

WISCONSIN POWER AND LIGHT COMPANY ANNUAL REPORT

1986



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and Light Company's company

HOLDING COMPANY STRUCTURE

WP&L HOLDINGS, INC.

HEARTLAND DEVELOPMENT CORPORATION

WISCONSIN POWER & LIGHT COMPANY

RMT,
INC.

WP&L
COMMUNICATIONS,
INC.

ENSERV,
INC.

WP&L
FOUNDATION,
INC.

NUFUS
RESOURCES,
INC.

REAC,
INC.

SOUTH BELOIT
WATER, GAS AND
ELECTRIC COMPANY

WP&L
NUCLEAR
FUEL, INC.

remain with the utility business. Consistent with its long tradition of service, WP&L will continue to provide reliable energy to customers at the least possible cost. Customer bills, service requests, energy audits, etc., will continue to be the responsibility of WP&L.

How will the restructuring affect dividends?

It is expected that after the restructuring, dividends on WP&L Holdings, Inc. common stock will be paid on the present quarterly cycle at a rate at least equal to the rate most recently paid on WP&L common stock. The amount of the dividends on WP&L Holdings, Inc. common stock will depend upon holding-company earn-

ings, financial conditions and other factors, as has been the case for WP&L common-stock dividends. Because the business primarily will be utility in nature, management expects dividends to be typical for a utility of WP&L's size and financial condition.

What will be the impact of the restructuring on preferred stock and debt securities?

Existing preferred stock and debt securities will not be affected by the restructuring. They will remain as preferred stock or debt securities of Wisconsin Power and Light.

Will I have to turn in my stock certificates and receive new ones?

No. Because current WP&L shareowners will own all of the holding-company stock, it will not be necessary in the restructuring for holders of WP&L common stock to exchange their stock certificates.

What should I do if I have questions about the proposed restructuring?

Shareowners who have questions after they receive and review the proxy statement, which will be mailed in early March, should contact the Shareowner Services staff in Madison, Wisconsin.

TO THE OWNERS OF WISCONSIN POWER AND LIGHT COMPANY:

In April 1981, your management announced its intention to begin the steps necessary to restructure Wisconsin Power and Light and its subsidiaries into a holding company. Our 1981 plans were delayed due to concerns about whether the Public Service Commission of Wisconsin had jurisdiction over the proposed restructuring. Questions also were raised about how the holding company would interact with the utility. Until these issues were resolved, we could not proceed with our plans. In November 1985 the Wisconsin Legislature passed a law clarifying the process of restructuring public utilities and setting various criteria that must be met to operate in a holding-company format.

As indicated at the 1986 Annual Shareowners' Meeting, we were carefully reviewing the new state law, the business environment and the legal implications of the proposed restructuring on our operations. We have completed that review and now propose to move forward with our plans to restructure the Company into a holding-company format. Under the reorganization plan, the utility operations (Wisconsin Power and Light Co.) would become a subsidiary of the holding company.

The reorganization into a holding-company structure will provide your Company with the flexibility to better manage and operate our present utility business in a rapidly changing business environment. Of particular concern at this time is how to deal with the growing competition within the industry. The restructuring also will enable us to move into additional areas of business

that provide opportunities to broaden our financial base and to reward you for your investment.

The new corporate structure will become a reality only after we receive approval of our plan from the Public Service Commission of Wisconsin, the Internal Revenue Service, the Securities and Exchange Commission and, most important of all, our more than 46,000 common and preferred shareowners. As shareowners, you will have the opportunity to vote on the proposed corporate restructuring at the April 22 Annual Meeting.

The proxy statement you will receive in March will include a detailed discussion of specific topics related to the holding company. To give you an overview of the proposed restructuring, we have included some general information in the cover pages immediately following this letter.

I encourage you to carefully review the proxy statement when you receive it. Then, if you have questions about the proposed corporate restructuring, please direct them to our Shareowner Services staff.

Sincerely,



James R. Underkofler
Chairman, President and
Chief Executive Officer
February 5, 1987

Wisconsin Power proposed holding



What will the name of the holding company be?

A final decision on the holding-company name has not been made. However, to begin the process of obtaining the various regulatory approvals, we temporarily are using "WP&L Holdings, Inc." as the working name. We will select the permanent name prior to the actual reorganization.

What will the new company structure look like?

Upon completion of the proposed restructuring, WP&L Holdings, Inc. will become the parent company of Wisconsin Power and Light Co. and its utility-related subsidiaries. A new company, Heartland Development Corp., will be formed for the purpose of managing present non-utility businesses. WP&L will remain a regulated public utility.

Who will manage WP&L Holdings, Inc.?

Initially, all of the present members of WP&L's Board of Directors and several of its principal executive officers also are expected to serve on the Board of Directors and as executive officers of WP&L Holdings, Inc. The day-to-day management of non-utility businesses will be carried out by Heartland Development Corp., which will hire persons for their expertise and experience in non-utility business fields. Heartland Development Corp. staff will not be involved in utility operations.

What is the proposed effective date of the restructuring?

Assuming that the Company receives all of the required approvals, the proposed holding company is scheduled to become effective in August 1987.

What is the status of the Company's application to the Public Service Commission (PSC) of Wisconsin?

The Company filed an application with the PSC late in 1986. It officially was accepted by the commission January 6, 1987. Under Wisconsin's new holding-company law, the PSC has 120 days — or until May 6, 1987 — in which to make a determination.

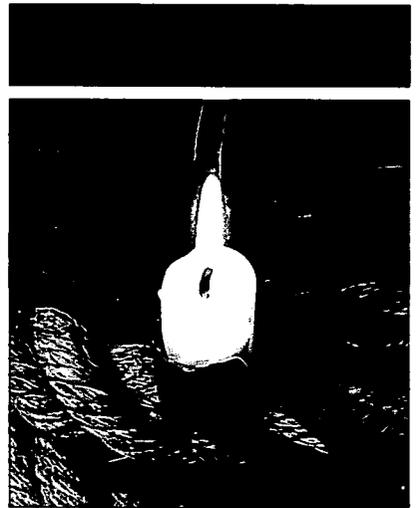
Will the restructuring have an impact on the utility and its customer service?

The Company management is committed to maintaining the high quality of the utility. It will remain the primary focus of the holding company. The 1985 Wisconsin holding-company law generally limits the assets invested in Heartland Development Corp. to no more than 25 percent of the total assets of WP&L. So, in the proposed holding-company structure, the non-utility investments, by law, always will be a fraction of the utility. The utility will continue to be regulated by the PSC, the Illinois Commerce Commission and the Federal Energy Regulatory Commission. Except for a few senior executives, present utility management and employees will



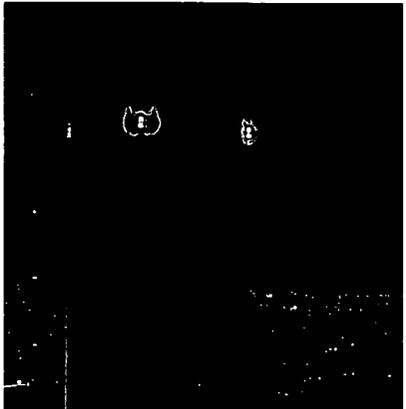
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C O V E R

Sheboygan, Wis. — photographed from Wisconsin Power and Light's newest generating station, Edgewater 5 — typifies the Company's increasingly competitive marketplace. Served by WP&L, the city of 48,000 on the shore of Lake Michigan is surrounded by two other investor-owned utilities and two municipally owned utilities.



Market value per share of common stock reached a record high of \$60¼ in 1986 and exceeded book value at year-end by 72 percent.

Dividends per share have increased for 11 consecutive years, and earnings per share have increased for the last eight years.

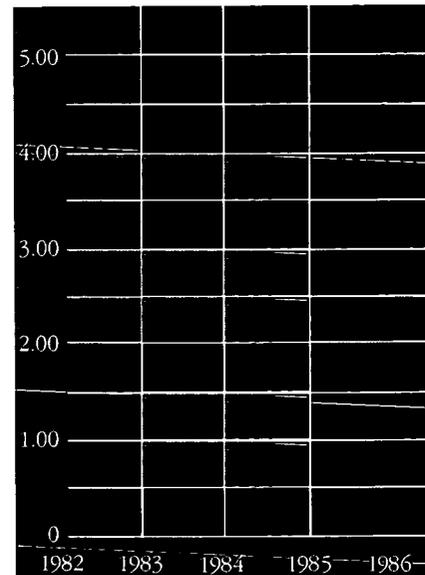
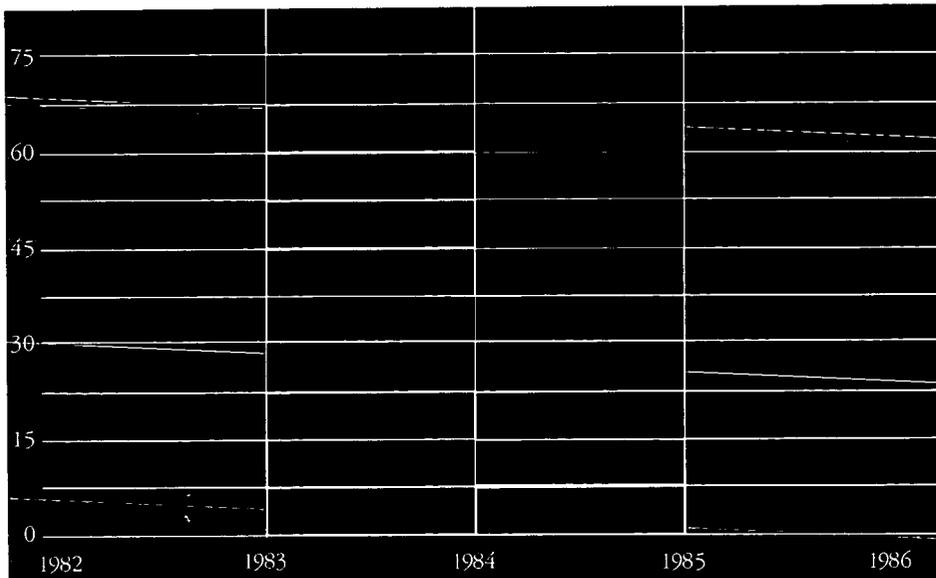
Forbes magazine ranked WP&L's profitability first among electric utilities in Wisconsin and third among 26 north-central utilities. Return on shareowner investment in 1986 was 15.3 percent and has averaged 16 percent over the last five years.

86 percent of total construction capital requirements for the last five years was generated internally.

Approximately 3,000 new homes were constructed in our service area in 1986.

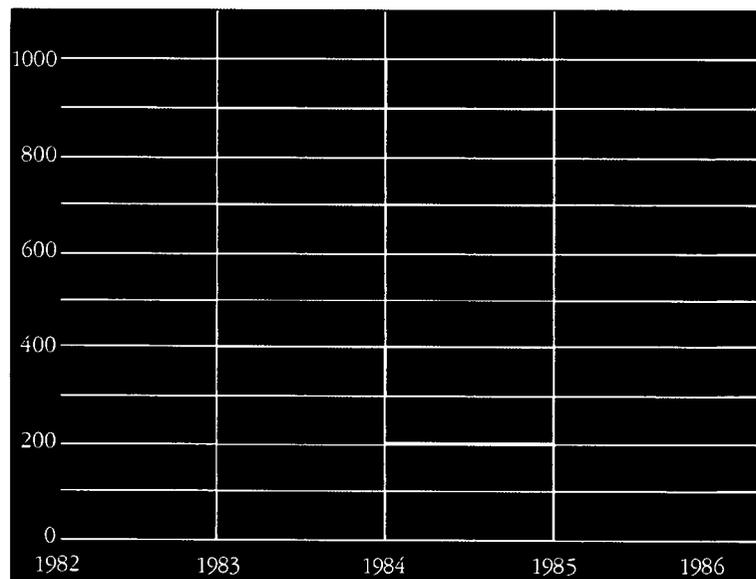
- Market Value Per Share of Common Stock 1986: \$60.25
- Book Value Per Share 1986: \$29.00 (*In dollars at year-end*)

Earnings Per Share of Common Stock (*In dollars*)
1986: \$4.28

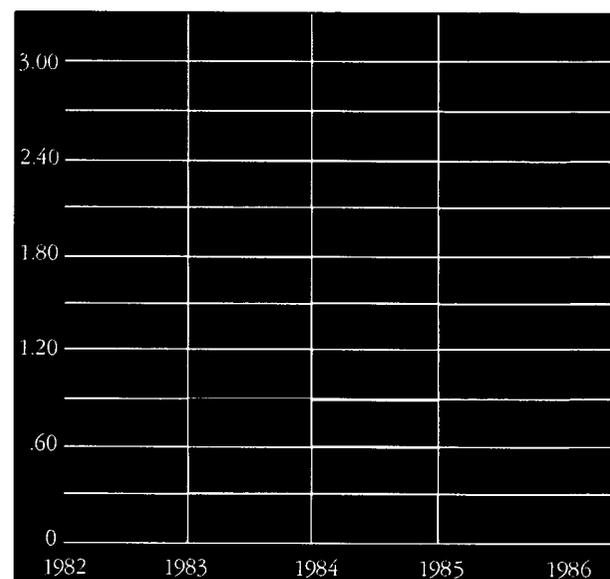


	1986	1985
Operating revenues	\$569,246,000	\$588,931,000
Operating expenses	\$480,440,000	\$508,523,000
Net income	\$ 60,484,000	\$ 60,728,000
Earnings on common stock	\$ 56,670,000	\$ 56,368,000
Earnings per share of common stock	\$4.28	\$4.26
Dividends per share of common stock	\$2.90	\$2.70
Total capitalization	\$777,108,000	\$758,527,000
Electric sales (thousand kilowatthours)	8,714,953	8,791,896
Gas sales, including transported gas (thousand therms)	250,984	269,153

Total Net Utility Plant
(In millions of dollars)
1986: \$809



Dividends Per Share of Common Stock
(In dollars)
1986: \$2.90



A new era of competition for the utility industry



The utility industry faces a new challenge — a challenge that will intensify in the future. Its name is competition.

The industry as we have known it for the past 60 years is changing. The forces of change are propelling the utility industry into a new era of competition.

When Grover Neff became the first president of Wisconsin Power and Light in 1924, one of the cornerstones of the modern utility industry — the natural monopoly — already had been laid.

The monopoly structure served the utilities and the public well. The government gave utilities exclusive franchises to serve specified geographic areas in return for their commitment to provide service to all who wanted it. The result was that efficient utility service was available to everyone without costly duplication of facilities. In the utility marketplace, government regulation was the substitute for competition.

But we have begun to see changes in that traditional arrangement. We are witnessing a basic restructuring within the American economy. That restructuring is, in part, the result of market forces and technological advancements that are pushing regulated industry — from telecommunications to transportation to utilities — into an era of intense competition.

A major push also has come from large customers, who are demanding to be served by the lowest-cost producer — regulated or unregulated. Many of these customers are competing in a world market that has low wage rates and, in some areas, subsidized energy costs. Because energy costs are a large part of the cost of American-made products, our utility services must be competitively priced to enable our

customers to compete within their industries.

Federal deregulation of the utility industry, which began with the telephone utilities, progressed to the natural-gas industry and now is heading into the electric arena, is chipping away at the natural-monopoly cornerstone.

It is no longer a question of *if* the electric utility industry will become competitive, but rather, *when*, and to what extent. Deregulation of generation and transmission may be the inevitable result of the marketplace demanding increasingly competitive pricing and services.

Change — a part of any business — and competition together will strengthen our industry. I remain optimistic about the long-range outlook for the utility industry. However, I believe that regulatory changes and competitive forces will result in significantly fewer utility companies. Those that remain will be businesses that are prepared today for change and competition.

Wisconsin Power and Light will remain a strong utility. We are proceeding to form a holding company to ensure the continued growth of WP&L's core utility business and to permit us greater flexibility to deal more effectively with change, including competition. The Company essentially will remain an electric and gas entrepreneur in a new, competitive environment.

Making the transition to a competitive environment will be a challenge. The change will be especially difficult because we will be competing against unregulated businesses while we still will be regulated.

In this environment, price and quality will be the drivers of success or failure.



“The way we will be successful in a competitive market is to become even more customer focused.”

We need to emphasize marketing and pricing flexibility and innovativeness. The marketing of “energy efficiency” fits within that scenario. At the same time, we must be sensitive to today’s realities and not commit resources to conservation programs that will drive up the price of our products to the detriment of our customers and our shareholders.

Pricing is a major part of the new game. We must be price competitive, and that requires serious self-examination. We must take a new look at all aspects of expenses, including the layers of management, layers of supervision, pay scales, productivity and, most important of all, our corporate culture.

In short, the way we will be successful in a competitive market is to become even more customer focused. Providing customer satisfaction is not something new for WP&L. We can take pride in our history of outstanding customer service. Now, however, we are facing a more competitive market that will require us to become even more responsive to customers’ needs. We must give customers what they want, how they want it and when they want it.

