engineering.

COMPETITIVE POSITION

MGE is well-positioned for the next century. We are financially strong and offer competitive rates. We know our customers' needs and continue developing innovative ways to add value to their service. We understand the importance of producing solid results for our investors.

Thank you for your confidence and support.



David C. Mebane

David C. Mebane
Chairman, President and
Chief Executive Officer

February 7, 1997

*1980's*
*MGE purchases Cross Plains Electric Company, extends gas service to Iowa County and builds new headquarters on Blair Street.*

*1992-94*
*Gas systems in Viroqua and Elroy are acquired by MGE. The company expands gas service to Crawford, Monroe, and Vernon Counties.*

*1996*
*MGE celebrates 100 years of providing quality service to customers.*

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND OPERATIONS

## GENERAL

Certain matters that are discussed in the Management's Discussion and Analysis of Financial Condition and Results of Operations are forward-looking statements and can generally be identified as such because the content includes statements like the Company "believes," "anticipates," or "expects." Such forward-looking statements are subject to certain risks and uncertainties which could cause actual results to differ materially from those currently anticipated.

## RESULTS OF OPERATIONS

### Earnings Overview

Earnings from Madison Gas and Electric Company's (the Company) core utility operations increased to $1.48 per share in 1996, compared to $1.42 in 1995. Earnings from utility operations were higher despite $0.9 million (after tax) of additional costs for 1996 related to the extended outage of the Kewaunee Nuclear Power Plant (Kewaunee). The Company's consolidated earnings per share were negatively impacted by the following items:

- a one-time charge of $10.4 million (after tax) to reflect the current value of the Company's investments in its gas marketing subsidiaries,
- a one-time charge of $1.6 million (after tax) resulting from a refund to natural gas customers under a sharing mechanism between Great Lakes Energy Corp. (GLENCO) and the Company,
- and operating losses of the Company's gas marketing subsidiaries of $5.4 million (after tax).

Consolidated earnings per share of the Company's common stock decreased to $0.40 in 1996, compared to $1.49 in 1995. The Company earned $1.0 million or $0.07 per share on its gas marketing subsidiaries in 1995.

The consolidated earnings in 1995 of $1.49 per share were lower than the $1.53 earned in 1994 due to the costs associated with industry restructuring, various regulatory filings in relation to the proposed utility mergers within the state, and a lower authorized return on common stock equity, which became effective in January 1995.

### Electric Sales and Revenues

Electric retail sales for 1996 increased slightly from 1995, despite the cold summer experienced in 1996 compared to 1995. The increase can be attributable to an increase of 1.2 percent in the number of electric customers. The electric sales breakdown by customer class is shown in the table below:

| Electric Sales *Megawatt Hours* | 1996 | 1995 | % Change |
|---|---|---|---|
| Residential | **725,471** | 735,442 | (1.4) |
| Commercial | **1,381,043** | 1,347,947 | 2.5 |
| Industrial | **289,903** | 292,649 | (0.9) |
| Other | **305,962** | 320,869 | (4.6) |
| Total Retail | **2,702,379** | 2,696,907 | 0.2 |
| Resale – Utilities | **26,815** | 26,344 | 1.8 |
| Total Sales | **2,729,194** | 2,723,251 | 0.2 |

Electric revenues decreased slightly in 1996 compared to 1995. The Company's electric margin decreased $3.1 million or 2.6 percent during 1996 compared to 1995. The primary factor for the decrease in the electric margin is the increase in replacement purchased power costs due to the extended outage at Kewaunee.

Electric retail sales for 1995 increased 7.1 percent from 1994. This increase is attributable to the hot and humid weather experienced in the summer of 1995. As a result of the increase in electric sales, electric revenues increased $3.9 million or 2.6 percent in 1995 compared to 1994. The increase in electric revenues occurred despite a 3.3 percent reduction to electric rates effective January 1, 1995.

### Gas Sales and Revenues

Total gas therms delivered by the Company increased 3.3 percent in 1996 compared to 1995, largely reflecting the colder weather experienced during the first quarter of 1996. Gas therms delivered during the first quarter of 1996 increased 12.7 percent over the same 1995 period. The table below shows total gas deliveries for 1996 by customer class:

| Therms Delivered *Thousands* | 1996 | 1995 | % Change |
|---|---|---|---|
| Residential | **96,062** | 89,099 | 7.8 |
| Commercial and Industrial | **93,723** | 94,729 | (1.1) |
| Total Retail System | **189,785** | 183,828 | 3.2 |
| Transport | **37,707** | 36,502 | 3.3 |
| Total Gas Deliveries | **227,492** | 220,330 | 3.3 |

Gas revenues increased $5.5 million or 5.8 percent in 1996 when compared to the same period a year ago. This was mainly attributable to the increase in gas deliveries due to the cold weather experienced in the first quarter as well as the increase in the number of gas customers of 2.2 percent. The Company's gas margin (revenues less natural gas purchased) decreased $3.0 million or 8.1 percent in 1996 compared to 1995. The main reason for the decreased margin is the Company's return of $2.5 million of revenue to gas customers under a prior sharing mechanism between GLENCO and the Company (see Note 5).

Gas delivered to customers in 1995 increased 6.3 percent from 1994. Despite the increase in gas delivered in 1995, gas revenues remained constant when compared to 1994. A shift in customers from retail system rates to transportation rates is the main reason gas revenues did not increase in proportion to gas deliveries. Gas transport customer revenue is recorded on a margin basis, whereas retail system customer revenue is recorded on a total revenue basis.

## Electric Fuel and Natural Gas Costs

Electric fuel costs and purchased power costs increased $2.3 million or 6.4 percent in 1996 compared to 1995. As previously mentioned, the increase is mainly attributable to the increased purchased power costs associated with replacing power caused by the extended outage at Kewaunee. Purchased power costs increased $3.6 million or 45.2 percent for 1996 over 1995. This was offset somewhat by a $1.3 million or 4.8 percent decrease in fuel used for electric generation for the same comparable periods. Kewaunee normally provides over 25 percent of the generation requirements of the Company. Electric fuel costs and purchased power costs remained constant in 1995 compared to 1994.

Natural gas costs increased $8.5 million or 14.8 percent during 1996 compared to 1995. Due to the cold first quarter experienced in 1996, the demand for natural gas increased significantly causing the cost per therm to rise accordingly. The cost per therm in 1996 increased $0.04 or 13.4 percent over 1995.

Natural gas costs decreased $2.2 million or approximately 3.7 percent during 1995 compared to 1994. This was due to a decrease in the cost per therm of approximately 3.0 percent from the previous year.

## Other Operating Expenses

Operations and maintenance (O&M) expenses decreased $2.8 million or 3.8 percent during 1996 compared to 1995. Management's continued effort to control O&M expenses is the primary reason for the decrease. Depreciation expense increased $0.7 million or 2.8 percent in 1996 compared to 1995. Depreciation expense related to decommissioning costs contributed $0.4 million of the increase in total depreciation expense.

Other operations increased $4.7 million or 8.3 percent during 1995 compared to 1994. This is due in part to an increase in industry restructuring costs and costs associated with participation in proposed utility merger filings.

## Other Nonoperating Expenses

The Company's gas marketing subsidiaries had an after-tax operating loss of $5.4 million in 1996, compared to $1.0 million in after-tax operating income in 1995. The main reason for the operating losses this year is due to the increase in the cost of gas, specifically in the first quarter when the demand was the highest. In the first quarter of 1996, extremely cold weather caused natural gas supply prices to rise substantially. Gas marketing companies are severely impacted by the volatility in natural gas supply prices because they work on a margin basis (revenues less cost of gas). Therefore, when gas costs increase, profit margins are reduced.

The Company recorded a one-time write down in 1996 of $10.4 million (after tax) to properly reflect the current value of the Company's investments in its gas marketing subsidiaries and reorganizing these activities for the future (see Note 4).

Total interest expense decreased $0.6 million or 5.4 percent in 1996 compared to 1995. This is mainly due to lower interest rates in 1996 than in 1995. Also, in November 1995, the Company replaced its 7¾%, 2001 Series, First Mortgage Bonds, with lower cost short-term debt.

## Electric and Gas Operations Outlook

The Company anticipates electric and gas sales to each grow at a compound annual rate of 1.5 percent over the next five-year period ending December 31, 2001. The service territory remains well-insulated against economic downturns. The Company's service area is one of America's most economically vibrant. The Company expects to remain at a competitive advantage in a disaggregated electric utility market because of its low generation costs, competitive rates, and low percentage of industrial customers. The Company continues to respond with rates and services to meet the needs of its customers as the gas industry proceeds toward deregulation.

