

MGE ENERGY INC
Form 10-Q
August 07, 2018

United States
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended:

June 30, 2018

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission	Name of Registrant, State of Incorporation, Address	IRS Employer
File No. 000-49965	of Principal Executive Offices, and Telephone No. MGE Energy, Inc. (a Wisconsin Corporation) 133 South Blair Street Madison, Wisconsin 53788 (608) 252-7000 mgeenergy.com	Identification No. 39-2040501
000-1125	Madison Gas and Electric Company (a Wisconsin Corporation)	39-0444025

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133 South Blair Street

Madison, Wisconsin 53788

(608) 252-7000

mge.com

Indicate by check mark whether the registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) have been subject to such filing requirements for the past 90 days: Yes No

Indicate by check mark whether the registrants have submitted electronically and posted on their corporate Web sites, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrants were required to submit and post such files):

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

	Large Accelerated Filer	Accelerated Filer	Non-accelerated Filer	Smaller Reporting Company	Emerging Growth Company
MGE Energy, Inc.	X				
Madison Gas and Electric Company			X		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

MGE Energy, Inc. and Madison Gas and Electric Company: Yes No

Number of Shares Outstanding of Each Class of Common Stock as of July 31, 2018

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MGE Energy, Inc.
Madison Gas and Electric
Company

Common stock, \$1.00 par value, 34,668,370 shares outstanding.
Common stock, \$1.00 par value, 17,347,894 shares outstanding (all of which are
owned beneficially and of record by MGE Energy, Inc.).

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PART I. FINANCIAL INFORMATION.

Filing Format

This combined Form 10-Q is being filed separately by MGE Energy, Inc. (MGE Energy) and Madison Gas and Electric Company (MGE). MGE is a wholly owned subsidiary of MGE Energy and represents a majority of its assets, liabilities, revenues, expenses, and operations. Thus, all information contained in this report relates to, and is filed by, MGE Energy. Information that is specifically identified in this report as relating solely to MGE Energy, such as its financial statements and information relating to its nonregulated business, does not relate to, and is not filed by, MGE. MGE makes no representation as to that information. The terms "we" and "our," as used in this report, refer to MGE Energy and its consolidated subsidiaries, unless otherwise indicated.

Forward-Looking Statements

This report, and other documents filed by MGE Energy and MGE with the Securities and Exchange Commission (SEC) from time to time, contain forward-looking statements that reflect management's current assumptions and estimates regarding future performance and economic conditions especially as they relate to economic conditions, future load growth, revenues, expenses, capital expenditures, financial resources, regulatory matters, and the scope and expense associated with future environmental regulation. These forward-looking statements are made pursuant to the provisions of the Private Securities Litigation Reform Act of 1995. Words such as "believe," "expect," "anticipate," "estimate," "could," "should," "intend," "will," and other similar words generally identify forward-looking statements. Both MGE Energy and MGE caution investors that these forward-looking statements are subject to known and unknown risks and uncertainties that may cause actual results to differ materially from those projected, expressed, or implied.

The factors that could cause actual results to differ materially from the forward-looking statements made by a registrant include (a) those factors discussed in the registrants' 2017 Annual Report on Form 10-K: Item 1A. Risk Factors, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, as updated by Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations in this report, and Item 8. Financial Statements and Supplementary Data Note 17, as updated by Part I, Item 1. Financial Statements Note 9 in this report, and (b) other factors discussed herein and in other filings made by that registrant with the SEC.

Readers are cautioned not to place undue reliance on these forward-looking statements, which apply only as of the date of this report. MGE Energy and MGE undertake no obligation to release publicly any revision to these forward-looking statements to reflect events or circumstances after the date of this report, except as required by law.

Where to Find More Information

The public may read and copy any reports or other information that MGE Energy and MGE file with the SEC at the SEC's public reference room at 100 F Street, NE, Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. These documents also are available to the public from commercial document retrieval services, the website maintained by the SEC at sec.gov, MGE Energy's website at mgeenergy.com, and MGE's website at mge.com. Copies may be obtained from our websites free of charge. Information contained on MGE Energy's and MGE's websites shall not be deemed incorporated into, or to be a part of, this report.

Definitions, Abbreviations, and Acronyms Used in the Text and Notes of this Report

Abbreviations, acronyms, and definitions used in the text and notes of this report are defined below.

MGE Energy and Subsidiaries:

CWDC	Central Wisconsin Development Corporation
MAGAEL	MAGAEL, LLC
MGE	Madison Gas and Electric Company
MGE Energy	MGE Energy, Inc.
MGE Power	MGE Power, LLC
MGE Power Elm Road	MGE Power Elm Road, LLC
MGE Power West Campus	MGE Power West Campus, LLC
MGE Services	MGE Services, LLC
MGE State Energy Services	MGE State Energy Services, LLC
MGE Transco	MGE Transco Investment, LLC
MGEE Transco	MGEE Transco, LLC

Other Defined Terms:

AFUDC	Allowance for Funds Used During Construction
ANPR	Advance Notice of Public Rulemaking
ARO	Asset Retirement Obligation
ASU	Accounting Standard Update
ATC	American Transmission Company LLC
ATC Holdco	ATC Holdco, LLC
Blount	Blount Station
CAVR	Clean Air Visibility Rule
CCR	Coal Combustion Residual
CNG	Compressed Natural Gas
codification	Financial Accounting Standards Board Accounting Standards Codification
Columbia	Columbia Energy Center
cooling degree days	Measure of the extent to which the average daily temperature is above 65 degrees Fahrenheit, which is considered an indicator of possible increased demand for energy to provide cooling
CPP	Clean Power Plan
CSAPR	Cross-State Air Pollution Rule
Dth	Dekatherms, a quantity measure used in respect of natural gas
EGUs	Electric Generating Units
electric margin	Electric revenues less fuel for electric generation and purchase power costs, a non-GAAP measure
Elm Road Units	Elm Road Generating Station
EPA	United States Environmental Protection Agency
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission

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Forward Wind	Forward Wind Energy Center
FTR	Financial Transmission Rights
GAAP	Generally Accepted Accounting Principles
gas margin	Gas revenues less cost of gas sold, a non-GAAP measure
GHG	Greenhouse Gas
heating degree days (HDD)	Measure of the extent to which the average daily temperature is below 65 degrees Fahrenheit, which is considered an indicator of possible increased demand for energy to provide heating
IRS	Internal Revenue Service
kWh	Kilowatt-hour, a measure of electric energy produced

MISO	Midcontinent Independent System Operator (a regional transmission organization)
MW	Megawatt, a measure of electric energy generating capacity
MWh	Megawatt-hour, a measure of electric energy produced
NAAQS	National Ambient Air Quality Standards
NO _x	Nitrogen Oxides
PGA	Purchased Gas Adjustment clause, a regulatory mechanism used to reconcile natural gas costs recovered in rates to actual costs
PPA	Purchased Power Agreement
PSCW	Public Service Commission of Wisconsin
Riverside	Riverside Energy Center
ROE	Return on Equity
SCR	Selective Catalytic Reduction
SEC	Securities and Exchange Commission
SO ₂	Sulfur Dioxide
Stock Plan	Direct Stock Purchase and Dividend Reinvestment Plan of MGE Energy
Tax Act	Tax Cuts and Jobs Act
UW	University of Wisconsin at Madison
VIE	Variable Interest Entity
WCCF	West Campus Cogeneration Facility
WEPCO	Wisconsin Electric Power Company, a subsidiary of WEC Energy Group, Inc.
working capital	Current assets less current liabilities
WPL	Wisconsin Power and Light Company, a subsidiary of Alliant Energy Corporation
XBRL	eXtensible Business Reporting Language

Item 1. Financial Statements.

MGE Energy, Inc.
Consolidated Statements of Income (unaudited)
(In thousands, except per-share amounts)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Operating Revenues:				
Electric revenues	\$ 99,282	\$ 102,382	\$ 194,149	\$ 200,779
Gas revenues	24,980	24,081	87,745	82,507
<i>Total Operating Revenues</i>	124,262	126,463	281,894	283,286
Operating Expenses:				
Fuel for electric generation	15,251	11,910	27,151	24,109
Purchased power	12,979	16,720	30,012	32,074
Cost of gas sold	9,562	9,231	49,188	45,015
Other operations and maintenance	43,453	44,880	87,846	88,644
Depreciation and amortization	13,872	13,275	27,495	26,234
Other general taxes	4,914	4,852	9,783	9,779
<i>Total Operating Expenses</i>	100,031	100,868	231,475	225,855
Operating Income	24,231	25,595	50,419	57,431
Other income, net	4,731	3,570	9,650	7,095
Interest expense, net	(4,783)	(4,886)	(9,522)	(9,780)
Income before income taxes	24,179	24,279	50,547	54,746
Income tax provision	(5,828)	(8,736)	(12,195)	(19,903)
Net Income	\$ 18,351	\$ 15,543	\$ 38,352	\$ 34,843
Earnings Per Share of Common Stock				
(basic and diluted)	\$ 0.53	\$ 0.45	\$ 1.11	\$ 1.01
Dividends per share of common stock	\$ 0.323	\$ 0.308	\$ 0.645	\$ 0.615
Weighted Average Shares Outstanding				
(basic and diluted)	34,668	34,668	34,668	34,668

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

MGE Energy, Inc.
Consolidated Statements of Comprehensive Income (unaudited)
(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net Income	\$ 18,351	\$ 15,543	\$ 38,352	\$ 34,843
Other comprehensive income, net of tax:				
Unrealized gain on available-for-sale securities, net of tax (\$- and (\$21), and \$- and (\$86), respectively)	-	32	-	129
Comprehensive Income	\$ 18,351	\$ 15,575	\$ 38,352	\$ 34,972

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

MGE Energy, Inc.
Consolidated Statements of Cash Flows (unaudited)
(In thousands)

	Six Months Ended June 30,	
	2018	2017
Operating Activities:		
Net income	\$ 38,352	\$ 34,843
Items not affecting cash:		
Depreciation and amortization	27,495	26,234
Deferred income taxes	(664)	1,037
Provision for doubtful receivables	354	367
Employee benefit plan (credit) cost	(1,076)	727
Equity earnings in ATC	(4,441)	(5,094)
Other items	160	778
Changes in working capital items:		
Decrease in current assets	29,120	20,595
Decrease in current liabilities	(1,333)	(11,516)
Dividends from ATC	3,905	4,072
Cash contributions to pension and other postretirement plans	(2,640)	(8,284)
Other noncurrent items, net	2,386	3,257
<i>Cash Provided by Operating Activities</i>	91,618	67,016
Investing Activities:		
Capital expenditures	(100,389)	(42,169)
Capital contributions to investments	(3,280)	(5,557)
Other	598	852
<i>Cash Used for Investing Activities</i>	(103,071)	(46,874)
Financing Activities:		
Cash dividends paid on common stock	(22,361)	(21,321)
Repayment of long-term debt	(2,213)	(32,167)
Issuance of long-term debt	-	40,000
Proceeds from short-term debt	24,200	-
Other	-	(317)
<i>Cash Used for Financing Activities</i>	(374)	(13,805)
Change in cash, cash equivalents, and restricted cash	(11,827)	6,337
Cash, cash equivalents, and restricted cash at beginning of period	112,094	101,633
Cash, cash equivalents, and restricted cash at end of period	\$ 100,267	\$ 107,970

**Supplemental disclosures of cash flow
information:**

Significant noncash investing activities:

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Accrued capital expenditures	\$	6,467	\$	8,450
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The accompanying notes are an integral part of the unaudited consolidated financial statements.