We must become a marketer. At the same time, our regulators also must become more flexible and responsive to the fundamental changes in the electric utility industry.

Our customers today have more energy-service options than ever before. Some industries in our service area have replaced natural gas with less expensive oil or other fuels. Others are exploring ways to generate their own electricity, such as through cogeneration. A growing number of our customers are buying their own natural gas and contracting with us to transport it for them.

The public today wants both competition and regulation, and prefers short-term approaches with the lowest prices. Those demands challenge utilities’ traditional approaches to doing business, which have focused on long-range commitments of 30 years or more.

The future will require more short-term planning to enable us to anticipate and manage the constant changes in our industry. The future also demands greater managerial ability and a corporate culture described by a management consultant as one that encourages innovation and is hungry for new ideas. Our culture also must be flexible because of the unpredictability of the future and the acceleration of change.

To respond to the new competition and change, WP&L is:

- developing a Company-wide program designed to provide superior value to all customers,

- improving our operating performance and efficiency,
- working with our pipeline suppliers to reduce natural gas prices,
- continuing to control costs,
- negotiating fuel contracts to lower our price of electricity,
- aggressively marketing our energy services, and
- researching new technologies that will reduce the cost of energy.

You’ll be learning more about these initiatives beginning on page 11 of this report.

I believe that when we look back on the 1980s, we will see a time when we began to prepare for another decade of new challenges and change; when we developed marketing and pricing innovativeness to meet customer needs; when we became more efficient and competitive.

When the decade of the ’90s ends, we will take pride in having met challenges greater than those of the 1960s and ’70s. Wisconsin Power and Light will be a winner in the ’90s, just as it has been in the decades before.

We are proud of our past, of our fine record of customer commitment and service. Now, we must build on the past to meet today’s competition.

James R. Underkofler
Chairman, President and
Chief Executive Officer
February 5, 1987

Building for the future in a competitive marketplace

In 1986 Wisconsin Power and Light's earnings reached the highest level in the Company's 62-year history, overcoming the effects of mild weather, a slow economy and a reduction of WP&L's allowed rate of return from 14.5 percent to 13.5 percent.

In the financial area, 93 percent of the Company's total construction capital requirements was covered by internally generated funds in 1986, and we project that 100 percent of construction expenditures for the next five years will be funded with internally generated cash flows. As a result, WP&L will be able to limit its external financing activities.

The Board of Directors increased WP&L's quarterly common-stock dividend twice in 1986 by a total of 5 cents per share, to 74 cents per share at year-end. The Company has paid 164 consecutive quarterly common-stock dividends since 1946 and has increased the dividend payment each year for the past 11 years.

WP&L's compounded total return for the 1982-1986 period was 273 percent, compared with the industry average of 201 percent and with the Dow Jones Industrial Average of 168 percent. The market value per share of common stock reached a record high of \$60 $\frac{1}{4}$ in 1986 and exceeded book value at year-end by 72 percent.

Wall Street's view of WP&L clearly has been a positive one. If regulatory commissions continue to reduce the Company's authorized returns, however, and if Wall Street becomes uncomfortable with regulatory initiatives in

nontraditional areas, this view soon could change.

With WP&L's stock price at its present high level, investors naturally are interested in the possibility of a stock split. Our view is that WP&L's stock must be attractively priced to appeal to its major market, individuals with relatively small stock holdings. If the stock stays at its current level or increases for an extended period of time, management may determine that it is in the best interest of the Company's shareowners to take action. We will actively monitor this situation in 1987.

In the operations area, WP&L continued its outstanding performance in 1986. The operating performance of the Company's generating stations consistently has exceeded the national and state averages for key performance indicators. The availability of a utility's power plants, for example, is an important factor in the cost of customer service. WP&L's system-availability factor for the past 10 years ranks well above the national average. And, the Company operates four of the five most cost-effective generating stations in Wisconsin.

WP&L's operating performance and financial strengths are the bases upon which we will build its future.

Change — and preparation for that change — will be the dominant theme for the future utility industry. The regulated monopoly framework within which the Company has operated in the past is being pressured. As a result, there will be greater competition and



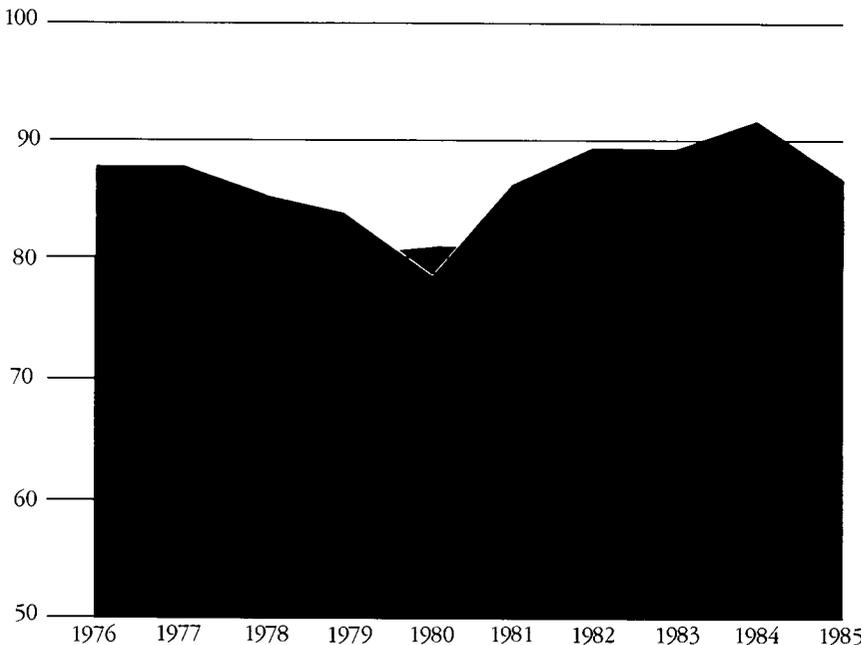
From left:
William L. Keepers,
Eugene O. Gehl
and Erroll B. Davis, Jr.

“WP&L’s operating performance and financial strengths are the bases upon which we will build its future.”

System Availability

Coal-Fired Generating Units
(In percent)

■ WP&L
■ National Average



an increased need to market competitively priced products.

WP&L begins 1987 in a strong position to meet competitive challenges in the utility marketplace. What distinguishes WP&L from its competitors?

- The Company is operationally excellent and financially sound.
- Because of a decline in construction, the Company does not face the prospect of large financings.
- The Company has a balanced mix of customers and the capability to deliver a mix of high-quality products and services to those customers.
- WP&L is committed to the efficient use of energy and continues to develop innovative programs and services to promote customers’ use of our products in the most efficient manner possible.
- The Company has achieved cost reductions in the prices of its products, making them more competitive. And, WP&L is committed to keeping its prices competitive.



WP&L is in a strong position to meet the competition

- The Company has an excellent employee group, its major strength. Their adaptability to change and their commitment to WP&L's historical ethic of quality and service to its customers places the Company in a strong competitive position.

Competition poses new regulatory challenges. We are hopeful that the Public Service Commission of Wisconsin will face those challenges in the same progressive manner in which it has faced similar challenges in the past and that the commission will allow us the flexibility we need to make market

responses in a more competitive marketplace.

WP&L's competitive strategy, in the short term, is to maintain its markets by being a low-cost provider. The Company's long-range strategy is to provide enhanced products and services to a growing base of customers that is not necessarily defined or limited by WP&L's historical geographic base.

We expect competition to increase in 1987, and meeting that competition will be a major focus of Wisconsin Power and Light's efforts. But, it will not be the Company's only focus. A corporate restructuring, various environmental issues, a state economy promising moderate growth in the 2.5-percent

to 3-percent range, deregulation and internal cost controls all will demand management's attention in the year ahead.

On the next page is a statement of WP&L's corporate commitment. It gives you a quick picture of the Company's major objectives, its principal achievements in 1986 and its key strategies for 1987. We believe that by achieving those objectives through the strategies outlined, Wisconsin Power and Light will not only maintain, but also enhance, its position as one of the top utilities in the nation.

Erroll B. Davis, Jr.
Executive Vice President

Eugene O. Gehl
Executive Vice President
and General Counsel

William L. Keepers
Executive Vice President

February 5, 1987

WP&L is committed to four major objectives that guide the Company in fulfilling its responsibility to its shareowners, customers, employees and the communities it serves. Established 40 years ago, the following four-fold goal continues to guide the Company in changing and challenging times.

SHAREOWNERS — to earn and pay to shareowners a fair return on their investment.

1986 Results

- Dividends per share of common stock have increased for 11 consecutive years and WP&L's annual dividend has been increasing faster than the utility industry average.
- Market value per share of common stock reached a record high of \$60 1/4 in 1986 and exceeded book value at year end by 72 percent.
- Most — 98 percent — of the WP&L shareowners who responded to the 1986 shareowner survey said they are satisfied or very satisfied with their WP&L investment.

1987 Strategies

- Reorganize the corporation into a holding-company structure to ensure the growth of its core utility business and to permit greater flexibility in seeking additional investment opportunities.
- Maintain WP&L's record of competitive dividend payment.
- Manage both the prices of the Company's products and its operating costs to maintain earnings and its competitive position within the utility industry, ensuring that WP&L remains an attractive investment for shareowners.

CUSTOMERS — to provide reliable utility service at the lowest rates possible.

1986 Results

- WP&L rates are among the lowest in the nation, according to a national survey conducted in 1986 by the Edison Electric Institute. WP&L's rates were found to be \$56 a year — or 12 percent — less than the typical residential bill in the United States.
- The 1986 Customer Attitude Survey showed that the majority of WP&L customers continue to be satisfied with the services it provides and that customers believe its products are good values.

1987 Strategies

- Continue to control costs in the areas of operations and maintenance expenses, and aggressively negotiate cost-effective contracts with the Company's suppliers to maintain its position as a low-cost provider.
- Increase WP&L's customer focus by developing and implementing a Company-wide program that will enable us to precisely determine customers' needs, to make the Company's resources more responsive to its customers, and to provide superior value to all customers.

EMPLOYEES — to maintain high standards of working conditions and to provide competitive compensation.

1986 Results

- The Company was a leader in adopting and implementing a new drug- and alcohol-abuse program. The program was recognized as setting the standard for industry in the communities WP&L serves.
- WP&L continued to be sensitive to and take measures to upgrade the work environment at Company locations consistent with employee needs and the financial resources available to meet those needs. In 1986, the Company spent more than \$1.45 million for this purpose.

1987 Strategies

- Provide training programs for all employees to help them understand their relationship to the customer in support of the Company's new customer-focused strategic direction.
- Continue WP&L's commitment to a safe and productive work environment with the modernization of physical facilities at an estimated annual cost of \$4.6 million.
- Continue to research the implications of the Tax Reform Act and other pieces of recent legislation on WP&L benefit packages and redesign, as necessary, in order to continue to provide attractive and forward-looking programs that will meet both the Company's and the employees' needs.

COMMUNITIES — to be a responsible member of each community we serve and to promote its social and economic well-being.

1986 Results

- The Company formed a joint initiative with the Wisconsin Department of Development to create a first-time Federal Procurement Technical Assistance Program designed to assist businesses in competing for government contracts.
- The Company's new Selling to the Government Program helped generate more than \$3 million in new business for WP&L customers and created or retained more than 150 jobs in Wisconsin.
- WP&L paid more than \$100,000 a day to other Wisconsin businesses for services and equipment purchases.
- Hundreds of WP&L employees volunteered their time and talents to myriad community programs and organizations.
- The Company established the Wisconsin Power & Light Foundation, Inc., in 1984 to administer an overall contributions program. In 1986 the foundation gave more than \$500,000 to a wide range of programs (primarily in the Company's service territory) aimed at providing an improved quality of community life.

1987 Strategies

- Develop and conduct a workshop series designed to help businesses in WP&L's service area gain the knowledge and skills to successfully compete for federal and state government contracts.
- Through workshops and a variety of media, inform WP&L customers about the assistance to be provided by Wisconsin's new federal procurement centers.
- Assist local communities in WP&L's service area in their industrial- and community-development efforts by identifying current growth industries, providing information about available sites and buildings and offering special economic-development programs.
- Through the Wisconsin Power & Light Foundation, continue a special focus on the support of educational activities and programs and, in addition, emphasize culture and the arts, including programs that broaden the access of the public at large to the arts.

Fiber optics — More than half of the construction of the 670-mile NorLight fiber-optics communication network was completed at year-end 1986. NorLight, which plans to begin operation in the spring of 1987, has signed agreements with seven telecommunications customers. The \$45-million fiber-optics network will link telecommunications services between Chicago and Minneapolis, as well as serve the Wisconsin cities of Milwaukee, Madison, La Crosse and Eau Claire. WP&L and four other Wisconsin and Minnesota utilities own an interest in NorLight through their subsidiaries.

In 1986 NorLight obtained a favorable Federal Communications Commission ruling on the company's request for status as a private telecom-



Energy Circus — The Company's energy-education activities include the Energy Circus, an entertaining program that uses feats of magic and student participation to teach children about the efficient and safe use of energy. The popular program has been performed before 100,000 children and teachers in 450 elementary schools since 1981.

Holding company — WP&L filed an application in November with the Public Service Commission (PSC) of Wisconsin for approval to form a holding company. Under the proposed corporate reorganization, WP&L will become a subsidiary of the holding company. In addition to the PSC, WP&L shareowners, the Securities and Exchange Commission and the Internal Revenue Service must approve the corporate restructuring proposal before it becomes a reality.

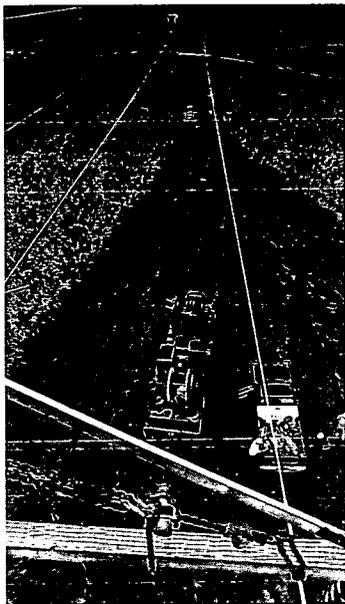
Idea Award — WP&L received the 1986 University of Wisconsin-Extension Wisconsin Idea Award for its comprehensive economic-development activities. Those activities include a federal and state contract procurement program aimed at helping businesses compete for government contracts. That effort paid off in 1986 when WP&L customers obtained more than \$3 million in federal and state contracts and created or retained more than 150 jobs in the Company's service area.

Refund for customers — A legal victory for WP&L meant a refund of \$7.2 million for WP&L's 335,000 customers in November. In 1986 a court ruled unconstitutional the 1981 state law that prohibited utilities from taking an income-tax credit on the property taxes they paid, a tax break that was allowed to other types of businesses and individual taxpayers. This disallowed tax credit was, in effect, a hidden tax placed on utility customers, and WP&L initiated a court challenge to the ruling. The Company's successful challenge resulted in the refund from the state, which WP&L passed directly on to customers.

Rate cases — In August the PSC issued a final order in the Company's retail rate case, which was filed in December 1985. The commission reduced WP&L's overall electric revenues by \$5.4 million and increased overall natural-gas revenues by \$640,000. The PSC also decreased the Company's rate of return on equity to 13.5 percent from 14.5 percent.

New system peak — How hot was the summer of '86? It was so hot that on July 18, WP&L set a record summer peak demand of 1,470 megawatts (or 1,470,000 kilowatts). The previous record summer peak — 1,427 megawatts — was set on Aug. 29, 1984.

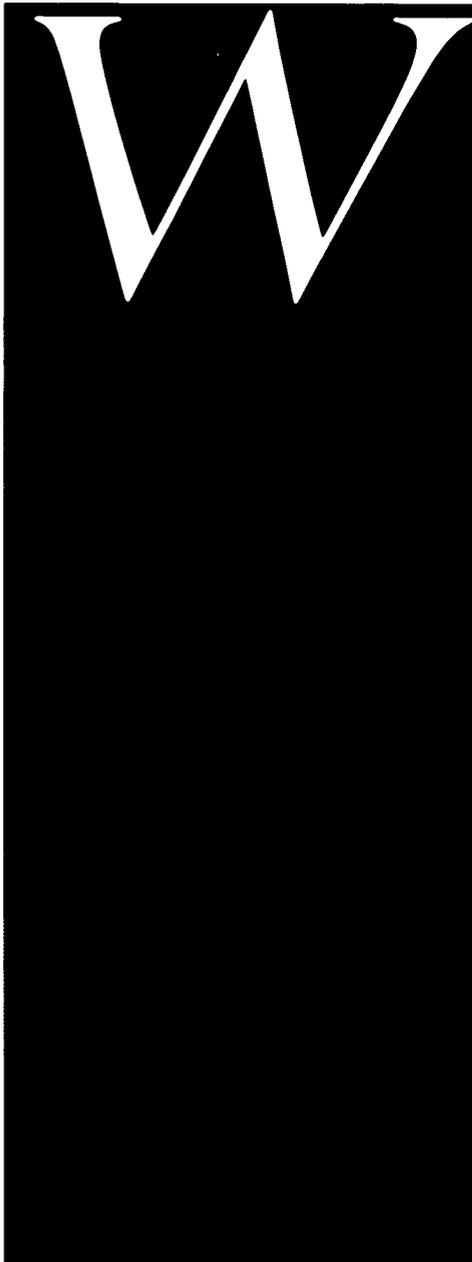
Ice storm — Customers and employees were battered in February 1986 by what has been called the worst ice storm to hit Wisconsin in 10 years. Nearly 10,000 customers were without power during the storm, which caused more than \$400,000 damage to WP&L's service area.



munications carrier, which exempts the setting of NorLight's rates and the operation of the system from federal and state regulation.



