Madison Gas and Electric Company 1981 Annual Report

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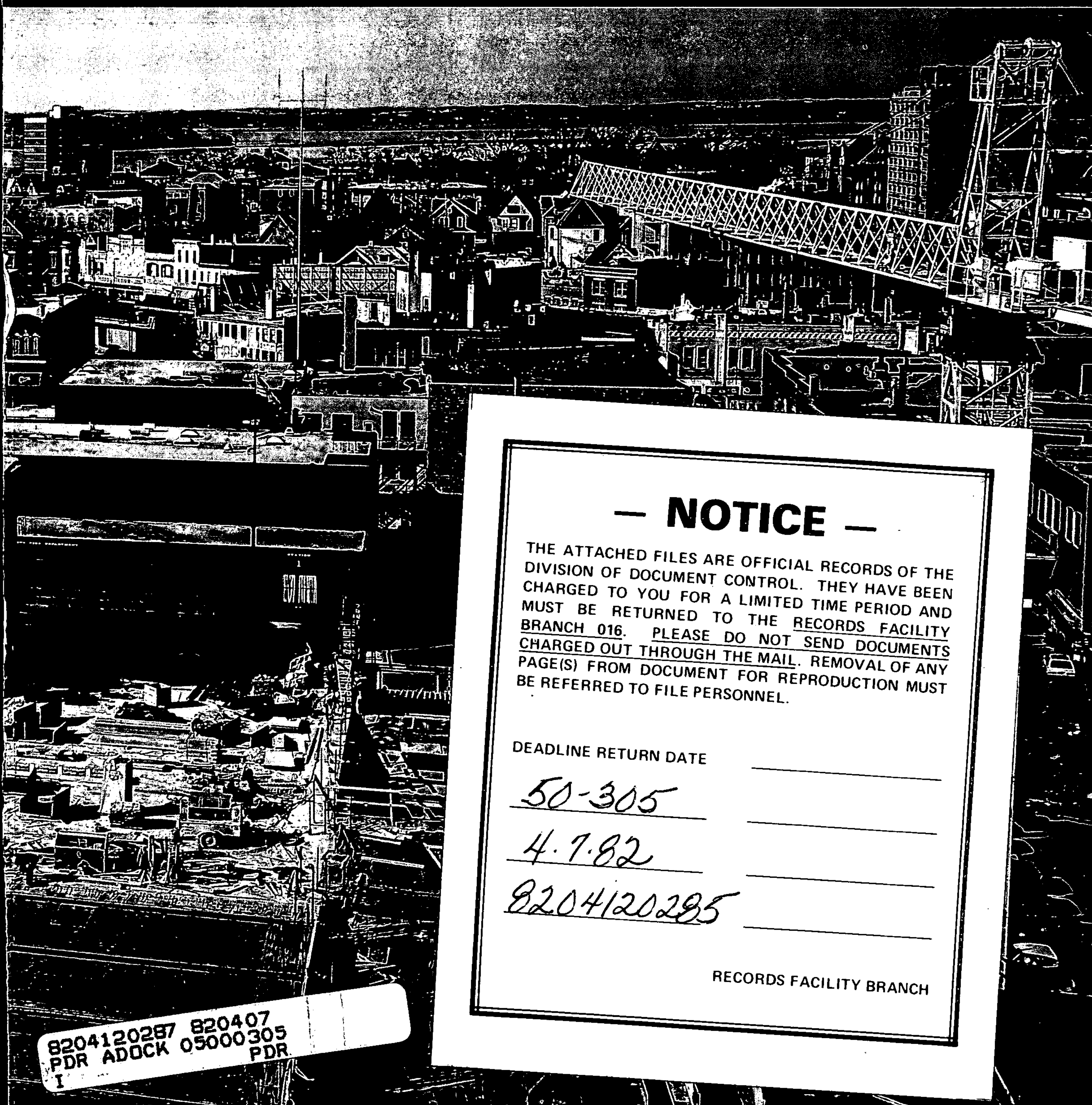

Officers

William A. McNamara
Chairman of the Board
Age 73, Years of Service, 23

Donald J. Helfrecht
President and Chief Executive Officer
Age 60, Years of Service, 35

Leo E. Brodzeller
Executive Vice President
Age 64, Years of Service, 42

Frank C. Vondrasek
Executive Vice President
Age 53, Years of Service, 11

Gerald A. Wilson
Senior Vice President—Administration
Age 59, Years of Service, 15

Richard M. Lawrence
Vice President—Public Affairs
Age 55, Years of Service, 31

Terrence J. Schuh
Vice President—Customer Services
Age 39, Years of Service, 13

G. Howard Phipps
Vice President—Finance and Treasurer
Age 38, Years of Service, 9

Dale W. St. John
Secretary and Assistant Treasurer
Age 57, Years of Service, 17

Billie C. Moore
Assistant Vice President and Director—Consumer Services
Age 60, Years of Service, 36

David C. Mebane
General Counsel
Age 48, Years of Service, 4

Beverly R. Duncan
Assistant Secretary—Corporate Affairs
Age 50, Years of Service, 31

Carol A. Bethke
Assistant Secretary—Administration and Investor Relations
Age 42, Years of Service, 15


Helfrecht, Duncan, McNamara


Schuh, Vondrasek, Moore


Brodzeller, Wilson


Phipps, Bethke


Lawrence, St. John, Mebane

The Year At A Glance

	1981	1980	Percent increase (decrease) 1981-1980
Operating revenues	**$162,082,000**	$161,756,000	.2%
Operating expenses	**$141,200,000**	$138,266,000	2.1
Net income	**$ 12,583,000**	$ 15,548,000	(19.1)
Earnings on common stock	**$ 9,542,000**	$ 12,399,000	(23.0)
Earnings per common share outstanding	**$1.66**	$2.21	(24.9)
Cash dividends paid per common share	**$1.76**	$1.66	6.0
Weighted average number of shares outstanding	**5,756,254**	5,607,319	2.7
Book value—year end	**$17.97**	$18.19	(1.2)
Electric sales to consumers	**1,686,000 mwh**	1,664,000 mwh	1.3
Electric customers in service—year end	**99,173**	97,248	2.0
Average use per residential customer	**6,073 kwh**	6,120 kwh	(.8)
Electric system one-hour net peak demand	**372,000 kw**	372,000 kw	—
Gas sales to consumers	**149,997,000 therms**	177,912,000 therms	(15.7)
Gas customers in service—year end	**67,727**	66,224	2.3
Gas system peak day	**1,346,000 therms**	1,360,000 therms	(1.0)
Investment in plant	**$380,303,000**	$362,235,000	5.0
Total capitalization (incl. interim loans)	**$244,969,000**	$240,590,000	1.8
Number of employees—year end	**643**	578	11.2

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 250 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—Capitol Centre, a two city block complex that will include senior citizen low-income apartments and senior center, market-rate housing, commercial space, and a parking ramp.

MGE™
MADISON GAS AND ELECTRIC

To Our Shareholders

The year 1981 has to be looked upon as one with both good and bad aspects. The effects of continued inflation and increased expenses resulted in a decline in earnings on common stock.

Total revenues were $162 million, the same as 1980. But operating expenses went up to $141 million in 1981, from $138 million in 1980.

Positive aspects of the year are the continued growth in number of customers we serve, including those added with the acquisition of the Cross Plains Electric Company property, and the continued improvement in supplies of natural gas available to MGE.

Dividends Grow

To maintain MGE's competitive position among investors, the quarterly dividend was increased on Sept. 15, 1981, from $.43 to $.45 per share of common stock. This raised the annual dividend rate to $1.80 per share. We feel a continuing commitment to a dividend policy that will sustain the loyalty of shareowners and maintain the Company's ability to attract and hold required capital. Through Dec. 31, 1981, the Company has paid 276 consecutive dividends on a regularly scheduled basis.

Request New Rate Increases

On Sept. 11, 1981, we filed an application with the Public Service Commission of Wisconsin (PSCW) for increases in electric and gas rates to cover increasing costs due to continuing inflation.

The total increases requested are $16,749,000 in electric service revenues and $7,191,000 in gas service revenues per year, or 19.3% in retail electric revenues and 8.6% in retail gas revenues. Based on information furnished by the staff of the PSCW, hearings on the request will not be held until some time during Spring 1982, and an order then would be issued close to mid-1982.

On Nov. 17, the Company filed a motion with the PSCW for temporary rate increases. This was in accordance with the application made in September, which included a request that the Company be authorized an interim surcharge on electric and natural gas rates if the rate case was not concluded promptly. This interim surcharge would have increased revenues enough to permit earning a return on common stock equity of at least 13%, the previously authorized level, and would have been subject to refund. The motion was denied by the PSCW on Dec. 2.

MGE is requesting a 16% return on equity at this time. The present return authorized is 13%; in spite of diligent efforts to control and reduce expenses, it has never been reached. Lack of adequate return, ironically, increases the Company's cost of doing business because we then must pay more for the capital we need than we would if earnings were more competitive.

Ruling on Previous Rate Matter

We have previously reported to you on two aspects of our 1979 rate increase request that had been the subject of a court challenge by MGE. The Company's position on both matters—one involving a $1.27-million revenue reduction and the other involving application of residential time-of-use electric rates—had been upheld by a Wisconsin Circuit Court. The PSCW had appealed only the ruling on the revenue matter; on Nov. 3, 1981, this appeal was denied by the Appellate Court. The PSCW is seeking further review by the Wisconsin Supreme Court. The 1.746% electric rate surcharge authorized by the PSCW as a result of the Circuit Court ruling continues in effect.

Acquisition of Cross Plains Electric

In July, 1981, we acquired the property of the Cross Plains Electric Company, a small investor-owned company whose service area abutted MGE's. Many of its customers were already receiving gas service from MGE. The purchase added about 1,100 electric customers to the 97,000 we already served and increased the physical area that MGE serves with electricity by about 13%. This increases our potential for growth as the area is developed.

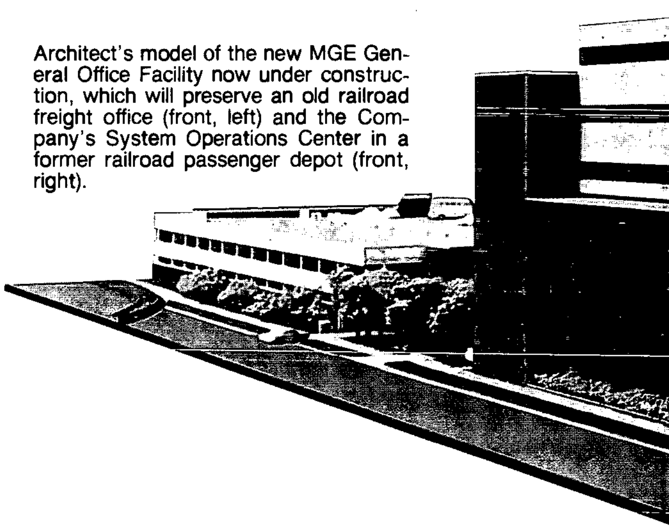
Future Funding Plans

The Company does not face any extraordinarily large construction requirements for the next several years. We are making every effort to control construction expenditures during this period of high interest rates. We expect to spend about $25 million per year for the next five years, with internally generated funds covering about 90% of this requirement. We are considering, however, some external financing during the last half of 1982 depending on prevailing market conditions. This will be new long-term debt to reduce some short-term debt and to replace some other outstanding securities.

New Office Construction

Construction of our new General Office Facility, which will consolidate in one place employees who now are scattered around in several locations, began last fall with work on the parking ramp. With the ramp completed in February, activity now focuses on the office building part of the project.

The new building basically is a three-story structure connecting with our existing System Operations Center. A smaller three-story tower, which will include solar energy collectors and other innovative design features, will extend part of the new building to a height of six floors. With completion of the project scheduled for mid-1983, we look forward to improving overall efficiency.



Architect's model of the new MGE General Office Facility now under construction, which will preserve an old railroad freight office (front, left) and the Company's System Operations Center in a former railroad passenger depot (front, right).