MGE Energy, Inc.
Consolidated Balance Sheets (unaudited)
(In thousands)

	June 30, 2018	December 31, 2017
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 95,579	\$ 107,952
Accounts receivable, less reserves of \$2,434 and \$2,840, respectively	35,473	42,299
Other accounts receivable, less reserves of \$588 and \$335, respectively	7,808	9,440
Unbilled revenues	24,031	31,400
Materials and supplies, at average cost	24,595	22,614
Fuel for electric generation, at average cost	9,451	8,256
Stored natural gas, at average cost	7,763	12,923
Prepaid taxes	16,042	26,535
Regulatory assets - current	7,462	7,888
Assets held for sale	1,392	8,817
Other current assets	12,714	12,507
<i>Total Current Assets</i>	242,310	290,631
Other long-term receivables	4,188	4,788
Regulatory assets	137,267	142,567
Pension and other postretirement benefit asset	11,956	7,336
Other deferred assets and other	5,379	731
Property, Plant, and Equipment:		
Property, plant, and equipment, net	1,345,255	1,283,313
Construction work in progress	75,007	58,044
<i>Total Property, Plant, and Equipment</i>	1,420,262	1,341,357
Investments	72,083	67,772
Total Assets	\$ 1,893,445	\$ 1,855,182
LIABILITIES AND CAPITALIZATION		
Current Liabilities:		
Long-term debt due within one year	\$ 4,502	\$ 24,452
Short-term debt	28,200	4,000
Accounts payable	37,498	47,645
Accrued interest and taxes	5,350	5,602
Accrued payroll related items	10,449	12,244
Regulatory liabilities - current	9,110	5,633
Derivative liabilities	8,860	8,180
Other current liabilities	14,457	18,758
<i>Total Current Liabilities</i>	118,426	126,514
Other Credits:		
Deferred income taxes	226,300	225,130
Investment tax credit - deferred	868	918
Regulatory liabilities	166,316	154,153
Accrued pension and other postretirement benefits	69,249	69,088
Derivative liabilities	29,890	33,990
Other deferred liabilities and other	72,120	69,041

<i>Total Other Credits</i>	564,743	552,320
Capitalization:		
Common shareholders' equity	794,178	778,187
Long-term debt	416,098	398,161
<i>Total Capitalization</i>	1,210,276	1,176,348
Commitments and contingencies (see Footnote 9)		
Total Liabilities and Capitalization	\$ 1,893,445	\$ 1,855,182

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

MGE Energy, Inc.
Consolidated Statements of Common Equity (unaudited)
(In thousands, except per-share amounts)

	Common Stock Shares	Common Stock Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total
2017						
Beginning balance - December 31, 2016	34,668	\$ 34,668	\$ 316,268	\$ 372,950	\$ 202	\$ 724,088
Net income				34,843		34,843
Other comprehensive income					129	129
Common stock dividends declared (\$0.615 per share)				(21,321)		(21,321)
Ending balance - June 30, 2017	34,668	\$ 34,668	\$ 316,268	\$ 386,472	\$ 331	\$ 737,739
2018						
Beginning balance - December 31, 2017	34,668	\$ 34,668	\$ 316,268	\$ 426,874	\$ 377	\$ 778,187
Cumulative effect of new accounting principle				377	(377)	-
Beginning balance - adjusted				427,251	-	778,187
Net income				38,352		38,352
Common stock dividends declared (\$0.645 per share)				(22,361)		(22,361)
Ending balance - June 30, 2018	34,668	\$ 34,668	\$ 316,268	\$ 443,242	\$ -	\$ 794,178

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

Madison Gas and Electric Company
Consolidated Statements of Income (unaudited)
(In thousands)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Operating Revenues:				
Electric revenues	\$ 99,282	\$ 102,382	\$ 194,149	\$ 200,783
Gas revenues	24,980	24,080	87,745	82,515
<i>Total Operating Revenues</i>	124,262	126,462	281,894	283,298
Operating Expenses:				
Fuel for electric generation	15,251	11,910	27,151	24,111
Purchased power	12,979	16,720	30,012	32,076
Cost of gas sold	9,562	9,230	49,188	45,023
Other operations and maintenance	43,001	44,663	87,188	88,058
Depreciation and amortization	13,872	13,275	27,495	26,234
Other general taxes	4,914	4,852	9,783	9,779
Income tax provision	5,129	7,756	10,653	18,021
<i>Total Operating Expenses</i>	104,708	108,406	241,470	243,302
Operating Income	19,554	18,056	40,424	39,996
Other Income and Deductions:				
AFUDC - equity funds	664	294	1,259	565
Income tax provision	(92)	(47)	(149)	(91)
Other income, net	1,650	845	3,552	1,843
<i>Total Other Income and Deductions</i>	2,222	1,092	4,662	2,317
Income before interest expense	21,776	19,148	45,086	42,313
Interest Expense:				
Interest on long-term debt	5,191	5,013	10,397	10,056
Other interest, net	206	65	255	96
AFUDC - borrowed funds	(224)	(80)	(425)	(172)
<i>Net Interest Expense</i>	5,173	4,998	10,227	9,980
Net Income	\$ 16,603	\$ 14,150	\$ 34,859	\$ 32,333
Less: Net Income Attributable to Noncontrolling Interest, net of tax	(5,505)	(5,396)	(11,311)	(10,785)
Net Income Attributable to MGE	\$ 11,098	\$ 8,754	\$ 23,548	\$ 21,548

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

Madison Gas and Electric Company
Consolidated Statements of Comprehensive Income (unaudited)
(In thousands)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Net Income	\$ 16,603\$	14,150\$	34,859\$	32,333
Other comprehensive income, net of tax:				
Unrealized loss on available-for-sale securities, net of tax (\$- and \$17, and \$- and \$21, respectively)	-	(25)	-	(31)
Comprehensive Income	\$ 16,603\$	14,125\$	34,859\$	32,302
Less: Comprehensive Income Attributable to Noncontrolling Interest, net of tax	(5,505)	(5,396)	(11,311)	(10,785)
Comprehensive Income Attributable to MGE	\$ 11,098\$	8,729\$	23,548\$	21,517

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

Madison Gas and Electric Company
Consolidated Statements of Cash Flows (unaudited)
(In thousands)

	Six Months Ended June 30,	
	2018	2017
Operating Activities:		
Net income	\$ 34,859	\$ 32,333
Items not affecting cash:		
Depreciation and amortization	27,495	26,234
Deferred income taxes	(2,574)	(149)
Provision for doubtful receivables	354	367
Employee benefit plan (credit) cost	(1,076)	727
Other items	707	969
Changes in working capital items:		
Decrease in current assets	28,686	19,702
Increase (decrease) in current liabilities	1,943	(11,021)
Cash contributions to pension and other postretirement plans	(2,640)	(8,284)
Other noncurrent items, net	2,293	3,141
<i>Cash Provided by Operating Activities</i>	90,047	64,019
Investing Activities:		
Capital expenditures	(100,389)	(42,169)
Other	(422)	65
<i>Cash Used for Investing Activities</i>	(100,811)	(42,104)
Financing Activities:		
Cash dividends paid to parent by MGE	-	(25,000)
Distributions to parent from noncontrolling interest	(13,500)	(10,000)
Repayment of long-term debt	(2,213)	(32,167)
Issuance of long-term debt	-	40,000
Proceeds from short-term debt	24,200	-
Other	-	(305)
<i>Cash Provided by (Used for) Financing Activities</i>	8,487	(27,472)
Change in cash, cash equivalents, and restricted cash	(2,277)	(5,557)
Cash, cash equivalents, and restricted cash at beginning of period	10,093	16,442
Cash, cash equivalents, and restricted cash at end of period	\$ 7,816	\$ 10,885

**Supplemental disclosures of cash flow
information:**

Significant noncash investing activities:

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Accrued capital expenditures	\$	6,467	\$	8,450
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The accompanying notes are an integral part of the unaudited consolidated financial statements.

Madison Gas and Electric Company
Consolidated Balance Sheets (unaudited)
(In thousands)

	June 30, 2018	December 31, 2017
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 3,128	\$ 5,951
Accounts receivable, less reserves of \$2,434 and \$2,840, respectively	35,473	42,299
Affiliate receivables	592	668
Other accounts receivable, less reserves of \$588 and \$335, respectively	6,297	6,984
Unbilled revenues	24,031	31,400
Materials and supplies, at average cost	24,595	22,614
Fuel for electric generation, at average cost	9,451	8,256
Stored natural gas, at average cost	7,763	12,923
Prepaid taxes	15,073	25,073
Regulatory assets - current	7,462	7,888
Assets held for sale	1,392	8,817
Other current assets	12,709	12,484
<i>Total Current Assets</i>	147,966	185,357
Affiliate receivable long-term	3,442	3,707
Regulatory assets	137,267	142,567
Pension and other postretirement benefit asset	11,956	7,336
Other deferred assets and other	7,558	3,280
Property, Plant, and Equipment:		
Property, plant, and equipment, net	1,345,283	1,283,341
Construction work in progress	75,007	58,044
<i>Total Property, Plant, and Equipment</i>	1,420,290	1,341,385
Investments	422	409
Total Assets	\$ 1,728,901	\$ 1,684,041
LIABILITIES AND CAPITALIZATION		
Current Liabilities:		
Long-term debt due within one year	\$ 4,502	\$ 24,452
Short-term debt	28,200	4,000
Accounts payable	37,498	47,614
Accrued interest and taxes	6,551	5,558
Accrued payroll related items	10,449	12,244
Regulatory liabilities - current	9,110	5,633
Derivative liabilities	8,860	8,180
Other current liabilities	14,448	16,749
<i>Total Current Liabilities</i>	119,618	124,430
Other Credits:		
Deferred income taxes	200,609	201,486
Investment tax credit - deferred	868	918
Regulatory liabilities	166,316	154,153
Accrued pension and other postretirement benefits	69,249	69,088
Derivative liabilities	29,890	33,990

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Other deferred liabilities and other	72,120	69,041
<i>Total Other Credits</i>	539,052	528,676
Capitalization:		
Common shareholder's equity	515,420	491,872
Noncontrolling interest	138,713	140,902
<i>Total Equity</i>	654,133	632,774
Long-term debt	416,098	398,161
<i>Total Capitalization</i>	1,070,231	1,030,935
Commitments and contingencies (see Footnote 9)		
Total Liabilities and Capitalization	\$ 1,728,901	\$ 1,684,041

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

Madison Gas and Electric Company
Consolidated Statements of Equity (unaudited)
(In thousands)

	Common Stock Shares	Stock Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Non- Controlling Interest	Total
2017							
Beginning balance - Dec. 31, 2016	17,348\$	17,348\$	192,417\$	277,300\$	19\$	115,665\$	602,749
Net income				21,548		10,785	32,333
Other comprehensive loss					(31)		(31)
Cash dividends paid to parent by MGE				(25,000)			(25,000)
Distributions to parent from noncontrolling interest						(10,000)	(10,000)
Ending balance - June 30, 2017	17,348\$	17,348\$	192,417\$	273,848\$	(12)\$	116,450\$	600,051
2018							
Beginning balance - Dec. 31, 2017	17,348\$	17,348\$	192,417\$	282,135\$	(28)\$	140,902\$	632,774
Cumulative effect of new accounting principle				(28)	28		-
Beginning balance - adjusted				282,107	-		632,774
Net income				23,548		11,311	34,859
Distributions to parent from noncontrolling interest						(13,500)	(13,500)
Ending balance - June 30, 2018	17,348\$	17,348\$	192,417\$	305,655\$	-\$	138,713\$	654,133

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

MGE Energy, Inc., and Madison Gas and Electric Company

Notes to Consolidated Financial Statements (unaudited)

June 30, 2018

1.

Summary of Significant Accounting Policies.

a.

Basis of Presentation - MGE Energy and MGE.

This report is a combined report of MGE Energy and MGE. References in this report to "MGE Energy" are to MGE Energy, Inc. and its subsidiaries. References in this report to "MGE" are to Madison Gas and Electric Company.

MGE Power Elm Road and MGE Power West Campus own electric generating assets and lease those assets to MGE. Both entities are variable interest entities under applicable authoritative accounting guidance. MGE is considered the primary beneficiary of these entities as a result of contractual agreements. As a result, MGE has consolidated MGE Power Elm Road and MGE Power West Campus. See Footnote 2 of Notes to Consolidated Financial Statements under Item 8, Financial Statements and Supplementary Data, of MGE Energy's and MGE's 2017 Annual Report on Form 10-K (the 2017 Annual Report on Form 10-K).

The accompanying consolidated financial statements as of June 30, 2018, and for the three and six months ended, are unaudited, but include all adjustments that MGE Energy and MGE management consider necessary for a fair statement of their respective financial statements. All adjustments are of a normal, recurring nature except as otherwise disclosed. The year-end consolidated balance sheet information was derived from the audited balance sheet appearing in the 2017 Annual Report on Form 10-K but does not include all disclosures required by accounting principles generally accepted in the United States of America. These notes should be read in conjunction with the financial statements and the notes on pages 54 through 103 of the 2017 Annual Report on Form 10-K.

b.