Building on the past to meet today's competition

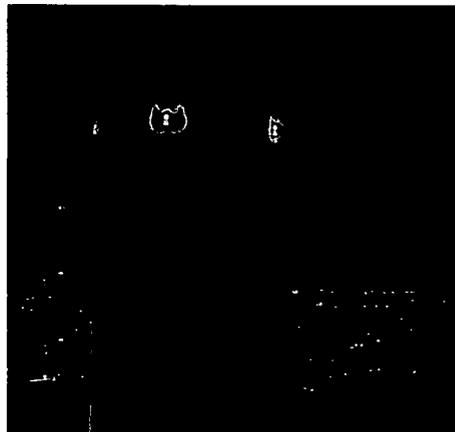


Wisconsin Power and Light Company and the communities it serves share a rich heritage in Wisconsin's heartland.

1986 marked the 150th anniversary of Wisconsin's existence as a separate governmental entity. Throughout the state, sesquicentennial celebrations honored the creation of the Wisconsin Territory and many of its counties and communities in 1836. From Fond du Lac, Poynette and Mineral Point to Delavan, Fontana and Beloit, WP&L's service area was alive with the celebrations' sights, sounds and pride. You will be reading about some of those communities in the next few pages.

But the sesquicentennial festivals were more than just community birthday parties. They were the celebration of 150-year-old values that still influence our lives today.

Wisconsin Power and Light is building on the solid foundations established by the communities it serves and on its own past accomplishments. At the same time, the Company is shaping and adapting proven values and principles



A futuristic robotic system and a computerized, 38-mile-long assembly line make the General Motors Assembly Division (GMAD) plant in Janesville, Wis., one of General Motors Corp.'s largest and most modern plants in the United States. The plant also was WP&L's largest revenue-producing customer in 1986. "Over the past year, we have worked very closely with WP&L to find ways to make our plant more competitive in the world market," said Mike Cubbin, Manager of GMAD-Janesville. "As a result of our joint efforts, we have implemented two major programs — interruptible electric rates and natural gas transportation — that are saving our plant hundreds of thousands of dollars in energy costs. The new programs have allowed the Janesville plant to be more competitive and were a major factor in helping us obtain a new product line."

to meet the future demands of a new, less regulated, more performance-oriented, competitive era.

The new competition

What a year 1986 was! The year was marked by changes, challenges and competition.

Yes, competition.

Why is a monopoly like Wisconsin Power and Light involved in competition? Because, quite simply, the utility industry as we have known it for the past 60 years is being pressured to change. The forces of change that have been building steadily since the 1970s converged in 1986 and propelled the utility industry into a new era of competition.

WP&L is an active and aggressive participant in that new competition. To strengthen its position in its marketplaces, the Company is committing the resources necessary to make its vision of becoming a more customer-focused organization a reality.

WP&L takes pride in its history of outstanding customer service and in the



high marks it consistently receives from appreciative customers. But today's more competitive marketplaces — which are offering customers alternatives they did not have in the past — demand increased responsiveness to customers' needs by every employee in the Company.

Providing superior value

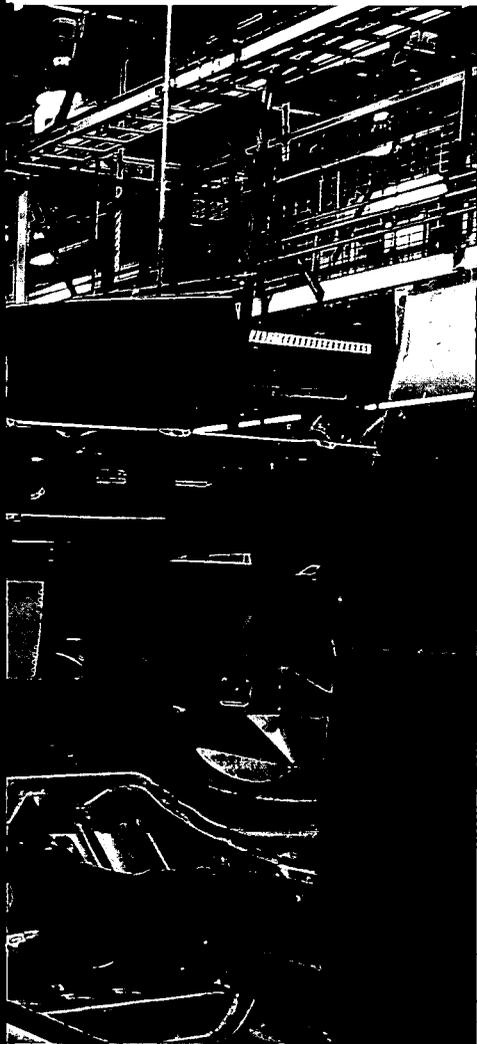
Becoming more customer focused will involve a Company-wide effort designed to provide "superior value" to all customers — residential, rural, commercial, industrial and wholesale — while meeting corporate goals and shareholder financial expectations. WP&L's plan for a more customer-focused organization includes providing a consistent level of "quality baseline service" to all customers and offering

"value-added services" to those customers who want more service and are willing to pay for it.

Baseline-service quality is measured by such factors as competitive rates, accurate billing and courteous customer communications. Value-added service may provide business advice to large industrial customers or energy-efficiency education seminars to residential customers, for example.

We have differentiated the two levels of service because it is clear that we must be able to compete both in a commodity market, in which price is the basis of competition, and in a more discriminating market, in which quality is more important.

The objective of WP&L's plan to become a more customer-focused organization is to establish the Company



as the primary energy supplier for existing and potential customers in a more competitive marketplace. Being the energy resource of first choice will require increased customer insight, to be gained through market research; innovative planning and programs; a willingness to take risks; and the ability to measure success in terms of customer satisfaction as well as sales growth and profitability.

Devising a more customer-focused program for doing business is a five-step process, with planning beginning in late 1986 in three WP&L districts — Tomah, Beloit and Beaver Dam.

The first step was to perform market surveys in each of the three districts to identify opportunities for marketing and to learn more about customers' specific expectations of their utility. The market surveys will give the district managers the information they need to take step two: developing a business plan custom-designed for

each district to increase district revenue opportunities.

The third step is to develop and test a way to measure customer satisfaction. Customer expectations gleaned from the market surveys will be used to write customer-satisfaction measures. Those measures will be used to chart our progress toward meeting customers' expectations.

With research results, business plans and customer-satisfaction measures in hand, the three district managers each will get a chance to plan what they believe is the "model" organizational structure for their district. Implementing the model organizations in the three test districts is the fifth step.

Change will not come all at once, particularly in an industry that traditionally has viewed itself as a product provider rather than a supplier of energy services. But by making a corporate commitment in 1986 to become a more customer-focused organization, WP&L

Beloit

The city of Beloit and Beloit College grew up together.

Soon after it was founded in 1836, Beloit pledged labor, land and money to bring a college to its site. Beloit College was founded in 1846 to be the "Yale of the West." It is Wisconsin's oldest college in continuous service.

Beloit College today is a four-year liberal arts college with a diverse student population of 1,000 from 44 states and 32 foreign countries, well known in educational circles for the excellence of its teaching. The college is a hub of cultural activity for the region, adding a rich dimension to the lives of both the students and the community.

Beloit, today a city of 36,000, grew into a diversified manufacturing site and the center of a rich farming area. Because of its accessible location on the border of Wisconsin and Illinois, Beloit rapidly is becoming a major food-processing, manufacturing, warehousing and distribution point for many large corporations.



The operating performance of WP&L's generating stations ranks high nationally and in Wisconsin — the result both of employee efficiency and a well-planned, adequately funded maintenance program. Regularly scheduled overhauls such as the \$456,000 overhaul in 1986 of WP&L's Columbia 1 Energy Center near Portage, Wis., help control electrical generation costs.

has positioned itself to achieve success in a more competitive business environment. The key to our continued success is to provide cost-effective, high-quality energy services that meet our customers' expectations.

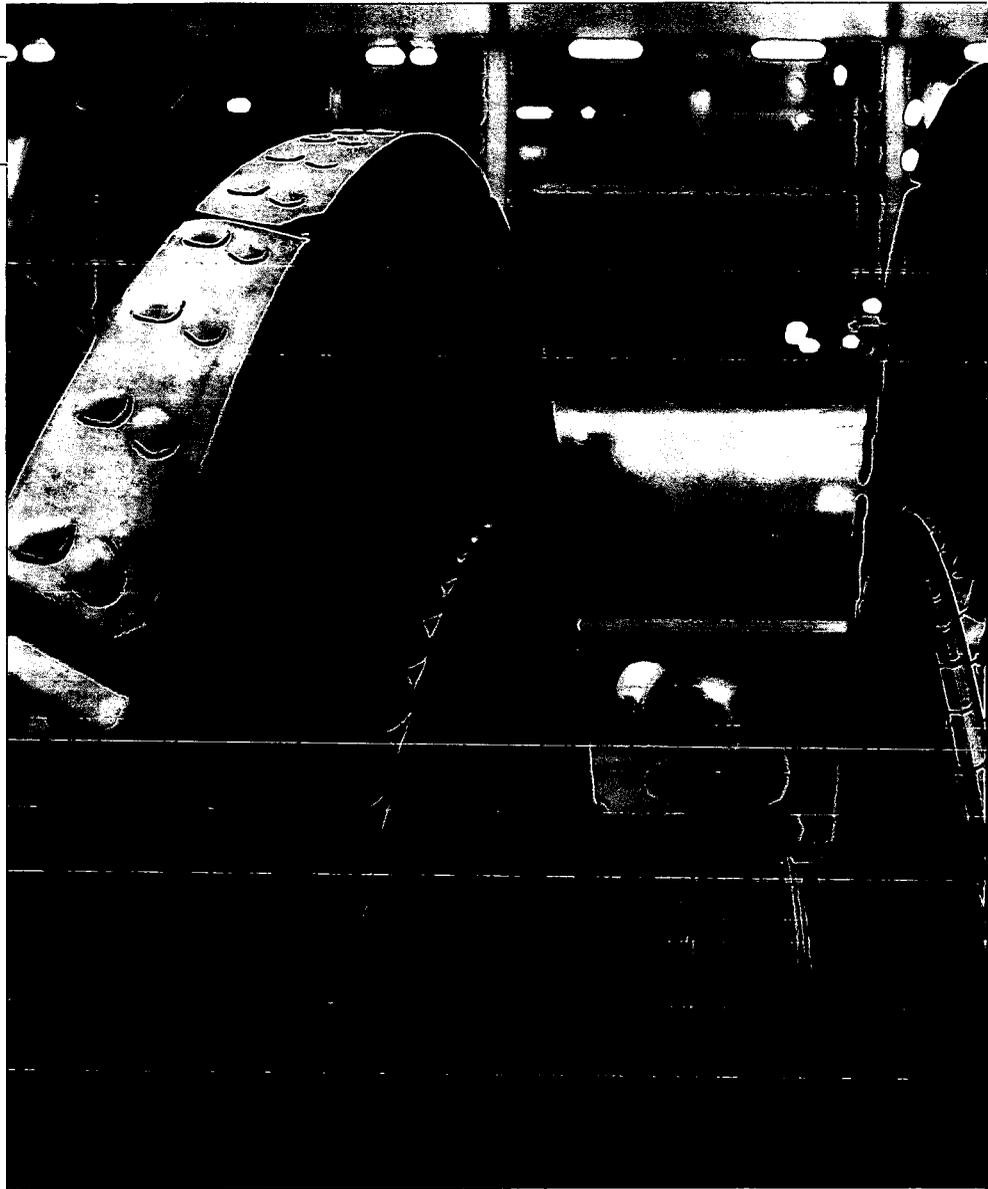
Top performers

A major success for the Company over the years has been the operating performance of the coal-fired generating stations that WP&L manages. The performance of these power plants consistently has exceeded national and state averages for key performance indicators.

That performance pays off in WP&L's ability to provide reliable service at the lowest-possible cost for our customers. And that gives WP&L a major advantage in a competitive marketplace. Here are several of WP&L's operating success stories.

Generating-station efficiency is measured by unit heat rate, which is the number of Btu required to generate one kilowatt-hour of electricity. The lower the heat rate, the greater the efficiency of a power plant, which results in lower fuel consumption.

Each year the 100 largest utilities in the nation are ranked by system heat rate. Every year since 1979 the WP&L system has ranked above the median



nationally and has been the most efficient investor-owned system in Wisconsin. And, every year since 1976, individual WP&L-operated generating stations consistently have produced heat rates that rank among the best in the state, according to a report by the Public Service Commission of Wisconsin.

In addition to equipment efficiency, WP&L's coal-procurement policies and operating-and-maintenance policies help control electrical generation costs. The WP&L system's coal and operating-and-maintenance costs per kilowatt-hour have been the lowest in Wisconsin

since 1976. During this period, coal-fired generating units operated by WP&L have recorded fuel and operating-and-maintenance costs that consistently have been among the lowest in Wisconsin.

While controlling maintenance costs, WP&L has not compromised the reliability of its generating units. The availability of a utility's power plants is another important factor in the cost of customer service. The availability factor is the percentage of time that a generating unit is available for customer service. The Company's system-availability factor has averaged 87 percent dur-



ing the past 10 years, compared with a national average of 81.3 percent for units of all sizes.

WP&L's forced-outage rate also reflects the reliability of the system. A forced, or unscheduled, outage occurs when a power plant unexpectedly goes out of service. The lower the forced-outage rate, the greater the system reliability. During the past 10 years, WP&L's average forced-outage rate has been 2.7 percent — less than one-third of the 10-year national average of 8.7 percent, according to the most current data available from the North American Electric Reliability Council.

Finally, WP&L is the most productive utility in the state on the basis of number of kilowatthours produced per generating-station employee.

These operating successes place the Company in a strong competitive position.

Aggressive cost control

To compete in a commodity market, WP&L must be cost competitive. Through Company-wide cost-containment initiatives, we have achieved cost reductions in the prices of our products, making them among the lowest in the nation.

According to the results of a 1986 Edison Electric Institute national survey of 216 electric utilities, WP&L's rates are 12 percent — or \$56 a year — less than the typical residential electric bill in the United States.

The price customers pay for natural gas decreased in 1986. The Company's major natural gas pipeline supplier, the ANR Pipeline Co., twice decreased the wholesale price it charges WP&L during 1986, allowing WP&L to reduce its residential gas customers' bills. As a result, the price our customers pay for natural gas today is the same as it was in 1983.

Even more significant price reductions by WP&L's other pipeline supplier, Northern Natural Pipeline Co., resulted in major savings for customers served by that supplier. In 1986 alone, residential customers' annual home-heating costs dropped by 12.9 percent. WP&L is working continuously to get the best possible prices from its gas suppliers.

We are committed to keeping our prices competitive. Cost effectiveness is WP&L's continuing mode of operation. There is an ongoing effort at all levels of the Company to perform productively and to control and decrease costs without reducing the quality of customer service. We believe that cost

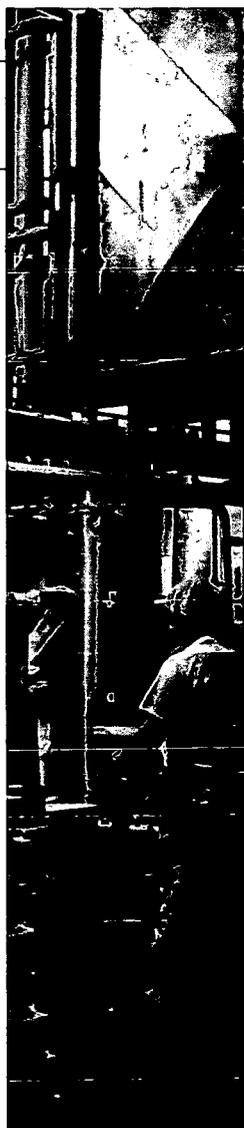
Delavan

Images of Delavan, population 6,000, located 50 miles southeast of Madison in one of Wisconsin's most popular resort areas: sailboats gliding on sparkling lakes, rich, rolling Wisconsin farmland, beautiful parks, leisurely fishing, thousands of flowering crab-apple trees, smalltown USA friendliness, and a unique circus heritage.