Prepared to Serve an Area of Growth and Economic Vitality

Corporate Objectives

Elsewhere in this report, you will see a brief statement of MGE's corporate objectives. This statement summarizes more-detailed definitions of our objectives with respect to our overall performance and our responsibilities to the owners, customers, and employees of the Company as well as to the communities we serve. These newly codified statements of objectives are part of our continuing effort to improve our corporate performance in both fiscal and human terms.

Future Outlook Bright

We take an optimistic view of the future. We detail our growth prospects later in this report, especially in terms of new customer additions. With a general overall improvement in the economy anticipated for the latter half of 1982, we expect growth to continue.

We also see very desirable growth as loads substantially increase in central Madison, the heart of our service area. The large commercial projects under way in this part of our territory are tapping electric and gas facilities that are already in place. So we are adding load with limited additional investment.

Rate Relief Still Needed

Inflation will continue to seriously impact on our costs. To offset these increases, we must continue to seek rate increases.

We expect that the inflation rate will decline during the second half of the year, as many predict. The sharply colder-than-normal weather at the beginning of 1982, something not experienced during the past two years, is a positive factor affecting our revenue.

Natural gas supplies and electric service capacity continue to be adequate with reasonable reserves. We will be able to get all the gas needed to satisfy our customers' needs for the next several years. The adequacy of our gas supplies is due mainly to the effect of the Natural Gas Policy Act of 1978 that permitted gradual phase-out of federal price regulation and the aggressive acquisition policy of our pipeline supplier. The gradual deregulation of gas is scheduled to continue through 1985. We favor this gradual approach, which has achieved an equitable balance between supply and price.

We have adequate electrical generating capacity to serve our system needs and expect that we will continue to be a seller to other systems through power pool and other agreements.

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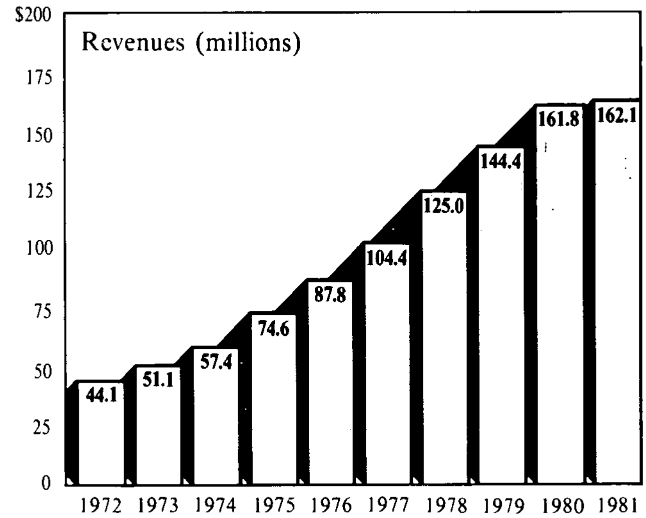
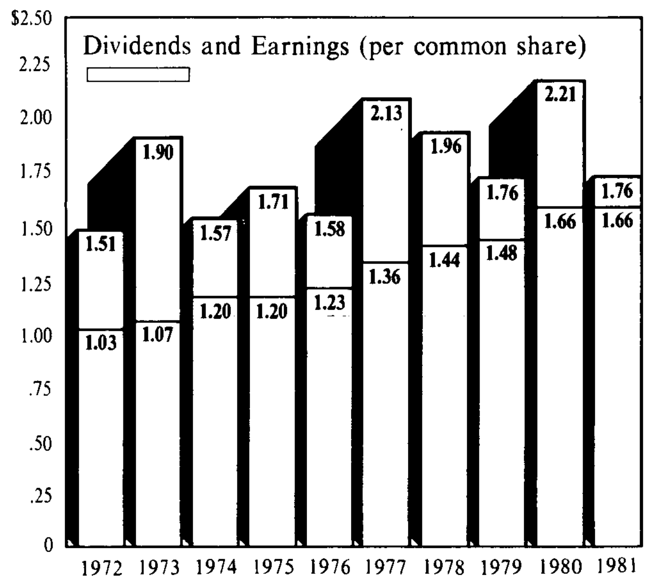
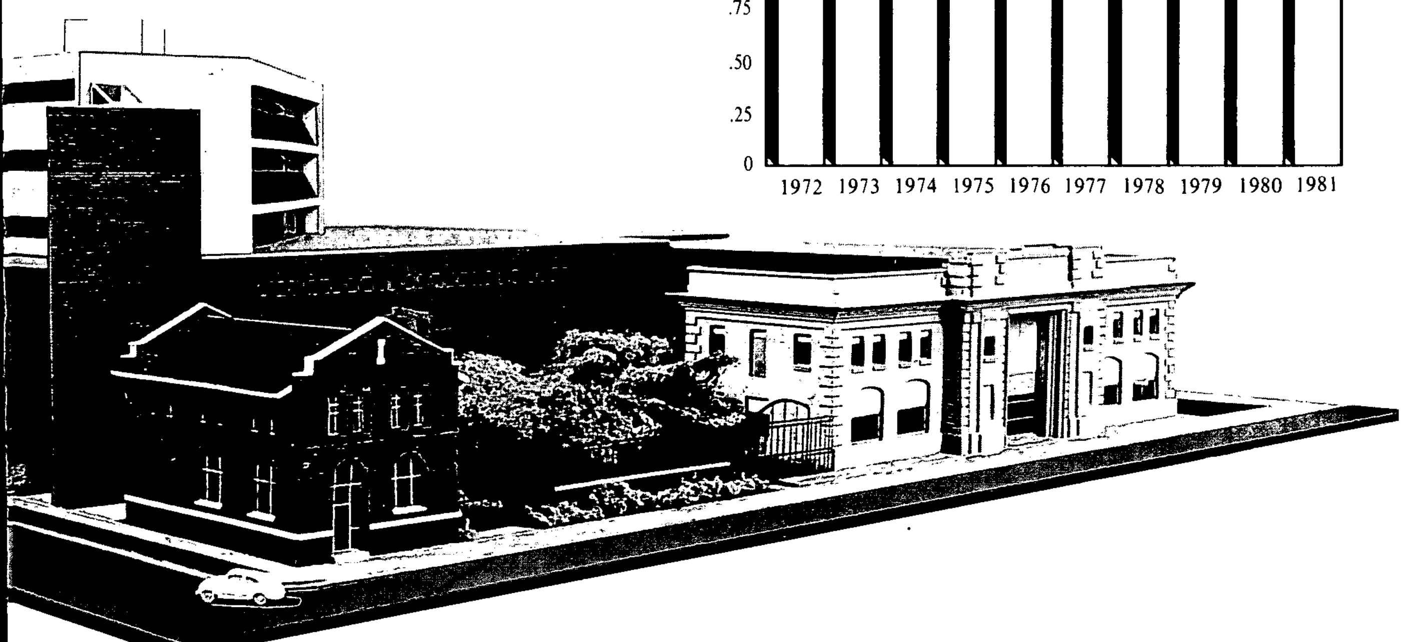






Employees

The experience and knowledge of employees are a major asset of any organization. This is especially true at MGE. Good customer relations practices are continually emphasized through training of both long-term and new employees. Our work force grew in all Company divisions, but especially so in the consumer advisory, data processing, information management, and system design and engineering areas.

A two-year agreement with the Office and Professional Employees International Union, Local No. 39, expires April 30, 1982. Discussions concerning renewal will begin in March. Local 39 represents 139 clerical employees. A two-year agreement effective May 1, 1981, with the International Brotherhood of Electrical Workers, Local No. 2304, representing 266 operating employees, continues until April 30, 1983.

Changes in Directors

On Oct. 23, 1981, Donald D. Haselhorst was elected to the Company's board of directors. Mr. Haselhorst is president and chief executive officer of Nicolet Instruments Corp., Madison, a manufacturer of computerized instrumentation equipment. He replaced Stanley V. Kubly who retired from the board after 21 years of loyal and dedicated service. Mr. Kubly's wisdom and balanced thinking were of great assistance to the management of the Company.

Frank C. Vondrasek, Jr., was elected to the board effective Jan. 1, 1982. Mr. Vondrasek is executive vice president of the Company in charge of operations. He replaced Leo E. Brodzeller, executive vice president in charge of administrative activities. Mr. Brodzeller resigned from the board to reduce his involvement in the management of the Company in anticipation of his retirement from MGE in March, 1982. His years of service as a director since 1977 and as an employee for 42 years are worthy of special note. The knowledge and expertise he developed were extremely valuable in the counsel he brought to his management and board responsibilities. His dedication and service indeed have been outstanding.

Management Change

During 1981, Gerald A. Wilson was appointed to the position of senior vice president—administration, reporting to Mr. Brodzeller. Mr. Wilson had been group vice president—energy supply.

We appreciate your confidence and support and hope that you will review the rest of this report to learn more about your Company's operations and future.

For the Board of Directors:

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

Donald J. Helfrecht
Donald J. Helfrecht
President

Feb. 18, 1982

Corporate Objectives

A formal statement of MGE's corporate objectives was issued this year. These objectives are summarized as follows:

• To effectively and fairly serve all the Company's constituencies — customers, investors, employees, governmental bodies, and suppliers—to best balance the mutual interests of all.

• To furnish reliable service in a safe, courteous, competent, and timely manner and at a reasonable cost to customers that also will provide sufficient earnings to adequately compensate our investors for use of their money.

• To recognize our social responsibilities as a corporation as an integral part of dealing with our various constituencies.

• To encourage and reward employee initiative, career development, productivity, and responsible performance.

• To encourage prudent growth in the use of our energy services, including the development of new technologies and applications.

Electric Operations

Prepared to Serve
an Area of Growth and
Economic Vitality

Ronald Skram, Electric Power Supply Office

During 1981, MGE added 1,925 electric customers within its 250-square-mile electric service area, reaching a total of 99,173 customers served at year end. The acquisition of Cross Plains Electric Company accounted for 1,054 of these new customers.

Electric sales were 2.0 billion kilowatt-hours (kwh), down 9% from the 2.2 billion in 1980. Electric revenues were $92.8 million in 1981, down 2% from the $94.9 million last year.

Generating Capacity Sufficient

MGE's 597,000-kilowatt (kw) generating capability is adequate to meet the foreseeable growing demand in its service area. This capability is 15% base-load nuclear fueled, 70% base-load and intermediate-load coal fired, and 15% oil- or gas-fired combustion turbines for peak loads.

Of the total electricity generated by wholly or partially owned Company facilities during 1981, the Kewaunee Nuclear Plant supplied 34%, coal at the Columbia Energy Center and at the Blount Plant provided 63%, and natural gas and oil-fueled equipment contributed 3%. The Blount Plant burned 11,155 tons of local refuse mixed with coal, replacing 5,590 tons of coal.

On July 13, 1981, MGE's electric peak demand reached 372,000 kw, which matched the previous peak reached in 1980.

RDF Gains National Attention

During the past two years, MGE has been recovering energy from a previously discarded resource — garbage — by burning a mixture of city refuse and coal to generate electricity at its Blount Plant.

Two boilers at Blount were modified to burn the maximum amount of combustible refuse the City can deliver daily—about 120 tons. MGE reimburses the City for the refuse based on its heating value as fuel.

As one of the few successful refuse derived fuel (RDF) operations in the country, the Company's facility has attracted the attention of other communities and utilities seeking alternatives to the environmental problems and escalating costs associated with providing landfills. During 1981, visitors from as far away as Hawaii, California, Virginia, and the United Kingdom toured the Madison facility. Video-taping crews from Iowa and Illinois also filmed the operation.

Wind Energy Project Breezes Along

A wind energy research program was established in 1981, consisting of five major phases: assembling a wind energy library, developing wind energy computer programs, assessing the wind energy potential in the MGE service area, monitoring customer-owned small wind energy conversion systems (SWECS), and installing and monitoring MGE-owned SWECS. The first three phases of this program were started during 1981.

Five customer-owned SWECS connected with the MGE power system will be monitored for performance and safety. In addition, three Company-owned and operated SWECS will be erected during 1982 and monitored for two years. By monitoring these eight installations, MGE will gain important data on the performance of such alternative energy sources.

