Madison Gas and Electric Company 1980 Annual Report

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The Year At A Glance

	1980	1979	Percent increase (decrease) 1980-1979
Operating revenues	**$161,756,000**	$144,380,000	12.0%
Operating expenses	**$138,266,000**	$123,651,000	11.8
Net income	**$ 15,548,000**	$ 12,822,000	21.3
Earnings on common stock	**$ 12,399,000**	$ 9,628,000	28.8
Earnings per common share outstanding	**$2.21**	$1.76	25.6
Cash dividends paid per common share*	**$1.66**	$1.48	12.2
Weighted average number of shares outstanding	**5,607,319**	5,477,541	2.4
Book value—year end	**$18.19**	$17.76	2.4
Electric sales to consumers	**1,664,220 mwh**	1,609,525 mwh	3.4
Electric customers in service—year end	**98,946**	95,237	3.9
Average use per residential customer	**6,111 kwh**	5,897 kwh	3.6
Electric system one-hour net peak demand	**372,000 kw**	349,000 kw	6.6
Gas sales to consumers	**17,767,000 mcf**	19,141,000 mcf	(7.2)
Gas customers in service—year end	**68,174**	63,466	7.4
Gas system peak day	**135,844 mcf**	129,776 mcf	4.7
Investment in plant	**$362,235,000**	$346,236,000	4.6
Total capitalization (incl. interim loans)	**$240,590,000**	$235,226,000	2.3
Number of employees—year end	**578**	549	5.3

*On November 21, 1980, the directors authorized an increase of 2 cents per share in the quarterly dividend, payable December 15, 1980, increasing the total dividend to 43 cents per share quarterly or the equivalent of $1.72 per share annually.

Business Description

Madison Gas and Electric Company generates, transmits, and distributes electric power, and purchases and distributes natural gas in the Madison trading area. The electric service area covers about 220 square miles, and natural gas is distributed throughout a 750-square-mile area. While its service area is compact, it is a growing community with a population of about 250,000 in the Cities of Madison, Middleton, Monona, two adjoining villages, surrounding areas including ten outlying villages, and the Cities of Lodi and Verona.

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Front Cover—MGE Gas Distribution personnel install new gas regulators at the Company's North Madison Gate Station.

Back Cover—MGE Electric Distribution and contractor personnel install cable in the new underground 69-kv, Walnut-West Middleton Transmission Line.

Individuals (top to bottom)—Joanne Tourdot, Laborer, Electric Production; John Blackmon, Lineman, Electric Distribution; Karen Kritzer, Manager, Records Management; Claine Judd, Superintendent, Gas Systems Operation.

125 Years of Service

8104060437

To Our Shareholders

We look on 1980, our 125th year of service, as a year of positive accomplishment for your Company. While inflation continued to push expenses up, we were able to achieve earnings and dividend growth, due in part to electric and gas rate increases that became effective in March, 1980, and also by effecting economies in operations. In the long run, this will benefit our customers and community as much as our employees and shareholders.

Another positive note was the continued improvement in natural gas supplies available to MGE.

Revenues and Expenses Grow

The $162 million total revenues for 1980 is an increase of 12 percent over the $144 million in revenues for 1979. Operating expenses also increased, to $138 million from $124 million, up nearly 12 percent over 1979. The fact that expenses increased as fast as revenues, even in the face of stringent efforts to control them, clearly illustrates inflation's impact and the need for the rate increases that were granted.

Dividends Increased

Common stock dividends were increased from $1.48 to $1.64 per share (on an annualized basis) in March, and further to $1.72 annually per share in December. This overall increase of 16 percent reflects the continuing need to compensate those who have invested in the Company if our capital structure is to remain sound and our cost of money is to remain reasonable.

Rate Increases Granted

As previously reported, the Public Service Commission of Wisconsin (PSCW) approved a $9 million total annual increase in revenues ($6 million for electric service and $3 million for gas). Two aspects of the rate order, however, became the subject of challenge through legal action initiated by MGE. One was a $1.27 million reduction by the PSCW in anticipated revenue from sales to other utilities, and the other involved mandatory time-of-use rates for larger residential users. In November, the Circuit Court ruled in the Company's favor by ordering the PSCW to reconsider both matters. The PSCW appealed the ruling on the revenue matter and has held additional hearings regarding both matters.

Although we had requested a 14 percent return on common stock equity, the rate order still permits only the 13 percent return that we have been authorized since 1976. In 1980, we earned 12.2 percent on our common stock. This is an increase over the 9.9 percent earned in 1979. During 1980, however, inflation continued virtually unchecked; the prime interest rate exceeded 21 percent at times.

Financial Future Good

Still, the quality of our earnings remains solid. Internal generation of funds continues at satisfactory levels — and is expected to grow in proportion to our construction needs over the next few years. During the last half of the 1970s, construction averaged just under $30 million each year, while internal generation of funds was about $18 million. For the next three to five years, however, we expect to internally generate all of the funds needed for our construction program. Therefore, we will be doing little financing through stock or bond issues in the near future.

New Office Facilities

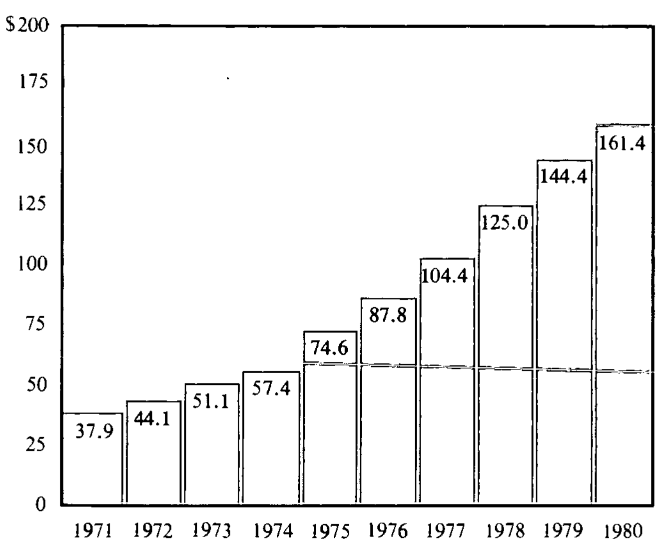
We submitted an application to the PSCW in January, 1981, for authority to construct a new office building next to our operating facilities in Madison. The primary reason for the new building is the high cost of the space limitations and severe overcrowding at our present headquarters, part of which is nearly 60 years old. The overcrowding forces us to rent outside space. By consolidating all Company facilities in one area, considerable operating efficiencies and cost savings will be realized.

The proposed new building will contain about 90,000 net usable square feet of space plus a parking ramp. Total cost is estimated at $9.8 million.

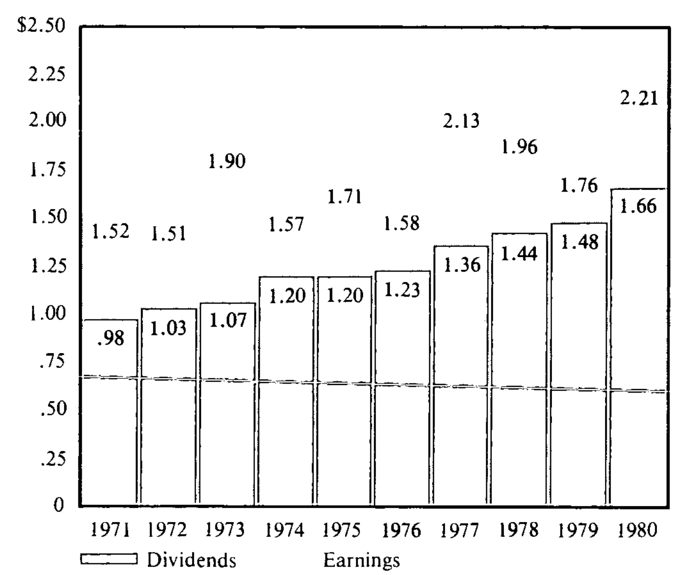
Management Changes

In mid-1980, a number of internal changes were made to our management

Revenues (millions)



Dividends and Earnings (per common share)



structure. The number of people reporting to the president has been reduced.

Executive Vice President Leo Brodzeller's duties have been realigned to primarily reflect direction of administrative activities of the Company. Frank Vondrasek, formerly Vice President-Electric System Operation, has been elected Executive Vice President with responsibilities for the Company's operations, including electric and gas production and supply, transmission, and distribution services, as well as customer services.

The position of Vice President-Customer Services was created; Terrence Schuh, formerly Director of Rates and Assistant Vice President, was elected to it. All customer services, including many that were previously spread through more than one division, now are the responsibility of Mr. Schuh, working in the Operations Division.

G. Howard Phipps was promoted to Vice President-Finance and Treasurer from the position of Treasurer and Assistant Secretary. David Mebane, formerly Corporate Attorney, was elected to the position of General Counsel.

Other changes have been made at all management levels to update our organizational structure. We expect that they will increase the Company's responsiveness to present and future demands of individual customers, as well as those of the many private and governmental organizations with whom we interact.

Employee Relations Good

The ability of any organization to operate successfully is controlled to a large extent by the expectations and motivations of the people within it. This is certainly true of MGE, whose employees span a wide range of knowledge, experience, and skills – including both highly technical and non-technical.

A two-year agreement effective May 1, 1980, was completed with the Office and Professional Employees International Union, Local No. 37, representing our 131 clerical employees. A one-year agreement, also effective May 1, 1980, was completed with the International Brotherhood of Electrical Workers, Local No. 2304, representing 258 operating employees. Both agreements conformed to federal wage and price guidelines. Discussion regarding renewal of the IBEW agreement will begin in March.

Future Outlook Promising

Looking ahead, we believe that the next several years present a promising outlook for your Company. We expect continued growth in number of customers and in total needs for our services. However, this growth will be taking place at a pace that will not require us to engage in any extensive, large-scale construction that would require external financing when capital costs apparently will be high.

A negative aspect of the future is the possibility of continued high inflation. This will continue to test our ability to control costs and maintain revenues at a level sufficient to offset the rising costs of operations.

We appreciate your continued confidence, interest, and support and urge you to review the rest of this report to learn more about your Company's operations. Your comments about any phase of MGE's activities are welcome.

For the Board of Directors:

William A. McNamara
William A. McNamara
Chairman of the Board

Donald J. Helfrecht
Donald J. Helfrecht
President

February 20, 1981

W.A. McNamara (left) and D.J. Helfrecht (right).

Dedicated People Make It Happen

Electric Operations

MGE provided electricity for 98,946 customers within its 220-square-mile electric service area in 1980, an increase of 3,709 customers over 1979. Electric sales were 2.2 billion kilowatt-hours (kwh) compared to 2.3 billion in 1979. The lack of growth in energy sales is an indication of conservation by our customers. Electric revenues totaled $94.9 million in 1980 compared to $88.8 million the prior year.

Generating Capacity Adequate

The Company's generating capability of 597,000 kilowatts (kw) is sufficient to readily satisfy the demands of MGE customers. Generating capacity is 15 percent base-load nuclear fueled, 70 percent base-load and intermediate-load coal fired, and 15 percent oil- or gas-fired combustion turbines for peak loads.

During 1980, 29 percent of the electricity generated was supplied by nuclear fuel at Kewaunee while 64 percent came from coal units at the Columbia Energy Center and the Blount Generating Station in Madison. Seven percent was furnished by the combustion turbines during peak-load periods. About 10,260 tons of local refuse was burned along with coal at Blount to generate electricity, replacing about 4,700 tons of coal.

Reach New Peak

A new electric peak demand, 372,000 kw, was reached twice during the hot weather last summer. MGE's long-range forecasts predict continuing growth in peak demand, averaging about 3 percent per year, depending on weather and economic conditions.

Revenues in 1980 continued to include substantial sales of capacity and energy to other utilities. The Company is in a selling position through a pooling arrangement with Wisconsin Power and Light Company and Wisconsin Public Service Corporation. This pool and MGE each also sells directly to Wisconsin Electric Power Company, Milwaukee. Even with present rates of retail sales growth within the Company's own service area, MGE expects this selling posture to continue for several years.