Founded July 19, 1836, Delavan proudly proclaims itself the 19th century circus capital of the nation. Hundreds of clowns, acrobats, entertainers and animal trainers — members of more than 25 circuses — made Delavan their winter home between 1847 and 1894. The P.T. Barnum Circus — billed as "The Greatest Show on Earth" — was founded in Delavan in 1871.



Like the General Motors plant in Janesville, Beatrice Food Ingredients, Inc. in Beloit, Wis., is among a growing number of WP&L's large industrial customers that are buying their own natural gas directly from the producer and contracting with the Company to transport the gas to them. Beatrice Food Ingredients is transporting an average of 5,800 therms of natural gas each day. A subsidiary of Beatrice U.S. Food Corp., the Beloit plant produces dehydrated food ingredients for a variety of products, including dried-soup mixes and potato-chip flavorings. At right, chicken is dehydrated in the dryer before being packaged in drums to be shipped throughout the world.



savings are the key to finding other strategies for strengthening the core utility business and to meeting our competition.

We have focused our cost-containment efforts on two primary areas — load management and operating cost control.

Load management is a technique used by utilities to control the times during which customers consume electricity and the way in which they use it. Our goal in load management is to increase the customer base over which we can spread our fixed costs while shifting load to off-peak times, periods of relatively low system demand. (Fixed costs are the annual costs related to the ownership of property, such as depreciation, taxes, insurance, customer services, general and administrative expenses and necessary regular line and plant maintenance.)

This strategy of leveling out the demand for electricity during peak periods helps minimize the need for costly new power plants. Presently, we do not anticipate having to build another plant in this century. Our marketing programs are designed to help us achieve our load-management goals.

We have moved aggressively to control our operating costs. We continu-

ously evaluate our generating capability to ensure that WP&L is using the most cost-effective power plants. In 1986, for example, we converted our Blackhawk Generating Station in Beloit, Wis., from a coal-fired unit to a natural gas peaking unit. The conversion means that the 50-megawatt plant, which began operation in the 1940s, only will be used for emergencies or for special system conditions. The change in operations provides greater flexibility today and in the future and has resulted in fuel savings and productivity gains.

Another example of our cost-control activities is the public sale of \$38 million in first-mortgage bonds in June 1986. The Company used the net proceeds

from the sale to help retire bonds sold when interest rates were considerably higher. WP&L estimates that the sale will save the Company about \$3 million in 1986 dollars over the next five years.

In 1986 we reorganized our purchasing department and established the fuel services department to place greater emphasis on administering our fuel supply. The national fuel-supply situation has undergone rapid change in the past five years. Other utilities also can take advantage of the over-capacity of some types of coal and of competitive rail situations, but WP&L's expertise, aggressiveness and management philosophy have set us apart. We are not satisfied with the way things have been done



in the past; we want to consistently do them better. We are not content with the more than \$19 million in delivered fuel costs that WP&L saved from mid-1984 through mid-1986; we want to save more money.

WP&L continuously monitors fuel prices and uses computer models to evaluate transportation costs, so we are able to take advantage of short-term price fluctuations. Our management approach is to negotiate a flexible mix of fuel contracts that includes spot, short-term and long-term. We are proud that WP&L pays less for fuel than any other utility in Wisconsin. And that pays off in savings for our customers.

Marketing new energy services

We also are making sure that we can compete with other energy suppliers if something other than cost becomes the basis of competition. Through our plan to establish the more customer-focused organization discussed earlier, we are putting even more emphasis on customer service than we have in the past. We are designing our marketing programs for both natural gas and electricity to emphasize more quality at the same cost through energy efficiency.

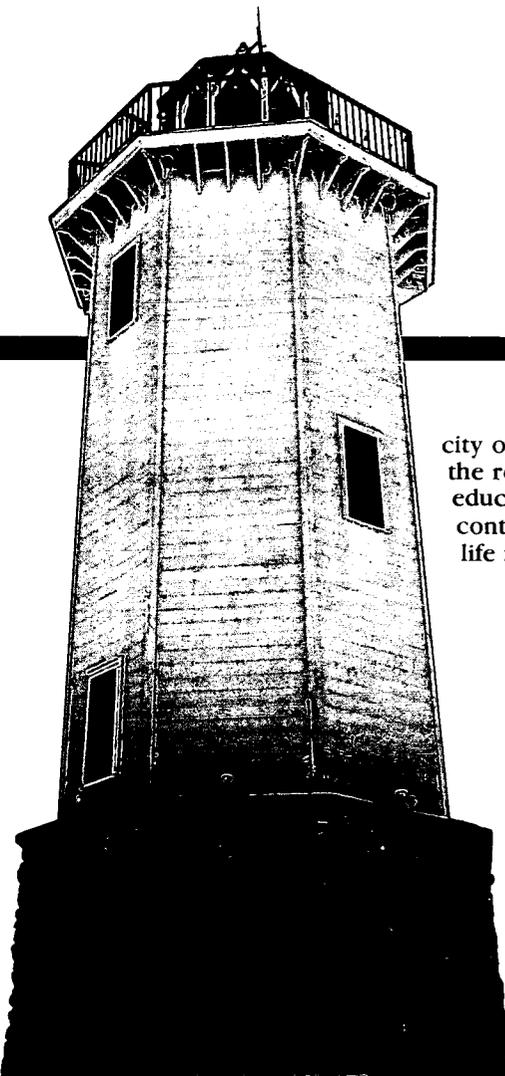
We offer residential customers an array of energy services. Through the Good Cents Home Program, WP&L's energy experts help customers and

Fond du Lac

People have depended on some form of lighthouse for nearly as long as they have sailed the open seas. For hundreds of years, navigators have searched anxiously for lights to tell them that land was near or to warn them of dangerous rocks and shoals.

A welcome signal to sailors since it was built in 1933, Fond du Lac's lighthouse also has become the symbol of the city. The 44-foot lighthouse is open to the public, offering a unique vantage point to view the city sights and lights.

Fond du Lac is nestled on Lake Winnebago, Wisconsin's largest inland lake, in a dairy-farming and resort region. Founded June 6, 1836, Fond du Lac today is a lively and liveable



city of 36,000. Its citizens prize the recreational, cultural and educational opportunities that contribute to the quality of life in Fond du Lac.

Vulcan Chemicals is WP&L's third-largest electric-revenue-producing customer. Located in Port Edwards, Wis., the plant produces inorganic chemicals, including chlorine, caustic soda and hydrochloric acid, for Wisconsin's paper industry, Midwest food processors and the oil-well industry. The plant recently completed an \$8.5-million expansion project for a new product, potassium hydroxide, whose primary markets are the liquid fertilizer, soap and detergent industries. Vulcan Chemicals, a division of Vulcan Materials Co., headquartered in Birmingham, Ala., has a total production capacity of more than 200 tons of chlorine per day.

builders design homes as much as 30 percent more energy efficient than a typical new home. This popular customer service began as a pilot program in 1985 with 35 new homes participating. In 1986, WP&L certified 260 new houses as Good Cents homes.

Incentives for conversion to natural gas include rebates and third-party financing in which WP&L works with a financial institution to acquire discounted interest rates.

We are implementing pilot programs for commercial and industrial customers using a shared-savings concept. Bright Ideas for Business is one of the shared-savings programs we are testing for commercial lighting customers. We will help customers evaluate their lighting technology and redesign it for greater efficiency and quality.

We have moved our rate-design staffs into the gas and electric marketing departments because we recognize that new pricing mechanisms and flexibility will become more and more important to meet the competition.

To stay competitive with alternate fuels, WP&L now is offering new rate options and services based on customer size and service needs. These options include new gas-transportation rates and services, which help customers take



advantage of gas transportation.

And, through continued use of time-of-day electric rates and other pricing structures that encourage off-peak use, we will be able to shift the demand on our generating stations and continue to postpone the construction of new power plants.

It is clear to us that, in a more competitive market, we must become a more market-driven company to meet the competition from other suppliers, especially in our natural gas business.

As oil prices continue to fall, more and more of our gas customers could switch to fuel oil to supply their energy requirements. Another competitive factor is the Federal Energy Regulatory

Commission's 1985 transportation rule, which opens up pipelines for transportation purposes. Large gas users now can shop around for the best deal on natural gas, buy directly from the producer, and pay the pipelines and the utilities between them and the producer to transport the gas to them. At year-end 1986, we were transporting customer-owned gas that amounted to nearly 10 percent of our annual gas sales.

Our market research shows that our natural gas customers would rather buy gas from us because they know we are reliable. Large customers must know that they have a stable supply. There is, of course, a threshold at which — if



alternate fuel prices are low enough — customers will switch.

We must be cost competitive while ensuring customers quality and reliability. We are, therefore, packaging new options and prices for gas transportation, supply and efficiency services to meet our customers' changing needs. Even if some customers no longer purchase natural gas directly from us, we want to keep them as customers and earn income on services provided to them.

This marketing focus also is important as the unlimited wheeling of electricity becomes a reality. Wheeling is the transmission of electrical power, for a fee, by a utility that neither produces nor uses the electricity. The wheeling company simply acts as a conduit between the generating and user companies. Again, flexible, market-responsive pricing and a range of services for customers both within our service area and outside it will turn wheeling from a threat into an opportunity for WP&L.

Researching new technologies

To meet the competition in future markets, WP&L in 1986 continued its research of new technologies.

A test project being administered in conjunction with the Gas Research Institute, for example, involves a high-efficiency, low-emission boiler system installed in a small commercial business. The boiler uses a new burner technology called fiber matrix. WP&L now is beginning its own demonstration project using that technology in Fond du Lac, Wis. Another gas research-demonstration project evaluates — through an operations and maintenance program — the energy-saving potential of the heating systems in 10 multi-family dwellings.

WP&L's electric demonstration projects include research to help dairy farmers use energy more efficiently, reduce the energy used to cool milk, improve the quality of the milk and reduce stray voltage; research to help residential customers achieve greater

Mineral Point

A century and a half ago, southwestern Wisconsin was a rough-and-tumble, lead-and-zinc mining region. When lead was discovered in 1828 near what is today Mineral Point, miners and settlers rushed to the site. Some miners, in a hurry to get to the diggings, lived in holes dug in the sides of the hills. These miners became known as badgers and, according to legend, gave Wisconsin its nickname. The lead mine boomtown became the center of commerce for the new Wisconsin Territory, which the U.S. Congress established July 3, 1836.

Today Mineral Point — the "crown jewel" of the history of territorial Wisconsin — is a quiet, picturesque community of 2,300 people located 54 miles southwest of Madison. In 1986 the city commemorated the 150th anniversary of the inauguration in Mineral Point of Henry Dodge as the first governor of the Wisconsin Territory.





The Good Cents Home Program is one of an array of energy services the Company offers residential customers. WP&L's energy experts such as Consumer Services Representative Ed Anderson, above left, help customers and their builders design homes as much as 30 percent more energy efficient than a typical new home. In 1986, WP&L certified 260 new houses as Good Cents homes, including the home of Dennis and Janice Everson and son Eric, above, in Monroe, Wis.

comfort at lower cost, such as through new heat-pump technology; and long-term research on indoor air quality, wind-energy systems, and photovoltaic power, which converts sunlight directly into electricity by means of solar cells.

WP&L also is involved in a number of research projects aimed at commer-

cial and industrial electric customers. One area of research focuses on lighting controls and sources and on using daylight more effectively. Another project will evaluate more efficient industrial electric-heating technologies.

The objectives of WP&L's research programs are to improve the environment in which our customers live and work; to reduce the cost of energy, which will enable WP&L to remain cost competitive and our customers to thrive and to be competitive within their industries; and to improve the quality of the energy we produce and the products our customers produce.

The utility of choice

Competition. It's a burgeoning reality in the utility industry and WP&L is a part of the new competition. By building on our past accomplishments, by

developing a plan to become a more customer-focused organization, by improving our operating performance and efficiency, by working with our pipeline suppliers to reduce natural gas prices, by continuing to control costs, by negotiating delivered fuel contracts to lower energy prices, by aggressively marketing our energy services and by researching new technologies that will reduce the cost of energy, Wisconsin Power and Light Company has achieved a strong competitive position.

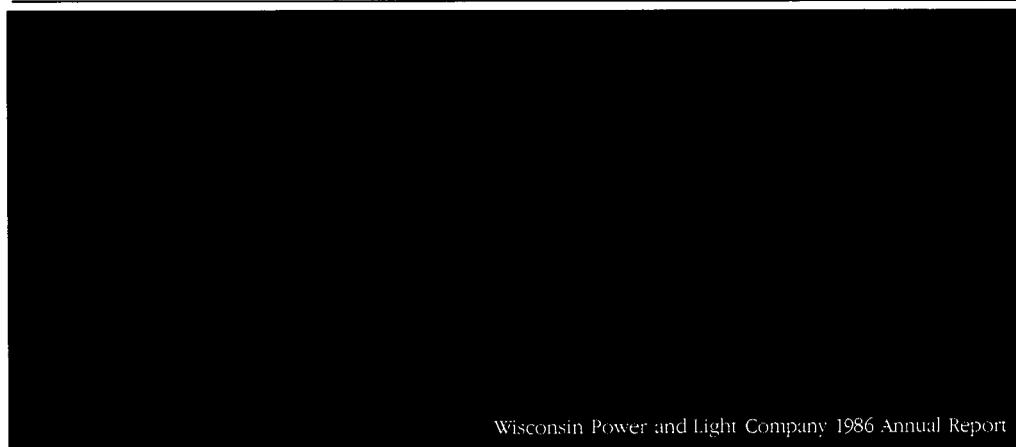
By continuing these successful past efforts and daring to try aggressive new approaches, we will provide cost-efficient and higher-quality energy services tailored to meet our customers' individual needs. We are determined that Wisconsin Power and Light Company will be the utility of choice.



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SELECTED FINANCIAL DATA

	1986	1985	1984	1983	1982
	(In Millions Except for Per Share Data)				
Operating revenues	\$ 569	\$ 589	\$ 575	\$ 556	\$ 512
Net income	\$ 60	\$ 61	\$ 58	\$ 55	\$ 47
Earnings per share of common stock	\$4.28	\$4.26	\$4.12	\$3.97	\$3.51
Total assets (at December 31)	\$ 988	\$ 977	\$ 925	\$ 881	\$ 834
Long-term obligations and preferred stock with mandatory redemption (at December 31)	\$ 333	\$ 333	\$ 306	\$ 295	\$ 304
Cash dividends declared per share of common stock	\$2.90	\$2.70	\$2.52	\$2.36	\$2.20



1986 FINANCIAL REVIEW

Management's Discussion and Analysis of Financial Condition and Results of Operations

FINANCIAL CONDITION

Financial position and changes in financial position of the Company are reflected in the consolidated balance sheets and consolidated statements of net changes in financial position. These financial statements portray the Company's capital resources and liquidity. As we use the term, liquidity means the ability of the Company to generate adequate amounts of cash to meet its needs. This concept is very important to the Company because our needs for cash include expenditures for construction, taxes, research and development, environmental programs, dividends and other operating expenses. Because the Company is capital intensive and requires large investments in long-lived assets, long-term liquidity is more important than short-term liquidity. Many of the measures of short-term liquidity that are important in other industries, such as the amount of working capital or the ratio of current assets to current liabilities, are less important in evaluating the financial condition of a public utility and the Company.

The Company has achieved a high degree of long-term liquidity by maintaining strong bond ratings, minimizing cost increases, aggressively pursuing appropriate rate adjustments and obtaining adequate depreciation rates.

The Company has continued to maintain an excellent bond rating by Standard & Poor's Corp. and by Moody's

Investors Service over the last five years, enabling it to take advantage of lower interest rates when issuing high-quality debt.

The Company's solid financial condition has enabled it to pay interest charges, preferred stock dividends and common stock dividends out of current earnings. The Company's ratio of earnings to fixed charges and preferred dividend requirements after taxes was 2.61 for 1986 and has averaged 2.58 over the last five years. The Company's common stock dividend coverage ratio was 3.04 for 1986 and averaged 3.47 over the last five years.

With the high cost of construction and uncertainties in the capital markets, an important measure of financial strength is the percentage of the Company's construction expenditures financed by internal sources. In addition to paying interest and dividends, the Company was able to finance 93 percent of its construction expenditures from internally generated funds for 1986 and has averaged 86 percent over the last five years.

The Company does not anticipate the need for any new major construction projects for the rest of the century and expects to be able to finance all construction expenditures internally over the next five years.

RESULTS OF OPERATIONS

The results of operations of the Company are reflected in the Consolidated Statements of Income.

The Company has been able to achieve earnings growth and increase its dividends over the past five years.