TMI Incident Impacts Kewaunee

As a result of lessons learned following the incident at the Three Mile Island nuclear facility in Pennsylvania, various safety projects have been initiated at the Kewaunee Plant to prevent the possibility of a similar occurrence there. A Technical Support Center Building has been erected adjacent to the main plant. If an accident occurred, plant personnel could safely monitor and remedy the problem using controls in this facility. The center is scheduled for completion in late 1982.

A training simulator for prospective nuclear plant operators and for retraining current operators is on order. This simulator will be installed within the recently completed Emergency Response Center, also located near the power plant, and will be fully operational by the end of 1984. Although the plant is operated by Wisconsin Public Service Corp., the cost of these projects is being shared by the three utilities who own the plant in proportion to their percentages of ownership.

MGE Hosts Load Management Test

As part of the Electric Distribution Engineering Department's plan to evaluate and establish a direct load management system, MGE served as upper-midwest host and participating utility for a demonstration of a sophisticated, two-way power line communication system. This system is designed to reduce peak demand and operating costs.

It can control water heaters and other electric loads. It can monitor voltage regulators, line switches, and substation breakers as well as read meters, detect meter tampering, and determine individual customer energy use. MGE is evaluating the system to the point of considering bids.

Undergrounding, Substation Work Completed

A three-year project to improve service and system reliability in the far-west Madison area moved nearer to completion in 1981. More than five miles of aluminum conductor was installed underground and connected to the recently completed addition to the West Towne Substation.

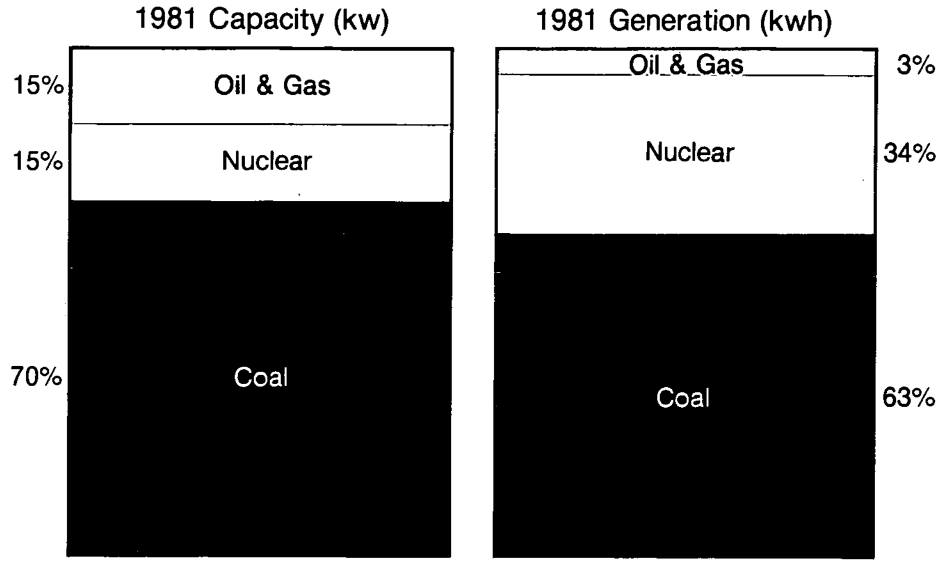
Improvements and additions made at the North Madison and Sycamore Substations in 1981 prepared the way for a 13 mile-long 138-kv transmission line between them. Work on the line began early in 1982. When completed in the third quarter of 1982, this line will increase the reliability of power supply from the Kewaunee and Columbia generating plants to the northeast side of the Company's distribution system.

With the acquisition of the Cross Plains Electric Company system, MGE's electric distribution staff began an extensive evaluation of that system—including meters, transformers, and overhead and underground services. Equipment will be installed at the West Middleton Substation to tie into the Cross Plains distribution system to help meet that demand for electricity.

Alternatives in Metering, Rates

Besides offering standard residential and commercial rates, MGE provides electric time-of-use and electric and gas lifeline rates for qualifying customers. The Company has about 450 customers on time-of-use rates. For the majority of these customers, the rates are mandatory because they have large electrical loads. Optional time-of-use rates are available for residential, commercial, and industrial customers also. These optional rates provide lower electric rates during off-peak periods than during on-peak periods (10 a.m. through 9 p.m. Monday through Friday).

Optional electric and gas lifeline rates are available to qualifying low-income households and recipients of Supplemental Security Income who apply to MGE for them. At year-end 1981, some 605 customers were on electric lifeline rates and 483 customers were on gas lifeline rates. For qualifying gas customers, these rates will result in lower bills than standard rates, regardless of the amount of gas consumed. For these electric customers, bills will be lower if monthly electric consumption is less than 1,655 kwh in winter and 931 in summer. MGE is the only utility in the state with lifeline rates.



Generation concentrates on drawing kilowatt-hours from the most energy-efficient units on the system. Nuclear was 34% of generation in 1981 compared to 29% in 1980 while oil and gas dropped from 7% of generation in 1980 to 3% in 1981.

Electric Service

	1981	1980	1979	1978	1977	1976	1971
Sales (Megawatt-hours)							
Residential	518,994	513,508	485,745	503,767	492,397	485,951	435,668
Commercial power & lighting	859,766	849,982	789,811	766,355	724,977	691,947	526,207
Industrial power & lighting	116,918	111,069	124,854	114,311	104,743	100,219	115,839
Street & highway lighting & public authorities	189,975	189,661	209,115	215,069	214,769	217,662	174,782
Other utilities	275,655	582,561	690,656	537,616	189,494	148,134	111,091
Total	1,961,308	2,246,781	2,300,181	2,137,118	1,726,380	1,643,913	1,363,587
Revenues (000)							
Residential	$27,083	$25,221	$22,429	$22,130	$20,974	$17,585	$ 8,924
Commercial power & lighting	41,688	38,716	32,739	30,157	27,802	23,043	10,070
Industrial power & lighting	4,959	4,536	4,547	3,983	3,598	2,905	1,646
Street & highway lighting & public authorities	7,580	7,079	6,704	6,447	6,223	5,176	2,054
Other utilities	11,530	19,380	22,383	15,488	6,426	3,950	1,085
Total	$92,840	$94,932	$88,802	$78,205	$65,023	$52,659	$23,779
Customers at Year End							
Residential	86,640	85,068	83,264	81,671	79,788	78,042	67,570
Commercial power & lighting	12,389	12,037	11,808	11,609	11,228	11,061	9,654
Industrial power & lighting	98	102	122	139	127	141	196
Street & highway lighting & public authorities	43	38	40	36	38	35	38
Other utilities	3	3	3	3	3	3	3
Total	99,173	97,248	95,237	93,458	91,184	89,282	77,461
Residential (Averages)							
Kilowatt-hours per customer	6,073	6,120	5,897	6,241	6,262	6,299	6,554
Rate per kilowatt-hour	5.22¢	4.91¢	4.62¢	4.39¢	4.26¢	3.62¢	2.05¢

Gas Operations

Prepared to Serve
an Area of Growth and
Economic Vitality

During 1981, MGE added 1,503 new residential and small commercial gas customers, reaching a total of 67,727 customers served at year-end within its 750-square-mile gas service area. A significant Company milestone was reached at mid-year with the purchase and installation of MGE's 100,000th gas meter.

Gas sales were 150 million therms, down 16% from the 178 million therms sold in 1980. Revenues rose $2 million over 1980, to $69 million, an increase of 3%.

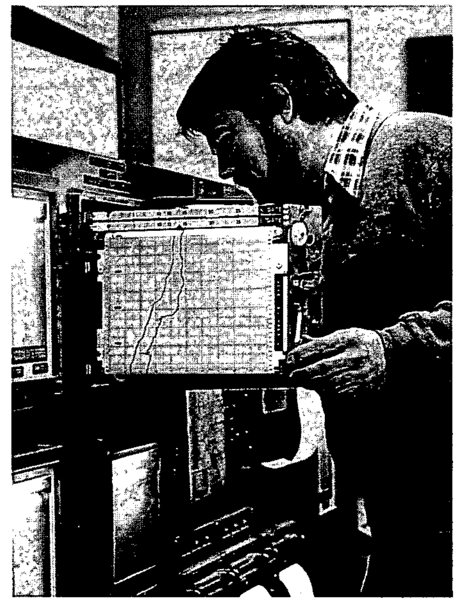
Supply Forecast Favorable

The Company has been assured by Michigan Wisconsin Pipe Line Company (Mich-Wis), its sole natural gas supplier, that MGE can depend on receiving its full annual gas requirements plus overrun quantities through 1985. With supplemental sources of gas expected to be added in the 1980s, supplies will be sufficient well into the 1990s.

Two major projects contribute to the favorable long-range gas supply outlook. One is the Great Plains Coal Gasification facility and the other is the Alaska-Canada natural gas pipeline.

One of the four companies making up the consortium building the coal gasification facility is American Natural Resources Company, parent company of Mich-Wis. Full-scale construction of the plant, at Beulah, N.D., began in 1981. Completion is scheduled for 1984. When completed, this will be the first commercial-scale, pipeline-quality coal gasification plant in the nation. It will produce 125 million cubic feet of gas daily, the energy equivalent of 20,000 barrels of oil.

The second project, the 4,800-mile Alaska-Canada natural gas pipeline, is at the stage of arranging financing and other pre-construction matters. American Natural is a member also of the consortium of energy companies planning to move the 26 trillion cubic feet of gas under Alaska's North Slope through this pipeline. These reserves are equal to 13% of the country's proven reserves and could reduce foreign oil imports by at least 400,000 barrels a day.



Gary Sanders, Electric Meter Shop

Mich-Wis has a contract to purchase one-third of Exxon-U.S.A.'s Alaskan reserve, or about 1.6 trillion cubic feet

Gas Service

	1981	1980	1979	1978	1977	1976	1971
Sales (Thousands of Therms)							
Residential	62,080	68,499	68,599	68,145	64,562	66,709	58,088
Commercial	70,806	74,842	90,953	88,929	79,433	88,639	72,123
Interruptible boiler fuel	7,152	24,344	17,354	5,134	5,445	14,929	10,524
Industrial	9,959	10,227	15,844	16,302	14,194	15,259	13,389
Total	149,997	177,912	192,750	178,510	163,634	185,536	154,124
Revenues (000)							
Residential	$30,238	$27,759	$21,677	$19,135	$16,856	$14,494	$ 6,610
Commercial	31,624	27,963	24,994	22,134	18,345	16,186	6,200
Interruptible boiler fuel	2,647	7,394	4,200	1,026	920	1,795	434
Industrial	4,047	3,524	4,002	3,802	3,006	2,479	787
Total	$68,556	$66,640	$54,873	$46,097	$39,127	$34,954	$14,031
Customers at Year End							
Residential	58,450	57,231	54,822	52,574	50,655	48,709	40,869
Commercial	9,201	8,916	8,566	8,338	8,016	7,854	6,389
Interruptible boiler fuel	3	4	5	4	3	3	4
Industrial	73	73	73	73	78	65	47
Total	67,727	66,224	63,466	60,989	58,752	56,631	47,309
Residential (Averages)							
Therms per space-heating customer	1,186	1,370	1,471	1,527	1,524	1,652	1,843
Rate per therm—space heating	48.4¢	40.2¢	31.3¢	27.8¢	25.8¢	21.5¢	11.2¢

over a 20-year period. By the last half of this decade, Alaskan gas should account for about 10% of the total gas supply of Mich-Wis.

System Improvements Completed

More than nine miles of new gas main was installed and placed in service during 1981 by MGE, four miles less than in the preceding year.

A five-year program to install sectionalizing valves throughout the Company's gas system was completed during 1981. These valves allow rapid shutdown of gas service in emergency situations to safely isolate specific, possibly hazardous, situations.

A major project under way is upgrading all low-pressure gas distribution main to intermediate-pressure main. This should be completed in 1983.