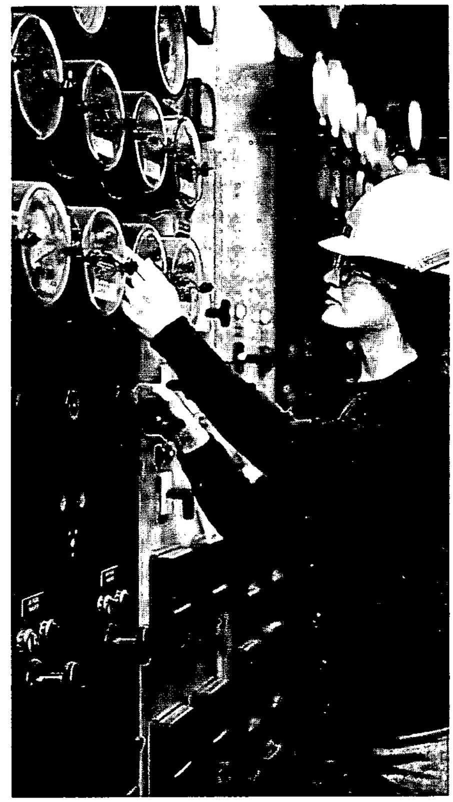
System Improves Efficiency

A two-year program of tabulation, identification, and computerization was completed in late fall and now is helping achieve the most economical use of the Company's nearly 16,000 electric distribution transformers. This load management system identifies MGE electric customers with the transformers serving them, providing historical data on the loads served by each transformer. The loading data then is compared with the capacity of each transformer to determine if it is overloaded or underloaded.

Having this information available on a timely basis helps the Company to maintain a high level of service continuity by identifying transformers that might become overloaded. This system also identifies those transformers that may be under-utilized, which then can be downsized to reduce expenditures for transformer capacity. In the partial year that the project has been operational, the savings have paid for the development costs and they will continue to accrue.

NRC Reviews Kewaunee

The Nuclear Regulatory Commis-



Barbara Cook, Electric Production

Danny Gest, Turbine Repair

Pedro Pena, Coal Unloading

sion (NRC) Region 3 staff, completed its annual review of the Kewaunee plant in May, 1980. The Company owns a 17.8 percent interest in this plant. (Region 3 is headquartered in Chicago and includes Illinois, Indiana, Iowa, Michigan, Minnesota, Missouri, Ohio, and Wisconsin.) Of the 13 nuclear units in Region 3, Kewaunee was found to have one of the best records for inspection results, enforcement action, and licensed events reports, all of which relate to NRC's standards of compliance with safety regulations.

Kewaunee's performance record is equally impressive. From the start of commercial operation in 1974 through May 10, 1980, the reactor has been available for service 89 percent of the time and the plant has been available for generating electricity 83 percent of the time. These availabilities are above industry norms. During this period, some 21.7 billion kwh of electricity has been generated.

Construction Projects Finished

Construction of the new 7.5-mile, 69-kv, Walnut-West Middleton transmission line was completed in December, 1980. Five miles of this line is pipe-type underground cable. It makes capacity available from the 138-kv transmission supply west of Madison to the new University of Wisconsin Medical Center complex and surrounding areas on the near-west side of the city. This project was a significant milestone in the completion of a major spoke in the Company's transmission grid between the central city area and the electric transmission loop around the service area.

The third phase of an 11-mile, three-year underground electric conductor replacement project was finished late last summer. It was a cooperative venture that consolidated new telephone and cable television lines in the same trench as the electric cable. This saved time, divided costs among three participants, and minimized digging.

Substation Work in Progress

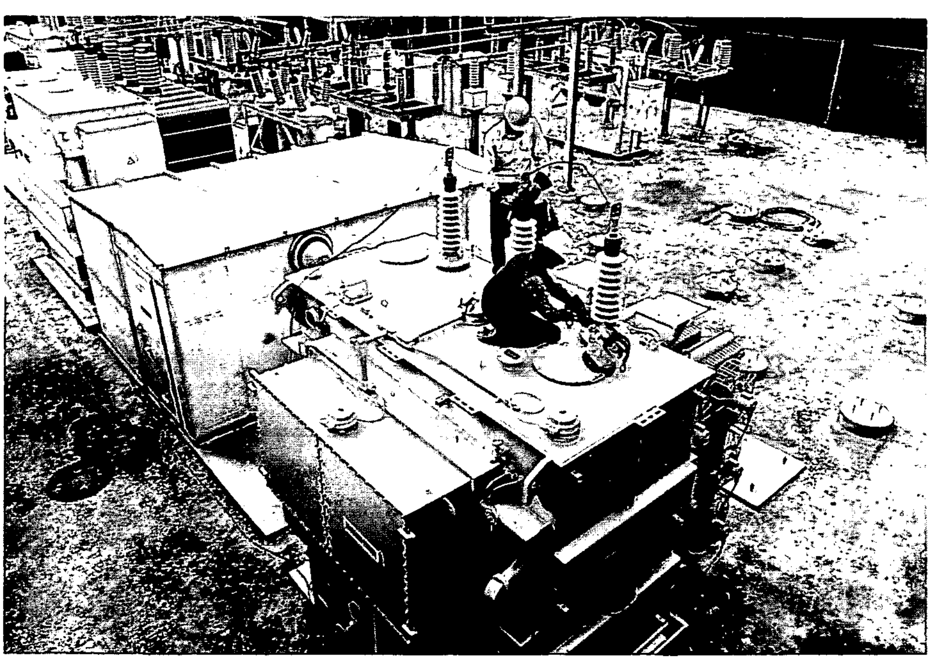
Construction was begun in 1980 to upgrade the Company's existing Blount, North Madison, West Towne, and Sycamore transmission substations, with work scheduled to be completed in early 1981. The new Huiskamp substation was placed in service during the year as well.

Weather Monitoring Goes 'Live'

A color weather radar system that provides real time or "live" displays of weather went into service at the Power Supply Office early in 1980. The system – jointly owned by MGE, Wisconsin Power and Light Company, and WKOW-TV – is a precipitation tracking system with a range of up to 250 miles.

The major equipment is at the television station's studio. The radar picture is transmitted to MGE over a telephone circuit for display on a television receiver. An overlay on the screen shows the Company's electric transmission system on a map of the area. The precipitation rate is indicated by various colors, ranging from light blue for light precipitation to red for very heavy.

The new system better prepares the staff to deal with approaching weather by pinpointing the areas most likely to be severely affected. Line crews and customer service personnel then can be dispatched where needed most.


Transformer Installation, West Towne Substation

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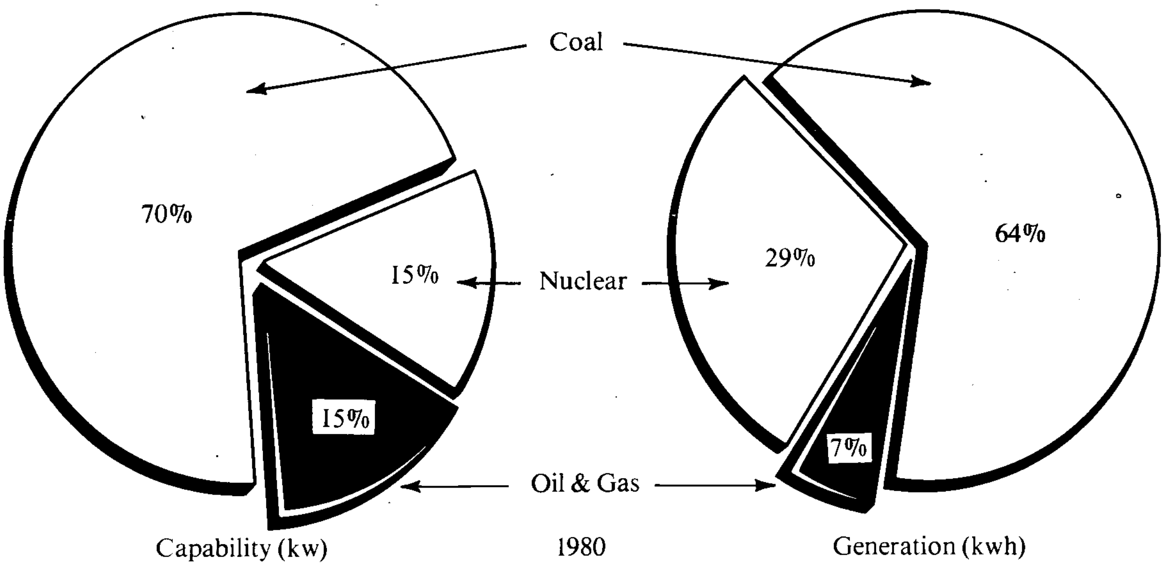
Electric Operations



Electric Service

	1980	1979	1978	1977	1976	1975	1970
Sales (Megawatt-bours)							
Residential	513,508	485,745	503,767	492,397	485,951	486,362	420,788
Commercial power & lighting	849,982	789,811	766,355	724,977	691,947	671,200	476,836
Industrial power & lighting	111,069	124,854	114,311	104,743	100,219	102,705	111,350
Street & highway lighting & public authorities	189,661	209,115	215,069	214,769	217,662	214,775	161,347
Other utilities	582,561	690,656	537,616	189,494	148,134	129,132	131,733
Total	2,246,781	2,300,181	2,137,118	1,726,380	1,643,913	1,604,174	1,302,054
Revenues (000)							
Residential	$25,221	$22,429	$22,130	$20,974	$17,585	$16,393	$ 7,768
Commercial power & lighting	38,716	32,739	30,157	27,802	23,043	20,800	8,605
Industrial power & lighting	4,536	4,547	3,983	3,598	2,905	2,765	1,485
Street & highway lighting & public authorities	7,079	6,704	6,447	6,223	5,176	4,606	1,792
Other utilities	19,380	22,383	15,488	6,426	3,950	2,716	1,544
Total	$94,932	$88,802	$78,205	$65,023	$52,659	$47,280	$21,194
Customers at Year End							
Residential	86,630	83,264	81,671	79,788	78,042	76,404	65,550
Commerical power & lighting	12,173	11,808	11,609	11,228	11,061	10,804	9,314
Industrial power & lighting	102	122	139	127	141	137	184
Street & highway lighting & public authorities	38	40	36	38	35	37	41
Other utilities	3	3	3	3	3	3	3
Total	98,946	95,237	93,458	91,184	89,282	87,385	75,092
Residential (Averages)							
Kilowatt-hours per customer	6,111	5,897	6,241	6,262	6,299	6,455	6,540
Rate per kilowatt-hour	4.91¢	4.62¢	4.39¢	4.26¢	3.62¢	3.37¢	1.85¢

Gas Operations

The Company added 4,709 new residential and small commercial customers during 1980. This is more than double the average of about 1,900 customer additions per year over the past decade. This large increase is due mainly to the great interest in use of natural gas for house heating that has come about with the rapid increase in the price of other fuels. The total number of gas customers rose to 68,174, spread over the 750-square-mile service territory. Gas sales were 178 million therms compared to 193 million last year, a 7.7 percent decrease. The decrease in gas use reflects the continuing successful conservation efforts of consumers and greater use of coal by the University of Wisconsin. Revenues were up $11.7 million over 1979, to $66.6 million in 1980.

Factors remain that tend to slow growth, however; these are the economic conditions that are limiting new home construction and the regulations requiring energy conservation measures before gas can be supplied for space heating in new or existing homes.

Supplies Plentiful

All of the Company's natural gas is purchased from Michigan Wisconsin Pipe Line Company (Mich-Wis). MGE recently was informed by Mich-Wis that it can provide all of the gas the Company can sell during the next three years. The primary reason for this excellent supply outlook is the positive effect of the Natural Gas Policy Act of 1978 in encouraging domestic gas exploration and production.