## Joint Venture

To strengthen its position in the gas marketing business, the Company's gas marketing subsidiaries entered into a joint venture with another gas marketing firm in January 1997. GLENCO and American Energy Management Inc.

(AEM), the Company's two gas marketing subsidiaries, formed a joint venture with National Gas & Electric L.P. (NG&E) to market gas and energy services to industrial and commercial customers in the Great Lakes region. The joint venture is called National Energy Management, L.L.C. and is based in Chicago. NG&E, a unit of PanCanadian Energy, Inc., is a Houston-based gas marketing company. NG&E has a proven track record of profitability providing gas to a growing commercial and industrial customer base.

## LIQUIDITY AND CAPITAL RESOURCES

### Cash Provided by Operating Activities

Cash provided by operating activities decreased $2.5 million or 4.9 percent in 1996 compared to a year ago. A portion of the decrease is attributable to an increase in the Company's net working capital. Accounts receivable increased $2.3 million or 6.3 percent in 1996 compared to a year ago. Also, stored natural gas and prepaid taxes combined increased $2.4 million or 19.9 percent over last year.

### Capital Requirements and Investing Activities

The Company's liquidity is primarily affected by the requirement of its ongoing construction program. In 1996, capital expenditures increased $2.7 million or 14.3 percent, as compared to 1995, mainly due to an increase in nuclear fuel expenditures. It is anticipated that capital expenditures will be in the range of $25 to $35 million for the years 1997 through 2001. For the five-year period ending December 31, 2001, the Company estimates that internally generated cash will provide, on average, more than 100 percent of the utility plant and nuclear fuel expenditures.

Expenditures for construction and nuclear fuel estimated for 1997, actual for 1996, and the average for the three-year period 1993 to 1995 are shown below.

### Financing Activities and Capitalization Matters

On June 1, 1996, the Company's 5.45%, 1996 Series, First Mortgage Bonds matured. The Company was able to satisfy this $7.8 million maturity with short-term debt.

At December 31, 1996, bank lines of credit available to the Company were $55 million which included $10 million for GLENCO, a wholly owned subsidiary of the Company, and AEM, a subsidiary of GLENCO. Credit requirements for GLENCO and AEM are being transferred to NG&E and the joint venture as part of the joint venture agreement. 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 23.

The Company anticipates it will be able to meet its construction requirements and sinking fund debt requirements with internally generated funds over the next three years.

### Kewaunee Nuclear Power Plant

Kewaunee is operated by Wisconsin Public Service Corporation. The Company has a 17.8 percent ownership interest in Kewaunee, which it owns jointly with two other utilities. Kewaunee is operating with a license that expires in 2013.

## EXPENDITURES FOR CONSTRUCTION AND NUCLEAR FUEL

| For the years ended December 31: | 1997 Estimated | | **1996** | | Annual Average 1993 to 1995 | |
|---|---|---|---|---|---|---|
| *(Thousands of dollars)* | | | | | | |
| Electric | | | | | | |
| Production | $ 6,012 | 19.5% | **$ 1,472** | **6.8%** | $ 2,563 | 11.1% |
| Transmission | 3,042 | 9.9 | **1,051** | **4.8** | 1,040 | 4.5 |
| Distribution and General | 9,146 | 29.7 | **9,058** | **41.3** | 8,958 | 38.8 |
| Nuclear Fuel | 4,600 | 14.9 | **4,304** | **19.6** | 2,288 | 9.9 |
| Total Electric | 22,800 | 74.0 | **15,885** | **72.5** | 14,849 | 64.3 |
| Gas | 5,200 | 16.9 | **4,431** | **20.2** | 5,877 | 25.5 |
| Common | 2,800 | 9.1 | **1,590** | **7.3** | 2,354 | 10.2 |
| Total | $30,800 | 100.0% | **$21,906** | **100.0%** | $23,080 | 100.0% |

Kewaunee was removed from service on September 21, 1996, for scheduled refueling and maintenance. Inspection of previously repaired steam generator tubes disclosed more extensive tube damage than had been anticipated. Repair of the tubes using laser welding was undertaken. As of December 31, 1996, it was anticipated that repairs would be completed sometime during the first quarter of 1997. Welding was completed late in January 1997. Subsequent testing indicated that the repair of a number of the tubes was not effective. The return of Kewaunee to service will be delayed indefinitely while additional repair requirements are being investigated. Nuclear Regulatory Commission (NRC) approval is needed for these repairs and to restart the plant.

If for any reason the steam generators cannot be repaired, the Kewaunee owners would need to decide on alternatives ranging from replacing the existing steam generators to early plant closure with replacement power options. Replacement of steam generators must also be approved by the Public Service Commission of Wisconsin (PSCW) and is estimated to cost $89.0 million (the Company's share would be 17.8 percent or $15.8 million), excluding additional replacement purchased power costs associated with an extended shutdown.

Even if the repairs are successful and the plant restarts, the tube repairs are expected to last only a few years. Therefore, Kewaunee would be retired prior to the expiration of the operating license in 2013 unless the steam generators are replaced.

The PSCW approved the accelerated recovery of the current undepreciated Kewaunee plant balance and the unfunded estimated costs to decommission the plant through 2002.

If Kewaunee returns to service, it will be shut down at midcycle (within one year after being returned to service) for tube inspection. If significant further tube damage is discovered during the midcycle shutdown, the NRC may not permit Kewaunee to continue to operate without replacement of the steam generators. Since the earliest date by which the steam generators could be replaced is sometime in 1999, a midcycle shutdown and subsequent requirement that the steam generators be replaced before startup could result in an extended outage.

An extended Kewaunee outage subjects the Company to increased purchased power costs and increased fuel costs and operating and maintenance costs at other generating units. Since most Kewaunee costs are incurred whether or not the plant generates electricity, an extended outage of the plant results in significant incremental costs for replacement electricity. The cost to use other generating units and to purchase replacement power is expected to cost on average $38,000 a day or approximately $3.4 million if the plant remains down through the end of the first quarter of 1997. The Company received an interim rate order from the PSCW in March 1997. The order provides for a $0.507 per kilowatt-hour surcharge on customers' bills to cover the continuing costs that will be incurred by the Company while Kewaunee remains out of service. The interim electric rate order is scheduled to remain in effect until either Kewaunee returns to service or the Company receives its final rate order. The Company anticipates it will have sufficient sources to meet its customers' energy requirements during the outage.

If Kewaunee is retired early, the Company believes it would be granted regulatory approval to recover from its customers the net plant carrying amount and the estimated costs to decommission Kewaunee in excess of the decommissioning trust assets. At December 31, 1996, the net plant carrying amount was approximately $21.7 million. The Company's share of the current estimated costs to decommission Kewaunee, assuming early retirement, exceeds the fair market value of decommissioning trust assets at December 31, 1996, by $26.2 million. If Kewaunee is retired early, the Company believes it will be able to meet its commitments to supply energy to its customers through either (1) possible investments in new generating units, and/or (2) contracting for additional purchased power. The Company is considering various options with respect to Kewaunee, including divestiture or early closure of the nuclear plant.

## Electric Industry Trend

During the past several years, the trend in the electric utility industry has been toward increased competition caused by a changing regulatory environment. In December 1995, the PSCW outlined its plan for the restructuring of the electric utility industry in Wisconsin. The PSCW's plan generally followed a plan proposed by the Company and a broad coalition of customers, public interest groups, cooperative associations, municipal power entities, organized labor, and others. Under the proposed PSCW plan, the Company is developing plans illustrating how it intends to separate generation, transmission, distribution, and energy services into separate business units. The PSCW would continue distribution and transmission regulation. To limit the market power of current transmission owners, the PSCW proposes moving either to appointment of an independent system operator or to organization of a single statewide transmission system. Additional proceedings and presentation to the state legislature on the PSCW's electric utility restructuring proposal are planned prior to the target implementation date. The targeted date under the PSCW proposal is the year 2001, at which time consumers will be able to choose their electricity provider. The Company cannot predict what impact future PSCW actions may have on its future financial condition, cash flows, or results of operations. However, the Company believes it is well-positioned to compete in a deregulated market.

## Regulatory and Accounting Issues

The Company operates under electric and natural gas utility rates that are approved by the PSCW. These rates are designed to recover the cost of service and provide a reasonable return to investors. The increasing trend toward deregulation and increased competition is causing the electric utility industry to restructure. The restructuring could affect the eligibility of the Company to continue applying Statement of Financial Accounting Standard (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation." Under this situation, continued deferral of certain regulatory asset and liability amounts on the Company's books may no longer be appropriate as allowed under SFAS 71. The Company is unable to predict whether any adjustments to regulatory assets and liabilities will occur in the future. The PSCW's restructuring plan specifically recognizes the need to allow recovery for commitments made under prior regulatory regimes.