More than one mile of 4- and 12-inch gas main was laid during October and November to strengthen the natural gas supply to MGE's customers in Verona and the southwest side of Madison. This line ties into existing main in the area and stabilizes gas pressure. In conjunction with this project, a special pressure-regulating facility was constructed at the Fitchburg Substation to reduce the gas pressure from 350 pounds-per-square-inch gauge (psig) at the inlet side to 150 psig at the outlet.

Replacing the old cast-iron main continued in 1981. About 17 of the original 150 miles of the main are yet to be upgraded to conform to federal and state safety codes. This project is slated to be completed early in 1983.

Solar Advances with MGE Grants

During 1981, five MGE-funded solar energy and conservation projects were completed in the Madison community. The MGE grants were applied toward two active solar space-heating and water heating systems, an alternative energy festival, a neighborhood energy project, and a mobile energy conservation center. Grants for similar energy projects are planned for 1982.

A solar hot water heating system was installed at one of the Company's office buildings in May. The 82-gallon system provides most of the hot water needs of that facility. The Company also has solar hot water heating equipment on display at its Consumer Energy Center.

Stanley Wirth, Gas Meter Shop

Corporate Operations

Diana Lepine, Rates Department

Corporate Operations, an area that encompasses and supports both Electric and Gas Operations, concentrated on upgrading customer and consumer service-oriented programs during 1981.

New Computer Increases Speed, Capacity

In mid-April, MGE installed a new main computer with four times the internal speed and memory capacity of the unit it replaced. The new machine makes staff more efficient by handling tedious, time-consuming tasks and also makes new functions possible.

Major areas where new computer applications have boosted productivity or where computer programs soon will be introduced are records management, word processing, management reporting, payroll, accounting, materials management, and rates. Other advantages of the new computer include reduced energy, maintenance, and air conditioning requirements.

Information Management Systems will be operated in a dual processor environment by 1983, when the new General Office Facility is occupied. This system, using two separate computers rather than one large unit, will greatly improve information reliability and security.

New Consumer Energy Center Opens

The MGE Consumer Energy Center, a new facility across from the present General Office Building, opened at midyear. It carries an extensive line of energy conservation equipment, devices, and materials ranging from a solar water heater to caulking compound to pipe insulation. Several displays show the workings of automatic vent dampers, intermittent ignition devices, and automatic setback thermostats. Other displays show where to insulate and weatherize a home for the greatest energy savings for the money invested. Free energy conservation literature is available also. This Center will become an integral part of the new General Office Facility upon its completion in 1983.

Energy Audit Program Expands

The Company's Residential Conservation Service (RCS) program went into full operation during August, 1981, with a mailing of announcements to MGE customers. RCS is a federal-state program to promote energy-efficient living.

This in-depth program is carried out by 17 MGE energy auditors who suggest energy-saving and renewable resource measures after inspecting a customer's home. The auditors suggest conservation practices and offer detailed information on estimated costs of making recommended changes and the related probable energy savings that could result. Auditors also take into consideration solar and wind alternatives.

Another audit program begun at midyear was the Rental Living Unit Conservation Program. This new program provides a Life-style Audit for renters to identify low-cost and no-cost energy conservation practices. It also provides a building Rental-property Audit for owners of rental units and indicates areas where additional weatherization measures would reduce energy costs. Owners making the recommended improvements are issued an "Energy Efficiency Certificate," making their properties more attractive to prospective renters or buyers.

During 1981, the Energy Utilization Department conducted 1,612 free Residential Conservation Service Audits, 263 Life-style Audits for renters, 440 Rental-property Audits for owners, 60 Commercial-building Audits, and 777 Fuel Conversion Audits (required by the PSCW of homeowners who want natural gas for heating).

Communications Amplify

During 1981, MGE expanded its Speakers Bureau and provided brochures to senior citizens groups and university student customers to better inform them about special services available to them.

Outreach to ethnic-minority customers was extended through an aggressive community relations effort that included a customer energy survey of members of the Madison Urban League and participation in Black History Week activities.

Maxine Harris, Customer Information and Applications Department

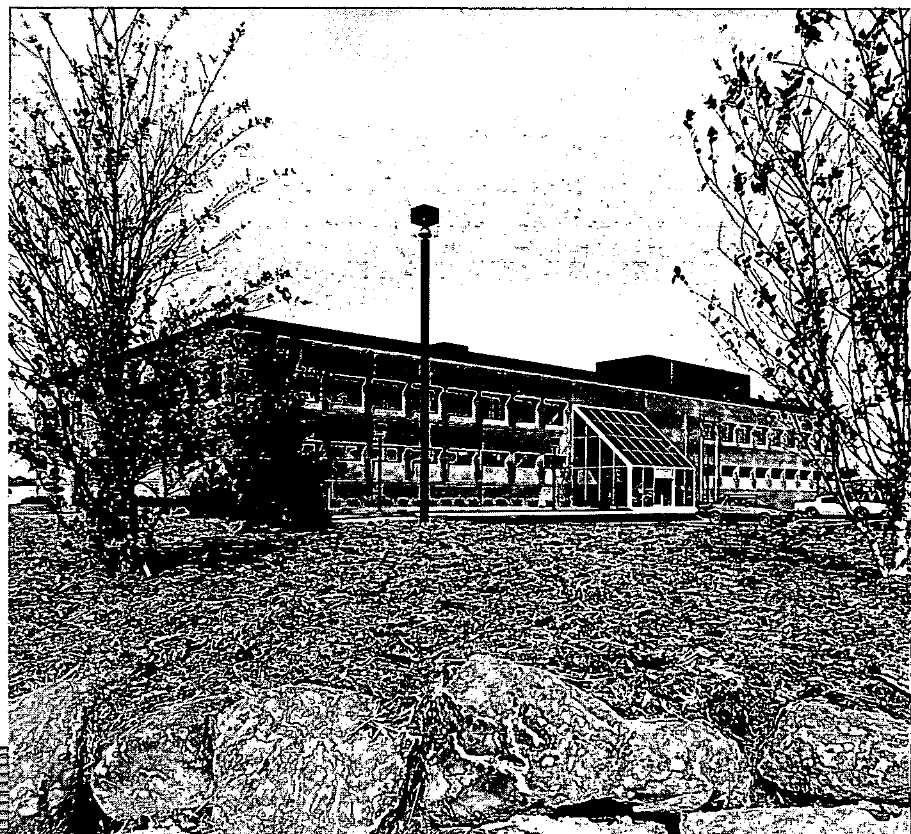
Prepared
to serve an area of growth and economic vitality

MGE's service territory is experiencing visible signs of growth and economic vitality during a time when a sluggish economy and a downturn in construction starts typify the national scene. A number of major expansion and rejuvenation projects have been completed recently, are in progress, or are about to begin. Many of these developments are located in the central area of Madison where major electric and gas service facilities are already in place.

The types of construction projects commissioned span the residential, commercial, medical, educational, governmental, and small industrial sectors of the community. New housing units and business establishments are sprouting on real estate in the heart of the service area that previously had been low-density or vacant property. The Capitol Centre project shown on the cover of this report is representative of these. A large hospital addition was recently occupied, and a federal court building soon will rise in downtown Madison as well. The Company's new General Office Facility now under construction is part of the growth in this area.

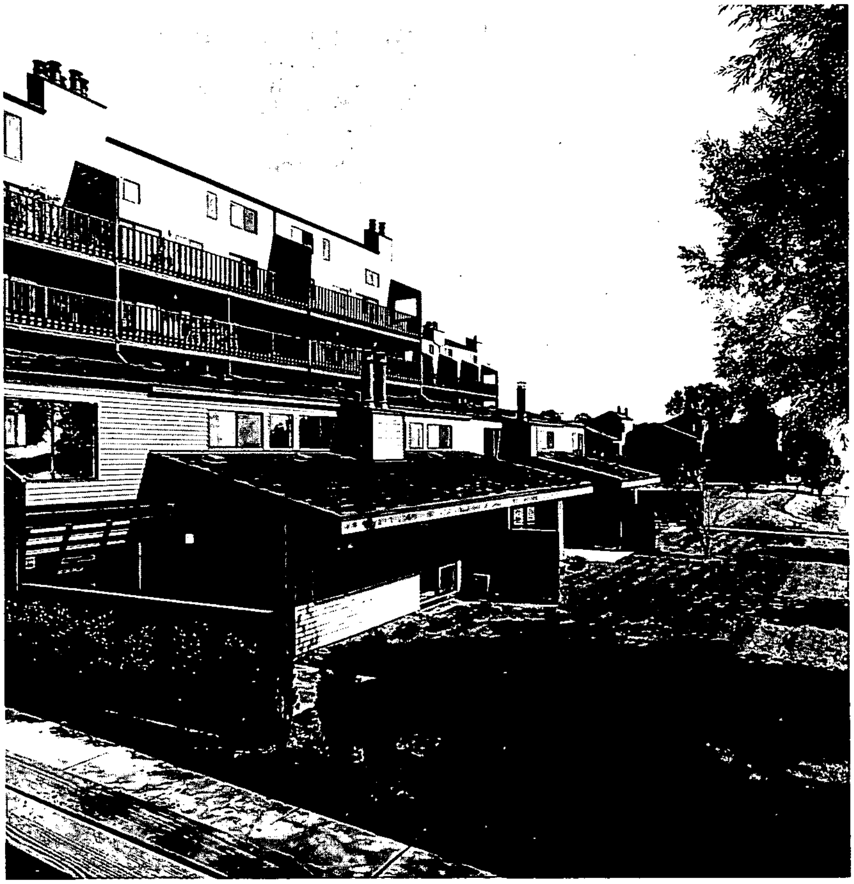
continued

▲ Nichols Station; future condominium site



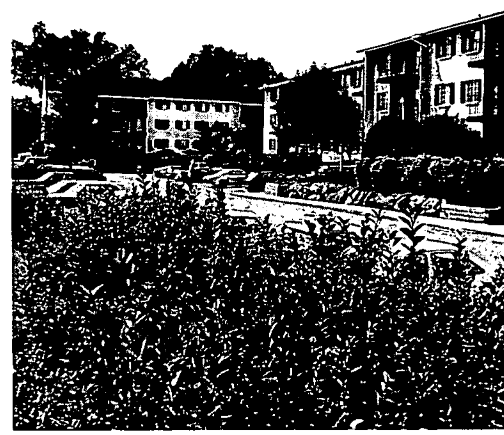
Wisconsin Physicians Service South Towne Office Building ▶