Cash, Cash Equivalents, and Restricted Cash MGE Energy and MGE.

The following table presents the components of total cash, cash equivalents, and restricted cash on the consolidated balance sheets.

<i>(In thousands)</i>	MGE Energy		MGE	
	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017
Cash and cash equivalents	\$ 95,579	\$ 107,952	\$ 3,128	\$ 5,951
Restricted cash	3,516	1,635	3,516	1,635
Receivable - margin account	1,172	2,507	1,172	2,507
Cash, cash equivalents, and restricted cash	\$ 100,267	\$ 112,094	\$ 7,816	\$ 10,093

Cash Equivalents

MGE Energy and MGE consider all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Restricted Cash

MGE has certain cash accounts that are restricted to uses other than current operations and designated for a specific purpose. MGE's restricted cash accounts include cash held by trustees for certain employee benefits and cash deposits held by third parties. These are included in "Other current assets" on the consolidated balance sheets.

Receivable Margin Account

Cash amounts held by counterparties as margin collateral for certain financial transactions are recorded as receivable margin account in "Other current assets" on the consolidated balance sheets. The costs being hedged are fuel for electric generation, purchased power, and cost of gas sold.

The following table presents the retrospective adjustments to cash flow amounts on MGE Energy's and MGE's consolidated statements of cash flows in accordance with the adoption of *ASU 2016-18, Restricted Cash*.

<i>(In thousands)</i>		Six Months Ended June 30, 2017
Cash provided by operating activities	\$	(694)
Cash used for investing activities		74
Change in cash, cash equivalents, and restricted cash		(620)
Cash, cash equivalents, and restricted cash at beginning of period		5,674
Cash, cash equivalents, and restricted cash at end of period	\$	5,054

2.

New Accounting Standards - MGE Energy and MGE.

a.

Recently Adopted

Revenue from Contracts with Customers.

The FASB issued authoritative guidance within the codification's Revenue Recognition topic that provides guidance on the recognition, measurement, and disclosure of revenue from contracts with customers. The new standard establishes a five-step model for recognizing and measuring revenue from contracts with customers and replaces existing guidance on revenue recognition. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services.

This authoritative guidance became effective January 1, 2018, and MGE Energy and MGE adopted the standard upon the effective date. Adoption of this standard is permitted under one of two methods: the full retrospective method or the modified retrospective method. MGE Energy and MGE implemented the standard using the modified retrospective method. The cumulative impact of this guidance on our financial statements is not material, except for additional footnote disclosures. See Footnote 3 for further information.

Financial Instruments.

In January 2016, the FASB issued authoritative guidance within the codification's Financial Instruments topic that provides guidance on the recognition and measurement of financial instruments. This authoritative guidance became effective January 1, 2018, and required equity investments to be measured at fair value with changes in fair value recognized in net income rather than in other comprehensive income. As a result of this guidance, MGE Energy and MGE will no longer have other comprehensive income related to equity investments. This standard was applied using a modified retrospective approach, with a cumulative effect adjustment recorded to opening retained earnings as of the beginning of the fiscal year of adoption. As of January 1, 2018, MGE Energy recorded a \$0.4 million increase in retained earnings and a corresponding decrease in accumulated other comprehensive income, and MGE recorded less than a \$0.1 million decrease in retained earnings and a corresponding increase in accumulated other comprehensive income, related to equity investments within the scope of this standard.

Restricted Cash.

In November 2016, the FASB issued authoritative guidance within the codification's Statement of Cash Flows topic that provides guidance on the classification and presentation of changes in restricted cash within the statement of cash flows. Under the new guidance, reporting entities are required to explain the changes in the total of restricted and unrestricted cash and cash equivalents when reconciling the beginning and ending balances on the statement of cash flows. Prior to the authoritative guidance, changes in restricted cash were presented as either cash flows from operating, investing, or financing activities within the statement of cash flows, as appropriate based on the nature of the restriction. Also under the new standard, reporting entities are required to provide a reconciliation from the balance sheet to the statement of cash flows and disclose the nature of the restrictions of cash. This authoritative guidance became effective January 1, 2018. Upon the effective date, MGE Energy and MGE changed the presentation of restricted cash on the consolidated statements of cash flows to reflect the new accounting guidance retrospectively to all periods presented. See Footnote 1.b. for further information.

Pension and Other Postretirement Benefits.

In March 2017, the FASB issued authoritative guidance within the codification's Compensation Retirement Benefits topic that provides guidance on the presentation of net periodic pension cost and net periodic postretirement benefit cost (together, net benefit cost). This authoritative guidance became effective January 1, 2018. Under the new guidance, the service cost component of net benefit cost is required to be recorded in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside of income from operations. A practical expedient within the standard permits an employer to use the amounts disclosed in its pension and other postretirement benefit plan footnote for prior comparative periods as the estimation basis for applying the retrospective presentation requirements. MGE Energy and MGE have elected to apply the practical expedient. Upon the effective date, MGE Energy and MGE changed the presentation of net benefit cost on the consolidated statements of income to reflect the new accounting guidance retrospectively to all periods presented. For both MGE Energy and MGE, "Other operations and maintenance expense" increased and "Other income, net" increased \$0.9 million and \$2.0 million for the three and six months ended June 30, 2017, respectively. The standard also only allows the service cost component to be eligible for capitalization prospectively from the effective date of the pronouncement (whereas under previous GAAP, all components of net benefit cost were eligible for capitalization). See Footnote 6 for further information.

b.

Recently Issued

Leases.

In February 2016, the FASB issued authoritative guidance within the codification's Leases topic that provides guidance on the classification, recognition, measurement, and disclosure of leases. The new leasing standard establishes that a lease conveys the right to control the use of identified property, plant, or equipment for a period of time in exchange for consideration. Under the new guidance, lessees will be required to recognize all leases with terms greater than one year, including operating leases, on the balance sheet by recording a right-of-use asset and lease liability. Prior to the authoritative guidance, only capital leases were recognized on the balance sheet by lessees. The new accounting guidance, as applied by lessors, is materially consistent with current GAAP. In January 2018, the FASB issued authoritative guidance which provided an optional practical expedient to grandfather the accounting for existing and expired land easements not accounted for as a lease under the new authoritative guidance. MGE Energy and MGE plan to adopt this practical expedient.

Management has begun utilizing a bottoms-up approach to analyze the impact of the standard on our lease portfolio. MGE Energy and MGE have been reviewing current accounting policies and procedures to identify potential differences in accounting treatment that would result from applying the requirements of the new standard to our existing lease portfolio. In addition, we are identifying appropriate changes to our business processes, systems, and controls to support recognition and disclosure requirements under the new standard. This authoritative guidance will

become effective January 1, 2019, with early adoption permitted. MGE Energy and MGE anticipate adopting the standard upon the effective date. The new leasing standard requires entities to recognize and measure leases at the beginning of the earliest comparative period presented using a modified retrospective approach. MGE Energy and MGE are currently assessing the impact this pronouncement will have on our financial statements.

3.

Revenue - MGE Energy and MGE.

Revenues disaggregated by revenue source were as follows:

<i>(In thousands)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Electric revenues				
Residential	\$ 32,217	\$ 31,634	\$ 65,476	\$ 64,987
Commercial ^(a)	50,174	54,721	97,626	104,885
Industrial	4,630	4,516	7,525	8,731
Other-retail/municipal	8,527	9,661	16,814	18,682
Total retail	95,548	100,532	187,441	197,285
Sales to the market	2,795	1,050	4,829	2,022
Other revenues	454	562	924	991
Adjustments to revenues	270	162	264	332
Total electric revenues	99,067	102,306	193,458	200,630
Gas revenues				
Residential	15,620	15,140	52,171	49,043
Commercial/Industrial ^(a)	8,206	7,842	33,158	30,890
Total retail	23,826	22,982	85,329	79,933
Gas transportation	1,053	991	2,189	2,341
Other revenues	101	108	227	233
Total gas revenues	24,980	24,081	87,745	82,507
Non-regulated energy revenues	215	76	691	149
Total Operating Revenue ^(a)	\$ 124,262	\$ 126,463	281,894	\$ 283,286

(a)

In 2017, MGE had less than \$0.1 million of revenues related to CNG vehicle fuel servicing. No revenue was recognized for fuel servicing by MGE Energy in 2017.

Performance Obligations

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer and is the unit of account. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. The majority of MGE Energy's and MGE's contracts have

a single performance obligation.

Retail Revenue (Residential, Commercial, Industrial, and Other Retail/Municipal)

Retail revenue of electric and gas utility service represent MGE's core business activities. Tariffs are approved by the PSCW through a rate order and provide MGE's customers with the standard terms and conditions, including pricing terms. The performance obligation to deliver electricity or gas is satisfied over time as the customer simultaneously receives and consumes the commodities provided by MGE. MGE recognizes revenues as the commodity is delivered to customers. Meters are read on a systematic basis throughout the month based on established meter-reading schedules and the customer is subsequently billed for their services. At the end of the month, MGE accrues an estimate for the unbilled amount of commodities delivered to customers. The unbilled revenue estimate is based on daily system demand volumes, weather factors, estimated line losses, estimated customer usage by class, and applicable customer rates.

Utility Cost Recovery Mechanisms

MGE's tariff rates include a provision for fuel cost recovery. The PSCW allows Wisconsin utilities to defer electric fuel-related costs, less excess revenues, that fall outside a symmetrical cost tolerance band. Any over/under recovery of the actual costs in a given year is determined in the following year and is then reflected in future billings to electric retail customers. Over-collection of fuel-related costs that are outside the approved range will be recognized as a reduction of revenue. Prior to adoption of the new revenue recognition guidance, effective January 1, 2018, over-collected fuel-related costs were reflected in "Purchased power" expense. Under-collection of these costs will continue to be recognized in "Purchased power" expense in the consolidated statements of income of MGE Energy and MGE. The cumulative effects of these deferred amounts will be recorded in "Regulatory assets" or "Regulatory liabilities" on the consolidated balance sheets of MGE Energy and MGE until they are reflected in future billings to customers. See Footnote 10.b. for further information.

MGE received a PSCW order in January 2018 to defer the over-collection of income tax expense collected in customer rates as a result of the Tax Cuts and Jobs Act (the Tax Act) reduction in the income tax rate to 21 percent. See Footnote 5 for further information.

MGE has other cost recovery mechanisms, any over-collection of the difference between actual costs incurred and the amount of costs collected from customers is recorded as a reduction of revenue in the period incurred.

Sales to the Market

Sales to the market include energy charges, capacity or demand charges, and ancillary charges represented by wholesale sales of electricity made to third parties who are not ultimate users of the electricity. Most of these sales are spot market transactions on the markets operated by MISO. Each transaction is considered a performance obligation and revenue is recognized in the period in which energy charges, capacity or demand charges, and ancillary services are sold into MISO. MGE reports on a net basis, transactions on the MISO markets in which it buys and sells power within the same hour to meet electric energy delivery requirements.

Transportation of Gas

MGE has contracts under which MGE provides gas transportation services to customers whom have elected to purchase gas from a third party and have the gas delivered via pipelines within MGE's service territory. Revenue is recognized as service is rendered or gas is delivered to customers. Tariffs are approved by the PSCW through a rate order and provide gas transportation customers with the standard terms and conditions, including pricing terms.

4.

Investment in ATC and ATC Holdco - MGE Energy and MGE.

ATC owns and operates electric transmission facilities primarily in Wisconsin. MGE received an interest in ATC when it, like other Wisconsin electric utilities, contributed its electric transmission facilities to ATC as required by Wisconsin law. That interest is presently held by MGE Transco, which, since December 1, 2016, is owned by MGE Energy. ATC Holdco was formed by several members of ATC, including MGE Energy, to pursue electric transmission development and investments outside of Wisconsin. The ownership interest in ATC Holdco is held by MGEE Transco, a wholly-owned subsidiary of MGE Energy.