The PSCW completed its generic investigation of the natural gas industry and made a determination as to whether or not traditional regulation should be replaced with a different approach. Currently, the Company has the ability through the Purchased Gas Adjustment Clause (PGAC) to recover from its customers the cost of gas purchased by the Company on behalf of its customers. The PGAC is often referred to as a one-for-one recovery mechanism. On November 8, 1996, the PSCW issued an order stating that the Company must file a modified one-for-one recovery mechanism or an incentive mechanism. On February 7, 1997, the Company filed a modified one-for-one recovery mechanism and supporting testimony. Approval of a mechanism from the PSCW is expected by July 1, 1997. The proposed implementation date is November 1, 1997. The proposed modified one-for-one recovery mechanism provides appropriate price signals to the Company's customers while minimizing the risk to shareholders.

SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," is effective for fiscal years beginning on or after December 15, 1995. SFAS 121 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. SFAS 121 also amends SFAS 71 to require the write-off of a regulatory asset if it is no longer probable that future revenues will recover the asset. The adoption of SFAS 121 did not have an impact on the Company's financial position, cash flows, or results of operations. However, the Company cannot predict what effect a competitive marketplace or future regulatory actions will have on the outcome of the application of SFAS 121.

## Mergers

On May 1, 1995, Northern States Power Company and Wisconsin Energy Corporation announced a proposed merger. If approved, the two companies would form a holding company called Primergy Corporation (Primergy), creating the tenth largest utility company in the United States. The merger has been approved by the shareholders of both companies. Various regulatory agency approval is required including the Securities and Exchange Commission, NRC, Federal Energy Regulatory Commission (FERC), and state regulatory agencies.

The Company and a broad coalition of customer groups are opposing approval of the merger on the grounds that the merger would violate antitrust laws and principles by increasing the exercise of anticompetitive market power by Primergy. Studies show Primergy could significantly raise prices for electric customers in Wisconsin by exercising anticompetitive market power. Hearings on the proposed merger have been concluded before the FERC and PSCW. The Company believes that the proposed merger would have a detrimental impact on the Wisconsin economy and that approval of the merger should be denied or strongly conditioned to prevent the significant anticompetitive effects.

## 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 recoverable in revenues. However, electric and gas utilities, in general, are adversely impacted by inflation because depreciation of the utility plant is limited to the recovery of historical costs. Thus, cash flows from the recovery of existing utility plant, to a certain extent, may not be adequate to provide replacement of plant investment.

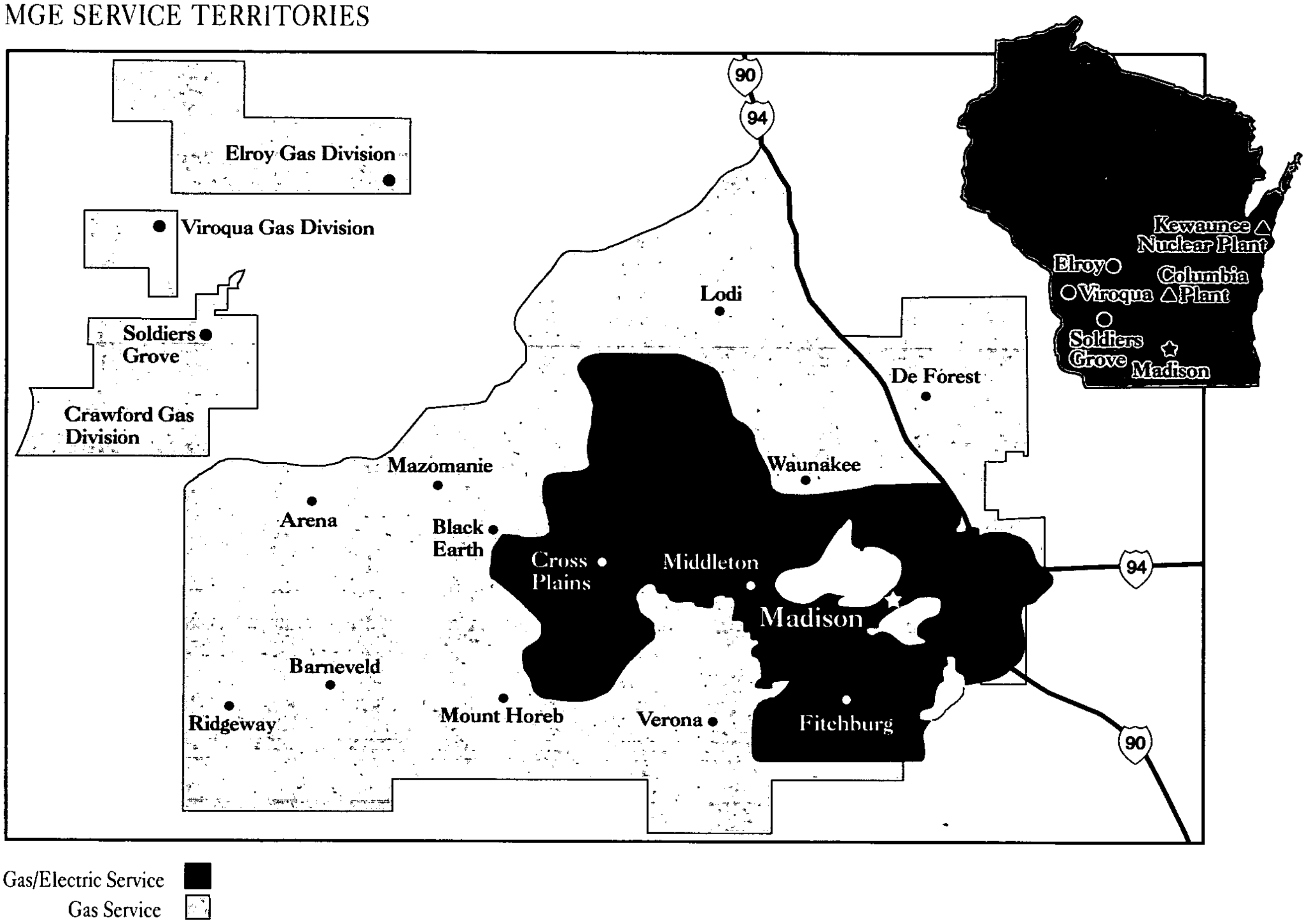
## Environmental Issues

Phase II of the Federal Clean Air Act amendments of 1990 sets stringent $SO_2$ and nitrogen oxide emission limitations, which generally take effect January 1, 2000. These may result in increased capital and operating and maintenance expenditures. Phase II emission compliance strategies for the Company include the following: fuel switching, emission trading, purchased power agreements, new emission control devices, or installation of new fuel-burning technologies and clean coal technologies. Phase II emission compliance strategies and their costs are currently being evaluated. The Company expects no major capital expenditures as a result of Phase II.

From 1980 to 1984, the Company disposed of fly-ash sludge at the Refuse Hideaway Landfill in Middleton, Wisconsin. In October 1992, the Environmental Protection Agency (EPA) placed the Refuse Hideaway Landfill on the national priorities Superfund list of sites requiring clean up under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). The scope of liability under CERCLA is very broad.

The Company is listed as a potentially responsible party on the roster of generators for the Refuse Hideaway Landfill. A group of approximately 45 companies is currently negotiating with EPA on the cleanup of the site. In the opinion of management and legal counsel, the Company's share of the final cleanup costs will not result in any materially adverse effects on the operations, cash flows, or financial position of the Company. Significant insurance recovery may also be available for the cleanup.