Madison Metro Transit Maintenance and Administration Building



The Fauerbach Condominiums

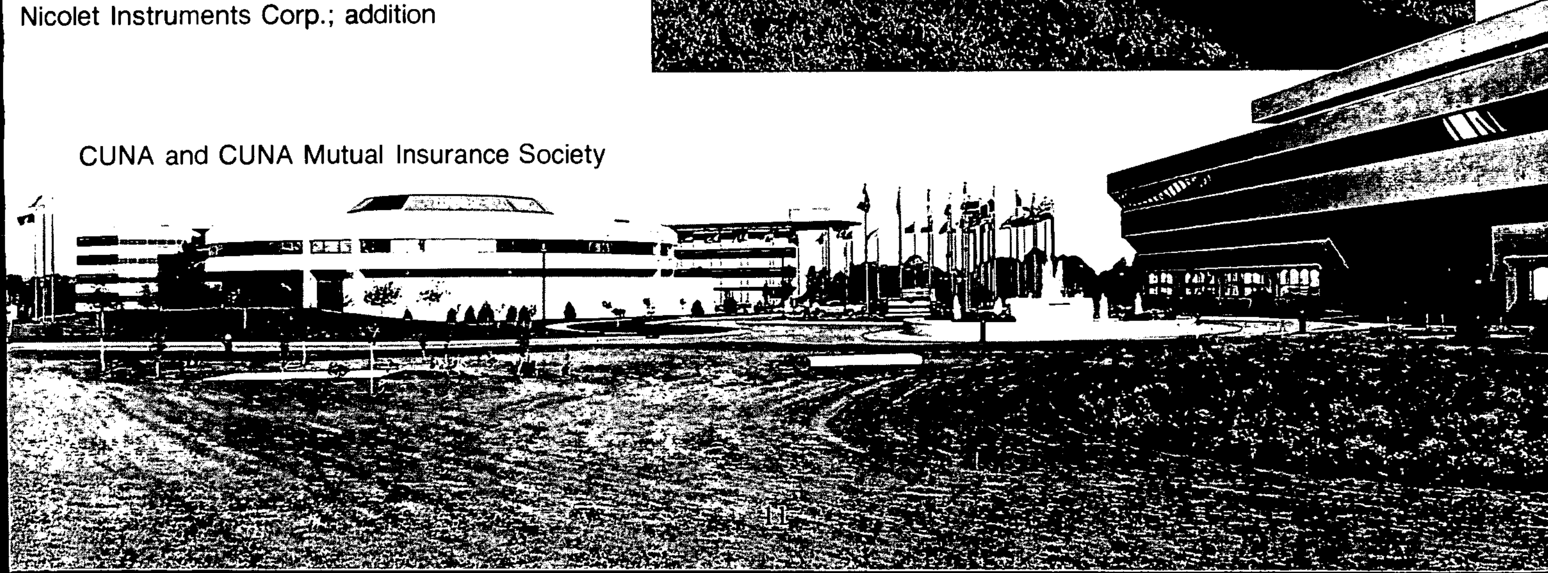
Camelot Apartments

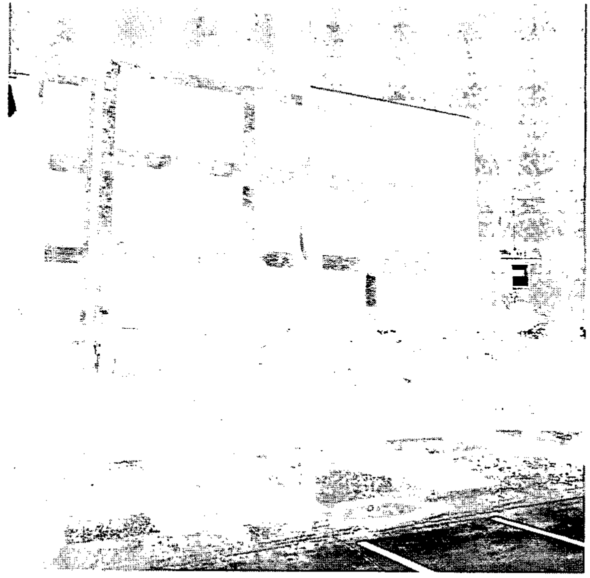


Nicolet Instruments Corp.; addition

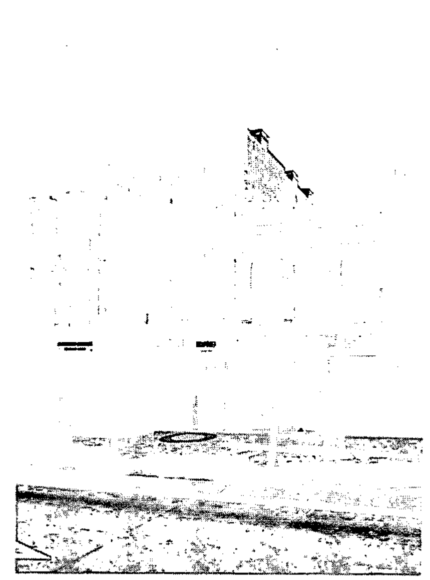
Wisconsin Dairy Herd Improvement Cooperative

CUNA and CUNA Mutual Insurance Society





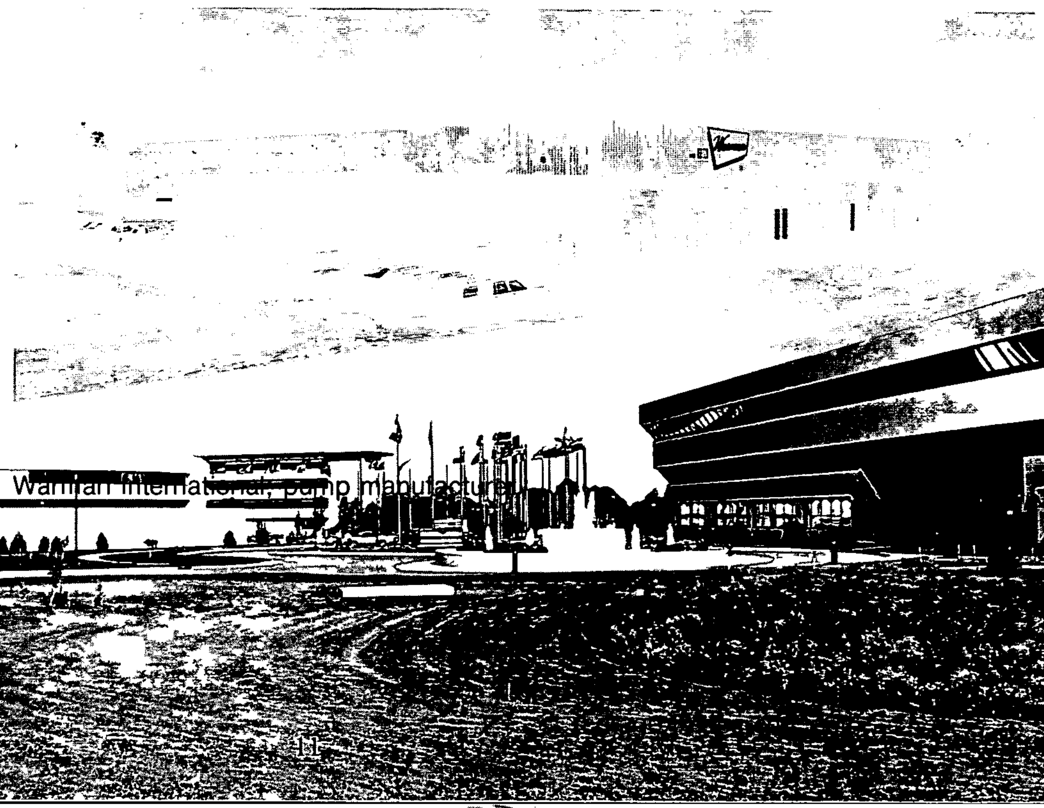
Emporium Building (44 On The Square); office, retail, and condominium complex



The Atrium; retail business rehabilitation

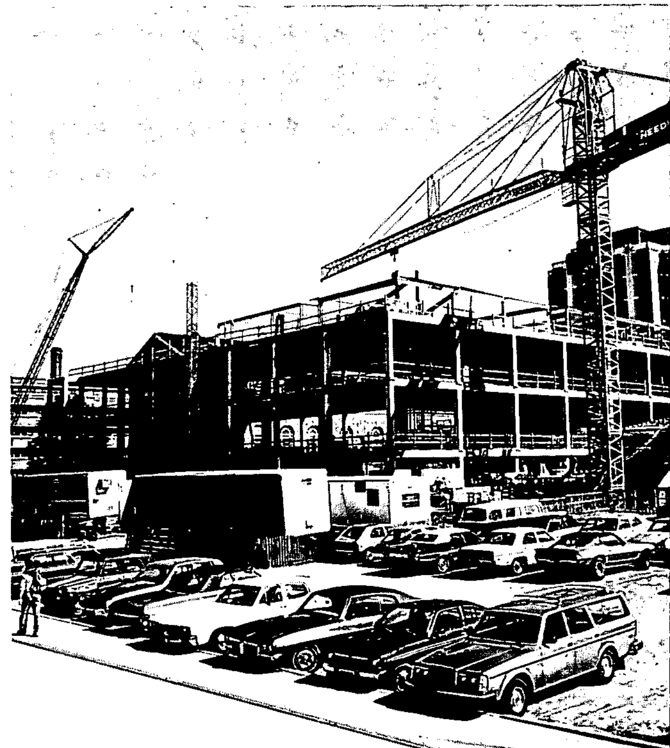
When these facilities are completed, they will greatly improve the Company's load density within the center of its service area where existing electric lines and gas mains can be readily tapped. That means added load with minimal investment.

This positive load growth assessment is good news, especially since continued energy conservation by MGE's customers has gradually reduced their individual consumption. While MGE recognizes the wisdom of conservation, the Company also is encouraged by the steady development in Madison that will mean increases in electric and gas loads.