At June 30, 2018, and December 31, 2017, MGE Transco held a 3.6% ownership interest in ATC. At June 30, 2018, and December 31, 2017, MGEE Transco held a 4.4% ownership interest in ATC Holdco.

MGE Transco and MGEE Transco have accounted for their investment in ATC and ATC Holdco, respectively, under the equity method of accounting. Equity earnings from investments are recorded as "Other income" on MGE Energy's consolidated statements of income. For the three and six months ended June 30, 2018 and 2017, MGE Transco recorded the following:

<i>(In thousands)</i>	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Equity earnings from investment in ATC	\$ 1,990	\$ 2,486	\$ 4,441	\$ 5,094
Dividends from ATC ^(a)	2,959	2,000	2,959	2,000
Capital contributions to ATC	1,065	888	1,775	2,308

(a)

MGE Transco recorded a \$2.3 million and \$2.1 million dividend receivable from ATC as of December 31, 2017 and 2016, respectively. A cash dividend was received in January of each of the preceding years. MGE Transco recorded a \$1.4 million dividend receivable from ATC as of June 30, 2018. A cash dividend was received in July 2018.

ATC Holdco was formed in December 2016. In the near term, it is expected that ATC Holdco will be pursuing transmission development opportunities that typically have long development and investment lead times before becoming operational. During the three and six months ended June 30, 2018, MGEE Transco recorded capital contributions of \$0.1 million and \$0.2 million, respectively, to ATC Holdco compared to \$0.5 million and \$0.7 million for the comparable periods in 2017.

In July 2018, MGE Transco made a \$0.5 million capital contribution to ATC and MGEE Transco made a \$0.1 million contribution to ATC Holdco.

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ATC's summarized financial data for the three and six months ended June 30, 2018 and 2017, is as follows:

<i>(In thousands)</i>	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Operating revenues	\$ 165,506	\$ 176,610	\$ 330,935	\$ 351,279
Operating expenses	(91,474)	(82,974)	(176,367)	(165,670)
Other income, net	1,520	1,088	1,631	1,771
Interest expense, net	(26,895)	(26,466)	(54,657)	(53,250)
Earnings before members' income taxes	\$ 48,657	\$ 68,258	\$ 101,542	\$ 134,130

MGE receives transmission and other related services from ATC. During the three and six months ended June 30, 2018, MGE recorded \$7.2 million and \$14.4 million, respectively, for transmission services received compared to \$7.3 million and \$14.6 million for the comparable periods in 2017. MGE also provides a variety of operational, maintenance, and project management services for ATC, which is reimbursed by ATC. As of June 30, 2018, and December 31, 2017, MGE had a receivable due from ATC of \$0.1 million and \$0.2 million, respectively.

5.

Taxes - MGE Energy and MGE.

Effective Tax Rate.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act. The Tax Act makes broad and complex changes to the U.S. tax code, including the reduction in the U.S. federal corporate tax rate from 35 percent to 21 percent, effective January 1, 2018. MGE Energy and MGE recorded a provisional decrease in deferred tax assets and deferred tax liabilities as of December 31, 2017. In accordance with Staff Accounting Bulletin 118, any subsequent adjustment to these amounts will be recorded in the quarter of 2018 when the analysis is complete. No adjustments have been recorded in the first half of 2018. Beginning January 1, 2018, MGE began amortization of the regulated utility excess deferred taxes recognized using a normalization method of accounting. For the three and six months ended June 30, 2018, MGE recognized \$0.6 million and \$1.2 million, respectively, of excess deferred taxes as a reduction of revenue and a corresponding increase in a regulatory liability. The amount and timing of the cash impacts will depend on the period over which certain income tax benefits are provided to customers, which will be determined by the PSCW.

Customer rates approved for 2018 reflect an income tax rate of 35 percent. In January 2018, the PSCW issued an order directing Wisconsin investor-owned utilities to defer the over-collection of income tax expense as a result of the

decrease in tax rate to 21 percent. The PSCW issued an order in May 2018 to return to customers the estimated 2018 over-collection of income tax expense. The decision includes a one-time bill credit on customer bills to reflect the estimate of the over-collection for January through June 2018. A monthly volumetric bill credit will begin in July 2018 and continue through the remainder of 2018 for the estimated remaining annual amount. In June 2018, customers received a \$4.1 million bill credit. Any over/under recovery of the actual costs will be subject to the PSCW's review in a future rate case. As of June 30, 2018, MGE has deferred \$1.7 million as a regulatory liability and recorded a corresponding reduction in operating revenues for over-collection of income tax expense (net of customer bill credits).

The components of net periodic benefit cost, other than the service cost component, are recorded in "Other income, net" on the consolidated statements of income. The service cost component is recorded in "Other operations and maintenance" on the consolidated statements of income. Prior to January 1, 2018, a portion of all net periodic benefit cost components were capitalized within the consolidated balance sheets. The FASB issued authoritative guidance within the codification's Compensation-Retirement Benefits topic that, beginning January 1, 2018, only allows the service cost component of net periodic benefit cost to be eligible for capitalization within the consolidated balance sheets. MGE has regulatory treatment and recognizes regulatory assets or liabilities for timing differences between when net periodic benefit costs are recovered and when costs are recognized.

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The following table presents the components of net periodic benefit costs recognized for the three and six months ended June 30, 2018 and 2017.

<i>(In thousands)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Pension Benefits				
Components of net periodic benefit cost:				
Service cost	\$ 1,404	\$ 1,360	\$ 2,861	\$ 2,692
Interest cost	3,222	3,194	6,430	6,313
Expected return on assets	(6,552)	(5,740)	(13,120)	(11,482)
Amortization of:				
Prior service credit	(11)	(4)	(22)	(8)
Actuarial loss	1,341	1,711	2,639	3,175
Net periodic benefit (credit) cost	\$ (596)	\$ 521	\$ (1,212)	\$ 690
Postretirement Benefits				
Components of net periodic benefit cost:				
Service cost	\$ 310	\$ 423	\$ 642	\$ 629
Interest cost	648	912	1,306	1,356
Expected return on assets	(814)	(971)	(1,616)	(1,443)
Amortization of:				
Transition obligation	-	1	1	1
Prior service credit	(667)	(898)	(1,334)	(1,334)
Actuarial loss	116	251	244	380
Net periodic benefit (credit) cost	\$ (407)	\$ (282)	\$ (757)	\$ (411)

7.

Equity and Financing Arrangements - MGE Energy.

a.

Common Stock.

MGE Energy sells shares of its common stock through its Stock Plan. Those shares may be newly issued shares or shares that MGE Energy has purchased in the open market for resale to participants in the Stock Plan. All sales under the Stock Plan are covered by a shelf registration statement that MGE Energy filed with the SEC. For both the three and six months ended June 30, 2018 and 2017, MGE Energy did not issue any new shares of common stock under the Stock Plan.

b.

Dilutive Shares Calculation.

MGE Energy does not have any stock option or stock award programs or any dilutive securities.

c.

Long-term Debt - MGE Energy and MGE.

In July 2018, MGE issued \$20 million of new long-term unsecured debt carrying an interest rate of 4.24% per annum over its 35-year term and \$20 million of new long-term unsecured debt carrying an interest rate of 4.34% per annum over its 40-year term. MGE has also committed to issue \$60 million of new long-term unsecured debt that will carry an interest rate of 4.19% per annum over its 30-year life with funding expected to occur in September 2018. The proceeds of these debt financings will be used to assist with capital expenditures, such as the Saratoga Wind Farm, and to refinance \$20 million of long-term debt at its maturity in September 2018. The covenants of this debt are substantially consistent with MGE's existing unsecured long-term debt. In accordance with applicable accounting guidance, MGE has classified the \$20 million of maturing unsecured debt as long-term debt on the consolidated balance sheets for the quarter ended June 30, 2018.

8.

Share-Based Compensation - MGE Energy and MGE.

Under MGE Energy's Director Incentive Plan and its Performance Unit Plan, non-employee directors and eligible employees, respectively, may receive performance units that entitle the holder to receive a cash payment equal to the value of a designated number of shares of MGE Energy's common stock, plus dividend equivalent payments thereon, at the end of the performance period set in the award.

In 2018, 5,810 units were granted under the Director Incentive Plan and are subject to a three-year graded vesting schedule, and 17,830 units were granted under the Performance Unit Plan and are subject to a five-year graded vesting schedule. On the grant date, the cost of the director or employee services received in exchange for a performance unit award is measured based on the current market value of MGE Energy common stock. The fair value of the awards is re-measured quarterly, including at June 30, 2018, as required by applicable accounting standards. Changes in fair value as well as the original grant are recognized as compensation cost. Since this amount is re-measured throughout the vesting period, the compensation cost is subject to variability.

For nonretirement eligible employees under the Performance Unit Plan, stock based compensation costs are accrued and recognized using the graded vesting method. Compensation cost for retirement eligible employees or employees that will become retirement eligible during the vesting schedule are recognized on an abridged horizon as retirement eligibility accelerated vesting.

During the three and six months ended June 30, 2018, MGE recorded \$0.8 million and \$1.0 million, respectively, in compensation expense as a result of awards under the plans compared to \$0.2 million and \$0.7 million for the comparable periods in 2017. In January 2018, cash payments of \$1.6 million were distributed relating to awards that were granted under the plans. No forfeitures of units occurred during the three and six months ended June 30, 2018 and 2017. At June 30, 2018, \$5.4 million of outstanding awards are vested, and of this amount, no cash settlements have occurred as cash payments are only made at the end of the period covered by the awards.

9.

Commitments and Contingencies.

a.

Environmental - MGE Energy and MGE.

MGE Energy and MGE are subject to frequently changing local, state, and federal regulations concerning air quality, water quality, land use, threatened and endangered species, hazardous materials handling, and solid waste disposal. These regulations affect the manner in which they conduct their operations, the costs of those operations, as well as capital and operating expenditures. Several of these environmental rules are subject to legal challenges, reconsideration and/or other uncertainties. Regulatory initiatives, proposed rules, and court challenges to adopted rules, have the potential to have a material effect on our capital expenditures and operating costs. Management believes compliance costs will be recovered in future rates based on previous treatment of environmental compliance projects. These initiatives, proposed rules, and court challenges include:

The EPA's published water effluent limitations guidelines and standards for steam electric power plants, which focus on the reduction of metals and other pollutants in wastewater from new and existing power plants, such as the coal-burning plants at Columbia and the Elm Road Units.

The EPA's cooling water intake rules, which require cooling water intake structures at electric power plants, such as our WCCF, Blount, and Columbia plants, meet best available technology standards so that mortality from entrainment (drawing aquatic life into a plant's cooling system) and impingement (trapping aquatic life on screens) are reduced.

Greenhouse Gas (GHG) reduction guidelines and approval criteria established under the Clean Air Act for states to use in developing plans to control GHG emissions from existing fossil fuel-fired electric generating units (EGUs) and systems (the Clean Power Plan, or CPP). Implementation of the CPP is expected to have a direct impact on existing coal and natural gas fired generating units, including possible changes in dispatch and additional operating costs. In May 2017, the EPA requested the U.S. Court of Appeals for the D.C. Circuit to put on hold, indefinitely, any ongoing challenges to the CPP while the EPA reviews the rule and undertakes any potential rulemaking. In October 2017, the EPA published a proposed rule announcing the EPA's intention to repeal the CPP and has sought public comment on whether to replace the rule, and if so how. In December 2017, the EPA published an Advance Notice of Public Rulemaking (ANPR) to solicit information from the public as it considers a future rule to limit GHG emissions from electric generating units.

Given the pending legal proceedings, and the ANPR, the nature and timing of any final requirements to control GHG emissions is subject to uncertainty. If the CPP remains substantially in its present form, it is expected to have a material impact on MGE. MGE will continue to monitor developments with this proposed rule.

The EPA's rule to regulate ambient levels of a pollutant through the Ozone National Ambient Air Quality Standards (NAAQS). The EPA issued final designations on May 1, 2018, which designated the northeast portion of Milwaukee County as nonattainment. The Elm Road Units are located outside the designated nonattainment area. MGE expects that Ozone NAAQS will not have a material effect on its existing plants based on final designations.

The State of Wisconsin has joined a lawsuit filed by several states challenging the EPA's new ozone standard, alleging that the new standard is not attainable and the EPA is not properly considering background levels in setting its ozone attainment levels. The lawsuit is ongoing; however, the significance of the challenge, as it might relate to MGE, is now diminished with the final ozone designations.