MGE SERVICE TERRITORIES



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# CONSOLIDATED STATEMENTS OF INCOME

| For the years ended December 31 | 1996 | 1995 | 1994 |
|---|---|---|---|
| *(Thousands of dollars, except per share amounts)* | | | |
| Operating Revenues | | | |
| Electric | **$152,747** | $153,554 | $149,665 |
| Gas (Note 5) | **100,544** | 95,036 | 95,307 |
| Total Operating Revenues | **253,291** | 248,590 | 244,972 |
| Operating Expenses | | | |
| Fuel for electric generation | **26,676** | 28,017 | 26,167 |
| Purchased power | **11,687** | 8,048 | 10,015 |
| Natural gas purchased | **66,021** | 57,488 | 59,693 |
| Other operations | **58,178** | 61,499 | 56,795 |
| Maintenance | **12,414** | 11,858 | 12,416 |
| Depreciation and amortization | **25,510** | 24,815 | 22,383 |
| Other general taxes | **8,736** | 8,709 | 8,619 |
| Income tax items | **12,553** | 14,285 | 14,822 |
| Total Operating Expenses | **221,775** | 214,719 | 210,910 |
| Net Operating Income | **31,516** | 33,871 | 34,062 |
| AFUDC - equity funds | **40** | 57 | 132 |
| Other income, net | **1,517** | 549 | 1,535 |
| Writedown of nonregulated gas subsidiaries, net (Note 4) | **(10,400)** | — | — |
| Non-utility operating (loss)/income, net | **(5,355)** | 1,000 | 404 |
| Income Before Interest Expense | **17,318** | 35,477 | 36,133 |
| Interest Expense | | | |
| Interest on long-term debt | **9,815** | 10,331 | 10,558 |
| Other interest (Note 5) | **1,097** | 1,205 | 639 |
| AFUDC - borrowed funds | **(21)** | (29) | (75) |
| Net Interest Expense | **10,891** | 11,507 | 11,122 |
| Net Income | **6,427** | 23,970 | 25,011 |
| Preferred stock dividends | **—** | 64 | 471 |
| Earnings on Common Stock | **$ 6,427** | $ 23,906 | $ 24,540 |
| Earnings Per Share of Common Stock (Average shares outstanding - 16,079,718 for all years) | **$0.40** | $1.49 | $1.53 |

# CONSOLIDATED STATEMENTS OF RETAINED INCOME

| For the years ended December 31 | 1996 | 1995 | 1994 |
|---|---|---|---|
| *(Thousands of dollars)* | | | |
| Balance — Beginning of Year | **$ 64,499** | $ 60,851 | $ 56,357 |
| Add - Net income | **6,427** | 23,970 | 25,011 |
| Deduct - Cash dividends on common stock | **(20,475)** | (20,258) | (20,046) |
| Preferred stock dividend | **—** | (64) | (471) |
| Balance—End of Year | **$ 50,451** | $ 64,499 | $ 60,851 |

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

# CONSOLIDATED STATEMENTS OF CASH FLOWS

| For the years ended December 31 | **1996** | 1995 | 1994 |
|---|---|---|---|
| *(Thousands of dollars)* | | | |
| Operating Activities | | | |
| Net income | **$ 6,427** | $23,970 | $25,011 |
| Items not affecting cash: | | | |
| Depreciation and amortization | **25,510** | 24,815 | 22,383 |
| Deferred income taxes | **(7,181)** | (2,442) | 2,428 |
| Amortization of nuclear fuel | **2,098** | 2,740 | 2,803 |
| Amortization of investment tax credits | **(792)** | (768) | (783) |
| AFUDC – equity funds | **(40)** | (57) | (132) |
| Writedown of nonregulated gas subsidiaries | **15,741** | — | — |
| Other | **1,146** | 1,729 | 994 |
| Net Funds Provided from Operations | **42,909** | 49,987 | 52,704 |
| Changes in working capital, excluding cash equivalents, sinking funds, maturities, and interim loans: | | | |
| Increase in current assets | **(3,445)** | (12,168) | (10,789) |
| Increase/(decrease) in current liabilities | **2,458** | 11,287 | (2,127) |
| Other noncurrent items, net | **6,386** | 1,716 | 1,171 |
| Cash Provided by Operating Activities | **48,308** | 50,822 | 40,959 |
| Financing Activities | | | |
| Cash dividends on common and preferred stock | **(20,475)** | (20,322) | (20,517) |
| Maturities/redemptions of First Mortgage Bonds | **(7,840)** | (13,263) | — |
| Increase in long-term debt | **—** | 11,000 | — |
| Other decreases in First Mortgage Bonds | **(162)** | (199) | (58) |
| Decrease in preferred stock | **—** | (5,300) | (200) |
| Decrease in bond construction funds, net | **—** | 8,090 | 10,892 |
| Increase/(decrease) in interim loans | **9,250** | (8,100) | 5,100 |
| Cash Used for Financing Activities | **(19,227)** | (28,094) | (4,783) |
| Investing Activities | | | |
| Acquisition of nonregulated subsidiary | **—** | (8,036) | — |
| Additions to utility plant and nuclear fuel | **(21,906)** | (19,162) | (26,429) |
| AFUDC – borrowed funds | **(21)** | (29) | (75) |
| Increase in nuclear decommissioning fund | **(4,710)** | (4,191) | (2,316) |
| Cash Used for Investing Activities | **(26,637)** | (31,418) | (28,820) |
| Change in Cash and Cash Equivalents | **2,444** | (8,690) | 7,356 |
| Cash and cash equivalents at beginning of period | **2,844** | 11,534 | 4,178 |
| Cash and cash equivalents at end of period | **$ 5,288** | $ 2,844 | $11,534 |

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

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# CONSOLIDATED BALANCE SHEETS

| At December 31<br>*(Thousands of dollars)* | 1996 | 1995 |
|---|---|---|
| **ASSETS** | | |
| Utility Plant, at original cost, in service: | | |
| Electric | **$500,690** | $489,399 |
| Gas | **178,312** | 173,890 |
| Gross Plant in Service | **679,002** | 663,289 |
| Less accumulated provision for depreciation | **(374,315)** | (348,254) |
| Net Plant in Service | **304,687** | 315,035 |
| Construction work in progress | **7,517** | 9,061 |
| Nuclear decommissioning fund | **44,617** | 36,965 |
| Nuclear fuel, net | **8,378** | 6,172 |
| Total Utility Plant | **365,199** | 367,233 |
| Other Property and Investments | **7,115** | 17,176 |
| Current Assets | | |
| Cash and cash equivalents | **5,288** | 2,844 |
| Accounts receivable, less reserves of $1,220 and $1,379, respectively | **39,145** | 36,817 |
| Unbilled revenue | **13,852** | 13,529 |
| Materials and supplies, at average cost | **5,740** | 5,987 |
| Fossil fuel, at average cost | **1,808** | 2,986 |
| Stored natural gas, at average cost | **7,189** | 6,203 |
| Prepaid taxes | **7,258** | 5,846 |
| Other prepayments | **1,429** | 1,608 |
| Total Current Assets | **81,709** | 75,820 |
| Deferred Charges | **30,146** | 33,647 |
| Total Assets | **$484,169** | $493,876 |
| **CAPITALIZATION AND LIABILITIES** | | |
| Capitalization (see statement) | **$307,975** | $322,185 |
| Current Liabilities | | |
| Long-term debt sinking fund requirements | **200** | 200 |
| Maturity of 5.45%, 1996 Series | — | 7,840 |
| Interim loans – commercial paper outstanding | **29,750** | 20,500 |
| Accounts payable | **30,094** | 25,928 |
| Accrued taxes | **79** | 1,500 |
| Accrued interest | **2,322** | 2,359 |
| Accrued nonregulated items (Note 4) | **7,923** | — |
| Other | **7,653** | 7,903 |
| Total Current Liabilities | **78,021** | 66,230 |
| Other Credits | | |
| Deferred income taxes | **46,972** | 54,153 |
| Regulatory liability – SFAS 109 | **23,914** | 25,177 |
| Investment tax credit – deferred | **11,439** | 12,231 |
| Other regulatory liabilities | **15,848** | 13 900 |
| Total Other Credits | **98,173** | 105,461 |
| Commitments | — | — |
| Total Capitalization and Liabilities | **$484,169** | $493,876 |

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

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# CONSOLIDATED STATEMENTS OF CAPITALIZATION

| At December 31 | 1996 | 1995 |
|---|---|---|
| *(Thousands of dollars)* | | |
| Common Shareholders' Equity | | |
| Common stock—par value $1 per share: | | |
| Authorized 50,000,000 shares | | |
| Outstanding 16,079,718 shares | **$ 16,080** | $ 16,080 |
| Amount received in excess of par value | **112,558** | 112,558 |
| Retained income | **50 451** | 64,499 |
| Total Common Shareholders' Equity | **179 089** | 193,137 |
| First Mortgage Bonds | | |
| 5.45%, 1996 Series | **—** | 7,840 |
| 6½%, 2006 Series: | | |
| Pollution Control Revenue Bonds | **6,875** | 7,075 |
| 8.50%, 2022 Series | **40,000** | 40,000 |
| 6.75%, 2027A Series: | | |
| Industrial Development Revenue Bonds | **28,000** | 28,000 |
| 6.70%, 2027B Series: | | |
| Industrial Development Revenue Bonds | **19,300** | 19,300 |
| 7.70%, 2028 Series | **25 000** | 25,000 |
| First Mortgage Bonds Outstanding | **119,175** | 127,215 |
| Unamortized discount and premium on bonds, net | **(1,089)** | (1,127) |
| Long-term debt sinking fund requirements | **(200)** | (200) |
| Maturity of 5.45%, 1996 Series | **—** | (7,840) |
| Total First Mortgage Bonds | **117 886** | 118,048 |
| Other Long-Term Debt | | |
| 6.01%, due 2000 | **11,000** | 11,000 |
| Total Capitalization | **$307,975** | $322,185 |

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

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1996, 1995, and 1994

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### a. General

Madison Gas and Electric Company (the Company) is an investor-owned public utility headquartered in Madison, Wisconsin. The Company generates, transmits, and distributes electricity to about 122,000 customers in a 250-square-mile area of Dane County. The Company also transports and distributes natural gas to over 105,000 customers in 1,325 square miles of service territories in seven counties. The Company has served the Madison area since 1896.