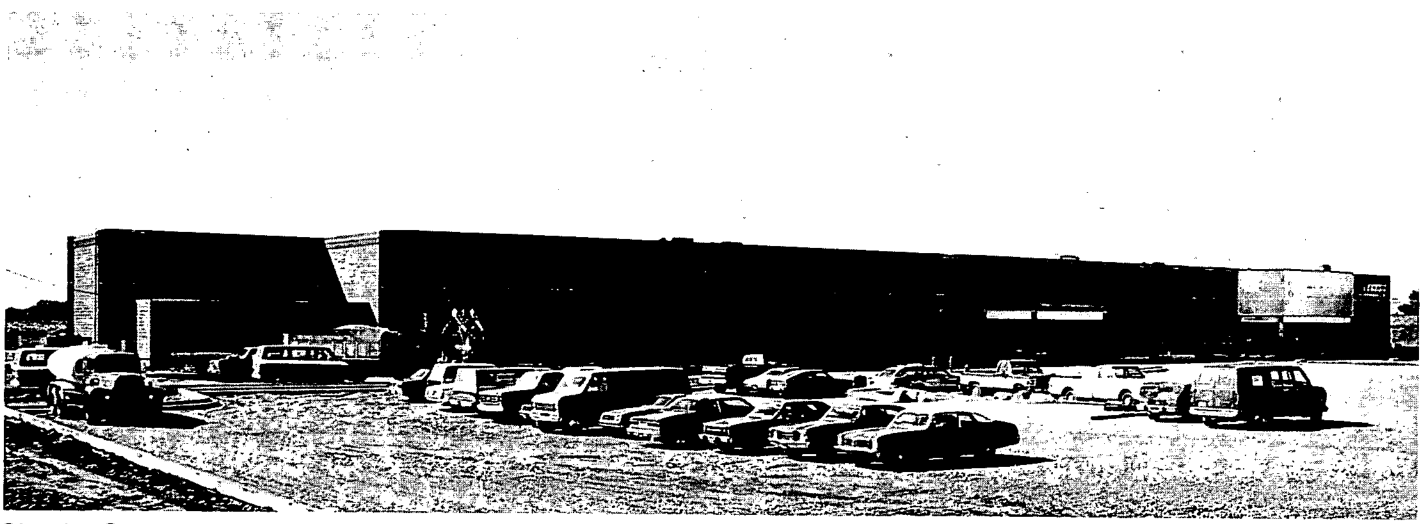
Warman International, pump manufacturer

Dunsinane Condominium; conversion project

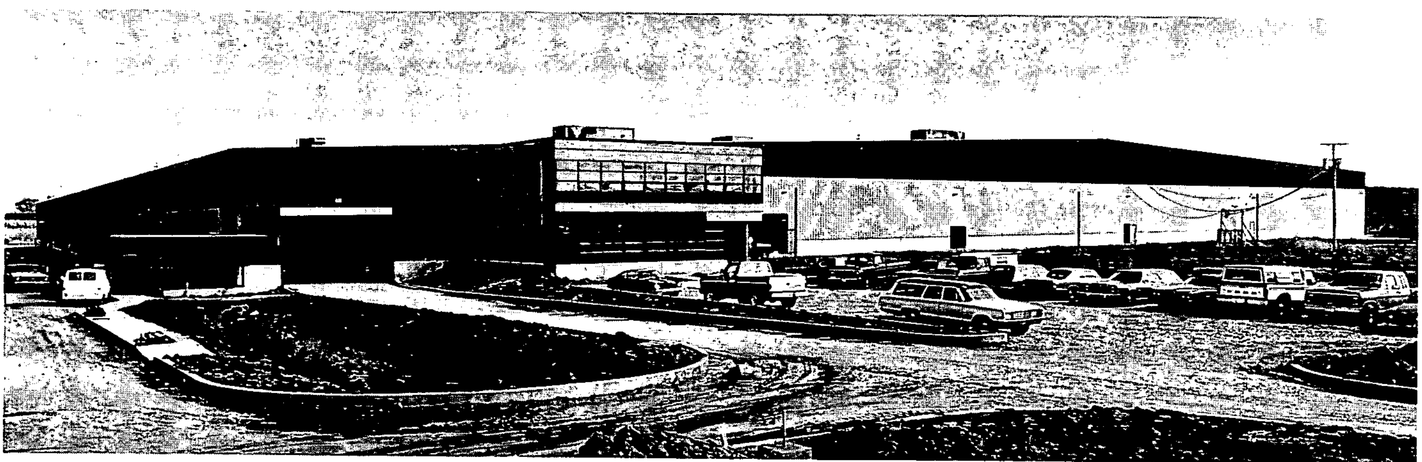


University of Wisconsin
Agricultural Engineering Building

Methodist Hospital Annex



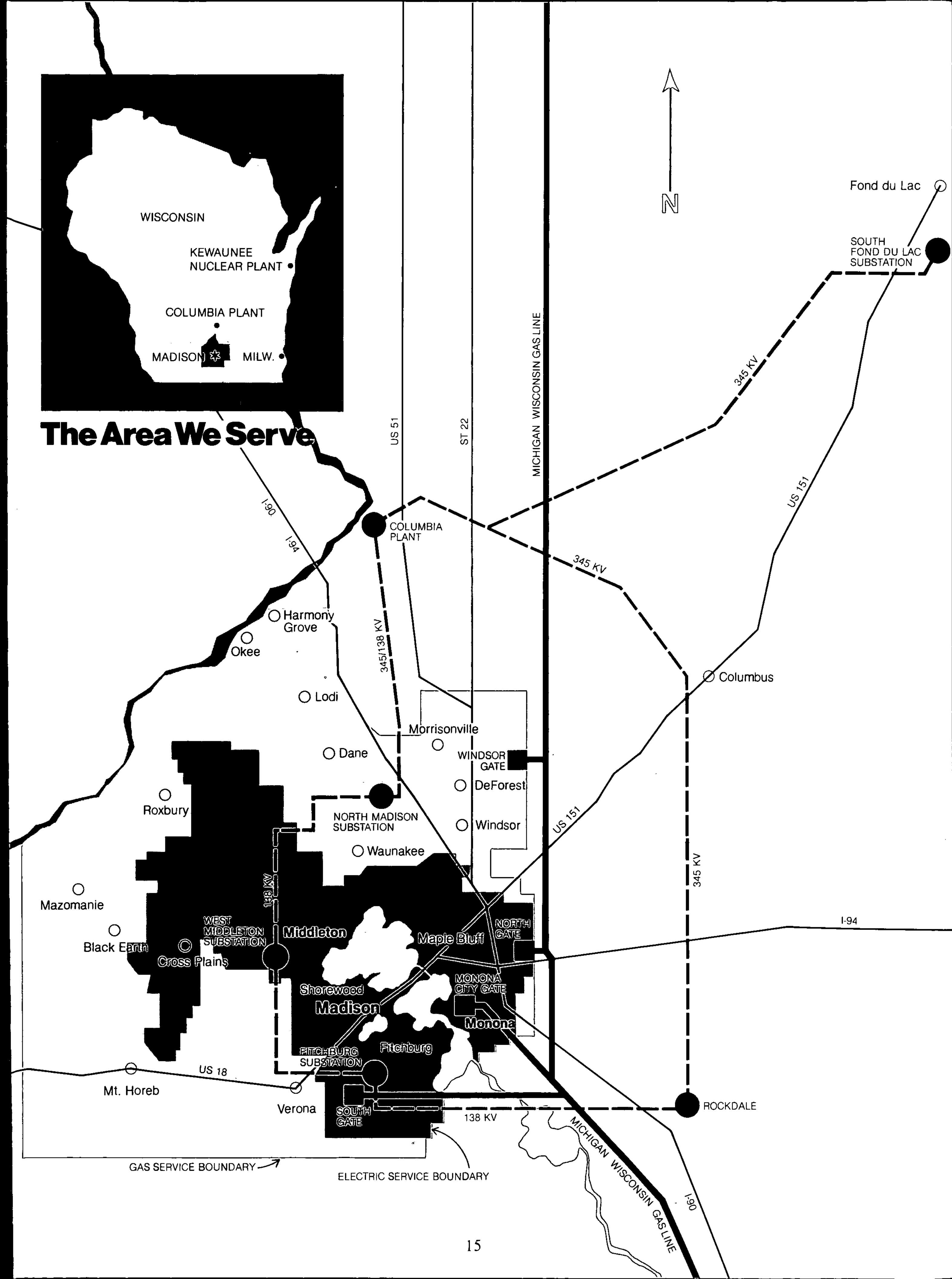
Shopko South Towne Department Store



Walgreen Drugs Distribution Center

University of Wisconsin
School of Veterinary Medicine

The Area We Serve



Summary of Selected Financial Data

(Thousands of Dollars Except Per-Share Amounts)

	1981	1980	1979	1978	1977
Operating Revenues					
Electric	**$ 93,232**	$ 95,317	$ 89,211	$ 78,588	$ 65,256
Gas	**68,850**	66,439	55,169	46,390	39,140
Total	**$162,082**	$161,756	$144,380	$124,978	$104,396
Income, Earnings, and Dividends					
Net income	**$ 12,583**	$ 15,548	$ 12,822	$ 13,359	$ 12,771
Earnings on common stock	**$ 9,542**	$ 12,399	$ 9,628	$ 10,558	$ 10,158
Earnings per average common share	**$ 1.66**	$ 2.21	$ 1.76	$ 1.96	$ 2.13
Cash dividends paid per common share	**$ 1.76**	$ 1.66	$ 1.48	$ 1.44	$ 1.36
Assets					
Electric	**$210,931**	$209,949	$207,806	$204,999	$195,072
Gas	**69,341**	65,308	60,732	57,071	49,966
Assets not allocated	**23,720**	17,975	17,545	16,223	17,296
Total	**$303,992**	$293,232	$286,083	$278,293	$262,334
Long-term Debt and Redeemable Preferred Stock (net of sinking funds and unamortized discounts and premiums on bonds)	**$126,296**	$129,641	$132,054	$133,692	$130,984
Internal Generation of Funds					
Net funds generated internally	**$ 17,392**	$ 20,896	$ 17,262	$ 22,288	$ 19,395
Total funds used for construction expenditures and nuclear fuel	**$ 23,956**	$ 21,520	$ 21,015	$ 26,261	$ 36,437
Percent generated internally	**72.6%**	97.1%	82.1%	84.9%	53.2%
Capitalization Ratios (end of year)*					
Common shareholders' equity	**42.9%**	43.0%	42.0%	40.9%	40.4%
Redeemable preferred stock*	**12.6**	13.7	14.2	14.5	11.9
Debt					
Long-term debt*	**39.4**	40.7	42.2	43.8	46.4
Short-term debt	**5.1**	2.6	1.6	0.8	1.3

*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 provide and maintain adequate earnings levels is largely determined by the securing of reasonable and timely rate increases. The effects of the March, 1980, rate increase have not been sufficient to provide an adequate level of earnings for 1981. An application for increases in electric and gas rates was filed on September 11, 1981. See Note 6 in Notes to Consolidated Financial Statements for further particulars relating to the pending rate application.

A comparison of operating revenues for each of the years 1981, 1980, and 1979 with the immediately preceeding year reflects increases and decreases (in millions of dollars) which can be segregated by the following principal factors:

	Electric Revenues			Gas Revennes		
	1981	1980	1979	1981	1980	1979
Sales to other utilities	$(7.9)	$(3.0)	$ 6.9	Not applicable		
Sales to consumers—						
Due to formal rate increases (1980), fuel and purchased gas adjustments, respectively, and other factors	4.8	6.8	3.3	$ 12.9	$15.2	$5.3
Due to sales increases (decreases)	1.0	2.3	.4	(10.5)	(3.9)	3.5
Total Increases (Decreases)	$(2.1)	$ 6.1	$10.6	$ 2.4	$11.3	$8.8

Electric sales to consumers increased 1.3 percent in 1981, 3.4 percent in 1980, and 0.6 percent in 1979, while gas therm sales to consumers decreased 15.6 percent, decreased 7.5 percent, and increased 7.9 percent, respectively. Revenues from sales to other utilities amounted to $11.5 million in 1981, $19.4 million in 1980, and $22.4 million in 1979.

Fuel for electric generation and natural gas purchases comprise a large segment of the Company's total operating expenses. Also, during the three-year period 1979-81, fuel used for electric generation and purchased power costs were 35 percent of electric operating revenues, and the costs of natural gas purchased amounted to nearly 75 percent of gas operating revenues. 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 of 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.

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.

Variations in income tax expenses during the periods are largely attributable to changes in pre-tax net income. Property, payroll, and other taxes have been relatively constant during the periods because generally increasing tax rates have been offset by declining property 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 was a significant 75 percent on a weighted average basis for the five-year period 1977-81. Construction expenditures for 1982 are expected to increase to approximately $27.6 million, or about $3.9 million over 1981 expenditures (but only $.5 million over the 1976-1980 average construction expenditures of $27.1 million). This projected increase includes major expenditures for transmission lines, new electric and gas distribution projects, and the construction of the new general office facility. As a result, the Company does not expect a significant change in the percentage of internally generated funds.

At December 31, 1981, 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 1981 and 1980 are as follows:

	Bid		Asked		Dividends
	High	Low	High	Low	Paid
1981					
First Quarter	14	12⅝	14½	12⅞	43¢
Second Quarter	14¼	12	14⅝	12¼	43¢
Third Quarter	14⅞	13¾	15⅛	13⅞	45¢
Fourth Quarter	15¾	14⅛	16	14⅜	45¢

	Bid		Asked		Dividends
	High	Low	High	Low	Paid
1980					
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¢

There were 17,102 shareholders of record as of February 5, 1982. 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, 1981, 1980, and 1979

	1981	1980	1979
Operating Revenues (Notes 1e & 6)			
Electric	**$ 93,231,809**	$ 95,316,716	$ 89,210,891
Gas	**68,850,602**	66,439,171	55,168,999
Total Operating Revenues	**162,082,411**	161,755,887	144,379,890
Operating Expenses			
Fuel used for electric generation	**29,482,704**	32,097,978	31,760,588
Purchased power	**1,995,901**	1,967,328	766,442
Natural gas purchased for resale	**52,650,228**	49,295,995	39,702,101
Other operations	**21,713,570**	17,958,314	15,159,627
Maintenance	**6,489,572**	6,224,455	5,096,175
Depreciation and amortization (Note 1d)—			
Straight-line depreciation and amortization	**12,083,120**	11,031,685	11,628,954
Additional depreciation (equivalent to estimated reduction in income taxes)	**2,706,503**	3,879,579	3,768,763
Taxes (Note 1h)—			
Current federal income	**5,453,285**	7,768,081	7,562,160
Investment tax credit deferred	**2,509,322**	2,075,824	1,681,826
Investment tax credit restored (credit)	**(850,889)**	(744,692)	(671,155)
Current state income	**1,449,842**	1,682,543	1,773,856
Property, payroll, and other	**5,516,842**	5,029,349	5,422,117
Total Operating Expenses	**141,200,000**	138,266,439	123,651,454
Net Operating Income	**20,882,411**	23,489,448	20,728,436
Other Income, Net*	**694,424**	444,456	299,558
Income Before Interest Expense	**21,576,835**	23,933,904	21,027,994
Interest Expense*			
Interest on long-term debt	**7,781,538**	7,904,336	8,018,671
Other interest	**1,212,592**	481,095	186,832
Total Interest Expense	**8,994,130**	8,385,431	8,205,503
Net Income	**12,582,705**	15,548,473	12,822,491
Preferred Stock Cash Dividend Requirements (Note 3b)	**3,041,144**	3,149,682	3,194,401
Earnings on Common Stock	**$ 9,541,561**	$ 12,398,791	$ 9,628,090
Earnings Per Share of Common Stock (Based on 5,756,254, 5,607,319 and 5,477,541 average shares outstanding, respectively)	**$1.66**	$2.21	$1.76

*No allowance for funds used during construction has been recorded during the three years (Note 1c).