	<u>1986</u>	<u>1985</u>	<u>1984</u>	<u>1983</u>	<u>1982</u>
Earnings per share of common stock	\$4.28	\$4.26	\$4.12	\$3.97	\$3.51
Cash dividends per share of common stock	\$2.90	\$2.70	\$2.52	\$2.36	\$2.20

Electric revenues increased in 1986, due primarily to recovery in rates of increased operation and maintenance expenses during the first half of the year. Retail base rate changes during the five-year period include a \$5.4 million annual decrease in August 1986, a \$17.4 million annual increase in September 1985, a \$14.4 million annual decrease in October 1984 and a \$5.7 million annual increase in September 1983. Settlements were reached in September 1985, April 1984 and March 1982 with the Company's wholesale customers, providing for annual increases of \$3,000,000 in 1986, \$1,500,000 in 1985, \$348,000 in 1984 and \$4,600,000 in 1982. Revenue increases were offset by decreased sales to other utilities. Sales to other electric utilities decreased 22 percent in 1986 compared with 1985, reflecting reduced requirements of out-of-state utilities.

Gas revenues decreased \$24 million in 1986 compared with 1985 resulting from transported gas, alternate fuels, weather and decreased purchased gas expense. Starting in 1986, approximately 50 industrial gas customers began purchasing their gas directly from suppliers and transporting it through the Company's distribution system at applicable transportation rates. Transportation rates are designed to recover all costs of gas distribution and a return on gas plant investment. This transportation of gas by the Company, instead of purchasing gas from suppliers and

reselling it to industrial customers, results in equal reductions of gas revenues and purchased gas expense but retains the contribution to earnings. During 1986, approximately 10 percent of gas sales were transportation sales and should be considered when comparing gas revenues with prior years. This decrease was somewhat offset by a 2 percent increase in the number of gas customers served and modest increases in base rates. Base rate increases during the period included an annual increase of about \$0.6 million in August 1986, \$0.6 million in September 1985, \$1.8 million in October 1984 and \$2.1 million in September 1983.

Total fuel costs, including fossil fuels and purchased power, decreased from the year before. Although fossil-fuel costs increased slightly in 1986, this increase was offset by a decrease in purchased power, resulting in a 7 percent decrease in total combined fuel costs. The decrease in purchased power expense reflects the decrease in sales to other utilities and the first full year of operation of our Edgewater 5 generating unit.

Other operation and maintenance expenses increased due to higher labor costs, employee benefits, material costs, and increased environmental and safety requirements of power plants, including the new Edgewater 5 plant.

Straight-line depreciation expense decreased due to lower authorized rates and lower provisions for decommissioning the Kewaunee Nuclear Plant at the end of its operating license. The lower provisions were part of the requirements by the Public Service Commission to establish external trust funds to provide for the decommissioning of the Kewaunee plant (see "Notes to Consolidated Financial Statements," Note 1h).

Allowance for funds used during construction (AFUDC) continued to decrease in 1986, reflecting the completion of Edgewater 5. See "Notes to Consolidated Financial Statements," Note 1d, for additional information about AFUDC.

Interest on bonds increased in 1986 compared with 1985, resulting from the issuance of \$88 million in first mortgage bonds in 1986 (see "Notes to Consolidated Financial Statements," Note 3). The bonds were issued to pay off short-term debt, provide for establishment of a decommissioning trust fund and refinance a portion of our Series S, 13 $\frac{3}{4}$ % bond due in 1991. This refinancing with 8.00% Series U bonds will result in annual interest savings of approximately \$1.3 million.

Other interest expense decreased in 1985, as explained in the "Notes to Condolitated Financial Statements," Note 4.

Other taxes increased in 1986 compared with 1985, reflecting increased state license fee taxes.

Current financial statements report operating results in terms of historic cost and provide a reasonable, objective, quantifiable statement of financial results, but do not evaluate the impact of inflation. Under ratemaking prescribed by the various commissions regulating the company, projected operating costs, including the impacts of inflation, are recoverable in rates. However, the effects of inflation on utility plant depreciation are not recoverable in rates, but are generally offset by the holding gain resulting from the use of debt to finance utility plant.

The Tax Reform Act of 1986 effected several changes in federal taxation including lower rates beginning in 1987, repeal of the investment credit and slower tax depreciation. This will generally cause higher cash outflows for the Company and result in changes in rates charged customers. While separately, the Financial Accounting Standards Board has proposed a change in accounting for income taxes that would adjust deferred tax balances to reflect changes in tax rates, for utilities, such immediate adjustments to income are restricted by the act. Accordingly, the Company does not anticipate a significant effect on net income should this proposal be enacted. The repeal of the investment tax credit, effective January 1, 1986, results in the substantial decrease in investment tax credits deferred for 1986 compared with 1985.

Report on the Financial Information

Wisconsin Power and Light Company management is responsible for all the information appearing in this annual report and for the accuracy and internal consistency of that information. The consolidated financial statements that follow have been prepared in accordance with generally accepted accounting principles. In addition to selecting appropriate accounting principles, management is responsible for the manner of presentation and for the reliability of the financial information. In fulfilling that responsibility, it is necessary for management to make estimates based on currently available information and judgments of current conditions and circumstances.

Through a well-developed system of internal controls, management seeks to assure the integrity and objectivity of the financial information presented in this report. This system of internal control provides reasonable assurance

that the assets of the Company are safeguarded and that the transactions are executed according to management's authorizations and are recorded in accordance with the appropriate accounting principles.

The Board of Directors participates in the financial information reporting process through its Audit Committee, whose composition and duties are described on page 38 of this Annual Report.



James R. Underkoffler
Chairman of the Board, President and Chief Executive Officer



Edward M. Gleason
Vice President - Finance and Treasurer

February 5, 1987

Auditors' Report

To the Shareowners and Board of Directors of Wisconsin Power and Light Company:

We have examined the consolidated balance sheets and statements of capitalization of WISCONSIN POWER AND LIGHT COMPANY (a Wisconsin corporation) and subsidiaries as of December 31, 1986 and 1985, and the related consolidated statements of income, common shareowners' investment and changes in cash for each of the five years in the period ended December 31, 1986. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Wisconsin Power and Light Company and subsidiaries as of December 31, 1986 and 1985, and the results of their operations and their changes in cash for each of the five years in the period ended December 31, 1986, in conformity with generally accepted accounting principles applied on a consistent basis.

Milwaukee, Wisconsin,
February 5, 1987.

ARTHUR ANDERSEN & CO.

Wisconsin Power and Light Company and Subsidiaries
Consolidated Statements of Income

	Year Ended December 31,				
	1986	1985	1984	1983	1982
	<i>(In Thousands Except For Per Share Data)</i>				
Operating revenues (Note 1g):					
Electric	\$437,033	\$432,314	\$425,004	\$406,466	\$370,863
Gas	128,201	152,588	146,809	145,663	138,388
Water	4,012	4,029	3,663	3,373	3,226
	<u>569,246</u>	<u>588,931</u>	<u>575,476</u>	<u>555,502</u>	<u>512,477</u>
Operating expenses:					
Electric production fuels	127,476	126,957	119,817	122,908	107,283
Purchased power	12,262	22,764	34,230	19,225	13,934
Purchased gas	66,763	112,364	111,694	112,574	104,046
Other operation	101,545	96,191	91,776	87,545	81,420
Maintenance	34,807	33,673	30,827	29,855	28,005
Depreciation (Notes 1h and 1j) —					
Straight-line	45,139	50,945	42,147	37,144	36,145
Deferred income taxes	13,449	12,589	11,926	10,849	983
Taxes (Note 1j) —					
Current Federal income	31,082	30,232	21,055	26,447	32,331
Investment tax credit —					
Deferred	361	6,436	10,437	8,809	9,711
Restored	(3,373)	(3,539)	(2,751)	(2,555)	(2,500)
Current state income	5,978	4,936	6,100	8,001	8,875
Other	22,931	14,975	22,251	19,887	17,573
	<u>480,440</u>	<u>508,523</u>	<u>499,509</u>	<u>480,689</u>	<u>437,806</u>
Net operating income	<u>88,606</u>	<u>80,408</u>	<u>75,967</u>	<u>74,813</u>	<u>74,671</u>
Other income and (deductions):					
Allowance for equity funds used during construction (Note 1d)	769	2,646	8,421	2,766	1,601
Other	694	(3,155)	(2,699)	(1,120)	(203)
Income tax benefit (expense)	1,005	1,650	126	1,459	(477)
	<u>2,468</u>	<u>1,141</u>	<u>5,848</u>	<u>3,105</u>	<u>921</u>
Income before interest expense	<u>91,274</u>	<u>81,549</u>	<u>81,815</u>	<u>77,918</u>	<u>75,592</u>
Interest expense:					
Interest on bonds	30,520	26,938	27,023	26,926	26,967
Allowance for borrowed funds used during construction (Note 1d)	(535)	(3,181)	(5,384)	(4,512)	(2,401)
Other (Note 4)	805	(2,936)	1,844	917	3,671
	<u>30,790</u>	<u>20,821</u>	<u>23,483</u>	<u>23,331</u>	<u>28,237</u>
Net income	<u>60,464</u>	<u>60,728</u>	<u>58,332</u>	<u>54,587</u>	<u>47,355</u>
Cash dividends on preferred stock	<u>3,814</u>	<u>4,360</u>	<u>4,780</u>	<u>4,963</u>	<u>5,099</u>
Earnings on common stock	<u>\$ 56,670</u>	<u>\$ 56,368</u>	<u>\$ 53,552</u>	<u>\$ 49,624</u>	<u>\$ 42,256</u>
Earnings per share of common stock (Note 1e)	<u>\$4.26</u>	<u>\$4.26</u>	<u>\$4.12</u>	<u>\$3.97</u>	<u>\$3.51</u>
Cash dividends paid per share of common stock ...	<u>\$2.90</u>	<u>\$2.70</u>	<u>\$2.52</u>	<u>\$2.36</u>	<u>\$2.20</u>

The accompanying notes are an integral part of the consolidated financial statements.

**Wisconsin Power and Light Company and Subsidiaries
Consolidated Balance Sheets**

	December 31,	
	1986	1985
Assets	<i>(In Thousands)</i>	
Utility plant (Notes 1c, 1d and 2):		
Plant in service —		
Electric	\$1,154,074	\$1,119,065
Gas	122,643	115,709
Water	15,064	14,763
Common	60,341	54,354
	<u>1,352,062</u>	<u>1,303,891</u>
Dedicated decommissioning fund (Note 1h)	20,000	—
	<u>1,372,062</u>	<u>1,303,891</u>
Less—Accumulated provision for depreciation (Note 1h)	<u>595,130</u>	<u>545,221</u>
	776,932	758,670
Construction work in progress	10,180	10,513
Nuclear fuel, net (Note 1f)	21,423	22,057
Total utility plant	<u>808,535</u>	<u>791,240</u>
Investments, at cost or less (Note 1b)	<u>16,221</u>	<u>16,024</u>
Current assets:		
Cash	790	1,424
Temporary cash investments, at lower of cost or market	3,500	—
Accounts receivable, less allowance for doubtful accounts of \$2,020,000 and \$2,284,000, respectively	48,282	53,889
Unbilled revenue (Note 1g)	37,869	48,046
Fossil fuel, at average cost (Note 6)	28,527	26,366
Materials and supplies, at average cost	18,892	18,208
Prepayments	15,409	14,583
	<u>153,269</u>	<u>162,516</u>
Deferred charges	<u>9,894</u>	<u>6,940</u>
TOTAL ASSETS	<u>\$ 987,919</u>	<u>\$ 976,720</u>
Capitalization and Liabilities		
Capitalization (See statements on page 27):		
Common shareowners' investment	\$ 383,926	\$ 365,650
Preferred stock without mandatory redemption	60,000	60,000
First mortgage bonds, net	333,182	302,877
Short-term debt expected to be refinanced (Note 3c)	—	30,000
Total capitalization	<u>777,108</u>	<u>758,527</u>
Current liabilities:		
First mortgage bonds to be retired (Note 3c)	12,726	—
Short-term debt (Notes 3c and 7)	6,000	20,100
Accounts payable	63,755	57,867
Accrued payroll and vacations	7,477	7,787
Accrued taxes	15,121	20,965
Accrued interest	7,114	9,671
Other	16,925	16,559
	<u>129,118</u>	<u>132,949</u>
Other credits:		
Accumulated deferred investment tax credits (Note 1j)	59,698	63,358
Other	21,995	21,886
	<u>81,693</u>	<u>85,244</u>
Construction commitments (Note 2)		
TOTAL CAPITALIZATION AND LIABILITIES	<u>\$ 987,919</u>	<u>\$ 976,720</u>

The accompanying notes are an integral part of the consolidated financial statements.

Wisconsin Power and Light Company and Subsidiaries Consolidated Statements of Changes in Cash

	Year Ended December 31,				
	1986	1985	1984	1983	1982
	(In Thousands)				
Operating activities:					
Net income	\$ 60,484	\$ 60,728	\$ 58,332	\$ 54,587	\$ 47,355
Items not affecting working capital:					
Depreciation	56,588	63,534	54,073	47,993	37,128
Investment tax credit deferred (restored), net	(3,660)	2,433	7,089	5,998	5,948
Amortization of nuclear fuel	5,776	6,230	7,086	12,748	16,786
Amortization of unbilled revenue	(1,231)	(1,291)	(1,291)	(1,290)	(1,291)
Equity component of allowance for funds used during construction (AFUDC)	(769)	(2,646)	(8,421)	(2,766)	(1,601)
Other	1,916	1,956	1,889	2,906	2,826
Working capital provided by operations	121,106	130,944	118,757	120,176	107,151
Cash dividends on stock	(42,200)	(40,099)	(37,417)	(34,389)	(31,518)
Working capital generated internally	78,906	90,845	81,340	85,787	75,633
Changes in working capital other than cash:					
Accounts receivable	5,607	(6,153)	3,433	(8,065)	(5,805)
Unbilled revenue	10,177	(8,538)	5,301	(10,340)	816
Fossil fuel	(2,161)	832	(5,671)	5,468	4,495
Materials and supplies	(664)	(1,878)	(3,244)	(1,331)	(41)
Prepayments	(826)	(13,508)	(371)	32	(212)
Accounts payable	5,888	8,724	(17,815)	8,818	18,310
Accrued taxes	(5,844)	4,484	(1,444)	(12,521)	3,034
Accrued interest	(2,557)	556	(1,735)	1,147	(126)
Other	56	71	5,183	1,607	(5,785)
Cash generated internally	88,562	75,435	64,977	70,602	90,319
Financing activities:					
Sale of first mortgage bonds	88,000	—	8,500	—	—
Sale of common stock	—	—	12,614	11,989	9,780
Net change in total short-term debt and temporary cash investments	(47,600)	19,000	20,100	6,000	5,000
Bond maturities, redemptions and sinking fund retirements	(44,704)	(742)	(13,276)	(5)	(5,030)
Preferred stock redemptions	—	(6,672)	(1,531)	(1,511)	(636)
Net change in pollution control construction fund	—	3,326	4,621	5,133	1,592
	(4,304)	14,912	31,028	21,606	10,706
Construction and nuclear fuel expenditures:					
Additions to utility plant, excluding AFUDC	(56,943)	(62,010)	(81,921)	(85,706)	(87,388)
Additions to nuclear fuel	(6,936)	(4,878)	(9,791)	(6,833)	(12,645)
Dedicated decommissioning fund (Note 1h)	(20,000)	—	—	—	—
Payments for nuclear fuel disposal	—	(15,369)	—	—	—
AFUDC	(1,304)	(5,827)	(13,805)	(7,278)	(4,002)
	(85,183)	(88,084)	(105,517)	(99,817)	(104,035)
Other activities	291	(1,700)	9,642	5,826	4,807
Changes in cash	\$ (634)	\$ 563	\$ 130	\$ (1,783)	\$ 1,797

The accompanying notes are an integral part of the consolidated financial statements.