The consolidated financial statements reflect the application of certain accounting policies described in this note. The financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The Company records unbilled revenue on the basis of service rendered. Gas revenues are subject to an adjustment clause related to periodic changes in the cost of gas.

Preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

### b. Utility Plant

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

AFUDC represents the approximate cost of debt and equity capital devoted to plant under construction. 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.

### c. 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 $2.4 million for the Company's portion of the special assessment. The Company believes all costs will be recovered in future rates.

### d. 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)* | **1996** | 1995 | **1996** | 1995 |
| Utility plant | **$85,377** | $85,075 | **$57,929** | $57,853 |
| Accumulated depreciation | **(46,704)** | (44,366) | **(36,271)** | (34,263) |
| Net plant | **$38,673** | $40,709 | **$21,658** | $23,590 |

### e. Depreciation

Provisions at composite straight-line depreciation rates, excluding decommissioning costs discussed as follows, approximate the following percentages of the cost of depreciable property: electric, 3.3 percent in 1996 through 1994; gas, 3.4 percent in 1996 and 3.5 percent in 1995 and 1994. Depreciation rates are approved by the Public Service

Commission of Wisconsin (PSCW) and are generally based on the estimated economic lives of property.

Nuclear decommissioning costs are accrued over the estimated service life of Kewaunee, which is through the year 2013. These costs are currently recovered from customers in rates and are deposited in external trusts. For 1996, the decommissioning costs recovered in rates were $3.1 million.

Decommissioning costs are recovered through depreciation expense, excluding earnings on the trusts. Net earnings on the trusts are included in other income. The long-term, after-tax earnings assumption on these trusts is 6.2 percent. As of December 31, 1996, the decommissioning trusts, totaling $45 million, are shown on the balance sheet in the utility plant section and offset by an equal amount under accumulated provision for depreciation.

The Company's share of Kewaunee decommissioning costs is estimated to be $70.8 million in current dollars based on a site-specific study performed in 1992 using immediate dismantlement as the method of decommissioning. Decommissioning costs as studied are assumed to inflate at an average rate of 6.1 percent. Physical decommissioning is expected to occur during the period 2014 through 2021, with additional expenditures being incurred during the period 2022 through 2050 related to the storage of spent nuclear fuel at the plant site.

## f. Income Taxes

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

| *(Thousands of dollars)* | **1996** | 1995 | 1994 |
|---|---|---|---|
| Income taxes charged to operations | **$12,553** | $14,285 | $14,822 |
| Income taxes charged to other income | **(7,942)** | 786 | 612 |
| Total income taxes | **$ 4,611** | $15,071 | $15,434 |

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

| *(Thousands of dollars)* | **1996** | 1995 | 1994 |
|---|---|---|---|
| Currently payable | | | |
| Federal | **$ 9,317** | $14,602 | $10,985 |
| State | **3,267** | 3,679 | 2,804 |
| Net deferred | | | |
| Federal | **(7,079)** | (2,217) | 1,756 |
| State | **(102)** | (225) | 672 |
| Amortized investment tax credits | **(792)** | (768) | (783) |
| Total income taxes | **$ 4,611** | $15,071 | $15,434 |

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

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

| | **1996** | 1995 | 1994 |
|---|---|---|---|
| Statutory federal income tax rate | **35.0%** | 35.0% | 35.0% |
| Amortized investment tax credits | **(7.2)** | (2.0) | (1.9) |
| State income taxes, net of federal benefit | **7.3** | 5.8 | 5.6 |
| Valuation allowance | **10.9** | — | — |
| Other, individually insignificant | **(4.2)** | (0.2) | (0.5) |
| Effective income tax rate | **41.8%** | 38.6% | 38.2% |

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

| *(Thousands of dollars)* | **1996** | 1995 |
|---|---|---|
| Property-related | **$ 59,522** | $59,767 |
| Other | **6,788** | 8,062 |
| Gross deferred income tax liabilities | **66,310** | 67,829 |
| Accrued expenses | **(7,629)** | (3,571) |
| Other | **(3,311)** | — |
| Deferred tax regulatory account | **(9,598)** | (10,105) |
| Gross deferred income tax assets | **(20,538)** | (13,676) |
| Less valuation allowance | **1,200** | — |
| Net deferred income tax assets | **(19,338)** | (13,676) |
| Deferred income taxes | **$ 46,972** | $54,153 |

Excess deferred income taxes, resulting chiefly from taxes provided at rates higher than current rates, have been recorded as a net regulatory liability ($23.9 million and $25.2 million at December 31, 1996 and 1995, respectively), refundable through future rates.

As discussed in Note 4, the Company's nonregulated gas marketing subsidiaries have entered into a joint venture with an unrelated third party. Realization of state deferred tax assets including net operating loss carryforwards of these subsidiaries is dependent on future income of the joint venture in states where the subsidiaries file separate tax returns. Due to the circumstances associated with these temporary differences, a valuation allowance was established at December 31, 1996, for these deferred tax assets.

For tax purposes, these subsidiaries, as of December 31, 1996, had approximately $8.8 million of state tax net operating loss carryforwards which expire, if unused, in the year 2011.

## g. 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 on 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.

Effective January 1, 1995, the Company began recovering pension costs in customer rates under Statement of Financial Accounting Standard (SFAS) No. 87, "Employers' Accounting for Pensions." Prior to this date, pension costs were recovered in rates as funded. Of these funded pension costs, $0.8 million was charged to operating expenses in 1994. The plans' assets are in a master trust with a bank.

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

| *(Thousands of dollars)* | **1996** | 1995 |
|---|---|---|
| Fair value of plan assets | **$58,010** | $50,152 |
| Actuarial present value of benefits rendered to date–Accumulated benefits based on compensation to date, including vested benefits of $40,840 and $44,554, respectively | **46,019** | 45,574 |
| Additional benefits based on estimated future salary levels | **9,093** | 9,943 |
| Projected benefit obligation | **$55,112** | $55,517 |
| Plan assets greater/(less) than projected benefit obligation | **2,898** | (5,365) |
| Unrecognized net (gain)/loss | **(4,621)** | 1,586 |
| Unrecognized prior service cost | **1,004** | 1,130 |
| Net liability | **$ (719)** | $ (2,649) |

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

| *(Thousands of dollars)* | **1996** | 1995 | 1994 |
|---|---|---|---|
| Service costs (benefits earned during the period) | **$ 1,715** | $ 1,416 | $ 1,462 |
| Interest costs on projected benefit obligation | **4,090** | 3,724 | 3,462 |
| Actual (return)/loss on plan assets | **(6,542)** | (10,033) | 412 |
| Net amortization and deferral | **1,793** | 6,466 | (4,056) |
| Regulatory effect based on funding | **—** | — | (186) |
| Net pension costs | **$ 1,056** | $ 1,573 | $ 1,094 |

The assumed rates for calculations used in the above tables were:

| | **1996** | 1995 | 1994 |
|---|---|---|---|
| Expected long-term rate of return on plan assets | **9.50%** | 9.50% | 9.00% |
| Average rate of increase in salaries | **5.00%** | 5.00% | 5.00% |
| Weighted average discount rate | **7.75%** | 7.25% | 8.25% |

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 1996 through 1994 were $0.2 million for each year.

## h. Postretirement Benefits Other than Pensions

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. These benefits are accrued over the period in which employees provide services to the Company.

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 obligation and costs are based on a discount rate of 7.75 percent in 1996, 7.25 percent in 1995, and 8.25 percent in 1994. The assumed rate of increase in health care costs (health-care-cost trend rate) is 11 percent in 1996, 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 $2.5 million and would increase annual aggregate service and interest costs by $0.3 million.