Rules regulating nitrogen oxide (NO_x) and sulfur dioxide (SO₂) emissions, including the Cross State Air Pollution Rule (CSAPR) and Clean Air Visibility Rule (CAVR). At this time, regulatory obligations, compliance strategies, and costs remain uncertain due to uncertainties surrounding the ongoing implementation of Phase II of CSAPR and the continued legal challenges surrounding CSAPR and CAVR.

The EPA's Coal Combustion Residuals Rule (CCR), which regulates coal ash as a solid waste, and defines what ash use activities would be considered generally exempt beneficial reuse of coal ash. The rule also regulates landfills, ash ponds, and other surface impoundments for coal combustion residuals by regulating their design, location, monitoring, and operation. Review of our Elm Road Units has indicated that the costs to comply with this rule are not expected to be significant. Columbia's operator has completed a review of their system and has determined that an onsite ash pond will need to be closed by 2023 and replace it with a dry ash handling system. The dry ash handling system installation is planned for 2020-2021. In 2015, MGE recorded an asset retirement obligation for its share of the legal liability associated with the effect of the CCR rule. Actual costs of compliance may be different than the amount recorded due to potential changes in compliance strategies that will be used, as well as other potential cost estimate changes.

b.

Legal Matters - MGE Energy and MGE.

MGE is involved in various legal matters that are being defended and handled in the normal course of business. MGE maintains accruals for such costs that are probable of being incurred and subject to reasonable estimation. The accrued amount for these matters is not material to the financial statements. MGE does not expect the resolution of these matters to have a material adverse effect on its consolidated results of operations, financial condition, or cash flows.

c.

Purchase Contracts - MGE Energy and MGE.

MGE Energy and MGE have entered into various commodity supply, transportation, and storage contracts to meet their obligations to deliver electricity and natural gas to customers. Management expects to recover these costs in future customer rates. The following table shows future commitments related to purchase contracts as of June 30, 2018:

<i>(In thousands)</i>	2018	2019	2020	2021	2022	Thereafter
Coal ^(a)	\$ 13,301	\$ 17,831	\$ 5,297	\$ -	\$ -	\$ -
Natural gas supply ^(b)	11,624	12,587	-	-	-	-
Saratoga wind ^(c)	1,038	858	2,266	1,775	1,784	4,429
Other	1,772	502	502	502	502	502
	\$ 27,735	\$ 31,778	\$ 8,065	\$ 2,277	\$ 2,286	\$ 4,931

(a)

Total coal commitments for the Columbia and Elm Road Units, including transportation. Fuel procurement for MGE's jointly owned Columbia and Elm Road Units is handled by WPL and WEPCO, respectively, who are the operators of those facilities.

(b)

These commitments include market-based pricing.

(c)

In December 2017, the PSCW authorized construction of a 66MW wind farm, consisting of 33 turbines, located near Saratoga, Iowa. MGE received specific approval to recover 100% AFUDC on the project. As of June 30, 2018, MGE has incurred \$42.6 million of capital expenditures. Construction of the project is expected to be completed by the end of 2018, with an estimated capital cost of \$108 million.

10.

Rate Matters - MGE Energy and MGE.

a.

Rate Proceedings.

In July 2018, MGE filed an application with the PSCW to decrease electric rates and increase gas rates in 2019 and 2020. MGE filed its application through a settlement agreement between MGE and intervening parties in the rate case, subject to PSCW approval. The settlement proposal would decrease electric rates by 1.94% in 2019. This amount is subject to change based on the final outcome of MGE's 2019 Fuel Cost Plan. MGE will maintain this rate level for 2020, with the exception that MGE will file a 2020 Fuel Cost Plan in 2019 and MGE's rates will decrease or increase accordingly. The decrease reflects the ongoing tax impacts of the Tax Act and the addition of lower-cost renewable generation capacity. The settlement proposal would increase gas rates by 1.06% in 2019 and 1.46% in 2020. The requested increase covers infrastructure costs. It also reflects the impacts of the Tax Act. The proposed return on common stock equity for 2019 and 2020 will be 9.8% based on a capital structure consisting of 56.6% common equity in 2019 and 56.1% common equity in 2020.

In December 2016, the PSCW authorized MGE, effective January 1, 2017, to decrease 2017 rates for retail electric customers by 0.8% or \$3.3 million on an annual basis and to increase rates for retail gas customers by 1.9% or \$3.1 million on an annual basis. The decrease in retail electric rates was attributable to declining fuel and purchased power costs. The increase in retail gas rates covers costs associated with MGE's natural gas system infrastructure improvements. The authorized return on common stock equity for 2017 was 9.8% based on a capital structure consisting of 57.2% common equity. The PSCW also approved MGE's request to extend the current accounting treatment for transmission related costs through 2018. This accounting treatment allows MGE to reflect any differential between transmission costs reflected in rates and actual costs incurred in its next rate case filing.

b.

Fuel Rules.

Fuel rules require the PSCW and Wisconsin utilities to defer electric fuel-related costs that fall outside a symmetrical cost tolerance band around the amount approved for a utility in its annual fuel proceedings. Any over/under recovery of the actual costs is determined in the following year and is then reflected in future billings to electric retail customers. The fuel rules bandwidth is currently set at plus or minus 2%. Under fuel rules, MGE would defer costs, less any excess revenues, if its actual electric fuel costs exceeded 102% of the electric fuel costs allowed in its latest rate order. Excess revenues are defined as revenues in the year in question that provide MGE with a greater return on common equity than authorized by the PSCW in MGE's latest rate order. Conversely, MGE is required to defer the

benefit of lower costs if actual electric fuel costs were less than 98% of the electric fuel costs allowed in that order.

In July 2017, the PSCW issued a final order in the fuel rules proceedings requiring MGE to refund additional fuel savings realized during 2015 and 2016 to its retail electric customers over a one-month period. In October 2017, MGE returned \$6.2 million to customers through bill credits.

In December 2017, the PSCW approved a surcharge for 2018 electric fuel-related costs. The surcharge will increase electric retail revenue in 2018 by \$0.5 million or 0.1%.

In July 2018, the PSCW issued a preliminary decision in the fuel rules proceedings for MGE to refund \$4.2 million of additional fuel savings realized during 2017 to its retail electric customers over a one-month period in the second half of 2018. There was no change to the refund in the fuel rules proceedings from the amount MGE deferred as of December 31, 2017.

As of June 30, 2018, MGE has deferred \$5.2 million of 2018 fuel savings. The 2018 fuel savings will be subject to the PSCW's annual review of 2018 fuel costs, expected to be completed in 2019. As of June 30, 2017, MGE had deferred \$1.8 million of 2017 fuel savings.

11.

Derivative and Hedging Instruments - MGE Energy and MGE.

a.

Purpose.

As part of its regular operations, MGE enters into contracts, including options, swaps, futures, forwards, and other contractual commitments, to manage its exposure to commodity prices. To the extent that these contracts are derivatives, MGE assesses whether or not the normal purchases or normal sales exclusion applies. For contracts to which this exclusion cannot be applied, the derivatives are recognized in the consolidated balance sheets at fair value. MGE's financial commodity derivative activities are conducted in accordance with its electric and gas risk management program, which is approved by the PSCW and limits the volume MGE can hedge with specific risk management strategies. The maximum length of time over which cash flows related to energy commodities can be hedged is four years. If the derivative qualifies for regulatory deferral, the derivatives are marked to fair value and are offset with a corresponding regulatory asset or liability depending on whether the derivative is in a net loss or net gain position, respectively. The deferred gain or loss is recognized in earnings in the delivery month applicable to the instrument. Gains and losses related to hedges qualifying for regulatory treatment are recoverable in gas rates through the PGA or in electric rates as a component of the fuel rules mechanism.

b.

Notional Amounts.

The gross notional volume of open derivatives is as follows:

	June 30, 2018	December 31, 2017
Commodity derivative contracts	525,570 MWh	552,310 MWh
Commodity derivative contracts	6,002,500 Dth	5,460,000 Dth
FTRs	5,326 MW	2,226 MW
PPA	2,350 MW	2,650 MW

c.

Financial Statement Presentation.

MGE purchases and sells exchange-traded and over-the-counter options, swaps, and future contracts. These arrangements are primarily entered into to help stabilize the price risk associated with gas or power purchases. These transactions are employed by both MGE's gas and electric segments. Additionally, as a result of the firm transmission agreements that MGE holds on electricity transmission paths in the MISO market, MGE holds financial transmission rights (FTRs). An FTR is a financial instrument that entitles the holder to a stream of revenues or charges based on the differences in hourly day-ahead energy prices between two points on the transmission grid. The fair values of these instruments are offset with a corresponding regulatory asset/liability depending on whether they are in a net loss/gain position. Depending on the nature of the instrument, the gain or loss associated with these transactions will be reflected as cost of gas sold, fuel for electric generation, or purchased power expense in the delivery month applicable to the instrument. At June 30, 2018, and December 31, 2017, the fair value of exchange traded derivatives and FTRs exceeded their cost basis by \$1.8 million and \$0.2 million, respectively.

MGE is a party to a purchased power agreement that provides MGE with firm capacity and energy during a base term from June 1, 2012, through May 31, 2022. The agreement also allows MGE an option to extend the contract after the base term. The agreement is accounted for as a derivative contract and is recognized at its fair value on the consolidated balance sheets. However, the derivative qualifies for regulatory deferral and is recognized with a corresponding regulatory asset or liability depending on whether the fair value is in a loss or gain position. The fair value of the contract at June 30, 2018, and December 31, 2017, reflects a loss position of \$38.8 million and \$42.2 million, respectively. The actual cost will be recognized in purchased power expense in the month of purchase.

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The following table summarizes the fair value of the derivative instruments on the consolidated balance sheets. All derivative instruments in this table are presented on a gross basis and are calculated prior to the netting of instruments with the same counterparty under a master netting agreement as well as the netting of collateral. For financial statement purposes, instruments are netted with the same counterparty under a master netting agreement as well as the netting of collateral. As of June 30, 2018, and December 31, 2017, the receivable margin account balance of \$1.2 million and \$2.5 million, respectively, is shown net of any collateral posted against derivative positions.

<i>(In thousands)</i>	Derivative Assets	Derivative Liabilities	Balance Sheet Location
June 30, 2018			
Commodity derivative contracts ^(a)	\$ 1,109	\$ 209	Other current assets
Commodity derivative contracts ^(a)	71	86	Other deferred charges
FTRs	941	-	Other current assets
PPA	N/A	8,860	Derivative liability (current)
PPA	N/A	29,890	Derivative liability (long-term)
December 31, 2017			
Commodity derivative contracts ^(a)	\$ 566	\$ 603	Derivative liability (current) ^(b)
Commodity derivative contracts ^(a)	110	190	Derivative liability (long-term)
FTRs	329	-	Other current assets
PPA	N/A	8,180	Derivative liability (current)
PPA	N/A	33,990	Derivative liability (long-term)

(a)

As of December 31, 2017, collateral of \$0.1 million was posted against and netted with derivative liability positions on the consolidated balance sheets. No collateral was posted against derivative positions as of June 30, 2018.

(b)

As of December 31, 2017, MGE presented \$0.1 million as other current assets on the consolidated balance sheets.

The following tables show the effect of netting arrangements for recognized derivative assets and liabilities that are subject to a master netting arrangement or similar arrangement on the consolidated balance sheets.

Offsetting of Derivative Assets

<i>(In thousands)</i>	Gross Amounts	Gross Amounts Offset in Balance Sheets	Collateral Posted Against Derivative Positions	Net Amount Presented in Balance Sheets
June 30, 2018				
Commodity derivative contracts	\$ 1,180	\$ (295)	\$ -	\$ 885
FTRs	941	-	-	941
December 31, 2017				
Commodity derivative contracts	\$ 676	\$ (654)	\$ -	\$ 22
FTRs	329	-	-	329

Offsetting of Derivative Liabilities

<i>(In thousands)</i>	Gross Amounts	Gross Amounts Offset in Balance Sheets	Collateral Posted Against Derivative Positions	Net Amount Presented in Balance Sheets
June 30, 2018				
Commodity derivative contracts	\$ 295	\$ (295)	\$ -	\$ -
PPA	38,750	-	-	38,750
December 31, 2017				
Commodity derivative contracts	\$ 793	\$ (654)	\$ (139)	\$ -
PPA	42,170	-	-	42,170

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The following tables summarize the unrealized and realized gains (losses) related to the derivative instruments on the consolidated balance sheets at June 30, 2018 and 2017, and the consolidated income statements for the three and six months ended June 30, 2018 and 2017.