A supply and market forecast by Mich-Wis shows that, by the end of the decade, more than half of that

Dean Hewitt, Gas Furnace Inspection

Gas Service

	1980	1979	1978	1977	1976	1975	1970
Sales (Thousands of Therms)							
Residential	68,499	68,599	68,145	64,562	66,709	62,309	55,300
Commercial	74,842	90,953	88,929	79,433	88,639	90,736	60,730
Interruptible boiler fuel	24,344	17,354	5,134	5,445	14,929	20,584	390
Industrial	10,227	15,844	16,302	14,194	15,259	14,831	10,740
Total	177,912	192,750	178,510	163,634	185,536	188,460	127,160
Revenues (000)							
Residential	$27,759	$21,677	$19,135	$16,856	$14,494	$10,908	$ 6,305
Commercial	27,963	24,994	22,134	18,345	16,186	12,573	5,442
Interruptible boiler fuel	7,394	4,200	1,026	920	1,795	1,950	17
Industrial	3,524	4,002	3,802	3,006	2,479	1,713	701
Total	$66,640	$54,873	$46,097	$39,127	$34,954	$27,144	$12,465
Customers at Year End							
Residential	59,009	54,822	52,574	50,655	48,709	47,000	39,489
Commercial	9,088	8,566	8,338	8,016	7,854	7,546	6,095
Interruptible boiler fuel	4	5	4	3	3	5	1
Industrial	73	73	73	78	65	63	52
Total	68,174	63,466	60,989	58,752	56,631	54,614	45,637
Residential (Averages)							
Therms per space-heating customer	1,366	1,471	1,527	1,524	1,652	1,616	1,854
Rate per therm—space heating	40.3¢	31.3¢	27.8¢	25.8¢	21.5¢	17.3¢	11.2¢

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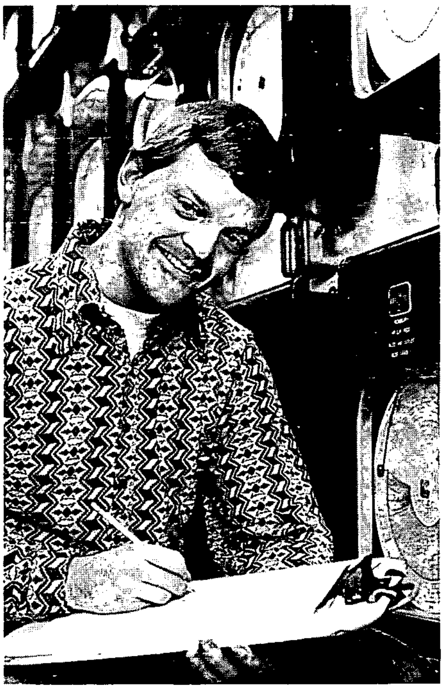
Gas Operations



Thomas Egan, Gas Pressure House

company's supply of gas will come from wells that are not currently producing or are not yet drilled. A $2.5-billion exploration program is planned by Mich-Wis over the next 10 years.

Coal Gasification Under Way

Mich-Wis' parent company, American Natural Resources (ANR), is part of the consortium building the first commercial-scale, pipeline-quality coal gasification plant. This plant, which will produce gas from lignite coal, is under construction in North Dakota.

ANR has joined another consortium to construct the Arctic natural gas pipeline that will tap the large reserve of gas on Alaska's North Slope and bring it to market in the lower 48 states. Facilities also are being developed to bring in liquified natural gas from Nigeria.

Mich-Wis now obtains natural gas from the Texas-Oklahoma Panhandle area, the Louisiana offshore area, and others. It is one of the leaders in the High Island Offshore System and also is very active in the Rocky Mountain Overthrust area. About 15 percent of its gas supply is obtained from Canadian sources. And it continues to explore in Alabama, Mississippi, and offshore Texas and Louisiana.

Conservation also is contributing significantly to MGE's supply. The PSCW revealed in 1980 that MGE customers had cut their average natural gas space-heating use by 20.9 percent per customer over the past five years. That is the best conservation achievement among the customers of the 10 largest utilities in the state.

System Improvements

Some 12.6 miles of new gas main was laid in 1980, 12.4 miles less than in the previous year.

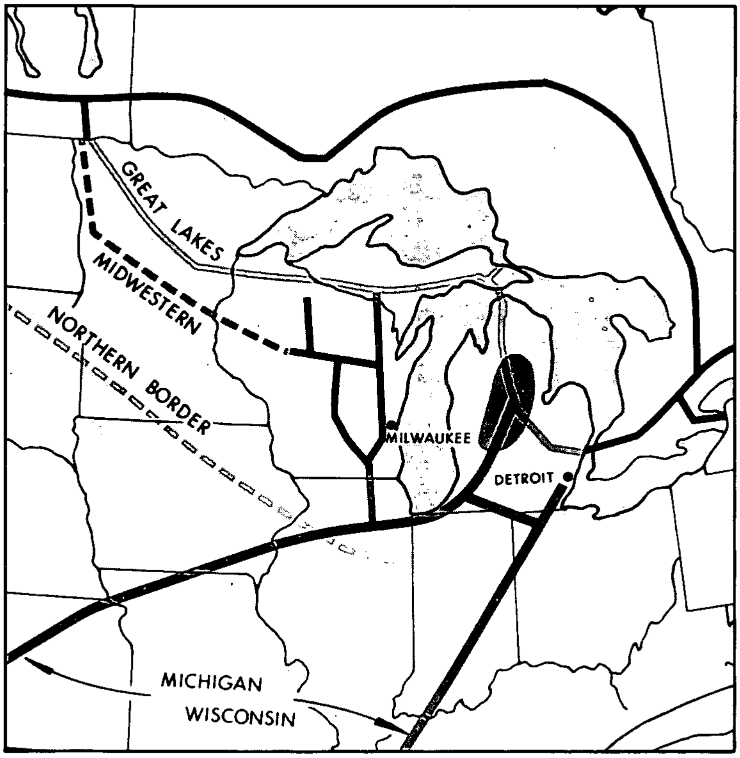
Replacement of old, cast-iron gas mains to conform with federal and state safety codes continued during 1980. Some 15.2 miles of main was upgraded compared to 26 miles the prior year.

Work continued on the program to install sectionalizing valves throughout the system. These valves allow rapid shut-down of gas service in emergency situations to safely isolate specific potentially hazardous areas. The project will be completed in about one more year.

New regulators were installed at the North Madison Gate Station, a point of gas supply from Mich-Wis. The new regulators maintain a stable gas main pressure for users during peak-load conditions when pressure is more difficult to sustain. These regulators improve supply stability for the increasing number of customers in the northern and far-western portions of the MGE service territory.

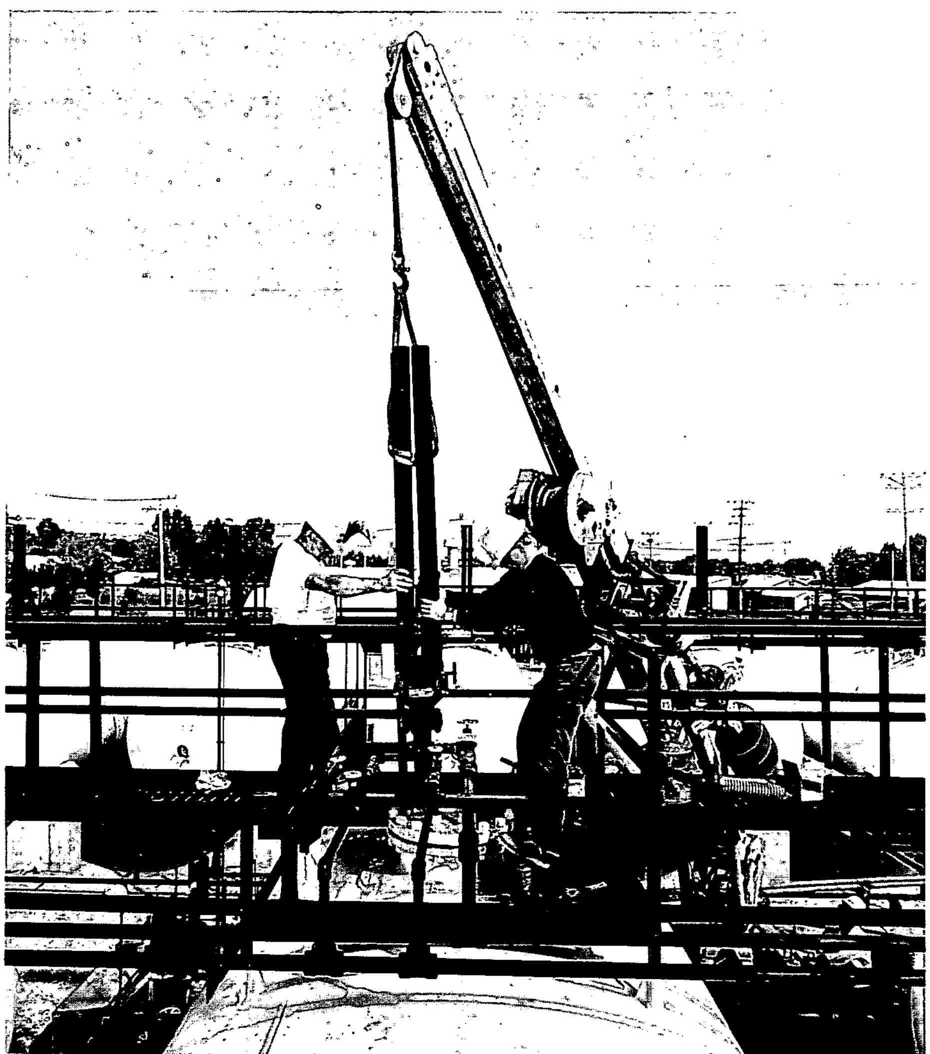
New multi-port safety relief valves were installed on the 12 propane storage tanks at the Company's peak-shaving facility on the west side of Madison. The new relief valves substantially reduce the amount of time and labor required to remove the valves for routine testing every five years.

Michael Meier, Dispatcher's Office



Natural gas pipelines that service portions of the states of Michigan and Wisconsin

Safety Relief Valve Replacement, Summit Propane/Air Plant



MGE's 125 Years of Service

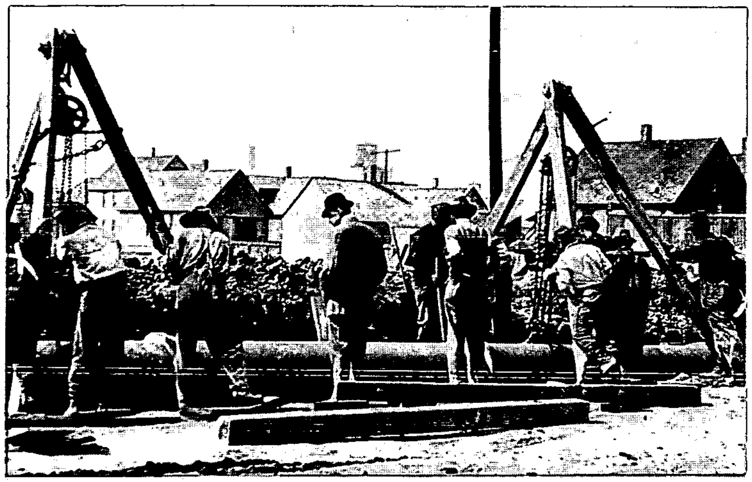
The year 1980 marked 125 years of service by MGE and its predecessor companies to the Madison area.

Madison was still a village of about 7,000 people and 700 homes when gas was first introduced in 1855. The start of rail service a year earlier, making coal available from which to manufacture the gas, spurred the development of the first gas works.

In January of 1855, the Wisconsin Legislature authorized the incorporation of the Madison Gas Light and Coke Company. On the evening of July 19, a civic celebration commemorated completion of the gas works as 20 gas street lights were turned on around Capitol Square. This officially marked the beginning of gas service to the area. A reporter covering the event for *The Wisconsin State Journal* wrote:

"The gas burned admirably, and it was universally remarked by those present familiar with such matters that the light was more brilliant and steady than they had ever seen on the first trial of gas after the completion of the works."

Production of gas from the plant accelerated quickly. Two weeks later, on August 1, some 9,771 cubic feet of gas was consumed. The total amount used in the first full month of operation was 244,083 cubic feet. Within two years, the Company had about 200 customers.



In 1925, MGE Gas Distribution crewmen relied on a few simple tools and considerable muscle to wrestle this pipeline into place for the coal-derived manufactured gas.

The original gas company, Madison Gas Light and Coke Company, operated as such until 1871. It was succeeded by the Madison City Gas Light and Coke Company, which operated until April 1, 1896, when it was succeeded by Madison Gas and Electric Company.

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Dedicated People Make It Happen

The utility business is highly complex. The climate in which it operates is changing rapidly. Inflation, environmental concerns, and regulation are just some of the factors that demand increased attention daily.