Wisconsin Power and Light Company and Subsidiaries Consolidated Statements of Capitalization

	December 31,	
	1986	1985
	<i>(In Thousands)</i>	
Common shareowners' investment (Note 3a):		
Common stock, \$5 par value, authorized — 18,000,000 shares; issued and outstanding — 13,236,601 shares	\$ 66,183	\$ 66,183
Premium on capital stock	111,052	111,052
Capital surplus	1,747	1,747
Reinvested earnings	204,044	186,668
Total common shareowners' investment	383,928	365,650
Preferred stock without mandatory redemption (Note 3b):		
Cumulative, without par value, authorized 3,750,000 shares, maximum aggregate stated value \$150,000,000; issued and outstanding 600,000 shares, \$100 stated value:		
4.50% series, 100,000 shares outstanding	10,000	10,000
4.80% series, 75,000 shares outstanding	7,500	7,500
4.96% series, 65,000 shares outstanding	6,500	6,500
4.40% series, 30,000 shares outstanding	3,000	3,000
4.76% series, 30,000 shares outstanding	3,000	3,000
8.48% series, 150,000 shares outstanding	15,000	15,000
7.56% series, 150,000 shares outstanding	15,000	15,000
Total preferred stock	60,000	60,000
First mortgage bonds, net (Note 3c):		
Series J, 4 $\frac{5}{8}$ %, due 1989	6,303	7,803
Series K, 4 $\frac{1}{4}$ %, due 1992	4,437	4,437
Series L, 6 $\frac{1}{4}$ %, due 1998	9,299	20,229
Series M, 8%, due 1999	24,509	24,509
Series N, 8 $\frac{7}{8}$ %, due 2000	24,900	24,900
Series O, 8%, due 2001	29,995	29,995
Series P, 8 $\frac{7}{8}$ %, due 2004	35,000	35,000
1975 Series A, 7 $\frac{3}{4}$ %, due 1991-2005	16,000	16,000
1975 Series B, 7 $\frac{3}{4}$ %, due 2000	875	875
1975 Series C, 7 $\frac{3}{4}$ %, due 2000	1,000	1,000
Series Q, 8 $\frac{7}{8}$ %, due 2006	35,000	35,000
Series R, 9 $\frac{1}{8}$ %, due 2008	35,000	35,000
1980 Series A, 8%, due 2000	9,000	9,000
1980 Series A, 8 $\frac{1}{4}$ %, due 2007-2010	7,000	7,000
Series S, 13 $\frac{3}{8}$ %, due 1991	—	45,000
1984 Series A, floating rate, due 2014 (6% at December 31, 1986)	8,500	8,500
1986 Series T, 10% due 2016	50,000	—
1986 Series U, 8% due 1991	38,000	—
	334,818	304,248
Unamortized discount and premium, net	(1,636)	(1,371)
Total first mortgage bonds, net	333,182	302,877
Short-term debt expected to be refinanced (Note 3c)	—	30,000
TOTAL CAPITALIZATION	\$777,198	\$758,527

The accompanying notes are an integral part of the consolidated financial statements.

Wisconsin Power and Light Company and Subsidiaries
Consolidated Statements of Common Shareowners' Investment

	Year Ended December 31,				
	1986	1985	1984	1983	1982
	<i>(In Thousands)</i>				
Common stock:					
Balance at beginning of year	\$66,183	\$66,183	\$63,787	\$61,418	\$59,177
Par value of common stock issued	—	—	2,396	2,369	2,241
Balance at end of year	<u>66,183</u>	<u>66,183</u>	<u>66,183</u>	<u>63,787</u>	<u>61,418</u>
Premium on capital stock:					
Balance at beginning of year	111,052	111,018	100,834	91,222	83,678
Excess of amount received over par value of common stock issued and other	—	34	10,184	9,612	7,544
Balance at end of year	<u>111,052</u>	<u>111,052</u>	<u>111,018</u>	<u>100,834</u>	<u>91,222</u>
Capital surplus:					
Balance at beginning and end of year	<u>1,747</u>	<u>1,747</u>	<u>1,747</u>	<u>1,747</u>	<u>1,747</u>
Reinvested earnings:					
Balance at beginning of year	186,663	166,368	145,501	125,310	109,505
Add — Net income	<u>60,484</u>	<u>60,728</u>	<u>58,332</u>	<u>54,587</u>	<u>47,355</u>
	<u>247,152</u>	<u>227,096</u>	<u>203,833</u>	<u>179,897</u>	<u>156,860</u>
Deduct —					
Cash dividends on preferred stock	3,814	4,360	4,780	4,963	5,099
Cash dividends on common stock	<u>38,386</u>	<u>35,739</u>	<u>32,637</u>	<u>29,426</u>	<u>26,419</u>
Expense of issuing common stock and other	<u>8</u>	<u>329</u>	<u>48</u>	<u>7</u>	<u>32</u>
	<u>42,208</u>	<u>40,428</u>	<u>37,465</u>	<u>34,396</u>	<u>31,550</u>
Balance at end of year	<u>204,944</u>	<u>186,668</u>	<u>166,368</u>	<u>145,501</u>	<u>125,310</u>
TOTAL COMMON SHAREOWNERS' INVESTMENT (Note 5)	<u>\$383,926</u>	<u>\$365,650</u>	<u>\$345,316</u>	<u>\$311,869</u>	<u>\$279,697</u>

The accompanying notes are an integral part of the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES:

a. **Accounting Policies:**

Our books and records are maintained in accordance with the uniform systems of accounts prescribed by our regulators. The Public Service Commission (PSC) of Wisconsin and the Illinois Commerce Commission have jurisdiction over our retail rates, and the Federal Energy Regulatory Commission (FERC) has jurisdiction over our wholesale rates.

b. **Consolidation and Investment in Subsidiaries:**

The consolidated financial statements include the Company and its wholly owned consolidated subsidiaries — South Beloit Water, Gas and Electric Co. and Wisconsin Power and Light Nuclear Fuel, Inc. Other subsidiaries are accounted for on the equity method and are not material. All significant inter-company transactions and accounts have been eliminated in these statements.

c. **Utility Plant:**

Utility plant is recorded at original cost. Such cost includes material, labor, overhead and an allowance for funds used during construction. Normal repairs and replacements of minor items are charged to maintenance expense. The costs of depreciable property retired, including removal costs less salvage value, are charged to accumulated depreciation upon removal from utility plant accounts. Thus, no gain or loss is recognized in connection with the ordinary retirement of depreciable utility property. Substantially all of the Company's utility plant is pledged as security for its first mortgage bonds. The Company has no material leases.

d. Allowance for Funds Used During Construction (AFUDC):

AFUDC represents the interest cost of borrowed funds and the imputed cost of equity funds used for construction and does not contribute to the current cash flow of the Company.

Prior to the October 1984 Wisconsin retail rate order, the Company was limited to a 7 percent AFUDC rate on retail construction work in progress (CWIP) not included in rate base, representing approximately 30 percent of CWIP. Effective with the October 1984 order, the Company capitalized AFUDC at 11.05 percent on qualifying CWIP not included in rate base, representing approximately 90 percent of CWIP. In accordance with the Company's 1985 retail rate order, effective September 1985, the Company capitalized AFUDC at 11.45 percent on all qualifying CWIP. In accordance with the Company's latest retail rate order, effective August 1986, the Company is capitalizing AFUDC at 10.93 percent on all qualifying CWIP.

For its wholesale jurisdiction, the Company capitalized AFUDC on qualifying CWIP at 10.6 percent, 10.13 percent, 11.29 percent and 7 percent for the years 1986, 1985, 1984 and prior to 1984, respectively.

e. Earnings Per Share:

Earnings per share of common stock are computed by dividing earnings on common stock by the weighted average number of common shares outstanding, which were:

	(In Thousands)
1986	13,237
1985	13,237
1984	12,998
1983	12,507
1982	12,043

f. Nuclear Fuel:

Nuclear fuel is recorded as an asset at its original cost and is charged to expense based upon the quantity of heat produced for the generation of electricity. Estimated future disposal costs of such fuel are expensed based on kilowatthours (kWhs) generated. Under the Nuclear Waste Policy Act of 1982, the U.S. Department of Energy (DOE) is responsible for the ultimate storage and disposal of spent nuclear fuel removed from nuclear reactors. Disposal costs are recovered in rates charged for electric utility service.

Net nuclear fuel consists of:

	December 31,	
	1986	1985
	(In Thousands)	
Original cost of nuclear fuel ...	\$98,805	\$91,772
Accumulated amortization	77,382	69,715
Net nuclear fuel	<u>\$21,423</u>	<u>\$22,057</u>

Accumulated amortization includes the income tax effects of using liberalized depreciation methods and assumes that plutonium and uranium in the spent nuclear fuel will have no residual value.

Nuclear fuel obtained from NUFUS Resources, Inc. is recorded at cost, which includes the cost of operations of this subsidiary.

g. Revenue:

The Company accrues estimated utility revenues for services rendered but not yet billed at each month end.

Starting in 1986, approximately 50 industrial gas customers began purchasing their gas directly from suppliers and transporting it through the Company's distribution system at applicable transportation rates. Transportation rates are designed to recover all costs of gas distribution and a return on gas plant investment. This transportation of gas by the Company, instead of purchasing gas from suppliers and reselling it to industrial customers, results in equal reductions to gas revenues and purchased gas expense but retains the contribution to earnings. During 1986 approximately 10% of gas sales were transportation sales and should be considered when comparing gas revenues with prior years.

h. Depreciation:

Straight-line — The Company allocates the cost of utility plant over the useful life of such plant through depreciation expense. Straight-line depreciation is computed on the average balance of depreciable property at individual straight-line rates, approved by the PSC, applied to various classes of property. Effective January 1, 1986 lower straight-line rates ordered by the PSC decreased annual depreciation expense an estimated \$3.2 million. The annual composite rates were:

	Electric	Gas	Water	Common
1986	3.3%	3.9%	2.5%	6.5%
1985	4.2%	4.2%	2.3%	6.3%
1984	4.3%	4.2%	2.2%	6.1%
1983	4.0%	4.2%	2.2%	5.9%
1982	3.8%	4.2%	1.9%	5.8%

Depreciation expense related to the Kewaunee Nuclear Plant includes a provision for decommissioning the plant. During 1986, Wisconsin utilities operating nuclear generating plants were required by the PSC to establish external trust funds to provide for the decommissioning of such plants and to deposit current and previously collected funds in such trust funds. During 1986 the Company established a dedicated \$20 million decommissioning fund from proceeds of a bond issue (See "Notes to Consolidated Financial Statements," Note 3) pending establishment of the external trust funds, determination by the Internal Revenue Service of the tax deductibility of deposits to the trust funds and further direction by the PSC. The Company anticipates such funds will be established in 1987 and all applicable amounts (currently \$20 million at December 31, 1986) will be deposited in the trust fund.

i. Retirement Plans:

The Company has retirement plans for substantially all of its employees. Some employees participate in plans completely paid for by the Company, while other employees participate in plans in which they share the cost with the Company.

The Company's policy is to fund the retirement plans and to amortize the unfunded prior-service costs over a period of approximately 30 years.

Information related to the plans is presented below:

Summary Retirement Plans Information As of January 1,

	<u>1986</u>	<u>1985</u>	<u>1984</u>	<u>1983</u>	<u>1982</u>
	(In Thousands)				
Actuarial value of accumulated plan benefits:					
Vested	\$ 58,785	\$45,657	\$45,072	\$39,749	\$34,444
Nonvested	1,183	1,181	2,016	1,791	1,308
Total	<u>\$ 59,968</u>	<u>\$46,838</u>	<u>\$47,088</u>	<u>\$41,540</u>	<u>\$35,752</u>
Net assets available for benefits	<u>\$110,817</u>	<u>\$92,555</u>	<u>\$86,119</u>	<u>\$71,680</u>	<u>\$55,464</u>
Total plan provisions (credit) for the year	<u>\$ (384)</u>	<u>\$,869</u>	<u>\$ 2,756</u>	<u>\$ 3,600</u>	<u>\$ 4,248</u>

Pension expense decreased for 1986, reflecting the favorable earnings on trust fund assets and was partially offset by plan amendments.

The average retirement age assumption is 63 for 1986 and 1985 and 63.5 prior to 1985. In addition, the assumed investment rate is 8.75 percent for 1986 and 1985 and 7.5 percent prior to 1985.

The Financial Accounting Standard Board's Statement No. 87, "Employers' Accounting for Pensions" (FASB 87), will be effective January 1, 1987, for the Company for financial reporting purposes. FASB 87 requires standardized methods for measuring net periodic pension costs and expanded disclosure of the components of net periodic pension costs. The Company will conform its accounting for such pension costs

to the standardized methods in 1987 and the impacts of such a change on results of operations are expected to be minimal.

In addition to providing pension benefits, the Company provides certain health-care and life-insurance benefits for substantially all employees who reach early or normal retirement age while working for the Company. The estimated cost for such benefits, \$314,000, \$660,000 and \$715,000 for 1986, 1985 and 1984, respectively, is accrued and charged to expense as a level percentage of their payroll costs over the working lives of those employees expected to qualify for such benefits. The Company's policy is to fund the unfunded actuarial accrued liability over 20 years.

j. Income Taxes:

Depreciation expenses computed for tax purposes reflect the use of various available liberalized depreciation methods. Under PSC rules, the estimated reduction of federal income taxes due to the use of these practices is recorded as additional depreciation, described as deferred income taxes in the income statement. Beginning in October 1984, the state income tax effects of such timing differences are flowed through currently.

The amounts recorded as deferred income tax and the cumulative balances were:

	<u>Federal</u>	<u>State</u>	<u>Total</u>	<u>Year-End Balances</u>
	(In Thousands)			
1986	\$14,053	\$(603)	\$13,450	\$144,676
1985	\$13,068	\$(479)	\$12,589	\$131,226
1984	\$11,579	\$ 347	\$11,926	\$118,637
1983	\$10,133	\$ 716	\$10,849	\$106,711
1982	\$ 843	\$ 140	\$ 983	\$ 95,862

Deferred income taxes increased over the last three years primarily due to depreciable plant additions for

tax purposes. In 1983, deferred income taxes increased significantly due to the deduction of the DOE nuclear fuel disposal costs and increased federal repair allowance costs. In 1982, the reduction of income taxes was due to increased straight-line depreciation expense and increased amortization of nuclear fuel.

The Tax Reform Act of 1986 contains numerous provisions, including the reduction of the maximum corporate tax rate from 46% to 40% in 1987 and 34% thereafter, as well as the elimination of the investment tax credit effective January 1, 1986. It is anticipated that the impacts of the act will be included in future rates, either starting with the Company's next rate order or by special order.

As of December 31, 1986, \$16.8 million of deferred income taxes at the 46% rate (approximately \$12.8 million at the 34% rate) has not been provided on cumulative income tax timing differences of \$36.5 mil-

lion. These amounts are recoverable in rates under current regulatory policies.

The Company formerly received tax credits from the federal government for investing in certain types of property. The investment tax credit for this property was repealed, as noted above, except for certain transitional property. The benefits of these former investment tax credits are being spread over the useful lives of the property.

Certain costs have been capitalized for financial-reporting purposes, but deducted for income-tax purposes. The tax benefit of these items is used to reduce the income-tax provision in the period the costs are incurred.

The Company's effective income-tax rate can be computed by dividing total income-tax expense, investment tax credits deferred and restored, and deferred income taxes by the sum of such expense and net income. The following table reconciles the effective income-tax rate to the statutory federal income-tax rate:

	<u>1986</u>	<u>1985</u>	<u>1984</u>	<u>1983</u>	<u>1982</u>
Effective income-tax rate	43.5%	44.7%	44.4%	47.9%	51.3%
Allowance for funds used during construction, which does not constitute current taxable income5	2.5	5.5	3.2	1.9
State income taxes and state additional depreciation, net	(2.2)	(1.9)	(3.5)	(4.7)	(5.1)
Reversals of various plant-related timing differences for which deferred taxes had not been provided	(1.8)	(2.5)	(2.0)	(2.0)	(2.0)
Investment tax credits restored	3.1	3.2	2.6	2.4	2.6
Other differences, net	2.9	—	(1.0)	(0.8)	(2.7)
Statutory federal income-tax rate	<u>46.0%</u>	<u>46.0%</u>	<u>46.0%</u>	<u>46.0%</u>	<u>46.0%</u>

NOTE 2. JOINTLY OWNED UTILITY PLANTS AND CONSTRUCTION COMMITMENTS:

The Company participates with other Wisconsin utilities in the construction and operation of several jointly owned electric plants. The chart below represents the Company's proportionate share of such plants as of December 31, 1986:

	<u>Ownership Interest</u>	<u>Plant in Service</u>	<u>Accumulated Provision For Depreciation</u>
		(In Thousands)	
Coal:			
Columbia Energy Center	46.2%	\$153,277	\$ 74,360
Edgewater Unit 4	68.2%	44,556	22,404
Edgewater Unit 5	75.0%	231,563	32,524
Nuclear:			
Kewaunee Nuclear Plant	41.0%	<u>113,612</u>	<u>79,109</u>
TOTAL		<u>\$543,008</u>	<u>\$208,397</u>

The Company's share of operations and maintenance expenses is included in the appropriate expense categories in the income statements.

Utility plant construction and net removal costs expenditures for 1987 are estimated to be \$79.5 million, and substantial commitments have been incurred in connection with such expenditures.

NOTE 3. CAPITALIZATION:

a. Common Stock:

Shares of common stock were issued by the Company through its Dividend Reinvestment and Stock Purchase Plan (DR Plan) and Employee Stock Ownership Plan (ESOP) for 1982 through 1984.