	2018		2017	
	Current and Long-Term Regulatory Asset	Other Current Assets	Current and Long-Term Regulatory Asset	Other Current Assets
<i>(In thousands)</i>				
Three Months Ended June 30:				
Balance at April 1,	\$ 41,241	\$ 319	\$ 48,073	\$ 142
Unrealized gain	(4,027)	-	(1,731)	-
Realized (loss) gain reclassified to a deferred account	(363)	363	(544)	544
Realized gain (loss) reclassified to income statement	73	(42)	(482)	(68)
Balance at June 30,	\$ 36,924	\$ 640	\$ 45,316	\$ 618
Six Months Ended June 30:				
Balance at January 1,	\$ 41,958	\$ 806	\$ 49,281	\$ 230
Unrealized gain	(3,899)	-	(2,420)	-
Realized (loss) gain reclassified to a deferred account	(521)	521	(622)	622
Realized loss reclassified to income statement	(614)	(687)	(923)	(234)
Balance at June 30,	\$ 36,924	\$ 640	\$ 45,316	\$ 618

	Realized Losses (Gains)			
	2018		2017	
	Fuel for Electric Generation/ Purchased Power	Cost of Gas Sold	Fuel for Electric Generation/ Purchased Power	Cost of Gas Sold
<i>(In thousands)</i>				
Three Months Ended June 30:				
Commodity derivative contracts	\$ (190)	\$ 22	\$ 17	\$ 63
FTRs	(300)	-	(439)	-
PPA	437	-	909	-
Six Months Ended June 30:				
Commodity derivative contracts	\$ 184	\$ 637	\$ 402	\$ 209
FTRs	(475)	-	(1,124)	-
PPA	955	-	1,670	-

MGE's commodity derivative contracts, FTRs, and PPA are subject to regulatory deferral. These derivatives are marked to fair value and are offset with a corresponding regulatory asset or liability. Realized gains and losses are deferred on the consolidated balance sheets and are recognized in earnings in the delivery month applicable to the instrument. As a result of the above described treatment, there are no unrealized gains or losses that flow through earnings.

The PPA has a provision that may require MGE to post collateral if MGE's debt rating falls below investment grade (i.e., below BBB-). The amount of collateral that it may be required to post varies from \$20.0 million to \$40.0 million, depending on MGE's nominated capacity amount. As of June 30, 2018, no collateral is required to be, or has been, posted. Certain counterparties extend MGE a credit limit. If MGE exceeds these limits, the counterparties may require collateral to be posted. As of June 30, 2018, no counterparties were in a net liability position. As of December 31, 2017, certain counterparties were in a net liability of \$0.1 million.

Nonperformance of counterparties to the non-exchange traded derivatives could expose MGE to credit loss. However, MGE enters into transactions only with companies that meet or exceed strict credit guidelines, and it monitors these counterparties on an ongoing basis to mitigate nonperformance risk in its portfolio. As of June 30, 2018, no counterparties have defaulted.

12.

Fair Value of Financial Instruments - MGE Energy and MGE.

Fair value is defined as the price that would be received to sell an asset or would be paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. The accounting standard clarifies that fair value should be based on the assumptions market participants would use when pricing the asset or liability including assumptions about risk. The standard also establishes a three level fair value hierarchy based upon the observability of the assumptions used and requires the use of observable market data when available. The levels are:

Level 1 - Pricing inputs are quoted prices within active markets for identical assets or liabilities.

Level 2 - Pricing inputs are quoted prices within active markets for similar assets or liabilities; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations that are correlated with or otherwise verifiable by observable market data.

Level 3 - Pricing inputs are unobservable and reflect management's best estimate of what market participants would use in pricing the asset or liability.

a.

Fair Value of Financial Assets and Liabilities Recorded at the Carrying Amount.

The carrying amount of cash, cash equivalents, and outstanding commercial paper approximates fair market value due to the short maturity of those investments and obligations. The estimated fair market value of long-term debt is based on quoted market prices for similar financial instruments. Since long-term debt is not traded in an active market, it is classified as Level 2. The estimated fair market value of financial instruments are as follows:

<i>(In thousands)</i>	June 30, 2018		December 31, 2017	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
MGE Energy				
Assets:				
Cash and cash equivalents	\$ 95,579	\$ 95,579	\$ 107,952	\$ 107,952

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Liabilities:

Short-term debt - commercial paper	28,200	28,200	4,000	4,000
Long-term debt ^(a)	424,670	464,428	426,883	475,282

MGE

Assets:

Cash and cash equivalents	\$ 3,128	\$ 3,128	\$ 5,951	\$ 5,951
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Liabilities:

Short-term debt - commercial paper	28,200	28,200	4,000	4,000
Long-term debt ^(a)	424,670	464,428	426,883	475,282

(a)

Includes long-term debt due within one year. Excludes debt issuance costs and unamortized discount of \$4.1 million and \$4.3 million at June 30, 2018, and December 31, 2017, respectively.

b.

Recurring Fair Value Measurements.

The following table presents the balances of assets and liabilities measured at fair value on a recurring basis.

<i>(In thousands)</i>	Total	Fair Value as of June 30, 2018		
		Level 1	Level 2	Level 3
MGE Energy				
Assets:				
Derivatives, net	\$ 2,121	\$ 502	\$ -	\$ 1,619
Exchange-traded investments	902	902	-	-
Total Assets	\$ 3,023	\$ 1,404	\$ -	\$ 1,619
Liabilities:				
Derivatives, net	\$ 39,045	\$ 94	\$ -	\$ 38,951
Deferred compensation	3,065	-	3,065	-
Total Liabilities	\$ 42,110	\$ 94	\$ 3,065	\$ 38,951
MGE				
Assets:				
Derivatives, net	\$ 2,121	\$ 502	\$ -	\$ 1,619
Exchange-traded investments	77	77	-	-
Total Assets	\$ 2,198	\$ 579	\$ -	\$ 1,619
Liabilities:				
Derivatives, net	\$ 39,045	\$ 94	\$ -	\$ 38,951
Deferred compensation	3,065	-	3,065	-
Total Liabilities	\$ 42,110	\$ 94	\$ 3,065	\$ 38,951
MGE Energy				
Assets:				
Derivatives, net	\$ 1,005	\$ 278	\$ -	\$ 727
Exchange-traded investments	792	792	-	-
Total Assets	\$ 1,797	\$ 1,070	\$ -	\$ 727
Liabilities:				
Derivatives, net ^(b)	\$ 42,963	\$ 210	\$ -	\$ 42,753
Deferred compensation	3,065	-	3,065	-
Total Liabilities	\$ 46,028	\$ 210	\$ 3,065	\$ 42,753
MGE				
Assets:				
Derivatives, net	\$ 1,005	\$ 278	\$ -	\$ 727
Exchange-traded investments	64	64	-	-
Total Assets	\$ 1,069	\$ 342	\$ -	\$ 727
Liabilities:				

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Derivatives, net ^(b)	\$	42,963	\$	210	\$	-	\$	42,753
Deferred compensation		3,065		-		3,065		-
Total Liabilities	\$	46,028	\$	210	\$	3,065	\$	42,753

(b)

These amounts are shown gross and exclude \$0.1 million of collateral that was posted against derivative positions with counterparties as of December 31, 2017.

No transfers were made in or out of Level 1 or Level 2 for the six months ended June 30, 2018.

Investments include exchange-traded investment securities valued using quoted prices on active exchanges and are therefore classified as Level 1.

Derivatives include exchange-traded derivative contracts, over-the-counter transactions, a purchased power agreement, and financial transmission rights (FTRs). Most exchange-traded derivative contracts are valued based on unadjusted quoted prices in active markets and are therefore classified as Level 1. A small number of exchange-traded derivative contracts are valued using quoted market pricing in markets with insufficient volumes and are therefore considered unobservable and classified as Level 3. Transactions done with an over-the-counter party are on inactive markets and are therefore classified as Level 3. These transactions are valued based on quoted prices from markets with similar exchange-traded transactions. FTRs are priced based upon monthly auction results for identical or similar instruments in a closed market with limited data available and are therefore classified as Level 3.

The purchased power agreement (see Footnote 11) was valued using an internally-developed pricing model and therefore is classified as Level 3. The model projects future market energy prices and compares those prices to the projected power costs to be incurred under the contract. Inputs to the model require significant management judgment and estimation. Future energy prices are based on a forward power pricing curve using exchange-traded contracts in the electric futures market. A basis adjustment is applied to the market energy price to reflect the price differential between the market price delivery point and the counterparty delivery point. The historical relationship between the delivery points is reviewed and a discount (below 100%) or premium (above 100%) is derived. This comparison is done for both peak times when demand is high and off-peak times when demand is low. If the basis adjustment is lowered, the fair value measurement will decrease, and if the basis adjustment is increased, the fair value measurement will increase.

The projected power costs anticipated to be incurred under the purchased power agreement are determined using many factors, including historical generating costs, future prices, and expected fuel mix of the counterparty. An increase in the projected fuel costs would result in a decrease in the fair value measurement of the purchased power agreement. A significant input that MGE estimates is the counterparty's fuel mix in determining the projected power cost. MGE also considers the assumptions that market participants would use in valuing the asset or liability. This consideration includes assumptions about market risk such as liquidity, volatility, and contract duration. The fair value model uses a discount rate that incorporates discounting, credit, and model risks.

The following table presents the significant unobservable inputs used in the pricing model.

Significant Unobservable Inputs	Model Input	
	June 30, 2018	December 31, 2017
Basis adjustment:		
On peak	91.1%	92.3%
Off peak	93.1%	94.1%
Counterparty fuel mix:		
Internal generation	50% - 75%	55% - 75%
Purchased power	50% - 25%	45% - 25%

The deferred compensation plan allows participants to defer certain cash compensation into a notional investment account. These amounts are included within other deferred liabilities in the consolidated balance sheets of MGE Energy and MGE. The notional investments earn interest based upon the semiannual rate of U.S. Treasury Bills having a 26-week maturity increased by 1% compounded monthly with a minimum annual rate of 7%, compounded monthly. The notional investments are based upon observable market data, however, since the deferred compensation obligations themselves are not exchanged in an active market, they are classified as Level 2.

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The following table summarizes the changes in Level 3 commodity derivative assets and liabilities measured at fair value on a recurring basis.

<i>(In thousands)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Beginning balance	\$ (41,463)	\$ (48,354)	\$ (42,026)	\$ (50,305)
Realized and unrealized gains (losses):				
Included in regulatory assets	4,130	2,748	4,693	4,701
Included in other comprehensive income	-	-	-	-
Included in earnings	82	(550)	(460)	(1,136)
Included in current assets	(297)	(222)	(470)	(97)
Purchases	6,032	6,186	11,866	12,182
Sales	-	-	-	-
Issuances	-	-	-	-
Settlements	(5,816)	(5,413)	(10,935)	(10,950)
Transfers in and/or out of Level 3	-	-	-	-
Balance as of June 30,	\$ (37,332)	\$ (45,605)	\$ (37,332)	\$ (45,605)
Total gains (losses) included in earnings attributed to the change in unrealized gains (losses) related to assets and liabilities held at June 30, ^(c)	\$ -	\$ -	\$ -	\$ -

The following table presents total realized and unrealized gains (losses) included in income for Level 3 assets and liabilities measured at fair value on a recurring basis (c).

<i>(In thousands)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Purchased Power Expense	\$ 60	\$ (487)	\$ (663)	\$ (918)
Cost of Gas Sold Expense	22	(63)	203	(218)
Total	\$ 82	\$ (550)	\$ (460)	\$ (1,136)

(c)

MGE's exchange-traded derivative contracts, over-the-counter party transactions, purchased power agreement, and FTRs are subject to regulatory deferral. These derivatives are therefore marked to fair value and are offset in the financial statements with a corresponding regulatory asset or liability.