At MGE, these complexities and changes show up in the expanding diversity and number of skilled support people needed to keep the Company functioning smoothly and efficiently. The lineman, meter reader, and gas main installer traditionally are the most visible. But, a myriad of other critical staff employees work behind the scenes in increasing numbers. From financial analyst to fleet maintenance mechanic to computer operator – each support staff member fulfills an increasingly vital position.

The employees pictured in this report represent the varied kinds of dedicated people that have been making it all happen at MGE for 125 years.

Human Resources

MGE experienced a continuing demand for more support staff for its basic business operations during 1980. The Company had 578 employees at the end of the year, about a 5-percent increase from 1979. New staff positions had to be created to deal with the impact of increasingly complex regulation and legislation. Recruitment concentrated in the financial, energy utilization, and information management areas.

Increased automation of data handling in many areas is improving efficiencies and making information available within the Company and to the public on a more timely and comprehensive basis.

Customer Services Reorganized

Major management and organizational changes were made within the Company during 1980. In the area of customer services, a new officer position was created to consolidate responsibility for all customer-contact functions and to improve efficiency in handling customer relationships and services. This new position oversees all customer services – including billing, meter reading, service applications, credit and collections, energy utilization, energy audits, load management, meter and connection, and appliance repair.

Customer Contact/Communications

The continuing increase of energy costs during 1980 spurred public interest in conservation. To help cus-

Jean DiPiazza, General Accounting

Darl Shimko, Engineering Planning

tomers with their conservation efforts, MGE produced a series of five step-by-step, "how-to" brochures. These range in subject from insulating basements and crawl spaces to installing storm windows and doors. More than 18,500 of these brochures were distributed in 1980.

The 15-person MGE energy audit staff provided more than 4,550 free home insulation and weatherization checks – 2,550 regular energy audits and 2,000 conversion audits required by the PSCW of homeowners who want natural gas for heating. Since the program began in September, 1976, the Company has done more than 14,550 audits.

Late in the year, computer equipment was introduced for use in conjunction with the federal Residential Conservation Service energy audit program. The equipment computes heat loss, energy savings, and payback time for various conservation measures.

More than 150 energy-related presentations and demonstrations were made to the public during the year. The Consumer Services Department handled 23,000 telephone, mail, and in-person contacts with customers during 1980.

Grants for Conservation

During 1980, the Company awarded three grants for solar energy projects. One was applied toward construction of a passive solar home with an active solar water heating system in Madison's 1980 Parade of Homes. Another funded installation of a solar water heating system at a housing complex for senior citizens. The third provided funds for solar water heaters and insulating materials for two single-family homes being rehabilitated by a local nonprofit organization.

A fourth grant was provided in July to assist the Community Action Commission in publicizing self-help conservation workshops.

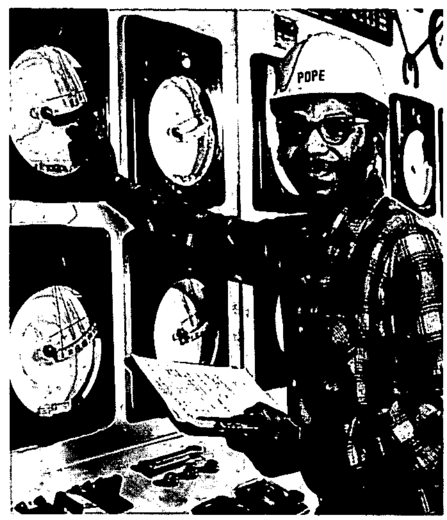
MGE continues to support research projects at the Energy Research Center at University of Wisconsin-Madison, either directly or through the Wisconsin Electric Utilities Research Foundation (WEURF). This year, the Company directly contributed funds for continued research on superconductive magnetic energy storage. Among projects supported by WEURF are fusion reactor technology studies and a professorship in energy engineering.

Training and Development Expands

With gasoline prices steadily increasing, the Company initiated a training program to help the drivers of MGE vehicles improve their gas mileage. All MGE employees who routinely drive a Company vehicle participated in the program last summer.

To improve the effectiveness of all employee training programs, new audio/visual equipment was purchased in 1980. Video taping equipment – including cameras, recorders, and playback units – will be a primary communications tool for new employee orientations, general announcements, and purchased and in-house-produced technical training programs.

The Training and Development Department's audio cassette training library was expanded during the year due to the immense employee response to the program. Such self-improvement programs as "Clues to Executive Time Control" and "Leading The Way In Human Resource Management" have been added to the library to supplement other training developed for executive and supervisory staff.



Kenneth Pope, Boiler Operations

continued

MGE's 125 Years of Service Continued

Interest in an electric light plant for Madison had begun early in the 1880s. Investigations into the feasibility of electric lights for the city were made several years before a commercial plant became a reality.

On April 13, 1888, the Madison Electric Company received a franchise from the Common Council to build and operate the city's first electric plant.

Unfortunately, the introduction of the electric lighting did not go as smoothly as that of the gas lights 33 years earlier. *The Wisconsin State Journal* of May 31, 1888, reported:

"Last evening the Capitol City Band celebrated the electric light opening, but the light failed to stay open for more than a moment at a time, and finally ceased altogether. The engine power was not strong enough to drive the dynamo with the number of lights taken by businessmen. A new engine has been telegraphed for, and it will be about 10 days before it is in place."

Incandescent lighting followed within a year of the arc lighting. Then, in 1891, Madison City Gas Light and Coke Company purchased Madison Electric Company. A year later, Madison Electric Company sold its property to the Four Lakes Light and Power Company, which subsequently was acquired by Madison Gas and Electric Company in 1896.

Other significant events in MGE's history are:

1902 – Blount Street Gas Engine Station, the first plant in the nation to use gas to power generators, is built.

1929 – Construction of underground electric lines begins.

1948 – MGE becomes an investor-owned public utility.

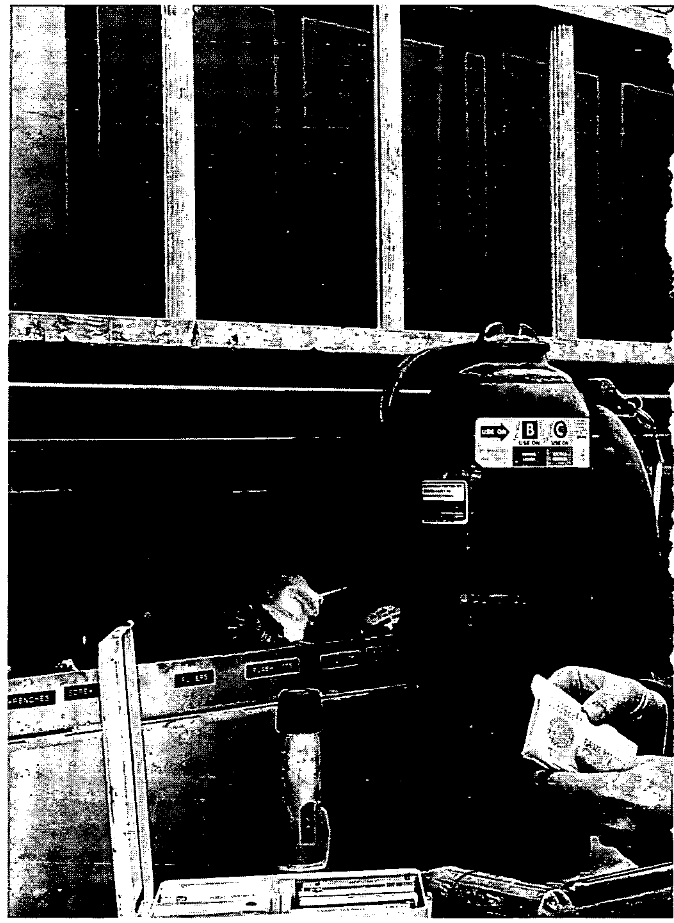
1949 – Natural gas is first delivered from Michigan Wisconsin Pipe Line Company.

1974 – The Kewaunee Nuclear Plant begins service.

1975 – The Columbia plant begins commercial operation.

A Company Line and Pole crew proudly poses beside a brand new 1927 vehicle.