A retail rate order issued by the PSC in October 1984 required that no new shares of stock be issued under the Company's DR Plan after January 1, 1985. Accordingly, the Company changed the DR Plan to an open-market-purchase plan effective that date and issued no new shares of common stock during 1985 and 1986. During the period 1982 thru 1984, 448,000, 474,000 and 479,000 new shares of common stock were issued, respectively, and generated proceeds of \$9.8 million, \$12.0 million and \$12.6 million, respectively.

b. Preferred Stock:

There were no issues of preferred stock during the five years ended December 31, 1986. Pursuant to a 1985 PSC order, the Company called and retired all of the remaining 12% preferred stock during 1985.

c. Bonds:

On February 11, 1986, the Company issued \$50 million of First Mortgage Bonds, Series T, 10%, due February 1, 2016, and on June 12, 1986, issued \$38 million of First Mortgage Bonds, Series U, 8%, due June 1, 1991. The Series T bonds were used for

general corporate purposes, including payment of short-term borrowings and funding of a dedicated fund of \$20 million for nuclear plant decommissioning costs. Accordingly, \$30 million of short-term debt (representing the balance of this bond issue) as of December 31, 1985, was classified as long-term. The Series U bond proceeds also were applied to general corporate purposes, including retirement of outstanding First Mortgage Bonds, Series S, 13 $\frac{3}{8}$ %, due February 1, 1991. As of December 31, 1986, \$32,274,000 principal amount of Series S Bonds had been purchased by the Company and retired. The Company purchased and retired the remaining Series S Bonds (approximately \$12.7 million at December 31, 1986) either through purchase on the open market or through redemption on February 1, 1987, and, accordingly, such bonds were classified as short-term at December 31, 1986. Pursuant to PSC ratemaking, redemption premium and costs incurred to retire the Series S Bonds totaling \$1.6 million at December 31, 1986, have been deferred and are being amortized to expense over the life of the Series U Bonds.

Bond sinking fund requirements for the next five years not satisfied as of December 31, 1986, include \$9.5 million in each of the years 1988, 1989 and 1990 and \$.7 million in 1991. Bonds maturing for the next five years include \$6.3 million in 1989 and \$9.5 million in 1991.

NOTE 4. OTHER INTEREST EXPENSE:

On August 29, 1985, the PSC issued a final retail rate order that contained a provision for recovery over five years of interest charges paid on income tax deficiencies. As a result, the Company discontinued expensing such items and reversed all previous interest accruals, increasing earnings per share by approximately 23 cents in 1985.

NOTE 5. PROPOSED RESTRUCTURING:

In 1985 the Wisconsin Legislature approved and the governor signed into law a bill providing for the regulation of utilities that diversify through a holding-company structure. On November 17, 1986, the Company filed an application with the PSC seeking authority to form a parent holding company. It is anticipated that the

proposal will be presented to the shareowners for vote at the Annual Meeting of shareowners, to be held April 22, 1987. The proposed holding-company structure is also subject to receipt of other necessary regulatory approvals, favorable tax rulings and other legal requirements.

NOTE 6. ACID RAIN REGULATION:

In April 1986 new acid rain legislation was enacted that established system-wide sulfur-dioxide emission limits for all utilities in the state. Under the legislation, the Company estimates that it will be required to make additional capital expenditures prior to January 1, 1993, of not more than \$9.8 million for pollution-control equipment and to incur additional annual fuel costs in 1993 and 1994, principally to pay for lower-sulfur coal, of not more than \$50 million (including demand charges for coal contracts for the Columbia 1 and Edgewater 4 plants, which the Company is required to pay even if it

is unable to fully utilize all contracted quantities due to the new law) and \$35 million thereafter. In the opinion of management, it exercised reasonable and prudent management judgment in entering into such contracts and, therefore, any such costs incurred to meet mandatory emission limits would be considered a legitimate cost-of-service item subject to recovery in rates. The Company has established a planning team to review coal supplies and emerging technologies in order to manage and reduce these projected impacts.

NOTE 7. SHORT-TERM DEBT AND LINES OF CREDIT:

The Company maintains bank lines of credit to obtain short-term borrowing flexibility. The Company either pays commitment fees, maintains compensating balances, or a combination of both. Compensating balances are average bank deposits that earn no interest. There are no legal restrictions on withdrawal of these funds. In accordance with normal banking practice, such unused lines of credit may generally be withdrawn at the discretion of the lenders. Information regarding short-term borrowings and lines of credit is as follows:

	<u>1986</u>	<u>1985</u>
	(In Thousands)	
As of end of year —		
Average interest rate on outstanding short-term borrowings	7.98%	7.96%
Unused lines of credit	\$30,000	\$65,200
Commercial paper outstanding	—	\$36,100
Notes payable to financial institutions	\$ 6,000	\$14,000
For the year ended —		
Maximum month-end amount of short-term borrowings	\$30,000	\$50,100
Average amount of short-term borrowings (based on daily outstanding balances)	\$ 5,188	\$30,244
Average interest rate on short-term borrowings ..	7.92%	8.11%

The above amounts include \$30 million classified as long-term debt as of December 31, 1985. See Note 3c.

The average interest rate was computed by dividing total short-term interest expense for the period by the average amount of such borrowings outstanding.

NOTE 8. SEGMENT INFORMATION:

The following table sets forth certain information relating to the Company's consolidated operations.

	Year Ended December 31,				
	1986	1985	1984	1983	1982
	(In Thousands)				
OPERATION INFORMATION:					
Customer sales —					
Electric	\$436,047	\$431,333	\$424,212	\$405,637	\$370,074
Gas	127,144	152,106	146,134	144,627	137,508
Water	4,005	4,004	3,655	3,368	3,223
Interdepartmental sales —					
Electric	986	981	792	829	789
Gas	1,057	482	675	1,036	880
Water	7	25	8	5	3
Total operating revenues	<u>\$569,246</u>	<u>\$588,931</u>	<u>\$575,476</u>	<u>\$555,502</u>	<u>\$512,477</u>
Operating profit —					
Electric	\$126,616	\$117,224	\$112,131	\$116,264	\$113,068
Gas	8,426	12,306	9,373	8,984	9,942
Water	1,281	1,532	1,230	1,116	1,061
Income taxes, current and deferred (see Note 1j)	(47,517)	(50,654)	(46,767)	(51,551)	(49,400)
Other income and deductions, net	2,468	1,141	5,848	3,105	921
Interest expense, net	(30,790)	(20,821)	(23,483)	(23,331)	(28,237)
Net income per consolidated statements of income	<u>\$ 60,484</u>	<u>\$ 60,728</u>	<u>\$ 58,332</u>	<u>\$ 54,587</u>	<u>\$ 47,355</u>
INVESTMENT INFORMATION:					
Identifiable assets including allocated common plant at Dec. 31 —					
Electric	\$041,334	\$827,309	\$802,074	\$757,608	\$720,180
Gas	101,331	107,084	99,273	100,372	90,777
Water	11,978	11,720	11,013	10,617	10,208
Assets not allocated (cash, prepayments and other)	33,276	30,607	12,742	12,570	12,781
Total assets	<u>\$987,919</u>	<u>\$976,720</u>	<u>\$925,102</u>	<u>\$881,167</u>	<u>\$833,946</u>
OTHER INFORMATION:					
Construction and nuclear fuel expenditures —					
Electric	\$74,917	\$ 77,276	\$ 96,759	\$ 92,402	\$ 95,141
Gas	9,453	9,698	8,024	6,604	8,069
Water	813	1,110	734	811	825
Total construction and nuclear fuel expenditures	<u>\$ 85,183</u>	<u>\$ 88,084</u>	<u>\$105,517</u>	<u>\$ 99,817</u>	<u>\$104,035</u>
Provision for straight-line depreciation —					
Electric	\$ 39,703	\$ 45,575	\$ 37,141	\$ 32,433	\$ 31,718
Gas	5,033	5,023	4,687	4,419	4,160
Water	403	347	319	292	267
Total provision for straight-line depreciation	<u>\$ 45,139</u>	<u>\$ 50,945</u>	<u>\$ 42,147</u>	<u>\$ 37,144</u>	<u>\$ 36,145</u>

NOTE 9. CONSOLIDATED QUARTERLY FINANCIAL DATA (Unaudited):

Seasonal factors significantly affect utilities and, therefore, the data presented below should not be expected to be comparable between quarters. Quarterly data is not necessarily indicative of the results to be expected for an annual period.

Quarter Ended	Operating Revenues	Net Operating Income	Net Income	Earnings on Common Stock	Earnings Per Share of Common Stock
(In Thousands except for Per Share Data)					
1986:					
March 31	\$170,202	\$25,467	\$17,597	\$16,643	\$1.26
June 30	\$123,759	\$16,740	\$ 9,525	\$ 8,571	\$0.65
September 30	\$126,157	\$21,209	\$14,063	\$13,109	\$0.99
December 31	\$149,127	\$25,390	\$19,300	\$18,346	\$1.39
1985:					
March 31	\$169,990	\$22,348	\$19,644	\$18,469	\$1.40
June 30	\$125,619	\$15,288	\$ 8,018	\$ 6,857	\$0.52
September 30	\$127,434	\$18,045	\$16,974	\$15,902	\$1.20
December 31	\$165,889	\$24,726	\$16,093	\$15,140	\$1.14

Five-Year Comparative Data

	Year Ended December 31,					Four-Year Change	
	1986	1985	1984	1983	1982	Amount	Percent
CONSOLIDATED ELECTRIC STATISTICS							
Customers served (end of period):							
Residential and rural	283,977	281,056	277,521	274,253	270,924	13,053	4.8%
Industrial	576	560	534	511	495	81	16.4
Commercial	37,573	36,830	35,905	35,019	34,450	3,123	9.1
Wholesale	37	37	37	42	41	(4)	(9.8)
Class A	6	6	6	6	6	—	—
Other	916	908	892	893	915	1	0.1
Total	323,085	319,397	314,895	310,724	306,831	16,254	5.3%
Sales — kilowatthours (in thousands):							
Residential and rural	2,288,790	2,276,424	2,222,626	2,232,331	2,153,905	134,885	6.3%
Industrial	2,489,158	2,430,487	2,337,477	2,134,768	1,932,986	556,172	28.8
Commercial	1,344,783	1,319,511	1,273,430	1,232,932	1,171,030	173,753	14.8
Wholesale	1,577,405	1,468,945	1,465,144	1,379,151	1,288,842	288,563	22.4
Class A	958,587	1,235,951	1,235,939	691,796	365,871	592,716	162.0
Other	56,230	60,578	54,874	58,759	57,241	(1,011)	(1.8)
Total	8,714,953	8,791,896	8,589,490	7,729,737	6,969,875	1,745,078	25.0%
Electric operating revenues (in thousands):							
Residential and rural	\$157,611	\$154,416	\$149,734	\$152,075	\$143,236	\$ 14,375	10.0%
Industrial	107,477	105,518	99,996	94,587	86,122	21,355	24.8
Commercial	84,953	82,341	80,588	80,566	75,856	9,097	12.0
Wholesale	62,019	55,393	54,831	51,893	47,061	14,958	31.8
Class A	17,802	27,526	33,299	19,398	11,543	6,259	54.2
Other	7,171	7,120	6,556	7,947	7,045	126	1.8
Total	\$437,033	\$432,314	\$425,004	\$406,466	\$370,863	\$ 66,170	17.8%
System capacity — at time of system peak (kW):							
Company plants (including jointly owned)	1,901,000	1,889,100	1,621,100	1,637,200	1,631,000	270,000	16.6%
Firm purchased power	60,000	41,700	162,700	184,700	157,700	(97,700)	(62.0)
Total	1,961,000	1,930,800	1,783,800	1,821,900	1,788,700	172,300	9.6
System peak demand	1,470,000	1,371,000	1,427,000	1,403,000	1,252,000	218,000	17.4
Reserve margin at time of peak	491,000	559,800	356,800	418,900	536,700	(45,700)	(8.5%)
CONSOLIDATED GAS STATISTICS:							
Customers served (end of period):							
Residential	99,713	97,436	95,159	93,498	92,289	7,424	8.0%
Commercial firm	11,786	11,472	11,167	10,812	10,655	1,131	10.6
Industrial firm	383	383	372	384	382	1	0.3
Interruptible	109	139	139	144	143	(34)	(23.8)
Transportation	51	—	—	—	—	51	100.0
Total	112,042	109,430	106,837	104,838	103,469	8,573	8.3%
Sales — therms (in thousands):							
Residential	101,808	106,424	101,846	101,427	106,587	(4,779)	(4.5%)
Commercial firm	59,998	63,786	59,783	58,284	63,025	(3,027)	(4.8)
Industrial firm	21,245	25,764	26,510	25,757	23,641	(2,396)	(10.1)
Interruptible	40,391	72,024	72,449	64,425	65,293	(24,902)	(38.1)
Interdepartmental sales	2,444	1,033	1,329	2,252	1,378	1,066	77.4
Transported gas	25,098	122	—	—	—	25,098	100.0
Total	250,984	269,153	261,917	252,145	259,924	(8,940)	(3.4%)
Gas operating revenues (in thousands):							
Residential	\$ 86,082	\$ 70,758	\$ 66,763	\$ 66,359	\$ 61,660	\$ 4,422	7.2%
Commercial firm	32,270	34,832	34,566	34,072	32,576	(306)	(0.9)
Industrial firm	10,675	14,999	13,969	14,577	12,278	(1,603)	(13.1)
Interruptible	15,453	31,025	30,463	28,998	28,174	(12,721)	(45.2)
Interdepartmental sales and other	1,449	966	1,048	1,657	3,700	(2,251)	(60.8)
Transported gas	2,272	8	—	—	—	2,272	100.0
Total	\$128,201	\$152,588	\$146,809	\$145,663	\$138,388	\$(10,187)	(7.4%)
Maximum daily sendout — therms (in thousands)							
	1,856	2,070	2,043	2,077	2,031	(175)	(8.6%)

OFFICERS

As of December 31, 1986

(Date in parenthesis indicates year the person joined WP&L)

James R. Underkofler, 63 (1941)

Chairman of the Board,
President and Chief Executive Officer

Erroll B. Davis, Jr., 42 (1978)

Executive Vice President

Eugene O. Gehl, 63 (1985)

Executive Vice President and
General Counsel

William L. Keepers, 48 (1962)

Executive Vice President

Robert A. Carlsen, 62 (1951)

Vice President - Customer Service and
Corporate Communications

David E. Ellestad, 46 (1960)

Vice President - Electrical Engineering
and Procurement

Edward M. Gleason, 46 (1977)

Vice President - Finance and Treasurer

William D. Harvey, 37 (1986)

Vice President - Associate General Counsel

James E. Johnson, 54 (1960)

Vice President - Natural Gas

Edward F. Killeen, 56 (1976)

Vice President - Administration

William C. Register, 58 (1954)

Vice President - Power Production and
System Planning

Thomas L. Consigny, 52 (1968)

Assistant Vice President - Public Affairs

Edward G. Young, Jr., 47 (1986)

Controller

Thomas A. Landgraf, 38 (1979)

Corporate Secretary and Director of
Risk Management and Shareowner
Services

Mary Fujimoto, 57 (1971)

Assistant Secretary

Thomas M. Regner, 34 (1978)

Assistant Treasurer

MANAGEMENT

GENERAL OFFICE DEPARTMENT HEADS

Daniel L. Bartel

Director of Electrical Operations

James W. Bindl

Director of Human Resource Planning
and Development

Donald L. Brown

Director of Generation and System
Planning

James E. Emerick

Director of Budgets and Financial
Planning

John G. Fabie

Director of Electrical Engineering

George E. Gibert

Director of Gas Supply and Engineering

Daniel A. Gomez-Ibanez

Director of Strategic Business Planning

Richard M. Gregory

Director of Fuel Services

William J. Holewinski

Director of Generating Station
Engineering

Merlin E. Horn

Director of Environmental Affairs

Henry R. Hosterman

Director of Generating Station
Performance and Planning

Theodore J. Iltis

Director of Advanced Technology and
Nuclear Affairs

Glen R. Kielley

Director of Personnel

LuAnn G. Killeen

Director of Gas Marketing and Customer
Service

REGION MANAGERS

Duaine L. Mossman

Western Region (Madison)

Suzette M. Mullooly

Southern Region (Janesville)

DISTRICT MANAGERS

Thomas L. Adelman

Lake Geneva

Roger L. Baumann

Fond du Lac

Ronald L. Cowan

Baraboo

Philip E. Crawford

Mineral Point

John D. Grawe

Janesville

Jules A. Nicolet

Sheboygan

W. Keith Penniston

Berlin

Eliot G. Protsch

Dane County (Oregon)

GENERATING STATION MANAGERS

Norman E. Boys

Edgewater (Sheboygan)

Carl R. Diehls

Columbia (Portage)

William A. Frederick

Nelson Dewey (Cassville)

Paul F. Koeppe

Director of Electric Marketing and
Customer Service

John W. Laub

Director of Information and
Administrative Services

Robert G. Lindenau

Director of Safety and Real Estate

Thaddeus A. Miller

Director of Materials Management

Dale G. Moody

Director of Gas Operations

Donald R. Piepenburg

Director of Corporate Communications

David W. Thompson

Director of Generating Station Operations

Charlotte O. Woods

Director of Internal Audits

George E. Weunerlyn

Northern Region (Fond du Lac)

Kenneth L. Robenolt

Portage

Larry L. Studesville

Beloit

Michael J. Wish

Tomah

Kim K. Zuhlke

Beaver Dam

Thomas M. Schroeder

Blackhawk and Rock River (Beloit)

NON-UTILITY SUBSIDIARIES**RMT, INC.**

1406 E. Washington Ave.
Suite 124
Madison, WI 53703
608-255-2134

E. Brooks Becker

President

Thomas P. Kunes

Executive Vice President

John J. Reinhardt

Executive Vice President

WP&L COMMUNICATIONS, INC.