The Company's policy is to fund the obligation to the yearly maximum through tax-advantaged vehicles. The plan's assets are in trust or on reserve with an insurance company.

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

| *(Thousands of dollars)* | **1996** | 1995 |
|---|---|---|
| Accumulated postretirement benefit obligation (APBO): | | |
| Retirees | **$ (4,192)** | $ (4,054) |
| Fully eligible active plan participants | **(1,662)** | (1,701) |
| Other active plan participants | **(8,526)** | (7,986) |
| Total | **(14,380)** | (13,741) |
| Plan assets at fair value | **3,581** | 2,666 |
| APBO in excess of plan assets | **(10,799)** | (11,075) |
| Unrecognized transition obligation | **6,945** | 7,379 |
| Unrecognized prior service costs | **2,000** | 2,166 |
| Unrecognized gain | **(1,804)** | (1,129) |
| Accrued postretirement benefit liability | **$ (3,658)** | $ (2,659) |

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

| *(Thousands of dollars)* | **1996** | 1995 | 1994 |
|---|---|---|---|
| Service cost | **$ 546** | $ 429 | $ 402 |
| Interest cost on APBO | **1,062** | 989 | 772 |
| Actual return on plan assets | **(266)** | (177) | (91) |
| Net amortization and deferral | **601** | 606 | 427 |
| Regulatory effect based on phase in | **402** | 95 | (115) |
| Net periodic benefit cost | **$2,345** | $1,942 | $1,395 |

### i. Fair Value of Financial Instruments

At December 31, 1996, the carrying amount of cash and cash equivalents approximates fair value. The estimated fair market value of the Company's First Mortgage Bonds and other long-term debt, based on quoted market prices at December 31, is as follows:

| *(Thousands of dollars)* | **1996** | 1995 |
|---|---|---|
| Carrying amount (includes sinking funds) | **$130,175** | $138,215 |
| Fair market value | **$136,332** | $149,469 |

## 2. CAPITALIZATION MATTERS

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

The annual sinking fund requirements of the outstanding first mortgage bonds is $0.2 million in 1997 through 2001. In June 1996, the $7.8 million, 5.45%, 1996 Series, First Mortgage Bonds were retired.

### b. Preferred Stock

The Company has 1,175,000 shares of $25 par value redeemable preferred stock, cumulative, that is authorized but unissued at December 31, 1996.

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

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 had $55 million in bank lines of credit, which included $10 million for Great Lakes Energy Corp. (GLENCO) and American Energy Management Inc. (AEM).

Information concerning short-term borrowings for the years is set forth below:

| *(Thousands of dollars)* | **1996** | 1995 | 1994 |
|---|---|---|---|
| December 31: | | | |
| Available lines of credit (MGE) | **$45,000** | $35,000 | $32,000 |
| Available lines of credit (GLENCO) | **$10,000** | $ 5,000 | — |
| Commercial paper outstanding | **$29,750** | $20,500 | $28,600 |
| Weighted average interest rate | **5.63%** | 5.86% | 6.06% |
| During the year: | | | |
| Maximum short-term borrowings | **$29,750** | $28,600 | $29,500 |
| Average short-term borrowings | **$13,805** | $16,091 | $16,549 |
| Weighted average interest rate | **5.53%** | 6.03% | 4.57% |

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 3. RATE MATTERS

In September 1996, the Company announced its intention to increase electric rates for the test period beginning July 1, 1997, by $7.7 million or 5.1 percent annually and increase natural gas rates by $3.7 million or 3.8 percent annually for the same time period. The proposed changes are based on a requested return on common equity of 12.0 percent and would remain in effect through 1998. The proposed early recovery of the Kewaunee investment and accelerated decommissioning collections are the primary reasons for the increase in electric rates. Hearings will be held during April 1997 with a decision expected by the end of the second quarter of 1997.

The Company filed an application with the PSCW in December 1996 for interim electric rate relief for the first half of 1997. The reason for the interim request is a prolonged outage at Kewaunee, increasing maintenance costs and replacement power normally supplied by Kewaunee. The Company received an interim rate order from the PSCW in March 1997. The order provides for a $0.507 per kilowatt-hour surcharge on customers' bills to cover the continuing costs that will be incurred by the Company while Kewaunee remains out of service. The interim electric rate order is scheduled to remain in effect until either Kewaunee returns to service or the Company receives its final rate order.

## 4. GAS MARKETING SUBSIDIARIES

The Company continually evaluates its asset base, including certain intangible assets such as goodwill, for events or changes in circumstances that indicate the carrying amount of the assets may not be recoverable. Throughout 1996, the Company experienced a decline in operating margins and continuing operating losses at the Company's gas marketing subsidiaries. This prompted the Company to evaluate the assets of the two companies for potential impairment. In the Company's evaluation, it found that some of the assets would not be recoverable. Thus, in December 1996, the Company wrote down its assets in both GLENCO and AEM to properly reflect the current value. The write down resulted in an after-tax charge to income of $10.4 million.

GLENCO and AEM, two unregulated gas marketing subsidiaries, formed a joint venture, effective Januaty 1, 1997, with National Gas & Electric L.P. (NG&E) to market natural gas and energy services to industrial and commercial customers in the Great Lakes region. The joint venture is called National Energy Management, L.L.C. and is based in Chicago. NG&E, a unit of PanCanadian Energy, Inc., is a Houston-based gas marketing company. The partnership gives GLENCO and AEM customers additional services to strengthen their competitive edge while at the same time joining forces with a gas marketing firm with a proven record. NG&E will actively manage the joint venture.

## 5. GLENCO ECONOMIC BENEFIT

In the fourth quarter of 1996, the Company had a one-time charge resulting from a refund to its natural gas customers. Under a sharing mechanism with GLENCO, an economic benefit based on GLENCO's net income was to be passed back to the Company's natural gas utility customers.

GLENCO's economic benefit was $2.5 million plus an additional $0.2 million in interest, which was added to compensate the natural gas utility customers for the time funds were retained, for a total refund of $2.7 million. This had an after-tax impact of $1.6 million on net income. The refund was properly credited to customers through the Purchased Gas Adjustment Clause.

## 6. COMMITMENTS

Utility plant construction expenditures for 1997, including the Company's proportional share of jointly owned electric power production facilities and purchases of fuel for Kewaunee, are estimated to be $31 million, and substantial commitments have been incurred in connection with such expenditures. Significant commitments have also been made for fuel for Columbia.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 7. SEGMENTS OF BUSINESS

The table below presents information pertaining to the Company's segments of business. Information regarding the distribution of net assets between electric and gas for the years ended December 31 is set forth on page 23.

| *(Thousands of dollars)* | 1996 | 1995 | 1994 |
|---|---|---|---|
| Electric Operations | | | |
| Total revenues | **$152,747** | $153,554 | $149,665 |
| Operation and maintenance expenses | **90,862** | 89,994 | 87,748 |
| Depreciation and amortization | **20,094** | 19,503 | 17,337 |
| Other general taxes | **7,000** | 6,908 | 6,907 |
| Pre-tax Operating Income | **34,791** | 37,149 | 37,673 |
| Income taxes | **10,221** | 11,193 | 11,717 |
| Net Operating Income | **$ 24,570** | $ 25,956 | $ 25,956 |
| Construction and Nuclear Fuel Expenditures (Electric) | **$ 16,855** | $ 14,006 | $ 16,804 |
| Gas Operations | | | |
| Operating revenues | **$100,544** | $ 95,036 | $ 95,307 |
| Revenues from sales to electric utility | **2,304** | 3,100 | 1,671 |
| Total Revenues | **102,848** | 98,136 | 96,978 |
| Operation and maintenance expenses | **86,418** | 80,017 | 79,009 |
| Depreciation and amortization | **5,416** | 5,312 | 5,046 |
| Other general taxes | **1,736** | 1,801 | 1,712 |
| Pre-tax Operating Income | **9,278** | 11,006 | 11,211 |
| Income taxes | **2,332** | 3,091 | 3,105 |
| Net Operating Income | **$ 6,946** | $ 7,915 | $ 8,106 |
| Construction Expenditures (Gas) | **$ 5,051** | $ 5,156 | $ 9,625 |

### 8. 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 for the years ended December 31 were as follows:

| *(Thousands of dollars)* | 1996 | 1995 | 1994 |
|---|---|---|---|
| Interest paid, net of amounts capitalized | **$10,932** | $11,894 | $11,235 |
| Income taxes paid | **$16,041** | $18,016 | $13,602 |