13.

Joint Plant Ownership - MGE Energy and MGE.

a.

Columbia.

In 2016, MGE and WPL negotiated an amendment to the existing Columbia joint operating agreement, that has been approved by the PSCW, under which MGE will have the option to reduce its obligation to pay certain capital expenditures (other than SCR-related expenditures) at Columbia in exchange for a proportional reduction in MGE's ownership in Columbia. On January 1 of each year, that began in 2017 and will end June 1, 2020, the ownership percentage is adjusted, through a partial sale, based on the amount of capital expenditures foregone. In June 2017, the FERC approved the ownership transfer in Columbia, effective January 1, 2017.

During 2017, MGE accrued \$8.8 million of 2017 foregone capital expenditures as part of the ownership transfer agreement with WPL. As of December 31, 2017, MGE classified \$8.8 million of Columbia assets as held-for-sale on the consolidated balance sheets. In January 2018, MGE reduced its ownership interest in Columbia from 20.4% to 19.4% as a result of the partial sale of plant assets to WPL.

During the three and six months ended June 30, 2018, MGE accrued less than \$0.1 million and \$1.4 million, respectively, of 2018 foregone capital expenditures as part of the ownership transfer agreement. As of June 30, 2018, MGE classified \$1.4 million of Columbia assets as held-for-sale on the consolidated balance sheets. The assets recognized as held-for-sale are the ownership transfer agreement covering the sale of plant assets to WPL, expected to occur in January 2019.

b.

Forward Wind.

In April 2018, MGE, along with two other utilities, purchased the Forward Wind Energy Center (Forward Wind), which consists of 86 wind turbines located in Wisconsin with a total capacity of 129 MWs. The aggregate purchase price was approximately \$174 million of which MGE's proportionate share is 12.8%, or approximately \$23 million. The purchase of Forward Wind replaced an existing purchase power agreement, under which MGE purchased 12.8% of the facility's energy output.

MGE Energy and MGE are required to record a liability for the fair value of an asset retirement obligation (ARO) to be recognized in the period in which it is incurred if it can be reasonably estimated. The offsetting associated asset retirement costs are capitalized as a long-lived asset and depreciated over the asset's useful life. As of June 30, 2018, MGE recorded an obligation of \$1.6 million for the fair value of its legal liability for AROs associated with Forward Wind. MGE has regulatory treatment and recognizes regulatory assets or liabilities for the timing differences between when we recover legal AROs in rates and when those costs would actually be recognized.

14.

Segment Information - MGE Energy and MGE.

MGE Energy operates in the following business segments: electric utility, gas utility, nonregulated energy, transmission investment, and all other. See the 2017 Annual Report on Form 10-K for additional discussion of each of these segments.

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The following tables show segment information for MGE Energy's operations for the indicated periods:

(In thousands)

MGE Energy	Electric	Gas	Nonregulated Energy	Transmission Investment	All Others	Consolidation/ Elimination/ Entries	Consolidated Total
Three Months Ended June 30, 2018							
Operating revenues	\$ 99,067	\$ 24,980	\$ 215	\$ -	\$ -	\$ -	124,262
Interdepartmental revenues	(245)	3,493	9,847	-	-	(13,095)	-
Total operating revenues	98,822	28,473	10,062	-	-	(13,095)	124,262
Depreciation and amortization	(9,575)	(2,445)	(1,852)	-	-	-	(13,872)
Other operating expenses	(74,535)	(24,232)	(34)	(5)	(448)	13,095	(86,159)
Operating income (loss)	14,712	1,796	8,176	(5)	(448)	-	24,231
Other income, net	1,562	752	-	1,916	501	-	4,731
Interest (expense) income, net	(2,952)	(887)	(1,334)	-	390	-	(4,783)
Income before taxes	13,322	1,661	6,842	1,911	443	-	24,179
Income tax provision	(2,986)	(372)	(1,864)	(522)	(84)	-	(5,828)
Net income	\$ 10,336	\$ 1,289	\$ 4,978	\$ 1,389	\$ 359	\$ -	18,351

Three Months Ended June 30, 2017

Operating revenues	\$ 102,306	\$ 24,081	\$ 76	\$ -	\$ -	\$ -	126,463
Interdepartmental revenues	(119)	3,422	11,107	-	-	(14,410)	-
Total operating revenues	102,187	27,503	11,183	-	-	(14,410)	126,463
Depreciation and amortization	(9,185)	(2,232)	(1,858)	-	-	-	(13,275)
Other operating expenses ^(a)	(78,202)	(23,522)	(62)	-	(217)	14,410	(87,593)
Operating income (loss)	14,800	1,749	9,263	-	(217)	-	25,595
Other income (deductions), net ^(a)	778	361	-	2,506	(75)	-	3,570
Interest (expense) income, net	(2,801)	(805)	(1,392)	-	112	-	(4,886)
Income (loss) before taxes	12,777	1,305	7,871	2,506	(180)	-	24,279
Income tax (provision) benefit	(4,124)	(521)	(3,158)	(1,006)	73	-	(8,736)
Net income (loss)	\$ 8,653	\$ 784	\$ 4,713	\$ 1,500	\$(107)	\$ -	15,543

Six Months Ended June 30, 2018

Operating revenues	\$ 193,458	\$ 87,745	\$ 691	\$ -	\$ -	\$ -	281,894
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Interdepartmental revenues	(214)	7,840	19,667	-	-	(27,293)	-
Total operating revenues	193,244	95,585	20,358	-	-	(27,293)	281,894
Depreciation and amortization	(18,953)	(4,840)	(3,702)	-	-	-	(27,495)
Other operating expenses	(151,110)	(79,427)	(77)	(8)	(651)	27,293	(203,980)
Operating income (loss)	23,181	11,318	16,579	(8)	(651)	-	50,419
Other income, net	3,292	1,518	-	4,288	552	-	9,650
Interest (expense) income, net	(5,819)	(1,726)	(2,682)	-	705	-	(9,522)
Income before taxes	20,654	11,110	13,897	4,280	606	-	50,547
Income tax provision	(4,186)	(2,830)	(3,786)	(1,170)	(223)	-	(12,195)
Net income	\$ 16,468\$	8,280\$	10,111\$	3,110\$	383\$	-\$	38,352

Six Months Ended June 30, 2017

Operating revenues	\$ 200,630\$	82,507\$	149\$	-\$	-\$	-\$	283,286
Interdepartmental revenues	(224)	7,816	22,177	-	-	(29,769)	-
Total operating revenues	200,406	90,323	22,326	-	-	(29,769)	283,286
Depreciation and amortization	(18,085)	(4,445)	(3,704)	-	-	-	(26,234)
Other operating expenses ^(a)	(154,208)	(74,493)	(103)	-	(586)	29,769	(199,621)
Operating income (loss)	28,113	11,385	18,519	-	(586)	-	57,431
Other income (deductions), net ^(a)	1,648	760	-	4,984	(297)	-	7,095
Interest (expense) income, net	(5,577)	(1,604)	(2,799)	-	200	-	(9,780)
Income (loss) before taxes	24,184	10,541	15,720	4,984	(683)	-	54,746
Income tax (provision) benefit	(7,578)	(4,225)	(6,309)	(2,003)	212	-	(19,903)
Net income (loss)	\$ 16,606\$	6,316\$	9,411\$	2,981\$	(471)\$	-\$	34,843

(a)

Reflects retrospective application of new accounting pronouncement related to pension and other postretirement benefits, see Footnote 2 for further information.

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The following tables show segment information for MGE's operations for the indicated periods:

(In thousands)

MGE	Electric	Gas	Nonregulated Energy	Consolidation/ Elimination Entries	Consolidated Total
Three Months Ended June 30, 2018					
Operating revenues	\$ 99,067	\$ 24,980	215	-\$	124,262
Interdepartmental revenues	(245)	3,493	9,847	(13,095)	-
Total operating revenues	98,822	28,473	10,062	(13,095)	124,262
Depreciation and amortization	(9,575)	(2,445)	(1,852)	-	(13,872)
Other operating expenses ^(b)	(77,475)	(24,558)	(1,898)	13,095	(90,836)
Operating income ^(b)	11,772	1,470	6,312	-	19,554
Other income, net ^(b)	1,516	706	-	-	2,222
Interest expense, net	(2,952)	(887)	(1,334)	-	(5,173)
Net income	10,336	1,289	4,978	-	16,603
Less: Net income attributable to noncontrolling interest, net of tax	-	-	-	(5,505)	(5,505)
Net income attributable to MGE	\$ 10,336	\$ 1,289	\$ 4,978	(5,505)	\$ 11,098
Three Months Ended June 30, 2017					
Operating revenues	\$ 102,306	\$ 24,080	76	-\$	126,462
Interdepartmental revenues	(119)	3,423	11,107	(14,411)	-
Total operating revenues	102,187	27,503	11,183	(14,411)	126,462
Depreciation and amortization	(9,185)	(2,232)	(1,858)	-	(13,275)
Other operating expenses ^{(a), (b)}	(82,289)	(24,033)	(3,220)	14,411	(95,131)
Operating income ^(b)	10,713	1,238	6,105	-	18,056
Other income, net ^{(a), (b)}	741	351	-	-	1,092
Interest expense, net	(2,801)	(805)	(1,392)	-	(4,998)
Net income	8,653	784	4,713	-	14,150
Less: Net income attributable to noncontrolling interest, net of tax	-	-	-	(5,396)	(5,396)
Net income attributable to MGE	\$ 8,653	\$ 784	\$ 4,713	(5,396)	\$ 8,754
Six Months Ended June 30, 2018					
Operating revenues	\$ 193,458	\$ 87,745	691	-\$	281,894
Interdepartmental revenues	(214)	7,840	19,667	(27,293)	-
Total operating revenues	193,244	95,585	20,358	(27,293)	281,894
Depreciation and amortization	(18,953)	(4,840)	(3,702)	-	(27,495)
Other operating expenses ^(b)	(155,206)	(82,199)	(3,863)	27,293	(213,975)

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Operating income ^(b)	19,085	8,546	12,793	-	40,424
Other income, net ^(b)	3,202	1,460	-	-	4,662
Interest expense, net	(5,819)	(1,726)	(2,682)	-	(10,227)
Net income	16,468	8,280	10,111	-	34,859
Less: Net income attributable to noncontrolling interest, net of tax	-	-	-	(11,311)	(11,311)
Net income attributable to MGE	\$ 16,468\$	8,280\$	10,111\$	(11,311)\$	23,548

Six Months Ended June 30, 2017

Operating revenues	\$ 200,634\$	82,515\$	149\$	-\$	283,298
Interdepartmental revenues	(228)	7,808	22,177	(29,757)	-
Total operating revenues	200,406	90,323	22,326	(29,757)	283,298
Depreciation and amortization	(18,085)	(4,445)	(3,704)	-	(26,234)
Other operating expenses ^(a) , ^(b)	(161,715)	(78,698)	(6,412)	29,757	(217,068)
Operating income ^(b)	20,606	7,180	12,210	-	39,996
Other income, net ^(a) , ^(b)	1,577	740	-	-	2,317
Interest expense, net	(5,577)	(1,604)	(2,799)	-	(9,980)
Net income	16,606	6,316	9,411	-	32,333
Less: Net income attributable to noncontrolling interest, net of tax	-	-	-	(10,785)	(10,785)
Net income attributable to MGE	\$ 16,606\$	6,316\$	9,411\$	(10,785)\$	21,548

(a)

Reflects retrospective application of new accounting pronouncement related to pension and other postretirement benefits, see Footnote 2 for further information.

(b)

Amounts are shown net of the related tax expense, consistent with the presentation on the MGE Consolidated Statements of Income.