Consolidated Statement of Retained Income

For the years ended December 31, 1981, 1980, and 1979

	1981	1980	1979
Balance Beginning of Year	**$ 28,021,178**	$ 24,995,557	$ 23,521,863
Add—Net income	**12,582,705**	15,548,473	12,822,491
Total Before Deductions	**40,603,883**	40,544,030	36,344,354
Deduct			
Cash dividends on common stock	**10,128,804**	9,302,814	8,107,004
Preferred stock cash dividend requirements	**3,041,144**	3,149,682	3,194,401
Expense of issuing common stock	**86,984**	70,356	47,392
Total Deductions	**13,256,932**	12,522,852	11,348,797
Balance End of Year	**$ 27,346,951**	$ 28,021,178	$ 24,995,557

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

Consolidated Balance Sheet

December 31, 1981 and 1980

	1981	1980
Assets		
Utility Plant, at original cost (Note 1a)		
In service—		
Electric (Note 1b)	$278,716,197	$268,953,526
Gas	91,166,762	85,537,506
Gross Plant in Service	369,882,959	354,491,032
Less—Accumulated provision for depreciation (Note 1d)	(140,623,563)	(125,432,310)
Net Plant in Service	229,259,396	229,058,722
Construction work in progress (Note 1b)	10,419,894	7,743,574
Nuclear fuel, net (Note 1f)	7,553,914	7,698,116
Total Utility Plant	247,233,204	244,500,412
Investments		
Investment in future nuclear fuel (Note 1i)	4,105,674	3,232,541
Pollution control construction fund	617,522	556,761
Total Investments	4,723,196	3,789,302
Current Assets		
Cash	1,490,503	1,289,924
Deposits for jointly owned electric power production facilities	1,609,589	1,682,319
Temporary cash investments, at cost, which approximates market	4,043,242	—
Accounts receivable, less reserves of $303,128 and $262,922, respectively	17,685,673	16,251,594
Unbilled revenue (Note 1e)	8,687,374	7,905,101
Materials and supplies, at average cost	4,994,401	4,858,133
Fossil fuel, at cost (Note 1g)	8,198,044	8,373,987
Prepayments	500,735	433,237
Total Current Assets	47,209,561	40,794,295
Deferred Charges (Note 2)	4,825,611	4,148,489
Total Assets	$303,991,572	$293,232,498
Capitalization and Liabilities		
Capitalization (see statement) (Note 3)		
Common shareholders' equity—		
Common stock	$ 46,755,816	$ 45,508,312
Amount received in excess of par value	30,894,694	29,944,710
Retained income	27,346,951	28,021,178
Total Common Shareholders' Equity	104,997,461	103,474,200
Redeemable preferred stoek	29,825,000	31,650,000
Long-term debt	96,471,205	97,990,662
Total Capitalization	231,293,666	233,114,862
Current Liabilities		
Preferred stock sinking fund requirements (Note 3b)	1,175,000	1,175,000
Interim loans—commercial paper (Note 5)	12,500,000	6,300,000
Sinking Fund Requirements and Short-term Debt	13,675,000	7,475,000
Accounts payable	14,841,396	13,567,976
Gas refunds payable to customers	3,694,463	49,754
Accrued interest	1,859,990	1,889,335
Accrued taxes	5,760,785	5,449,534
Other	3,774,477	3,656,738
Total Current Liabilities	43,606,111	32,088,337
Otber Credits		
Contributions in aid of construction	8,299,134	7,999,826
Investment tax credit deferred(Note 1h)	16,678,796	15,376,228
Unamortized unbilled revenue (Note 1e)	3,083,452	3,597,352
Other	1,030,413	1,055,893
Total Other Credits	29,091,795	28,029,299
Construction Commitmeuts (Note 4)		
Total Capitalization and Liabilities	$303,991,572	$293,232,498

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

Consolidated Statoment of Capitalization

December 31, 1981 and 1980

	1981	1980
Common Sbareholders' Eqnity (Note 3a)		
Common stock—Par value $8 per share—		
Authorized 7,000,000 shares		
Outstanding 5,844,477 and 5,688,539 shares, respectively	**$ 46,755,816**	$ 45,508,312
Amount received in excess of par value	**30,894,694**	29,944,710
Retained income	**27,346,951**	28,021,178
Total Common Shareholders' Equity	**104,997,461**	103,474,200
Redeemable Preferred Stock, cumulative, $25 par value, authorized 1,540,000 and 1,613,000 shares, respectively (Note 3b)		
Series A, 9⅜%, 158,000 and 164,000 shares outstanding, respectively	**3,950,000**	4,100,000
Series B, 7.80%, 170,000 and 176,000 shares outstanding, respectively	**4,250,000**	4,400,000
Series C, 7.90%, 264,000 and 273,000 shares outstanding, respectively	**6,600,000**	6,825,000
Series D, 12%, 348,000 and 400,000 shares outstanding, respectively	**8,700,000**	10,000,000
Series E, 8.70%, 300,000 shares outstanding	**7,500,000**	7,500,000
Preferred Stock Outstanding	**31,000,000**	32,825,000
Current sinking fund requirements	**(1,175,000)**	(1,175,000)
Total Preferred Stock	**29,825,000**	31,650,000
First Mortgage Bonds (Note 3c)		
4⅝%, 1988 series	**7,080,000**	7,259,000
4¾%, 1991 series	**4,336,000**	4,341,000
5.45%, 1996 series	**8,000,000**	8,000,000
8%, 1999 series	**11,547,000**	11,616,000
7¾%, 2001 series	**13,663,000**	13,757,000
9¾%, 2004 series	**19,036,000**	19,403,000
9¾%, 2005 series	**23,575,000**	24,297,000
6½%, 2006 series	**8,780,000**	8,780,000
First Mortgage Bonds Outstanding	**96,017,000**	97,453,000
Unamortized discount and premium on bonds, net	**(174,862)**	(183,480)
Total First Mortgage Bonds	**95,842,138**	97,269,520
Otber Long-term Debt (Note 3d)	**629,067**	721,142
Total Long-term Debt	**96,471,205**	97,990,662
Total Capitalization	**$231,293,666**	$233,114,862

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, 1981, 1980, and 1979

	1981	1980	1979
Fuuds Generated Iuternally			
Net income	**$12,582,705**	$15,548,473	$12,822,491
Items not affecting current sources and uses of funds—			
Depreciation and amortization	**14,789,623**	14,911,264	15,397,717
Amortization of nuclear fuel	**4,603,109**	3,497,885	3,042,415
Investment tax credit deferred—net	**1,658,433**	1,331,132	1,010,671
Other	**280,690**	(168,328)	(242,258)
Funds Provided from Operations	**33,914,560**	35,120,426	32,031,036
Less—			
Cash dividends on common and preferred stock	**13,169,948**	12,452,496	11,301,405
Bond sinking fund retirements (including 1979 maturity) and other long-term debt repayments	**1,528,075**	1,247,264	2,942,822
Preferred stock sinking fund retirements	**1,825,000**	525,000	525,000
Net Funds Generated Internally	**17,391,537**	20,895,666	17,261,809
Funds Obtained from Outside Financiug—Sale of common stock, less expense of issuance	**2,110,504**	1,630,978	1,803,688
Iucrease in Iuterim Loans	**6,200,000**	2,400,000	1,900,000
Decreases (Increases) in Otber Net Curreut Assets (exclusive of interim loans and sinking fund requirements)			
Fossil fuel	**175,943**	(2,194,802)	(3,880,499)
Unbilled revenue	**(782,273)**	(2,166,716)	304,596
Temporary cash investments	**(4,043,242)**	1,310,000	(1,310,000)
Gas refunds payable to customers	**3,644,709**	49,754	—
Accrued taxes	**311,251**	321,424	3,314,830
Other, net	**(403,880)**	(666,935)	1,323,621
Net (Increase)	**(1,097,492)**	(3,347,275)	(247,452)
Otber—Net	**(648,813)**	(59,356)	296,822
Total Funds Used for Construction Expeuditures aud Nuclear Fuel	**$23,955,736**	$21,520,013	$21,014,867

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

Auditors' Repert

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, 1981, and December 31, 1980, and the related consolidated statements of income, retained income and sources of funds used for construction for each of the three years in the period ended December 31, 1981. 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, 1981, and December 31, 1980, and the results of their operations and their sources of funds used for construction for each of the three years in the period ended December 31, 1981, all in conformity with generally accepted accounting principles applied on a consistent basis.

ARTHUR ANDERSEN & CO.

Chicago, Illinois,
February 17, 1982

Notes te Consolidated Financial Statements

December 31, 1981, 1980, and 1979

1 Summary of Significant Accounting 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 (Columbia) and 17.8 percent (93 mw) of the Kewaunee Nuclear Plant (Kewaunee). 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, 1981	1980
Columbia	**$ 77,098,000**	$ 77,024,000
Kewaunee	**41,321,000**	38,969,000
Total	**$118,419,000**	$115,993,000

Expenditures for projects in process at Columbia and Kewaunee amounted to $1,634,869 and $1,816,783 at December 31, 1981 and 1980, respectively, and are included in construction work in progress as of those dates.

c. Allowance for funds used during construction

Pursuant to rate orders issued by the Public Service Commission of Wisconsin (the PSCW), the Company is to capitalize an allowance for funds used during construction (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 increases provided for in such orders have 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—$2,518,000, $3,604,000, and $3,522,000 and state—$189,000, $276,000, and $247,000 for the years 1981, 1980, and 1979, respectively) due to the use of liberalized depreciation allowances permitted for income tax purposes. Such accumulated additional depreciation totaled $36,852,000 and $33,996,000 as of December 31, 1981 and 1980, 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 1981, 1980, and 1979: electric, 3.5 percent, 3.4 percent, and 3.4 percent; gas, 3.2 percent for each year. 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 $17,242,000, which is being recovered through depreciation rates.

e. Revenue recognition

In accordance with a PSCW directive, the Company records unbilled revenue on the basis of service rendered. The directive also provides 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 recorded at average cost were 97 percent and 77 percent of total fossil fuel inventories at December 31, 1981 and 1980, 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, additional depreciation, and taxes included in other income by the sum of such expenses and net income, reconciles to the statutory federal income tax rate as follows:

	1981	1980	1979
Effective income tax rate as computed	47.7%	48.5%	52.7%
Restoration of investment tax credit	3.5	2.4	2.4
State income taxes and state additional depreciation, net	(4.1)	(3.9)	(4.6)
Other differences, net	(1.1)	(1.0)	(4.5)
Statutory federal income tax rate	46.0%	46.0%	46.0%

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 aequired 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 aequire 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 1981 through 1979 were $349,000, $153,000, and $120,000, respectively, of which $286,000, $126,000, and $99,000, respectively, were charged to operating expenses. The increased pension costs for 1981 resulted from changes in actuarial assumptions and determinations of future benefits.

The actuarial present values of aceumulated plan benefits, all of which were essentially vested, were $6,192,288 and $4,777,304 as of January 1, 1981 and 1980, respectively. Net assets available for benefits as of the corresponding dates were $9,300,490 and $7,533,615.

The assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 7 percent and 6 percent compounded annually for the years 1980 and 1979, respectively.

2. Koshkonong Project

At December 31, 1981, the Company had recorded deferred charges of $3,135,826 relating to its share of the abandoned Koshkonong nuclear facility which was to have been owned jointly with other Wisconsin investor-owned utilities.

The Company's share of expenditures, made primarily for engineering design and site selection, total $2,122,005. Regarding such costs, 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. The Company has included similar accounting in its current rate application (sce Note 6). In management's opinion, this rate-making treatment will be afforded to the Company for substantially all of its deferred Koshkonong expenditures.