Dedicated People Make It Happen

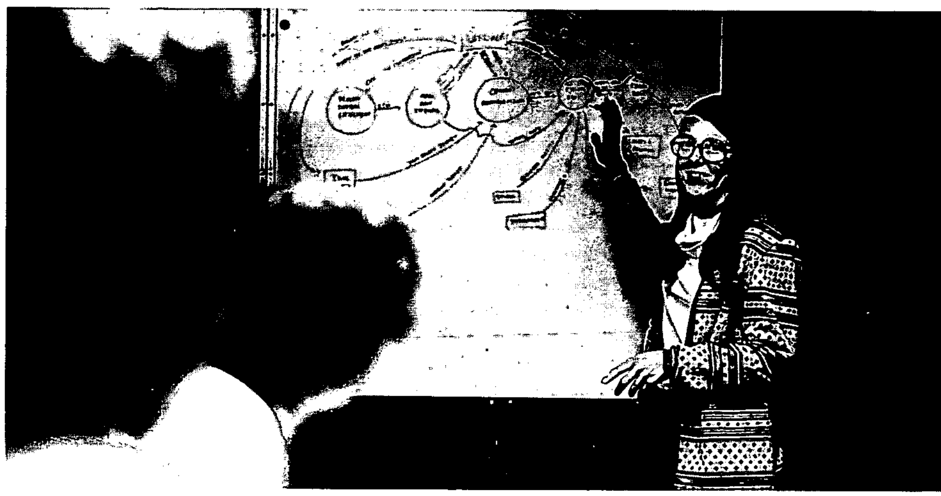


David Norman, Safety Manager

Larry Van Sickle, Fleet Maintenance

125 Years of Service

Kenneth Marr, Coal Handling



Theodosia Ewers, Information Management

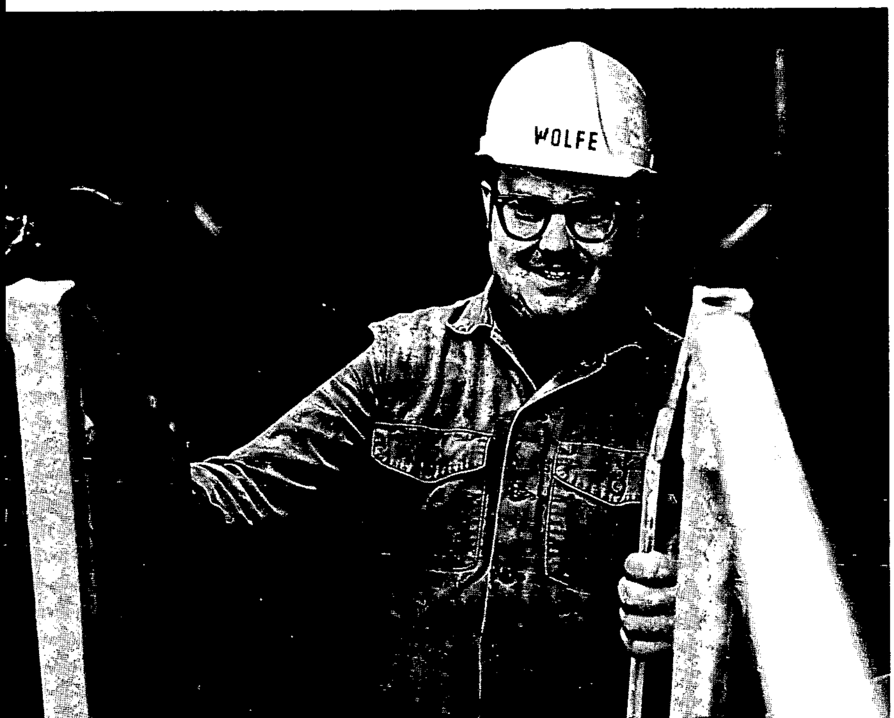
Ivadell Woolever, Customer Service

Bonita Shelton, Cash Processing

125 Years of Service

Dedicated People Make It Happen

David Riggle, Office Services



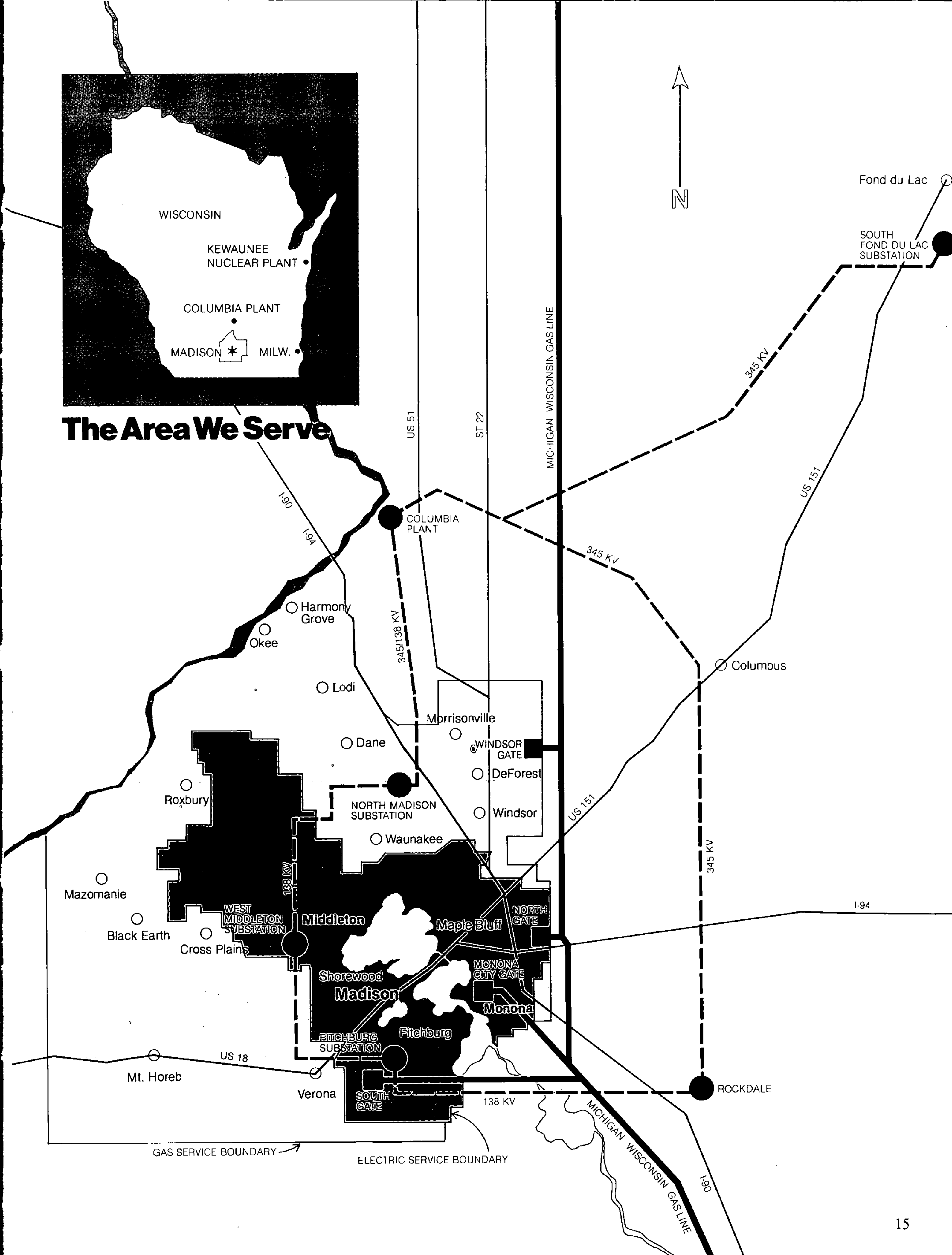
David Wolfe, Refuse-Derived-Fuel Receiving Station

Dolores Reese, Micrographics

Lila Pippin, Corporate Records

Robert Hefty, Time-of-Use MeterTesting

The Area We Serve



Summary of Selected Financial Data

(Thousands of Dollars Except Per-Share Amounts)

	1980	1979	1978	1977	1976
Operating Revenues					
Electric	**$ 95,317**	$ 89,211	$ 78,588	$ 65,256	$ 52,817
Gas	**66,439**	55,169	46,390	39,140	34,964
Total	**$161,756**	$144,380	$124,978	$104,396	$ 87,781
Income, Earniugs, and Dividends					
Net income	**$ 15,548**	$ 12,822	$ 13,359	$ 12,771	$ 8,656
Earnings on common stock	**$ 12,399**	$ 9,628	$ 10,558	$ 10,158	$ 6,021
Earnings per average common share	**$ 2.21**	$ 1.76	$ 1.96	$ 2.13	$ 1.58
Cash dividends paid per common share	**$ 1.66**	$ 1.48	$ 1.44	$ 1.36	$ 1.23
Assets					
Electric	**$209,949**	$207,806	$204,999	$195,072	$180,085
Gas	**65,308**	60,732	57,071	49,966	48,104
Assets not allocated	**17,975**	17,545	16,223	17,296	12,914
Total	**$293,232**	$286,083	$278,293	$262,334	$241,103
Long-term Debt and Redeemable Preferred Stock (net of sinking funds and unamortized discounts and premiums on bonds)	**$129,641**	$132,054	$133,692	$130,984	$134,430
Iuternal Generation of Funds					
Net funds generated internally	**$ 20,896**	$ 17,262	$ 22,288	$ 19,395	$ 14,937
Total funds used for construction expenditures and nuclear fuel	**$ 21,520**	$ 21,015	$ 26,261	$ 36,437	$ 30,469
Percent generated internally	**97.1%**	82.1%	84.9%	53.2%	49.0%
Capitalization Ratios (end of year)*					
Common shareholders' equity	**43.0%**	42.0%	40.9%	40.4%	29.7%
Redeemable preferred stock*	**13.7**	14.2	14.5	11.9	12.8
Debt					
Long-term debt*	**40.7**	42.2	43.8	46.4	50.5
Short-term debt	**2.6**	1.6	0.8	1.3	7.0

*Includes current sinking fund requirements and current redemptions.

Management's Discussion and Analysis of Operations and Financial Condition

Results of Operations

The Company's ability to maintain adequate earnings levels is largely determined by the securing of reasonable and timely rate relief. The results of operations for 1980 show the effects of such rate relief. The Company filed its last rate request on May 31, 1979, and received rate relief designed to increase annual revenues by $9 million beginning in March, 1980. See Note 6 in Notes to Consolidated Financial Statements for further particulars relating to the rate order. The Company had previously received formal rate relief designed to increase annual revenues by over $8 million in November, 1976.

A comparison of operating revenues for each of the years 1980, 1979, and 1978 with the immediately preceding year reflects increases and decreases (in millions of dollars) which can be segregated by the following principal factors:

	Electric Revenues			**Gas Revennes**		
	1980	1979	1978	1980	1979	1978
Sales to other utilities	$(3.0)	$ 6.9	$ 9.1	Not applicable		
Sales to consumers–						
Due to formal rate increases (1980), fuel and purchased gas adjustments, respectively, and other factors	6.8	3.3	2.0	$15.2	$5.3	$3.5
Due to sales increases	2.3	.4	2.2	(3.9)	3.5	3.8
Total Increases	$ 6.1	$10.6	$13.3	$11.3	$8.8	$7.3

Electric sales to consumers increased 3.4 percent in 1980, 0.6 percent in 1979, and 4.1 percent in 1978, while gas sales to consumers decreased 7.7 percent, rose 7.7 percent, and rose 9.7 percent, respectively. Revenues from sales to other utilities amounted to $19.4 million in 1980, $22.4 million in 1979, and $15.5 million in 1978.

Fuel for electric generation and natural gas purchases comprise a large segment of the Company's total operating expenses (23.2 percent and 35.7 percent, respectively, for 1980; 25.7 percent and 32.1 percent for 1979; and 22.2 percent and 30.4 percent for 1978). These costs have accelerated rapidly over the past several years, and further increases can be expected. However, the Company's electric rate schedules are permitted to be adjusted (after notice to the PSCW) from month to month to reflect changes in the costs of fuel and purchased energy. Gas rate schedules may be adjusted from time to time, upon approval by the PSCW, to reflect changes in the cost of purchased gas. In general, both types of such adjustments are effective immediately (at the time of cost changes) and provide for refinements to assure that cost changes are fully reflected. Prior to March, 1980, the fuel and purchased energy adjustment was limited to fossil fuel cost changes and was generally effective 30 days after such changes.

Other operation and maintenance expenses reflect increasing material and labor costs of both the electric and gas systems, together with increasing administrative and general expenses, all of which generally reflect the inflationary trends experienced in the past.

The statutory federal income tax rate was reduced from 48 percent to 46 percent on January 1, 1979. Other variations in income tax expenses during the periods are largely attributable to changes in pre-tax net income. Property taxes (2.9 percent, 3.7 percent, and 5.0 percent of total operating expenses for 1980, 1979, and 1978, respectively) have decreased during the periods as a result of declining assessment values.

Reference is made to the "Supplementary Information to Disclose the Effects of Changing Prices" following the Notes to Consolidated Financial Statements, for discussion of the effects of inflation on the Company.

Liquidity and Capital Resources

As indicated in the above Selected Financial Data, the internally generated percentage of funds used for construction is significant. Construction expenditures for 1981 are expected to increase to approximately $31.3 million, or about $9.8 million over 1980 expenditures (but only $2 million over the 1975-1979 average construction expenditures of $29.3 million). This projected increase includes major expenditures for transmission lines, new electric and gas distribution projects, and the start of construction of a new general office facility. As a result, the Company expects the percentage of internally generated funds to decrease from the 1980 level.

At December 31, 1980, the Company had unused lines of credit of $4.6 million with four local banks and $16 million with five other banks in Chicago and Milwaukee. The Company normally uses dealer-issued commercial paper for its short-term financial needs.

The Company's capitalization ratios at the end of the last five years are shown in the Selected Financial Data above.

The Company believes that trust indenture restrictions will not operate to prevent the issuance of additional long-term debt in the foreseeable future.

The Company's bonds are rated Aa by Moody's Investors Service, Inc., and AA by Standard & Poor's Corporation.

Common Stock Price Range and Dividends

The common stock of the Company is traded in the over-the-counter market. The range of bid and asked prices, as quoted by the National Association of Securities Dealers, and the dividends paid for the years 1980 and 1979 are as follows:

	Bid		Asked		Dividends
1980	High	Low	High	Low	Paid
First Quarter	13⅝	11¼	14⅛	11¾	41¢
Second Quarter	15⅝	11⅞	16⅛	12⅜	41¢
Third Quarter	15½	13½	15¾	13¾	41¢
Fourth Quarter	14½	11⅞	14¾	12	43¢

	Bid		Asked		Dividends
1979	High	Low	High	Low	Paid
First Quarter	16⅜	15½	16⅞	16	37¢
Second Quarter	15⅞	14¼	16⅜	14¾	37¢
Third Quarter	15⅞	14¾	16⅜	15¼	37¢
Fourth Quarter	14⅞	13⅛	15⅜	13⅝	37¢

There were 17,320 shareholders of record as of February 10, 1981. There currently 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 has no reason to expect that it will not continue to do so in the future.