### 9. REGULATORY ASSETS AND LIABILITIES

Pursuant to SFAS 71, the Company capitalizes, as deferred charges, incurred costs that are expected to be recovered in future electric and natural gas rates. The Company also records as other credits, obligations to customers to refund previously collected revenue or to spend revenue collected from customers on future costs. The Company's regulatory assets and liabilities consisted of the following as of December 31:

| *(Thousands of dollars)* | 1996 Assets | 1996 Liabilities | 1995 Assets | 1995 Liabilities |
|---|---|---|---|---|
| Demand-side management | **$12,284** | **$ 728** | $14,169 | $ 213 |
| Decommissioning & decontamination | **2,403** | **2,403** | 2,569 | 2,569 |
| Unamortized debt expense | **5,260** | **—** | 5,448 | — |
| Other postretirement benefits | **—** | **3,481** | — | 2,516 |
| Other | **10,199** | **9,236** | 11,461 | 8,602 |
| Other regulatory assets/liabilities | **$30,146** | **$15,848** | $33,647 | $13,900 |
| Regulatory liability – SFAS 109 | **—** | **23,914** | — | 25,177 |
| Total | **$30,146** | **$39,762** | $33,647 | $39,077 |

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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, 1996 and 1995, and the related consolidated statements of income and retained income and cash flows for the years ended December 31, 1996, 1995, and 1994. 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.

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, 1996 and 1995, and the consolidated results of their operations and their cash flows for the years ended December 31, 1996, 1995, and 1994, in conformity with generally accepted accounting principles.

Coopers & Lybrand LLP

Milwaukee, Wisconsin
February 7, 1997

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# QUARTERLY SUMMARY OF OPERATIONS AND STOCK PRICES

| *(Thousands of dollars, except per share amounts)* | Quarters Ended (Unaudited) March 31 | June 30 | Sept. 30 | Dec. 31 |
|---|---|---|---|---|
| **1996** | | | | |
| Operating Revenues: | | | | |
| Electric | **$36,078** | **$35,996** | **$44,547** | **$36,126** |
| Gas | **43,977** | **14,378** | **8,345** | **33,844** |
| Total | **80,055** | **50,374** | **52,892** | **69,970** |
| Operating Expenses | **68,311** | **44,059** | **43,851** | **65,554** |
| Net Operating Income | **11,744** | **6,315** | **9,041** | **4,416** |
| Interest, Preferred Dividends, and Other | **4,378** | **3,274** | **3,559** | **13,878** |
| Earnings on Common Stock | **$ 7,366** | **$ 3,041** | **$ 5,482** | **$ (9,462)** |
| Earnings per Common Share | **46.0¢** | **19.0¢** | **34.0¢** | **(59.0)¢** |
| Dividends Paid per Common Share | **31.7¢** | **31.7¢** | **32.0¢** | **32.0¢** |
| Price per Common Share – High | **$27½** | **$25¾** | **$23¾** | **$22⅜** |
| – Low | **$23⅛** | **$21½** | **$21½** | **$19⅝** |
| 1995 | | | | |
| Operating Revenues: | | | | |
| Electric | $ 34,612 | $ 35,980 | $ 47,316 | $ 35,646 |
| Gas | 39,840 | 12,540 | 7,407 | 35,249 |
| Total | 74,452 | 48,520 | 54,723 | 70,895 |
| Operating Expenses | 64,323 | 43,752 | 44,709 | 61,935 |
| Net Operating Income | 10,129 | 4,768 | 10,014 | 8,960 |
| Interest, Preferred Dividends, and Other | 1,566 | 1,986 | 2,489 | 3,924 |
| Earnings on Common Stock | $ 8,563 | $ 2,782 | $ 7,525 | $ 5,036 |
| Earnings per Common Share | 53.0¢ | 17.0¢ | 47.0¢ | 32.0¢ |
| Dividends Paid per Common Share | 31.3¢ | 31.3¢ | 31.7¢ | 31.7¢ |
| Price per Common Share – High | $21⅞ | $21⅞ | $22⅝ | $23⅜ |
| – Low | $20⅝ | $20½ | $20⅜ | $21⅞ |

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 18,245 shareholders as of January 31, 1997. 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 National Stock Market under the symbol MDSN.

## SUMMARY OF SELECTED FINANCIAL AND OPERATING DATA

| | 1996 | 1995 | 1994 | 1993 | 1992 | 1986 |
|---|---|---|---|---|---|---|
| **ELECTRIC** | | | | | | |
| Operating Revenues ($000s) | | | | | | |
| Residential | $ 53,971 | $ 54,928 | $ 51,751 | $ 51,718 | $ 49,479 | $ 41,460 |
| Commercial power and lighting | 74,291 | 72,885 | 79,295 | 78,085 | 76,042 | 65,736 |
| Industrial power and lighting | 10,095 | 10,245 | 9,022 | 7,999 | 7,930 | 5,818 |
| Street and highway lighting and public authorities | 13,236 | 13,855 | 7,684 | 8,076 | 7,692 | 9,537 |
| Other utilities | 466 | 1,092 | 1,584 | 367 | 602 | 2,284 |
| Miscellaneous | 688 | 549 | 329 | 956 | 901 | 548 |
| Total Operating Revenues | $ 152,747 | $ 153,554 | $ 149,665 | $ 147,201 | $ 142,646 | $ 125,383 |
| Kilowatt-hour Sales (000s) | | | | | | |
| Residential | 725,471 | 735,442 | 679,211 | 666,991 | 625,231 | 569,747 |
| Commercial power and lighting | 1,381,043 | 1,347,947 | 1,448,474 | 1,405,857 | 1,345,730 | 1,084,219 |
| Industrial power and lighting | 289,903 | 292,649 | 221,384 | 173,266 | 166,807 | 107,582 |
| Street and highway lighting and public authorities | 305,962 | 320,869 | 169,755 | 176,389 | 166,419 | 198,366 |
| Other utilities | 26,815 | 26,344 | 34,990 | 12,510 | 30,765 | 62,087 |
| Total Sales | 2,729,194 | 2,723,251 | 2,553,814 | 2,435,013 | 2,334,952 | 2,022,001 |
| Average Number of Customers | | | | | | |
| Residential | 104,778 | 103,624 | 102,255 | 100,721 | 99,244 | 91,577 |
| Commercial power and lighting | 15,841 | 15,581 | 15,348 | 15,037 | 14,840 | 13,414 |
| Industrial power and lighting | 74 | 75 | 75 | 77 | 80 | 87 |
| Street and highway lighting and public authorities | 53 | 52 | 51 | 53 | 51 | 51 |
| Other utilities | 5 | 5 | 4 | 3 | 3 | 4 |
| Total Average Customers | ,120,751 | ,119,337 | ,117,733 | ,115,891 | ,114,218 | ,105,133 |
| **GAS** | | | | | | |
| Operating Revenues ($000s) | | | | | | |
| Residential | $ 57,486 | $ 53,021 | $ 51,812 | $ 52,598 | $ 48,263 | $ 44,349 |
| Commercial | 36,917 | 33,550 | 33,436 | 35,757 | 29,730 | 33,700 |
| Industrial | 1,105 | 2,361 | 2,547 | 2,088 | 1,900 | 3,481 |
| Best efforts (includes interruptible boiler fuel) | 3,849 | 4,147 | 5,782 | 5,723 | 4,949 | 2,665 |
| Gas transport, net | 2,360 | 1,540 | 968 | 151 | 488 | 470 |
| Miscellaneous | (1,173) | 417 | 762 | 615 | 26 | 299 |
| Total Operating Revenues | $ 100,544 | $ 95,036 | $ 95,307 | $ 96,932 | $ 85,356 | $ 84,964 |
| Therms Sold and Transported (000s) | | | | | | |
| Residential | 96,062 | 89,099 | 84,326 | 84,713 | 79,031 | 69,512 |
| Commercial | 79,381 | 73,307 | 73,752 | 83,807 | 65,285 | 64,023 |
| Industrial | 2,653 | 6,279 | 8,056 | 6,651 | 4,587 | 7,725 |
| Best efforts (includes interruptible boiler fuel) | 11,689 | 15,143 | 18,633 | 18,079 | 15,860 | 7,074 |
| Gas transport, net | 37 707 | 36 502 | 22 463 | 1 678 | 10 104 | 8,107 |
| Total Sold and Transported | 227 492 | 220,330 | 207,230 | 194,928 | 174,867 | 156,441 |
| Average Number of Customers | | | | | | |
| Residential | 91,918 | 89,952 | 87,194 | 83,129 | 80,508 | 66,647 |
| Commercial | 11,799 | 11,483 | 11,053 | 10,477 | 10,184 | 8,126 |
| Industrial | 76 | 74 | 68 | 71 | 71 | 69 |
| Best efforts (includes interruptible boiler fuel) | 52 | 60 | 64 | 53 | 49 | 5 |
| Total Average Customers | 103,845 | 101,569 | 98,379 | 93,730 | 90,812 | 74,847 |