The remaining Koshkonong deferred charges ($1,013,821) represent payments made in settlement of a contract dispute concerning uranium for nuclear fuel. The PSCW has authorized the Company to account for such charges in the same manner as described in the preceding paragraph.

3. Capitalization Matters

a. Common stock

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

		Common Stock		
	Shares	Par Value	Excess of Par	Retained Income
1981				
Dividend Reinvestment	**105,714**	**$ 845,712**	**$651,779**	
Cross Plains Purchase	**50,224**	**401,792**	**298,205**	
	155,938	**$1,247,504**	**$949,984**	**$(86,984)***
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)*

*Represents expenses of issuing stock.

b. Redeemable preferred stock

The Company, within each 12-month period commencing with thc 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 dividcnds (totaling $1,175,000 annually for 1982-1983 and $1,275,000 annually for 1984-1986):

	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 two futurc 12-month periods ending July 31.

** 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 August 1, 1983, the Series E preferred stock may not be redeemed from borrowed funds or proceeds of other preferred stock (i) having interest costs or dividend costs to thc Company of less than its dividend rate (8.70 percent), and (ii) having a weighted average life less than its remaining weighted average life. Series D may not be redeemed from proceeds of borrowed funds maturing earlier than May 1, 1995, or junior stock.

c. First mortgage bonds

The sinking fund requirements of the outstanding first mortgage bonds are $980,000 for each of the years 1982 through 1986. As of December 31, 1981, the Company had satisfied all of its 1982 and $517,000 of its 1983 bond sinking fund requirements.

d. Other long-term debt

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 1982, including the Company's proportional share of jointly owned electric power production facilities, are estimated to be $27,622,000 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, 1982, 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, 1982 short-term borrowings may not exceed $25,000,000. The commercial paper outstanding at December 31, 1981 and 1980, was supported by unused lines of credit totaling $20,600,000, and was issued at commercial paper discount rates prevailing at the time of issuance.

In connection with certain lines of eredit, 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

In 1980, 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 gencrating capacity reserves, resulting in a $1,274,000 reduction in electric revenues. The Circuit Court ruled in the Company's favor and rcmanded the case to the PSCW. Subsequently, the Company sought, and, on March 19, 1981, obtained authorization from the PSCW to implement a surcharge of 1.746 percent on all electric bills, subject to refund, designed to produce additional annual revenues of $1,274,000. The Wisconsin Court of Appeals affirmed the Circuit Court Order. An appeal by the PSCW is currently being considered by the Wisconsin Supreme Court. Through December 31, 1981, the Company has recorded revenue from the surcharge of approximately $1,050,000.

On September 11, 1981, the Company filed an application for increases in electrie and gas rates with the PSCW. The amounts requested, based on the test year 1982, are $16,749,000 in electric service revenues and $7,191,000 in gas service revenues. The total increases are approximately 19.3 percent in retail electric revenues and 8.6 percent in gas revenues and represent a 16 percent return on common stock equity. These rate increases require PSCW approval before they can take effect. The Company expects thc PSCW to issue an order on the application in mid-1982.

On November 17, 1981, the Company filed a motion with the PSCW for temporary rate increases which would have allowed a rate of return on common stock equity at the currently authorized 13 percent level. The motion was denied by the PSCW on December 2, 1981.

7. Segments of Business

The following table presents information pertaining to the Company's segments of business for 1981, 1980, and 1979. The data does not necessarily reflect rate-making treatment. The preceding Notes are an integral part of this footnote.

	1981	1980	1979
OPERATING INFORMATION (Year Ended December 31)		(Thousands of Dollars)	
Electric Operations			
Operating revenues	**$ 93,232**	$ 95,317	$ 89,211
Revenues from sales to gas utility	—	—	—
Total revenues	**93,232**	95,317	89,211
Operating expenses:			
Operation and maintenance	**52,631**	52,496	47,636
Depreciation and amortization, excluding additional depreciation (a)	**9,325**	8,454	9,236
Property, payroll, and other taxes	**4,051**	3,756	4,157
Operating expenses before income taxes	**66,007**	64,706	61,029
Pre-tax operating income	**27,225**	30,611	28,182
Current federal and state income taxes, net investment tax credit deferred, and additional depreciation (a)	**9,846**	11,654	11,306
Net operating income	**$ 17,379**	$ 18,957	$ 16,876
Construction and Nuclear Fuel Expenditures (Electric)	**$ 16,778**	$ 15,724	$ 14,120
Gas Operatious			
Operating revenues	**$ 68,850**	$ 66,439	$ 55,169
Revenues from sales to electric utility	**3,694**	6,498	7,688
Total revenues	**72,544**	72,937	62,857
Operating expenses:			
Operation and maintenance	**63,395**	61,546	52,537
Depreciation and amortization, exeluding additional depreciation (a)	**2,758**	2,578	2,393
Property, payroll, and other taxes	**1,466**	1,273	1,265
Operating expenses before income taxes	**67,619**	65,397	56,195
Pre-tax operating income	**4,925**	7,540	6,662
Current federal and state income taxes, net investment tax credit deferred, and additional depreciation (a)	**1,422**	3,008	2,810
Net operating income	**$ 3,503**	$ 4,532	$ 3,852
Constructiou Expenditures (Gas)	**$ 7,178**	$ 5,796	$ 6,895
INVESTMENT INFORMATION (at December 31)			
Identifiable Assets (b)			
Electric	**$210,931**	$209,949	$207,806
Gas	**69,341**	65,308	60,732
Assets Not Allocated (c)	**23,720**	17,975	17,545
Total assets	**$303,992**	$293,232	$286,083

(a) Information regarding amounts recorded as additional depreciation in 1981, 1980, and 1979 is set forth in Note 1d.
(b) Includes allocated common plant and is net of the respective accumulated provisions for depreciation.
(c) Primarily includes cash, temporary cash investments, accounts receivable, and prepayments.

Quarterly Summary of Operations

The following is a summary of consolidated operations (in thousands of dollars except earnings per common share) for 1981 and 1980:

Quarter Ended	Operating Revenues	Net Operating Income	Net Income	Earnings on Common Stock	Earnings Per Common Share*
1981					
March 31	$49,489	$6,778	$4,545	$3,765	66¢
June 30	31,213	3,612	1,556	778	14
September 30	35,260	6,228	4,306	3,555	61
December 31	46,120	4,264	2,176	1,444	25
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

* 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 to Disclose the Effects of Changing Prices

The Company's estimates of the effects of changing prices (inflation) on its operations for the years 1981, 1980, and 1979, shown below, are presented in response to the Financial Accounting Standards Board's Statement No. 33, "Financial Reporting and Changing Prices". This information should be viewed as an estimate of the approximate effect of changing prices rather than as a precise measure. The Constant Dollar and Current Cost information for 1979 and 1980 in the Comparison of Selected Supplementary Financial Data were recalculated before the restatement to average 1981 dollars.

Statement of Income from Operations Adjusted for Changing Prices for the Year Ended December 31, 1981

(Thousands of Dollars)

	Constant Dollars—Average 1981 Dollars	Current Cost—Average 1981 Dollars
Income from operations applicable to common shareholders, as reported	$ 9,542	$ 9,542
Additional depreciation on plant costs restated for the effeets of changing prices	13,026	14,110
Adjusted income (loss) from operations applicable to common shareholders (exeluding adjustment to net recoverable amount)	(3,484)(1)	(4,568)
Other impacts of changing prices		
Adjustment to net recoverable amount	(11,554)	6,788
Excess of the increase in the general level of prices ($40,583) in the current year over specific price changes ($23,325)(2)		(17,258)
Gain from decline in purchasing power of net amounts owed	13,501	13,501
Net	1,947	3,031
Adjusted income (loss) after all impacts of changing prices	$ (1,537)	$ (1,537)

(1) Including the reduction to net recoverable amount, the income (loss) from continuing operations on a constant dollar basis would have been ($15,038).

(2) At December 31, 1981, current cost of utility plant, net of accumulated depreciation, was $463.5 million, while historical cost, net of aecumulated depreciation, was $288.2 million.

Comparison of Selected Supplementary Financial Data For the Five Years Ended December 31, 1981

(Constant Dollars and Current Cost in Average 1981 Dollars)

	Years Ended December 31				
	1981	1980	1979	1978	1977
Operating revenues (thousands of dollars)					
As reported	$162,082	$161,756	$144,380	$124,979	$104,396
Constant dollars	$162,082	$178,535	$180,907	$174,229	$156,680
Constant Dollar Information					
Income (loss) from operations applicable to common shareholders (excluding adjustment to net recoverable amount)	$ (3,484)	$ 2,319	$ 2,712		
Income (loss) per common share (excluding adjustment to net recoverable amount)	$ (.60)	$ .41	$ .50		
Net assets at year-end at net recoverable amount	$101,603	$109,080	$117,002		
Current Cost Information					
Income (loss) from operations applicable to common shareholders (excluding adjustment to net recoverable amount)	$ (4,568)	$ 430	$ (160)		
Income (loss) per common share (excluding adjustment to net recoverable amount)	$ (.79)	$ .08	$ (.03)		
Excess of increase in general price level over increase in specific prices after adjustment to net recoverable amount	$ 10,470	$ 23,289	$ 30,816		
Net assets at year-end at net recoverable amount	$101,603	$109,080	$117,002		
General Information					
Gain from decline in purchasing power of net amounts owed	$ 13,501	$ 20,073	$ 23,972		
Cash dividends declared per common share					
As reported	$ 1.76	$ 1.66	$ 1.48	$ 1.44	$ 1.36
Constant dollars	$ 1.76	$ 1.83	$ 1.85	$ 2.01	$ 2.04
Market price per common share at year-end					
As reported	$ 14.62	$ 13.88	$ 13.88	$ 15.88	$ 17.25
Constant dollars	$ 14.62	$ 15.12	$ 17.00	$ 22.03	$ 26.09
Average Consumer Price Index (Base year 1967 = 100)	272.4	246.8	217.4	195.4	181.5
End of year Consumer Price Index (Base year 1967 = 100)	281.5	258.4	229.9	202.9	186.1

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, 1981, 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 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 ($11.1 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 1981 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)

	1982 Estimated Construction Expenditures		Plant Additions (Including Allowance for Funds Used During Construction) 1981		Annual Average 1976-1980	
Electric Department						
Production plant	$ 3,084	11%	**$ 2,594**	**10%**	$ 7,321	28%
Transmission plant	3,145	12	**1,904**	**8**	5,668	22
Distribution plant	4,763	17	**6,207**	**25**	3,378	13
General plant	32	—	**59**	**—**	55	—
Nuclear fuel	4,117	15	**4,598**	**18**	3,265	12
Total	15,141	55	**15,362**	**61**	19,687	75
Gas Department						
Distribution plant	5,459	20	**5,878**	**24**	5,728	22
General and other plant	59	—	**48**	**—**	40	—
Total	5,518	20	**5,926**	**24**	5,768	22
Utility Plant Common to Botb Departments	6,963	25	**3,822**	**15**	662	3
Total	$27,622	100%	**$25,110**	**100%**	$26,117	100%

Goneral Information

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111 West Monroe Street
Chicago, Illinois 60603

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

Annual Meeting
The 1982 annual meeting will be held Tuesday, April 20, 1982, 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 1981 Annual Report on Form 10K as filcd 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.

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Blaney Agri-Research Foundation
Age 45, Director Since 1974

Robert M. Bolz
Madison, Wisconsin
Retired Vice Chairman,
Oscar Mayer & Co.
Age 59, Director Since 1972

Leo E. Brodzeller
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Age 64, Director from 1977 to 1981

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Chairman of the Board
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Frederic E. Mohs
Madison, Wisconsin
Partner, Mohs, MacDonald & Widder
Attorneys at Law
Age 44, Director Since 1975

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Central Life Assurance Company
Des Moines, Iowa
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Madison, Wisconsin
Executive Vice President
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Family and Consumer Economics
University of Wisconsin - Madison
and Financial Consultant
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Donald J. Helfrecht


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Frederick D. Mackie


William A. McNamara


Frederic E. Mohs

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