Consolidated Statement of Income

For the years ended December 31, 1980, 1979, and 1978

	1980	1979	1978
Operating Revenues (Notes 1e & 6)			
Electric	**$ 95,316,716**	$ 89,210,891	$ 78,588,601
Gas	**66,439,171**	55,168,999	46,389,975
Total Operating Revenues	**161,755,887**	144,379,890	124,978,576
Operating Expenses			
Fuel used for electric generation	**32,097,978**	31,760,588	23,027,520
Purchased power	**1,967,328**	766,442	1,349,618
Natural gas purchased for resale	**49,295,995**	39,702,101	31,480,416
Other operations	**17,958,314**	15,159,627	12,925,748
Maintenance	**6,224,455**	5,096,175	4,383,928
Depreciation and amortization (Notes 1d & 2)—			
Straight-line depreciation and amortization	**11,031,685**	11,628,954	10,495,666
Additional depreciation (equivalent to estimated reduction in income taxes)	**3,879,579**	3,768,763	4,831,989
Taxes (Note 1h)—			
Current federal income	**7,768,081**	7,562,160	4,055,805
Investment tax credit deferred	**2,075,824**	1,681,826	4,469,720
Investment tax credit restored (credit)	**(744,692)**	(671,155)	(536,946)
Current state income	**1,682,543**	1,773,856	1,183,546
Property, payroll, and other	**5,029,349**	5,422,117	5,923,158
Total Operating Expenses	**138,266,439**	123,651,454	103,590,168
Net Operating Income	**23,489,448**	20,728,436	21,388,408
Other Income			
Allowance for other than borrowed funds used during construction (Note 1c)	**—**	—	29,308
Other, net	**444,456**	299,558	246,920
Total Other Income	**444,456**	299,558	276,228
Income Before Interest Expense	**23,933,904**	21,027,994	21,664,636
Interest Expense			
Interest on long-term debt	**7,904,336**	8,018,671	8,179,390
Other interest	**481,095**	186,832	412,277
Allowance for borrowed funds used during construction (credit) (Note 1c)	**—**	—	(286,513)
Total Interest Expense	**8,385,431**	8,205,503	8,305,154
Net Income	**15,548,473**	12,822,491	13,359,482
Preferred Stock Cash Dividend Requirements (Note 3b)	**3,149,682**	3,194,401	2,801,756
Earnings on Common Stock	**$ 12,398,791**	$ 9,628,090	$ 10,557,726
Earnings Per Share of Common Stock (Based on 5,607,319, 5,477,541, and 5,376,758 average shares outstanding, respectively)	**$2.21**	$1.76	$1.96

Consolidated Statement of Retained Income

For the years ended December 31, 1980, 1979, and 1978

	1980	1979	1978
Balance Beginning of Year	**$ 24,995,557**	$ 23,521,863	$ 20,865,200
Add—Net income	**15,548,473**	12,822,491	13,359,482
Total Before Deductions	**40,544,030**	36,344,354	34,224,682
Deduct			
Cash dividends on common stock	**9,302,814**	8,107,004	7,742,421
Preferred stock cash dividend requirements	**3,149,682**	3,194,401	2,801,756
Expense of issuing common stock	**70,356**	47,392	91,494
Expense of issuing preferred stock	**—**	—	67,148
Total Deductions	**12,522,852**	11,348,797	10,702,819
Balance End of Year	**$ 28,021,178**	$ 24,995,557	$ 23,521,863

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

Consolidated Balance Sheet

December 31, 1980 and 1979

	1980	1979
Assets		
Utility Plant, at original cost (Note 1a)		
In service—		
Electric (Note 1b)	$268,953,526	$257,331,153
Gas	85,537,506	80,334,821
Gross Plant in Service	354,491,032	337,665,974
Less—Accumulated provision for depreciation (Note 1d)	(125,432,310)	(110,543,911)
Net Plant in Service	229,058,722	227,122,063
Construction work in progress (Note 1b)	7,743,574	8,570,359
Nuclear fuel, net (Note 1f)	7,698,116	7,576,915
Total Utility Plant	244,500,412	243,269,337
Investments		
Investment in future nuclear fuel (Note 1i)	3,232,541	2,561,109
Pollution control construction fund	556,761	484,331
Total Investments	3,789,302	3,045,440
Current Assets		
Cash	1,289,924	1,756,695
Deposits for jointly owned electric power production facilities	1,682,319	1,556,868
Temporary cash investments, at cost, which approximates market	—	1,310,000
Accounts receivable, less reserves of $262,922 and $216,741, respectively	16,251,594	13,982,996
Unbilled revenue (Note 1e)	7,905,101	5,738,385
Materials and supplies, at average cost	4,858,133	4,106,184
Fossil fuel, at cost (Note 1g)	8,373,987	6,179,185
Prepayments	433,237	495,302
Total Current Assets	40,794,295	35,125,615
Deferred Charges (Note 2)	4,148,489	4,642,224
Total Assets	$293,232,498	$286,082,616
Capitalization and Liabilities		
Capitalization (see statement)(Note 3)		
Common shareholders' equity—		
Common stock	$ 45,508,312	$ 44,489,408
Amount received in excess of par value	29,944,710	29,262,280
Retained income	28,021,178	24,995,557
Total Common Shareholders' Equity	103,474,200	98,747,245
Redeemable preferred stock	31,650,000	32,825,000
Long-term debt	97,990,662	99,229,218
Total Capitalization	233,114,862	230,801,463
Current Liabilities		
Preferred stock sinking fund requirements (Note 3b)	1,175,000	525,000
Interim loans—commercial paper (Note 5)	6,300,000	3,900,000
Sinking Fund Requirements and Short-term Debt	7,475,000	4,425,000
Accounts payable	13,567,976	12,223,844
Accrued interest	1,889,335	1,916,825
Accrued taxes	5,449,534	5,128,110
Other	3,706,492	3,023,153
Total Current Liabilities	32,088,337	26,716,932
Other Credits		
Contributions in aid of construction	7,999,826	8,211,054
Investment tax credit deferred (Note 1h)	15,376,228	14,367,915
Unamortized unbilled revenue (Note 1e)	3,597,352	4,111,252
Other	1,055,893	1,874,000
Total Other Credits	28,029,299	28,564,221
Construction Commitments (Note 4)		
Total Capitalization and Liabilities	$293,232,498	$286,082,616

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

Consolidated Statement of Capitalization

December 31, 1980 and 1979

	1980	1979
Common Shareholders' Equity (Note 3a)		
Common stock – Par value $8 per share –		
Authorized 7,000,000 shares and 6,000,000 shares, respectively		
Outstanding 5,688,539 and 5,561,176 shares, respectively	**$ 45,508,312**	$ 44,489,408
Amount received in excess of par value	**29,944,710**	29,262,280
Retained income	**28,021,178**	24,995,557
Total Common Shareholders' Equity	**103,474,200**	98,747,245
Redeemable Preferred Stock, cumulative, $25 par value, authorized 1,613,000 and 1,634,000 shares, respectively (Note 3b)		
Series A, 9⅜%, 164,000 and 170,000 shares outstanding, respectively	**4,100,000**	4,250,000
Series B, 7.80%, 176,000 and 182,000 shares outstanding, respectively	**4,400,000**	4,550,000
Series C, 7.90%, 273,000 and 282,000 shares outstanding, respectively	**6,825,000**	7,050,000
Series D, 12%, 400,000 shares outstanding	**10,000,000**	10,000,000
Series E, 8.70%, 300,000 shares outstanding	**7,500,000**	7,500,000
Preferred Stock Outstanding	**32,825,000**	33,350,000
Current sinking fund requirements	**(1,175,000)**	(525,000)
Total Preferred Stock	**31,650,000**	32,825,000
First Mortgage Bonds (Note 3c)		
4⅝%, 1988 series	**7,259,000**	7,526,000
4¾%, 1991 series	**4,341,000**	4,585,000
5.45%, 1996 series	**8,000,000**	8,000,000
8%, 1999 series	**11,616,000**	11,683,000
7¾%, 2001 series	**13,757,000**	14,183,000
9¾%, 2004 series	**19,403,000**	19,430,000
9¾%, 2005 series	**24,297,000**	24,427,000
6½%, 2006 series	**8,780,000**	8,780,000
First Mortgage Bonds Outstanding	**97,453,000**	98,614,000
Unamortized discount and premium on bonds, net	**(183,480)**	(192,188)
Total First Mortgage Bonds	**97,269,520**	98,421,812
Other Long-term Debt (Note 3d)	**721,142**	807,406
Total Long-term Debt	**97,990,662**	99,229,218
Total Capitalization	**$233,114,862**	$230,801,463

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

Consolidated Statement of Sources of Funds Used for Construction

For the years ended December 31, 1980, 1979, and 1978

	1980	1979	1978
Funds Generated Internally			
Net income	**$ 15,548,473**	$ 12,822,491	$ 13,359,482
Items not affecting current sources and uses of funds—			
Depreciation and amortization	**14,911,264**	15,397,717	15,327,655
Amortization of nuclear fuel	**3,497,885**	3,042,415	2,562,368
Investment tax credit deferred—net	**1,331,132**	1,010,671	3,932,774
Amortization of January 1, 1978, unbilled revenue	**(513,900)**	(513,900)	(513,900)
Equity component of the allowance for funds used during construction (Note 1c)	**—**	—	(29,308)
Other	**345,572**	271,642	163,338
Funds Provided from Operations	**35,120,426**	32,031,036	34,802,409
Less—			
Cash dividends on common and preferred stock	**12,452,496**	11,301,405	10,544,177
Bond sinking fund retirements (including 1979 maturity) and other long-term debt repayments	**1,247,264**	2,942,822	1,445,722
Preferred stock sinking fund retirements	**525,000**	525,000	525,000
Net Funds Generated Internally	**20,895,666**	17,261,809	22,287,510
Funds Obtained from Outside Financing			
Withdrawal from (increase in) pollution control construction fund	**(72,430)**	(43,661)	817,889
Retirement of other long-term debt	**—**	—	(1,300,000)
Sale of common stock, less expense of issuance	**1,630,978**	1,803,688	1,408,087
Sale of preferred stock, less expense of issuance	**—**	—	7,432,852
Increase (decrease) in interim loans	**2,400,000**	1,900,000	(1,000,000)
Net Funds Obtained from Outside Financing	**3,958,548**	3,660,027	7,358,828
Decreases (Increases) in Other Net Current Assets (exclusive of interim loans and sinking fund requirements)			
Accounts receivable—net	**(2,268,598)**	(73,885)	(3,325,500)
Fossil fuel	**(2,194,802)**	(3,880,499)	817,557
Accrued taxes	**321,424**	3,314,830	(3,553,101)
Other, net	**794,701**	392,102	(207,547)*
Net (increase)	**(3,347,275)**	(247,452)	(6,268,591)
Other—Net (includes equity component of allowance for funds used during construction)	**13,074**	340,483	2,883,578
Total Funds Used for Construction Expenditures and Nuclear Fuel	**$ 21,520,013**	$ 21,014,867	$ 26,261,325

*Net of $5,139,052 unbilled revenue recorded January 1, 1978.

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

Auditers' Report

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

We have examined the consolidated balance sheet and statement of capitalization of MADISON GAS AND ELECTRIC COMPANY (a Wisconsin corporation) and subsidiaries as of December 31, 1980, and December 31, 1979, and the related consolidated statements of income, retained income and sources of funds used for construction for the years ended December 31, 1980, 1979 and 1978. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Madison Gas and Electric Company and subsidiaries as of December 31, 1980, and December 31, 1979, and the results of their operations and their sources of funds used for construction for the years ended December 31, 1980, 1979 and 1978 in conformity with generally accepted accounting principles applied on a consistent basis.

ARTHUR ANDERSEN & CO.

Chicago, Illinois,
February 18, 1981

Notes te Consolidated Financial Statements

December 31, 1980, 1979, and 1978

1. Summary of Significant Accouuting Policies

The consolidated financial statements reflect the application of certain accounting policies described in this note.

a. Utility plant

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

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

b. Joint plant ownership

The Company and two other Wisconsin utilities, Wisconsin Power and Light Company (WPL) and Wisconsin Public Service Corporation (WPSC), 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 Columbia Energy Center and 17.8 percent (93 mw) of the Kewaunee Nuclear Plant. Each company provides its own financing and reflects the respective portion of facilities and operating costs in its financial statements. The Company's portions of these facilities were included in its utility plant in service as follows:

	December 31,	
	1980	1979
Columbia	$ 77,024,000	$ 75,960,000
Kewaunee	38,969,000	38,719,000
Total	$115,993,000	$114,679,000

Expenditures for projects at Columbia and Kewaunee amounted to $1,816,783 and $575,147 at December 31, 1980 and 1979, respectively, and are included in construction work in progress as of those dates.

c. Allowance for funds nsed during construction

The allowance for funds used during construction (Allowance) is recognized as a cost of utility plant because it constitutes an actual cost of construction and, under established regulatory rate practices, the Company is entitled to earn a fair return on such cost through utility rates. Pursuant to rate orders issued by the Public Service Commission of Wisconsin (the PSCW) since 1974, the Company capitalizes the Allowance (at 7 percent) only on that portion of construction work in progress which exceeds 10 percent of average net investment rate base for the respective calendar year. The annual revenue increase provided for in such orders, including the February, 1980, order (Note 6), has included compensation for the reduction in the Allowance attributable to this computation.

d. Depreciation

Depreciation expense includes, in addition to provisions at composite straight-line rates, amounts equivalent to the estimated reduction in income taxes (federal – $3,604,000, $3,522,000, and $4,463,000 and state – $276,000, $247,000, and $369,000 for the years 1980, 1979, and 1978, respectively), due to the use of liberalized depreciation allowances permitted for income tax purposes. Such accumulated additional depreciation totaled $33,996,000 and $29,963,000 as of December 31, 1980 and 1979, respectively. Provisions at composite straight-line depreciation rates, excluding the additional depreciation, approximate the following percentages of the cost of depreciable property for each of the years 1980, 1979, and 1978: electric, 3.4 percent, 3.4 percent, and 3.5 percent; gas, 3.2 percent, 3.2 percent, and 3.1 percent. These rates are approved by the PSCW and are generally based on the estimated economic lives of property.