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# SUMMARY OF SELECTED FINANCIAL AND OPERATING DATA

| | 1996 | 1995 | 1994 | 1993 | 1992 | 1986 |
|---|---|---|---|---|---|---|
| | *(Thousands of dollars, except per share amounts)* | | | | | |
| **Income, Earnings, and Dividends** | | | | | | |
| Net income | **$ 6,427** | $ 23,970 | $ 25,011 | $ 24,675 | $ 23,807 | **$ 19,796** |
| Earnings on common stock | **$ 6,427** | $ 23,906 | $ 24,540 | $ 24,186 | $ 23,301 | **$ 18,696** |
| Earnings per average common share | **$ 0.40** | $ 1.49 | $ 1.53 | $ 1.51 | $ 1.45 | **$ 1.28** |
| Cash dividends paid per common share | **$1.273** | $1.260 | $1.247 | $1.227 | $1.193 | **$1.033** |
| **Assets (year end)** | | | | | | |
| Electric | **$315,022** | $ 327,053 | $ 323,870 | $ 328,048 | $ 325,510 | **$ 279,098** |
| Gas | **116,723** | 119,968 | 118,210 | 114,626 | 106,837 | **92,695** |
| Assets not allocated | **52,424** | 46,855 | 45,679 | 22,690 | 20,390 | **30,462** |
| Total | **$484,169** | $493,876 | $487,759 | $ 465,364 | $452,737 | **$402,255** |
| **Internal Generation of Cash** | | | | | | |
| Total cash used for construction expenditures and nuclear fuel | **$ 21,906** | $ 19,162 | $ 26,429 | $ 23,648 | $ 16,364 | **$ 29,670** |
| Percent generated internally | **101.6%** | 126.0% | 120.8% | 128.3% | 180.6% | **93.2%** |
| **Long-term Debt and Redeemable Preferred Stock, Net (year end)** | **$128,886** | $129,048 | $ 135,900 | $ 125,796 | $127,963 | **$129,116** |
| **Capitalization Ratios (year end)** | | | | | | |
| Common shareholders' equity | **53.0%** | 55.1% | 53.4% | 55.3% | 55.4% | **50.3%** |
| Redeemable preferred stock | **0.0** | 0.0 | 1.5 | 1.7 | 1.8 | **4.9** |
| Long-term debt | **38.2** | 39.1 | 37.0 | 36.0 | 37.6 | **44.0** |
| Short-term debt (interim loans) | **8.8** | 5.8 | 8.1 | 7.0 | 5.2 | **0.8** |
| **Common Stock Data (year end)** | | | | | | |
| Per share – Close | **$ 20¼** | $ 23⅜ | $ 21⅝ | $ 22½ | $ 21⅝ | **$ 12¼** |
| Per share – Book value | **$ 11.14** | $ 12.01 | $ 11.79 | $ 11.51 | $ 11.25 | **$ 9.10** |
| Shares (000s) – Outstanding | **16,080** | 16,080 | 16,080 | 16,055 | 16,046 | **14,637** |
| – Authorized | **50,000** | 28,000 | 28,000 | 28,000 | 28,000 | **14,000** |
| **Interest Coverages (excludes AFUDC)** | | | | | | |
| Pre-tax | **2.73** | 4.31 | 4.54 | 4.30 | 3.72 | **4.98** |
| After-tax | **1.58** | 3.07 | 3.22 | 3.10 | 2.77 | **2.99** |
| **Sources of Energy Generated and Purchased Power** | | | | | | |
| Coal | **63.4%** | 61.3% | 55.6% | 47.1% | 56.1% | **59.1%** |
| Nuclear | **19.6** | 23.5 | 26.2 | 26.6 | 27.4 | **31.2** |
| Purchased Power | **14.9** | 11.6 | 16.4 | 23.1 | 12.5 | **7.5** |
| Gas | **1.8** | 3.4 | 1.6 | 3.2 | 3.6 | **1.8** |
| Other | **0.3** | 0.2 | 0.2 | — | 0.4 | **0.4** |
| **Cooling Degree Days (Normal – 619)** | **408** | 982 | 637 | 630 | 342 | **496** |
| **Heating Degree Days (Normal – 7,483)** | **8,124** | 7,431 | 7,170 | 7,351 | 7,050 | **7,821** |

## *Board of Directors*

**Jean Manchester Biddick**
Retired Chief Executive Officer,
Neesvig's Inc.
Age 70
Director Since 1982

**Richard E. Blaney**
Retired President,
Richard Blaney Seeds Inc.
Age 60
Director Since 1974

**David C. Mebane**
Chairman, President and
Chief Executive Officer
Age 63
Director Since 1984

**Regina M. Millner**
President,
RMM Enterprises, Inc.
Age 52
Director Since 1996

**Frederic E. Mohs**
Partner,
Mohs, MacDonald,
Widder & Paradise,
Attorneys at Law
Age 59
Director Since 1975

**Phillip C. Stark**
Chairman of the Board,
The Stark Company
Age 71
Director Since 1985

**H. Lee Swanson**
Chief Executive Officer,
President and Director,
State Bank of Cross Plains
Age 58
Director Since 1988

**Frank C. Vondrasek**
Vice Chairman
Age 68
Director Since 1982

## *Officers of the Company*

**David C. Mebane**
Chairman, President and
Chief Executive Officer
Age 63
Years of Service, 19

**Robert E. Domek**
Executive Vice President
Age 66
Years of Service, 27

**Mark C. Williamson**
Senior Vice President -
Energy Services
Age 43
Years of Service, 10

**Gary J. Wolter**
Senior Vice President -
Administration and Secretary
Age 42
Years of Service, 12

**James C. Boll**
Vice President -
Law and Corporate Communications
Age 61
Years of Service, 6

**Terry A. Hanson**
Vice President and Treasurer
Age 45
Years of Service, 15

**Lynn K. Hobbie**
Vice President - Marketing
Age 38
Years of Service, 11

**Thomas R. Krull**
Vice President -
Electric Transmission
and Distribution
Age 47
Years of Service, 24

**Joseph T. Krzos**
Vice President - Finance
Age 52
Years of Service, 14

**Richard H. Thies**
Vice President -
Gas Systems Operation
Age 55
Years of Service, 33

**Deborah L. Burgess**
Assistant Vice President -
Gas Rates and Fuels
Age 37
Years of Service, 8

**Peter J. Waldron**
Assistant Vice President -
Power Supply Operations
and Engineering
Age 39
Years of Service, 16

**Carol A. Wiskowski**
Assistant Vice President -
Administration and
Assistant Secretary
Age 57
Years of Service, 30

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**Audit Committee**
Directors: Biddick, Blaney, Millner, Mohs, Stark, Swanson and Vondrasek

**Compensation Committee**
Directors: Blaney, Mohs and Stark

**Executive Committee**
Directors: Biddick, Blaney, Mebane, Mohs and Vondrasek

**Personnel Committee**
Directors: Biddick, Mebane, Millner, Mohs, Swanson and Vondrasek

Note: Ages and years of service as of December 31, 1996.

## 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 1997 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.

## TRANSFER AGENT & REGISTRAR

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

## INVESTORS PLUS PLAN

MGE's Investors Plus Plan offers investors the opportunity to purchase company stock directly from MGE. Investors can make cash payments of $25 to $25,000 per quarter per account. A minimum of $50 is required for a first-time investment.

Shares can be purchased each month by automatic deductions from checking or savings accounts.

Shareholders may reinvest all or a portion of cash dividends received on any or all shares of common stock in their account. Cash dividends can be paid by check or electronic deposit.

For more information or to receive the plan prospectus, contact MGE Shareholder Services.

## STOCK LISTING

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

## 1997 ANNUAL MEETING

The annual meeting of shareholders will be held Monday, May 5, 1997, at 11 a.m.

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

## REPORTS AVAILABLE

Upon request, we will provide you with a copy of Form 10-K, our 1996 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, Vice President - Finance
Madison Gas and Electric Company
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
Internet: http://www.mge.com

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

MGE® P.O. Box 1231
Madison, Wisconsin 53701-1231



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# - NOTICE -

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