P.O. Box 192
222 W. Washington Ave.
Madison, WI 53701
608-252-3259

James R. Underkofler

President

David E. Ellestad

Vice President

Daniel A. Gomez-Ibanez

Secretary-Treasurer

ENSERV, INC.

P.O. Box 192
222 W. Washington Ave.
Madison, WI 53701
608-252-3257

James R. Underkofler

President

William L. Keepers

Vice President and Treasurer

Daniel A. Gomez-Ibanez

Secretary

1986 MANAGEMENT CHANGES

Wisconsin Power and Light Co.'s Board of Directors elected five new officers in 1986.

David E. Ellestad was elected Vice President - Electrical Engineering and Procurement. He had been Director of Electrical Engineering and Procurement.

James E. Johnson was elected Vice President - Natural Gas. He previously served as Director of Natural Gas.

Edward M. Gleason was elected Vice President - Finance and Treasurer. He had been Controller and Treasurer.

William D. Harvey was elected Vice President - Associate General Counsel. He previously was engaged in the private practice of law in Madison, Wis.

Edward G. Young, Jr., was elected Controller. He had been Administrator of the Division of State Finance and Program Management, Wisconsin Department of Administration. Young previously was Treasurer of General Telephone Companies of Wisconsin and Illinois.

Richard M. Gregory was named Director of Fuel Services. He previously served as Director of Purchases and Stores.

Thaddeus A. Miller was named Director of Materials Management. He had been District Manager at Lake Geneva. **Thomas L. Adelman** was named to succeed Miller. He previously served as Customer Service Administrator at Southern Region.

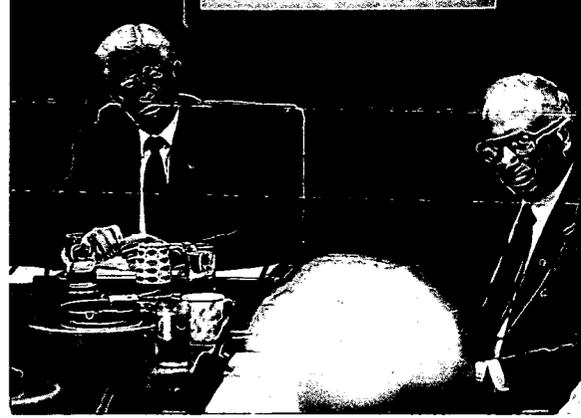
Kenneth L. Robenolt was named District Manager at Portage. Robenolt had been Manager, Monroe District. He succeeded **Felix J. Matarrese**, who retired with 39 years of service.



Katharine C. Lyall



Eugene O. Gehl



James R. Underkofler



Donald R. Haldeman



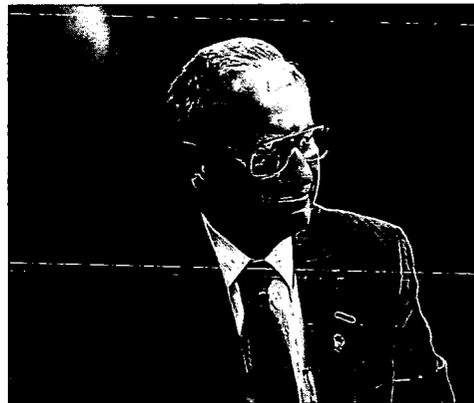
Henry F. Scheig



L. David Carley



Rockne G. Flowers



Henry C. Prange



COMMITTEES OF THE BOARD

The Audit Committee recommends the independent auditors to be selected by the shareowners at the Annual Meeting. The committee reviews with the independent auditors the scope and results of the audit and matters regarding the Company's financial-reporting and internal-accounting controls. It meets with the management and independent auditors to discuss and

review accounting and reporting principles, policies and practices to be used. Both the internal and the independent auditors periodically meet alone with the committee and have authority to contact it on any matters requiring its attention. The committee consists of all board members who are not employees or officers of the Company.

The Corporate Planning and Performance Committee examines corporate planning and performance, including the review of such items as sales and load forecasts, operating and construction plans and budgets, financing programs and rate-case matters. The committee consists of all members of the Board of Directors.

1986



Gerard E. Veneman



William L. Keepers

Erroll B. Davis, Jr.



Carol T. Toussaint



Milton E. Neshek

As of December 31, 1986

James R. Underkofler

Chairman of the Board, President and Chief Executive Officer, Wisconsin Power and Light Company
A WP&L director since 1965

L. David Carley

Partner, Carley Capital Group (a venture-capital group)
Washington, D.C.
A WP&L director since 1983; also was a WP&L director from 1975 to 1977

Erroll B. Davis, Jr.

Executive Vice President, Wisconsin Power and Light Company
A WP&L director since 1984

Rockne G. Flowers

President, Nelson Industries, Inc. (a muffler, filter and industrial-silencer manufacturing firm)
Stoughton, Wisconsin
A WP&L director since 1979

Eugene O. Gehl

Executive Vice President and General Counsel, Wisconsin Power and Light Company
A WP&L director since 1977

Donald R. Haldeman

President, Wisconsin Farm Bureau Federation (Wisconsin's largest general farm organization)
Madison, Wisconsin; and farm owner and operator, Norwalk, Wisconsin
A WP&L director since 1985

William L. Keepers

Executive Vice President, Wisconsin Power and Light Company
A WP&L director since 1984

Katharine C. Lyall

Executive Vice President, University of Wisconsin System
Madison, Wisconsin
Elected to the board in 1986

Milton E. Neshek

President and Chief Executive Officer, Godfrey, Pfeil & Neshek, S.C. (a law firm), Elkhorn, Wisconsin; and General Counsel and Assistant Secretary, Kikkoman Foods, Inc. (a food-products manufacturer)
Walworth, Wisconsin
A WP&L director since 1984

Henry C. Prange

Chairman of the Board, President and Chief Executive Officer, H. C. Prange Company (retail department stores)
Sheboygan, Wisconsin
A WP&L director since 1965

Henry F. Scheig

Chairman of the Board, Aid Association for Lutherans (a fraternal benefit society)
Appleton, Wisconsin
A WP&L director since 1980

Carol T. Toussaint

Consultant to the Wisconsin Academy of Sciences, Arts and Letters
Madison, Wisconsin
A WP&L director since 1976

Gerard E. Veneman

Director, Great Northern Nekoosa Corporation (a paper and pulp manufacturer and distributor)
Stamford, Connecticut; and retired Executive Vice President of Great Northern and President and Chief Executive Officer of one of its subsidiaries, Nekoosa Papers, Inc.
Port Edwards, Wisconsin
A WP&L director since 1980

The Personnel Committee functions as an executive review group, evaluating overall management performance and efficiency. The committee also reviews human-resource development and affirmative-action programs, benefit plans and changes and major provisions of negotiated employment contracts. It approves the salaries of officers

and managers. The committee consists of all board members who are not employees or officers of the Company and the chief executive officer as a non-voting member.

The Nominating Committee recommends to the board nominees for election to the board and reviews the appropriateness of present board members' continued membership on the board. The committee consists of the chief executive officer and two members of the board who are not employees or officers of the Company.

C O R P O R A T E P R O F I L E

Total assets \$988 million

Operating revenues \$569 million

Percentage of operating revenues

electric	76.8%
natural gas	22.5%
water	0.7%

Net income \$60 million

Customers

335,000 (electric, gas and water)

Service area

16,000 square miles in south-central Wisconsin — approximately one-third of the state

Full-time employees 2,560

Organization

- Corporate headquarters, Madison, Wis.
- Three regions
- 14 district offices
- Four coal-fired generating stations
- One dual-fuel (natural gas or coal) generating station
- Two hydroelectric generating stations
- One nuclear plant (jointly owned)

Total system capacity

1,901 megawatts

Percent of generation by fuel

coal	78.48%
nuclear	18.22%
hydroelectric	2.93%
natural gas	0.22%
oil	0.15%

Stock

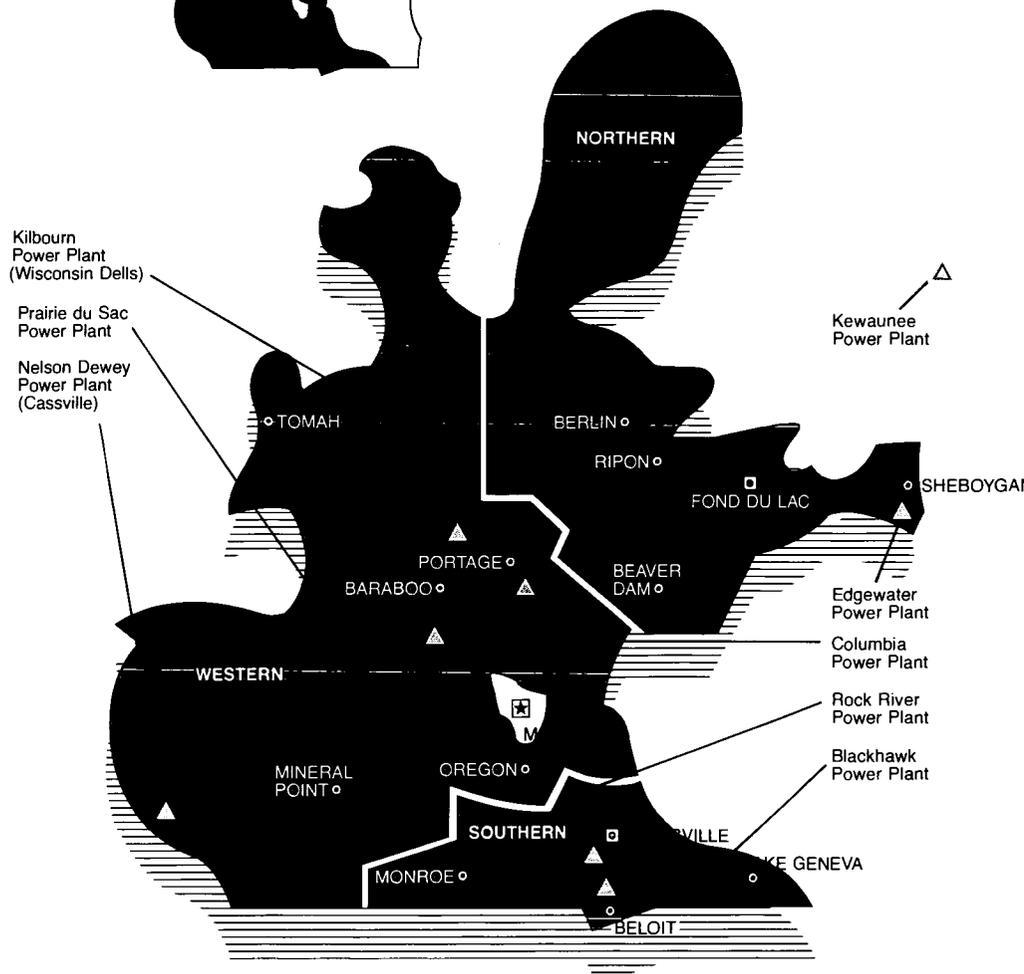
Earnings per share of common stock	\$4.28
Book value per share of common stock	\$29.00
Year-end stock price	\$50.00
Total shareowners	46,634
Percent of shareowners who are Wisconsin residents	
common	55%
preferred	80%
Average common-stock holding	356 shares
Holdings by individual investors	63% of total shares

Subsidiaries

- South Beloit Water, Gas & Electric Co. — 1926 — public utility
- NUFUS Resources, Inc. — 1976 — uranium mining
- RMT, Inc. — 1983 — environmental and engineering consulting
- ENSERV, Inc. — 1984 — energy services
- WP&L Communications, Inc. — 1985 — fiber optics



- ★ COMPANY HEADQUARTERS
- ⊠ REGION OFFICES
- DISTRICT OFFICES
- △ POWER PLANTS



*Editor: Mary Lynn Jartz, Wisconsin Power and Light Company
 Photographer: Douglas Wollin, Wisconsin Power and Light Company
 Designer: Paul Bruhn, Montzingo & Gustin Advertising, Ltd.*

On December 31, 1986, there were 46,634 shareowners of Wisconsin Power and Light Company. Whether you are a new shareowner of the Company or a shareowner of long standing, we recognize that occasionally you will have questions about your investment. Shareowner account records are maintained in the corporate general offices. Inquiries may be directed to:

Wisconsin Power and Light Company
 Attn: Shareowner Services
 P.O. Box 192
 Madison, WI 53701

Toll-free shareowner information numbers are:

Local calls (Madison area)	252-3110
Other Wisconsin calls	1-800-362-5490
Outside Wisconsin calls	1-800-356-5343

The Company maintains a direct mailing list to ensure that shareowners whose stock is held beneficially (street name) receive information on a timely basis, if they choose to do so. If your shares are held in this manner and you would like your name added to this list, please send your request to Shareowner Services.

MARKET INFORMATION

Stock Exchange Listings Trading Symbols

Common	New York Stock Exchange	WiscPL
4.50% Preferred	American Stock Exchange	WisP

All other preferred series are traded on the over-the-counter market.

Quarterly Common Stock Information

Quarter	1986			1985		
	High	Low	Dividend	High	Low	Dividend
First	\$46 ⁷ / ₈	\$39	\$.71	\$32 ³ / ₈	\$29 ¹ / ₈	\$.66
Second	49 ⁷ / ₈	44 ³ / ₄	.71	36 ¹ / ₂	32 ¹ / ₂	.66
Third	60 ¹ / ₄	48 ¹ / ₂	.74	40 ³ / ₈	34 ³ / ₈	.69
Fourth	55	50	.74	40 ¹ / ₂	34 ³ / ₄	.69
Year	<u>\$60¹/₄</u>	<u>\$39</u>	<u>\$2.90</u>	<u>\$40¹/₂</u>	<u>\$29¹/₈</u>	<u>\$2.70</u>

Preferred stock dividends paid per share for each quarter during 1986 were as follows:

4.40%	\$1.10	4.96%	\$1.24
4.50%	1.125	7.56%	1.89
4.76%	1.19	8.48%	2.12
4.80%	1.20		

RECORD AND DIVIDEND PAYMENT DATES

As authorized by the Board of Directors, dividends normally are payable as follows:

Common Dividend Payment Dates:

15th of February, May, August and November

Common Dividend Record Dates:

Last business day of January, April, July and October

Preferred Dividend Payment Dates:

15th of March, June, September and December

Preferred Dividend Record Dates:

Last business day of February, May, August and November

DIVIDEND REINVESTMENT PLAN

WP&L offers its shareowners and employees the opportunity to purchase shares of its common stock through the investment of common and preferred dividends and optional cash payments. Investment dates normally occur on the 15th of each month. Optional cash payments of up to \$3,000 per month may be made to purchase common stock under the plan. The price per share of shares purchased under the plan is the weighted average price (including brokerage commissions) at which the shares are acquired for participants.

Plan descriptions are available upon request from Shareowner Services.

STOCK TRANSFER AGENTS AND REGISTRARS

Transfer Agents

For Common and Preferred Stock:

Illinois Stock Transfer Company
 223 W. Jackson Blvd.
 Chicago, IL 60606

For Common Stock Only:

Morgan Shareholder Services Trust Company
 30 W. Broadway
 New York, NY 10015

Registrars

Continental Illinois National Bank
 & Trust Company of Chicago
 231 S. LaSalle St.
 Chicago, IL 60693

Morgan Shareholder Services Trust Company
 30 W. Broadway
 New York, NY 10015

FORM 10-K INFORMATION

A copy of Form 10-K as filed with the Securities and Exchange Commission will be provided without charge upon request. Requests may be directed to Shareowner Services.

ANNUAL MEETING

Shareowners are cordially invited to attend the corporate Annual Meeting at 10 a.m. local time, Wednesday, April 22, 1987, at the Dane County Memorial Coliseum, 1881 Expo Mall, Madison, Wis. Proxy materials will be mailed to shareowners in early March.



WISCONSIN POWER & LIGHT COMPANY 1986 ANNUAL REPORT

P. O. BOX 192
MADISON, WISCONSIN 53701-0192