The Company's portion of the estimated costs of decommissioning Kewaunee is $6,521,000, which is being recovered through depreciation rates.

e. Revenne recognition

In accordance with a PSCW directive, the Company began recording, as of January 1, 1978, unbilled revenue on the basis of service rendered. The directive also provided that the estimated amount of unbilled revenue ($5,139,052) as of January 1, 1978, be recorded as a deferred credit and amortized to income over a ten-year period beginning with 1978. The directive indicates that the amounts amortized are to be deemed reductions of annual revenue requirements in future rate proceedings.

f. Nuclear fuel

The cost of nuclear fuel (Note 1i) is being amortized to fuel expense based on the quantity of heat produced for the generation of electric energy by Kewaunee. Such costs include a provision for estimated future storage and disposal costs of spent nuclear fuel. The tax effect of differences between the fuel cost amortized and that deducted for income tax purposes is included in "Nuclear fuel, net."

g. Fossil fuel

The inventory of fossil fuel is recorded at average cost, except for the Company's Blount Plant coal which is recorded on essentially a last-in, first-out basis. Inventory amounts for Blount coal were $1,953,751, $1,297,566, and $421,214 as of December 31, 1980, 1979, and 1978, respectively.

h. Income taxes

(1) Depreciation for federal and state income taxes reflects the use of liberalized depreciation allowances permitted for income tax purposes. The estimated reductions in income taxes due to the application of these statutes are provided as additional depreciation as discussed under "Depreciation" (Note 1d).

(2) The ten percent basic investment tax credit is deferred and is amortized over the service lives of the related property.

(3) Certain capitalized indirect costs and certain capitalized research and development costs have been deducted as incurred for federal and state income tax purposes, and the income tax provision is reduced as the costs are incurred.

(4) The Company's effective income tax rate, computed by dividing the total of current federal and state income tax expense, net investment tax credit, and additional depreciation by the sum of such expenses and net income, reconciles to the statutory federal income tax rate as follows:

	1980	1979	1978
Effective income tax rate as computed	**48.5%**	52.7%	51.2%
Restoration of investment tax credit	**2.4**	2.4	2.0
State income taxes and state additional depreciation, net	**(3.9)**	(4.6)	(3.7)
Other differences, net	**(1.0)**	(4.5)	(1.5)
Statutory federal income tax rate	**46.0%**	46.0%	48.0%

i. Subsidiaries

The consolidated financial statements include the accounts of the Company and two wholly owned subsidiary companies which were established for the purposes of holding title to properties to be acquired for future utility plant expansion and holding title to the Company's portion of the nuclear fuel for Kewaunee. All significant inter-company accounts and transactions have been eliminated in consolidation. The Company also has a wholly owned subsidiary established to acquire uranium reserves for Kewaunee and to support the related mining and production operations. The investment in this subsidiary is carried on the equity basis of accounting, and the uranium thus obtained is recorded at cost, including the operations of the subsidiary.

j. Pension plans

The Company has contributory retirement annuity plans for substantially all of its employees. It is the policy of the Company to fund accrued pension costs. Pension costs relating to the Company's pension plans for the years 1980 through 1978 were $153,000, $120,000, and $106,000, respeetively, of which $126,000, $99,000, and $83,000, respectively, were charged to operating expenses.

The accumulated plan benefits and plan net assets available as of recent valuation dates are shown below:

	Jan. 1, 1980	Jan. 1, 1979
Actuarial present value of accumulated plan benefits		
Vested	**$4,503,868**	$3,880,843
Non-vested	**273,436**	62,873
Total	**$4,777,304**	$3,943,716
Net assets available for benefits	**$7,533,615**	$7,337,331

The assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 6 percent compounded annually for both 1979 and 1978.

2. Koshkouong Project

At December 31, 1980, the Company had deferred charges remaining of $2,053,773 as costs incurred for its share of the abandonment of the proposed construction of a nuclear facility (Koshkonong). Pursuant to a PSCW order, $521,000 ($284,000 net of income taxes) of similar charges was amortized as an operating expense in 1979.

In connection with the abandonment of the Koshkonong project, the PSCW notified the other participating utilities that they should amortize the remaining expenditures made in connection with the project as an operating expense over a three-year period starting with the completion of their next rate cases, and that the unamortized balance would be included in the capital base for return purposes in rate proceedings. In management's opinion, this rate-making treatment will be afforded to the Company for substantially all of its deferred Koshkonong expenditures.

3. Capitalizatiou Matters

a. Common stock

The following common stock transactions occurred, and allocations of proceeds were made, as the result of issues pursuant to the Company's Tax Reduction Act Employee Stock Ownership Plan (TRASOP) and its Automatic Dividend Reinvestment and Stock Purchase Plan (Dividend Reinvestment):

	Shares	Common Stock Par Value	Common Stock Excess of Par	Retained Income
1980				
Dividend Reinvestment	**106,688**	**$ 853,504**	**$ 558,345**	
TRASOP	**20,675**	**165,400**	**124,085**	
	127,363	**$1,018,904**	**$ 682,430**	**$ (70,356)***
1979				
Dividend Reinvestment	71,674	$ 573,392	$ 514,535	
TRASOP	49,636	397,088	366,065	
	121,310	$ 970,480	$ 880,600	$ (47,392)*
1978				
Dividend Reinvestment	58,303	$ 466,424	$ 479,813	
TRASOP	33,536	268,288	285,056	
	91,839	$ 734,712	$ 764,869	$ (91,494)*

*Represents expenses of issuing stock.

continued

b. Redeemable preferred stock

During 1978, the Company privately sold 300,000 shares of Series E, 8.70% Cumulative Preferred Stock, $25 Par Value, for $7,500,000 to an institutional investor. The proceeds of the issue were used to repay commercial paper.

The Company, within each 12-month period commencing with the 12-month periods ending as shown below, is obligated to retire a fixed number of shares of each series of preferred stock by redemption, at $25 per share plus accrued dividends (totaling $1,175,000 annually for 1981-1983 and $1,275,000 annually for 1984-1985):

	12-Month Period Ending	Number of Shares
Series A	November 1, 1975	6,000
Series B	May 1, 1977	6,000
Series C	November 1, 1978	9,000
Series D	August 1, 1981	26,000*
Series E	August 1, 1984	4,000**

* An additional 26,000 shares may be retired during each of any three 12-month periods commencing after August 1, 1980.

**For the 12-month periods ending August 1, 1994-1998, and August 1, 1999-2008, the Company's annual redemption obligation is 8,000 and 22,000 shares, respectively. The Company may also retire an additional number of shares equal to the annual redemption obligation during any 12-month period ending after August 1, 1984.

Prior to the above dates (except that such date is May 1, 1980, for Series D and August 1, 1983, for Series E), each series of preferred stock may not be redeemed from borrowed funds or proceeds of other preferred stock (i) having interest costs or dividend costs to the Company of less than each series' dividend rate, and (ii) having, in the case of Series E, a weighted average life less than the remaining weighted average life of the Series E stock. Series D may not be redeemed from proceeds of borrowed funds maturing earlier than May 1, 1995, or junior stock.

c. First mortgage honds

The outstanding $1,821,000 of 2⅝% First Mortgage Bonds due November 1, 1979, were retired at maturity.

The sinking fund requirements of the outstanding first mortgage bonds are $980,000 for each of the years 1981 through 1985. As of December 31, 1980, the Company had satisfied all of its 1981 and $287,000 of its 1982 bond sinking fund requirements.

d. Other long-term deht

In February, 1977, the Small Business Administration made a $1,000,000 loan to the Company in connection with the losses incurred in a 1976 ice storm. The ten-year loan is repayable in equal semi-annual installments (including interest at 6⅝ percent).

4. Construction Program

Utility plant construction expenditures for 1981, including the Company's proportional share of jointly owned electric power production facilities, are estimated to be $31,307,000 and substantial commitments have been incurred in connection with such expenditures.

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

Under a Revolving Credit Agreement with five banks, the Company is entitled to borrow and reborrow until August 31, 1981, up to:

a. $16,000,000 from the five banks in the form of 90-day notes which bear interest at the prime rate in effect at one particular bank three days prior to issuance;

b. $15,000,000 of commercial paper promissory notes; and

c. $5,000,000 of short-term borrowings with other banks.

Pursuant to an order of the PSCW, which type of order can be amended upon the request of the Company, 1981 short-term borrowings may not exceed $20,000,000. Unused lines of credit available to support commercial paper exceeded such commercial paper outstanding at December 31, 1980, 1979, and 1978. Commercial paper outstanding at December 31, 1980, 1979, and 1978, was issued at commercial paper discount rates prevailing at the time of issuance.

The following information relates to notes payable, commercial paper, and lines of credit for the periods indicated:

	1980	1979
As of end of year		
Weighted average discount rate on commercial paper outstanding	**18.17%**	13.68%
Unused lines of credit	**$20,600,000**	$20,400,000
For the year ended		
Maximum amount of borrowings	**$ 9,925,000**	$ 7,495,000
Average amount of borrowings (based on daily outstanding balances)	**$ 2,927,000**	$ 905,000
Weighted average interest rate on borrowings	**13.49%**	14.17%

In connection with certain lines of credit, the Company maintains average compensating balances ranging from 2½ percent of the lines to 15 percent of the amounts borrowed. There are no legal restrictions on withdrawal of these funds.

6. Rate Matters

On February 20, 1980, the PSCW authorized new rates to be effective after March 11, 1980, designed to produce additional annual revenues of $6,000,000 for electric service and $3,000,000 for gas service. The increase is based on a 13 percent rate of return on common stock equity.

The Company filed an appeal for review of certain portions of the PSCW's February 20, 1980, rate order with the Dane County Circuit Court. The appeal concerned the order's treatment of the Company's generating capacity reserves (resulting in a $1,274,000 reduction in electric revenues) and the method prescribed for establishing mandatory residential time-of-day rates. The Circuit Court ruled in the Company's favor and remanded the case to the PSCW. The Company requested that the PSCW authorize electric rates designed to increase revenues from sales to consumers by $1,274,000 annually by promptly implementing an electric rate surcharge with refund provisions.

Subsequently, the PSCW decided that it will change the rules under which the Company is to establish mandatory residential time-of-day rates. The new rules provide for a less rapid implementation of the time-of-day rates among the Company's electric customers. The requested surcharge continues to be under consideration by the PSCW.

7. Segments of Business

The following table presents information pertaining to the Company's segments of business for 1980, 1979, and 1978. The data does not necessarily reflect rate-making treatment. The preceding Notes are an integral part of this footnote.

	1980	1979	1978
OPERATING INFORMATION (Year Ended December 31)	(Thousands of Dollars)		
Electric Operations			
Operating revenues	$ 95,317	$ 89,211	$ 78,588
Revenues from sales to gas utility	—	—	—
Total revenues	95,317	89,211	78,588
Operating expenses:			
Operation and maintenance	52,496	47,636	37,140
Depreciation and amortization, excluding additional depreciation (a)	8,454	9,236	8,293
Property, payroll, and other taxes	3,756	4,157	4,550
Operating expenses before income taxes	64,706	61,029	49,983
Pre-tax operating income	30,611	28,182	28,605
Current federal and state income taxes, net investment tax credit deferred, and additional depreciation (a)	11,654	11,306	11,219
Net operating income (b)	$ 18,957	$ 16,876	$ 17,386
Construction and Nuclear Fuel Expenditures (Electric)	$ 15,724	$ 14,120	$ 19,715
Gas Operations			
Operating revenues	$ 66,439	$ 55,169	$ 46,390
Revenues from sales to electric utility	6,498	7,688	1,053
Total revenues	72,937	62,857	47,443
Operating expenses			
Operation and maintenance	61,546	52,537	37,080
Depreciation and amortization, excluding additional depreciation (a)	2,578	2,393	2,203
Property, payroll, and other taxes	1,273	1,265	1,373
Operating expenses before income taxes	65,397	56,195	40,656
Pre-tax operating income	7,540	6,662	6,787
Current federal and state income taxes, net investment tax credit deferred, and additional depreciation (a)	3,008	2,810	2,785
Net operating income	$ 4,532	$ 3,852	$ 4,002
Construction Expenditures (Gas)	$ 5,796	$ 6,895	$ 6,546
INVESTMENT INFORMATION (at December 31)			
Ideutifiable Assets (c)			
Electric	$209,949	$207,806	$204,999
Gas	65,308	60,732	57,071
Assets Not Allocated (d)	17,975	17,545	16,223
Total assets	$293,232	$286,083	$278,293

(a) Information regarding amounts recorded as additional depreciation in 1980, 1979, and 1978 is set forth in Note 1d.
(b) Excludes Allowance for Funds Used During Construction of $315,821 in 1978.
(c) Includes allocated common plant and is net of the respective accumulated provisions for depreciation.
(d) Primarily includes cash, temporary cash investments, accounts receivable, prepayments, and a portion of deferred charges.

Quarterly Summary of Operations

The following is a summary of consolidated operations (in thousands of dollars except earnings per common share) for 1980 and 1979:

Quarter Ended	Operating Revenues	Net Operating Income	Net Income	Earnings on Common Stock	Earnings Per Common Share*
1980					
March 31	$50,262	$6,935	$4,898	$4,107	74¢
June 30	32,604	4,563	2,536	1,747	31
September 30	34,857	6,452	4,695	3,907	70
December 31	44,033	5,539	3,419	2,638	47
1979					
March 31	46,243	6,920	4,919	4,116	76
June 30	28,571	3,867	1,904	1,104	20
September 30	28,254	4,842	2,869	2,071	38
December 31	41,312	5,099	3,130	2,337	42

*Because of the mathematical effect of new common stock issues on average shares outstanding during specific periods, the sum of earnings per share of common stock for any four quarterly periods may vary slightly from the earnings per share for the equivalent 12-month period.

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

Supplementary Information te Disclose the Effects of Changing Prices

The Company's estimates of the effects of changing prices (inflation) on its operations for the years 1979 and 1980, shown below, are presented in response to the Financial Accounting Standards Board's Statement No. 33, "Financial Reporting and Changing Prices." The format has been revised from that previously used for 1979 annual reporting purposes in order to show more clearly the effect of inflation. It should be viewed as an estimate of the approximate effect of changing prices rather than as a precise measure.

Statement of Income from Operations Adjusted for Changing Prices for the Year Ended December 31, 1980

(Thousands of Dollars)

	Constant Dollars—Average 1980 Dollars	Current Cost—Average 1980 Dollars
Income from operations applicable to common shareholders, as reported	$ 12,399	$ 12,399
Additional depreciation on plant costs restated for the effects of changing prices	10,996	11,767
Adjusted income (loss) from operations applicable to common shareholders (excluding reduction to net recoverable amount)	$ 1,403 (1)	$ 632
Otber impacts of changing prices		
Reduction to net recoverable amount	$(21,925)	$ (2,002)
Excess of the increase in the general level of prices ($12,952) in the current year over specific price changes ($32,104)(2)		(19,152)
Gain from decline in purchasing power of net amounts owed	10,729	10,729
Net	$(11,196)	$(10,425)
Adjusted income (loss) after all impacts of changing prices	$ (9,793)	$ (9,793)

(1) Including the reduction to net recoverable amount, the income (loss) from continuing operations on a constant dollar basis would have been ($20,522).

(2) At December 31, 1980, current cost of utility plant, net of accumulated depreciation, was $429.0 million, while historical cost, net of accumulated depreciation, was $281.7 million.

Comparison of Selected Supplementary Financial Data For the Five Years Ended December 31, 1980

(Constant Dollars and Current Cost in Average 1980 Dollars)

	Years Ended December 31				
	1980	1979	1978	1977	1976
Operating revenues (thousands of dollars)					
As reported	$161,756	$144,380	$124,979	$104,396	$ 87,781
Constant dollars	$161,756	$163,905	$157,855	$141,956	$127,064
Constant Dollar Information					
Income from operations applicable to common shareholders (excluding reduction to net recoverable amount)	$ 1,403	$ (2,048)			
Income per common share (excluding reduction to net recoverable amount)	$ .25	$ (.37)			
Net assets at year-end at net recoverable amount	$269,082	$264,023			
Current Cost Information					
Income (loss) from operations applicable to common shareholders (excluding reduction to net recoverable amount)	$ 632	$ (4,634)			
Income (loss) per common share (excluding reduction to net recoverable amount)	$ .11	$ (.84)			
Excess of increase in general price level over increase in specific prices after reduction to net recoverable amount	$ 21,154	$ 34,608			
Net assets at year-end at net recoverable amount	$269,082	$264,023			
General Information					
Gain from decline in purchasing power of net amounts owed	$ 10,729	$ 13,769			
Cash dividends declared per common share					
As reported	$ 1.66	$ 1.48	$ 1.44	$ 1.36	$ 1.23
Constant dollars	$ 1.66	$ 1.68	$ 1.82	$ 1.85	$ 1.78
Market price per common share at year-end					
As reported	$ 14.25	$ 13.88	$ 15.88	$ 17.25	$ 15.75
Constant dollars	$ 14.25	$ 15.60	$ 20.22	$ 23.95	$ 23.35
Average Consumer Price Index (Base year 1967 = 100)	246.8	217.4	195.4	181.5	170.5
End of year Consumer Price Index (Base year 1967 = 100)	258.4	229.9	202.9	186.1	174.3

The supplemental information is presented on two bases: constant dollars and current cost. Constant dollar amounts represent historical costs stated in terms of dollars of equal purchasing power, as measured by the Consumer Price Index for All Urban Consumers. Current cost amounts reflect the changes in specific prices of plant from the date the plant was acquired to the present, and differ from constant dollar amounts to the extent that specific prices have increased more or less rapidly than prices in general. The current cost amounts represent the estimated cost of replacing existing plant assets and were determined principally by indexing the surviving plant and equipment by use of the Handy-Whitman Index of Public Utility Construction Costs.

The current year's provision for depreciation on the constant dollar and current cost amounts of utility plant was determined by applying the Company's depreciation rates to the indexed plant amounts. The current cost accumulated depreciation at December 31, 1980, was determined by applying the rates of accumulated depreciation to historical cost, by existing classes of property, to the current cost by classes of property.

Fuel inventories, the cost of fuel used for electric generation, and the cost of natural gas purchased for resale have not been restated from their historical cost. Regulation limits the recovery of fuel and purchased gas costs through the operation of adjustment clauses or adjustments in basic rate schedules to historical costs. For this reason, fuel inventories are effectively monetary assets.

Since only historical costs are deductible for income tax purposes, the income tax expense in the historical cost financial statements is not adjusted.

Under the rate-making principles followed by the PSCW, only the historical cost of plant is recoverable in revenues as depreciation. Therefore, the excess of the cost of plant stated in terms of constant dollars over the historical cost of plant is not presently recoverable in rates as depreciation, and is reflected herein as a "reduction to net recoverable amount." Based on past practices, however, the Company believes it will be allowed to earn on the increased historical cost of its facilities when replacement actually occurs.

To reflect properly the economics of rate regulations, the purchasing power loss related to the reduction of net utility plant to net recoverable amount is offset by the reduction of purchasing power loss resulting from debt financing. During a period of inflation, holders of monetary assets, such as cash and receivables, suffer a loss of general purchasing power, while holders of

continued

Supplementary Information to Disclose Effects of Cbanging Prices (continued)

monetary liabilities are able to satisfy the liability with dollars of lower purchasing power. This unrealized gain, or reduction of purchasing power loss, which is primarily attributable to the substantial amount of debt which has been used to finance utility plant, partially offsets the purchasing power loss because depreciation on this plant is limited to the recovery of historical costs.

The difference ($22.2 million) between income from operations applicable to common shareholders, as reported, and the loss after all impacts of changing prices represents the loss of purchasing power incurred by the common shareholders in 1980 because present rate-making practices do not permit the excess of constant dollar or current cost depreciation over historical cost depreciation to be recovered in rates in future years.

Construction Program

(Thousands of Dollars)

	1981 Estimated Construction Expenditures		Plant Additions (Including Allowance for Funds Used During Construction) 1980		Annual Average 1975-1979	
Electric Department						
Production plant	$ 4,515	15%	**$ 2,143**	**11%**	$ 9,091	32%
Transmission plant	6,883	22	**4,888**	**24**	6,710	24
Distribution plant	5,959	19	**3,395**	**17**	3,116	11
General plant	134	–	**86**	**–**	51	–
Nuclear fuel	4,612	15	**3,790**	**18**	3,101	11
Total	22,103	71	**14,302**	**70**	22,069	78
Gas Department						
Distribution plant	5,368	17	**5,369**	**26**	5,775	20
General and other plant	61	–	**60**	**–**	30	–
Total	5,429	17	**5,429**	**26**	5,805	20
Utility Plant Common to Both Departments	3,775	12	**879**	**4**	492	2
Total	$31,307	100%	**$20,610**	**100%**	$28,366	100%

General Information

General Offices

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Transfer Agent

Harris Trust and Savings Bank
111 West Monroe Street
Chicago, Illinois 60603

Registrar

The First National Bank of Chicago
One First National Plaza
Chicago, Illinois 60607

Audit Committee

Directors Blaney, Bolz, Gruber, Kubly, Mohs, Sonderegger, and Young

Annual Meeting

The 1981 annual meeting will be held Tuesday, April 21, 1981, 7:30 p.m. at the Madison Holiday Inn Southeast, located near the Interstate 90 and U.S. Highway 12-18 interchange.

Reports Available

Upon written request, the Company will furnish to any shareholder a copy of its 1980 Annual Report on Form 10K as filed with the Securities and Exchange Commission. A Statistical Supplement to this Annual Report to Shareholders, containing additional financial and operating data, is available to shareholders. Please address requests for these reports to G. Howard Phipps, Post Office Box 1231, Madison, Wisconsin 53701.

Board of Directors

Richard E. Blaney
Madison, Wis., President, Blaney Agri-Research Foundation.
Age 44, Director Since 1974

Robert M. Bolz
Madison, Wis., Retired Vice Chairman, Oscar Mayer & Co.,
Age 58, Director Since 1972

Leo E. Brodzeller
Madison, Wis., Executive Vice President,
Age 63, Director Since 1977

Jon J. Gruber
Middleton, Wis., President, Gruber Furniture, Inc., Owner, Gruber Funeral Homes,
Age 40, Director Since 1978

Donald J. Helfrecht
Madison, Wis., President and Chief Executive Officer,
Age 59, Director Since 1972

Stanley V. Kubly
Madison, Wis., President, Kubly Enterprises, Inc.,
Age 72, Director Since 1960

Frederick D. Mackie
Madison, Wis., Retired Chairman of the Board,
Age 70, Director Since 1964

William A. McNamara
Madison, Wis., Chairman of the Board,
Age 72, Director Since 1958

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Age 43, Director Since 1975

John L. Sonderegger
Madison, Wis., President and Chief Executive Officer, Wisconsin Life Insurance Company,
Age 66, Director Since 1971

Louise A. Young
Madison, Wis., Professor Emeritus, Department of Home Management and Family Living, U.W.-Madison and Financial Consultant,
Age 70, Director Since 1973


Richard E. Blaney


Robert M. Bolz


Leo E. Brodzeller


Jon J. Gruber

Donald J. Helfrecht


Stanley V. Kubly


Frederick D. Mackie


William A. McNamara


Frederic E. Mohs


John L. Sonderegger


Louise A. Young

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