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The following table shows segment information for assets and capital expenditures:

<i>(In thousands)</i>	Utility		Consolidated				Consolidation/ Elimination Entries	Total
	Electric	Gas	Assets not Allocated	Nonregulated Energy	Transmission Investment	All Others		
MGE Energy								
<i>Assets:</i>								
June 30, 2018	\$ 1,112,411	\$ 333,621	\$ 17,648	\$ 266,154	\$ 64,135	\$ 477,257	(377,781)	\$ 1,893,445
December 31, 2017	1,043,181	344,337	26,345	270,384	61,783	485,548	(376,396)	1,855,182
<i>Capital Expenditures:</i>								
<i>Six Months Ended</i>								
June 30, 2018	\$ 82,148	\$ 14,774	\$ -	\$ 3,467	\$ -	\$ -	\$ -	\$ 100,389
Year ended Dec. 31, 2017	77,353	26,847	-	3,931	-	-	-	108,131

<i>(In thousands)</i>	Utility		Consolidated			Total
	Electric	Gas	Assets not Allocated	Nonregulated Energy	Elimination Entries	
MGE						
<i>Assets:</i>						
June 30, 2018	\$ 1,112,411	\$ 333,621	\$ 17,648	\$ 266,104	\$ (883)	\$ 1,728,901
December 31, 2017	1,043,181	344,337	26,345	270,334	(156)	1,684,041
<i>Capital Expenditures:</i>						
<i>Six Months Ended</i>						
June 30, 2018	\$ 82,148	\$ 14,774	\$ -	\$ 3,467	\$ -	\$ 100,389
Year ended Dec. 31, 2017	77,353	26,847	-	3,931	-	108,131

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

General

MGE Energy is an investor-owned public utility holding company operating through subsidiaries in five business segments:

- .
Regulated electric utility operations, conducted through MGE,
- .
Regulated gas utility operations, conducted through MGE,
- .
Nonregulated energy operations, conducted through MGE Power and its subsidiaries,
- .
Transmission investments, representing our equity investment in ATC and ATC Holdco, and
- .
All other, which includes corporate operations and services.

Our principal subsidiary is MGE, which generates and distributes electric energy, distributes natural gas, and represents a majority portion of our assets, liabilities, revenues, and expenses. MGE generates and distributes electricity to approximately 151,000 customers in Dane County, Wisconsin, including the city of Madison, and purchases and distributes natural gas to approximately 158,000 customers in the Wisconsin counties of Columbia, Crawford, Dane, Iowa, Juneau, Monroe, and Vernon.

Our nonregulated energy operations own interests in electric generating capacity that is leased to MGE. The ownership/leasing structure was adopted under applicable state regulatory guidelines for MGE's participation in these generation facilities, consisting principally of a stable return on the equity investment in the new generation facilities over the term of the related leases. The nonregulated energy operations include an ownership interest in two coal-fired generating units in Oak Creek, Wisconsin and a partial ownership of a cogeneration project on the UW-Madison campus. A third party operates the units in Oak Creek, and MGE operates the cogeneration project. Due to the nature of MGE's participation in these facilities, the results of MGE Energy's nonregulated operations are also consolidated into MGE's consolidated financial position and results of operations under applicable accounting standards.

Executive Overview

Our primary focus today and for the foreseeable future is our core utility customers at MGE as well as creating long-term value for our shareholders. MGE continues to face the challenge of providing its customers with reliable power at competitive prices. MGE meets this challenge by investing in more efficient generation projects, including renewable energy sources. MGE continues to examine and pursue opportunities to reduce the proportion that coal generation represents in its generation mix, including the announced reduction in its ownership of Columbia and its growing ownership of renewable generation sources. MGE will continue to focus on growing earnings while controlling operating and fuel costs. MGE maintains safe and efficient operations in addition to providing customer value. We believe it is critical to maintain a strong credit standing consistent with financial strength in MGE as well as the parent company in order to accomplish these goals.

We earn our revenue and generate cash from operations by providing electric and natural gas utility services, including electric power generation and electric power and gas distribution. The earnings and cash flows from the utility business are sensitive to various external factors, including:

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Weather, and its impact on customer sales,

.

Economic conditions, including current business activity and employment and their impact on customer demand,

.

Regulation and regulatory issues, and their impact on the timing and recovery of costs,

.

Energy commodity prices, including natural gas prices,

.

Equity price risk pertaining to pension related assets,

.

Credit market conditions, including interest rates and our debt credit rating,

.

Environmental laws and regulations, including adopted and pending environmental rule changes, and

Other factors listed in "Item 1A. Risk Factors" in our 2017 Annual Report on Form 10-K.

For the three months ended June 30, 2018, MGE Energy's earnings were \$18.4 million or \$0.53 per share compared to \$15.5 million or \$0.45 per share for the same period in the prior year. MGE's earnings for the three months ended June 30, 2018, were \$11.1 million compared to \$8.8 million for the same period in the prior year.

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For the six months ended June 30, 2018, MGE Energy's earnings were \$38.4 million or \$1.11 per share compared to \$34.8 million or \$1.01 per share for the same period in the prior year. MGE's earnings for the six months ended June 30, 2018, were \$23.5 million compared to \$21.5 million for the same period in the prior year.

MGE Energy's net income was derived from our business segments as follows:

<i>(In millions)</i>	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
Business Segment:	2018	2017	2018	2017
Electric Utility	\$ 10.3	\$ 8.6	\$ 16.5	\$ 16.6
Gas Utility	1.3	0.8	8.3	6.3
Nonregulated Energy	5.0	4.7	10.1	9.4
Transmission Investments	1.4	1.5	3.1	3.0
All Other	0.4	(0.1)	0.4	(0.5)
Net Income	\$ 18.4	\$ 15.5	\$ 38.4	\$ 34.8

Our net income during the three and six months ended June 30, 2018, compared to the same period in the prior year primarily reflects the effects of the following factors:

Electric Utility

For the three months ended June 30, 2018, electric operating income increased primarily as a result of more favorable weather conditions in the current year. For the six months ended June 30, 2018, electric operating income was relatively flat.

Gas Utility

For the three and six months ended June 30, 2018, gas operating income increased primarily related to an increase in gas retail sales reflecting higher customer demand resulting from colder weather experienced in April 2018 compared to the same period in the prior year and an increase in retail customers. The average temperature in April 2018 was 38 degrees compared to 50 degrees in April 2017.

During the first six months of 2018, the following events occurred:

Tax Reform: On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act. The Tax Act makes broad and complex changes to the U.S. tax code, including the reduction in the U.S. federal corporate tax rate from 35 percent to 21 percent, effective January 1, 2018.

Customer rates approved for 2018 reflect an income tax rate of 35 percent. In January 2018, the PSCW issued an order directing Wisconsin investor-owned utilities to defer the over-collection of income tax expense as a result of the decrease in tax rate to 21 percent. The PSCW issued an order in May 2018 to return to customers the estimated 2018 over-collection of income tax expense. The decision includes a one-time bill credit on customer bills to reflect the estimate of the over-collection for January through June 2018. A monthly volumetric bill credit will begin in July 2018 and continue through the remainder of 2018 for the estimated remaining annual amount. In June 2018, customers received a \$4.1 million bill credit. Any over/under recovery of the actual costs will be subject to the PSCW's review in a future rate case. As of June 30, 2018, MGE has deferred \$1.7 million as a regulatory liability and recorded a corresponding reduction in operating revenues for over-collection of income tax expense (net of customer bill credits).

Saratoga Wind Farm: In December 2017, the PSCW authorized construction of a 66MW wind farm, consisting of 33 turbines, located near Saratoga, Iowa. MGE received specific approval to recover 100% AFUDC on the project. As of June 30, 2018, MGE has incurred \$42.2 million of capital expenditures. MGE has recognized \$0.7 million (after tax) in AFUDC equity related to this project for the six months ended June 30, 2018. Construction of the project is expected to be completed by the end of 2018, with an estimated capital cost of \$108 million.

Forward Wind: In April 2018, MGE, along with two other utilities, purchased the Forward Wind Energy Center, which consists of 86 wind turbines located in Wisconsin with a total capacity of 129 MWs. The aggregate purchase price was approximately \$174 million of which MGE's proportionate share is 12.8%, or approximately \$23 million. The purchase of the Forward Wind Energy Center replaced an existing purchase power agreement, under which MGE purchased 12.8% of the facility's energy output.

Deferred Fuel Costs Subject to Refund: As of June 30, 2018, MGE has deferred \$5.2 million of 2018 fuel savings. These costs will be subject to the PSCW's annual review of 2018 fuel costs, expected to be completed in 2019.

In the near term, several items may affect us, including:

2017 Annual Fuel Proceeding: In July 2018, the PSCW issued a preliminary decision in the fuel rules proceedings for MGE to refund \$4.2 million of additional fuel savings realized during 2017 to its retail electric customers over a one-month period in the second half of 2018. There was no change to the refund in the fuel rules proceedings from the amount MGE deferred as of December 31, 2017.

2019/2020 Rate Change Settlement: In July 2018, MGE filed an application with the PSCW to decrease electric rates and increase gas rates in 2019 and 2020. MGE filed its application through a settlement agreement between MGE and intervening parties in the rate case, subject to PSCW approval. The settlement proposal would decrease electric rates by 1.94% in 2019. This amount is subject to change based on the final outcome of MGE's 2019 Fuel Cost Plan. MGE will maintain this rate level for 2020, with the exception that MGE will file a 2020 Fuel Cost Plan in 2019 and MGE's rates will decrease or increase accordingly. The decrease reflects the ongoing tax impacts of the Tax Act and the addition of lower-cost renewable generation capacity. The settlement proposal would increase gas rates by 1.06% in 2019 and 1.46% in 2020. The requested increase covers infrastructure costs. It also reflects the impacts of the Tax Act.

Tax Reform: Pursuant to the Tax Act, deferred income tax balances as of December 31, 2017, were remeasured to reflect the decrease in corporate tax rate. A \$130.5 million regulatory liability was recorded given that changes in income taxes are generally passed through in customer rates for the regulated utility. The amount and timing of the cash impacts will depend on the period over which certain income tax benefits are provided to customers, which will be determined by the PSCW. A portion of the regulatory liability will be returned to customers using a normalization method of accounting.

Debt Issuance: MGE issued \$40 million of long-term unsecured debt and committed to \$60 million of long-term unsecured debt in July 2018. The proceeds of these debt financings will be used to assist with the financing of additional capital expenditures, such as the Saratoga Wind Farm, and refinance \$20 million of long-term debt, upon its maturity in September 2018. The covenants of this debt are substantially consistent with MGE's existing unsecured long-term debt.

ATC Return on Equity: Several parties have filed complaints with the FERC seeking to reduce the ROE used by MISO transmission owners, including ATC. Any change to ATC's ROE could result in lower equity earnings and distributions from ATC in the future. We derived approximately 7.5% and 8.7% of our net income for the six months ended June 30, 2018 and 2017, respectively, from our investment in ATC. See "Other Matters" below for additional information concerning ATC.

Environmental Initiatives: There are proposed legislative rules and initiatives involving matters related to air emissions, water effluent, hazardous materials, and greenhouse gases, all of which affect generation plant capital expenditures and operating costs as well as future operational planning. At present, it is unclear how the changes in the Presidential and EPA administrations may affect existing, pending or new legislative or rulemaking proposals or regulatory initiatives. Such legislation and rulemaking could significantly affect the costs of owning and operating fossil-fueled generating plants, such as Columbia and the Elm Road Units, from which we derive approximately 44% of our electric generating capacity as of June 30, 2018. We would expect to seek and receive recovery of any such costs in rates; however, it is difficult to estimate the amount of such costs due to the uncertainty as to the timing and form of the legislation and rules, and the scope and time of the recovery of costs in rates, which may lag the incurrence of those costs.

EPA's Clean Power Plan: In October 2015, the EPA finalized its Clean Power Plan (CPP) rule with an effective date of December 2015, setting guidelines and approval criteria for states to use in developing plans to control GHG emissions from existing fossil fuel-fired electric generating units (EGUs) and systems. Implementation of the rule is expected to have a direct impact on existing coal and natural gas fired generating units, including possible changes in dispatch and additional operating costs. In October 2017, the EPA published a proposed rule announcing the EPA's intention to repeal the CPP and has sought public comment on whether to replace the rule, and if so how. Given the pending legal proceedings, and the EPA's proposal, the nature and timing of any final requirements to control GHG emissions from existing fossil fuel-fired EGUs is subject to uncertainty. If a rule is implemented substantially in its present form, it is expected to have a material impact on MGE. MGE will continue to monitor developments with this proposed rule.

Future Generation: During the first quarter of 2016, MGE entered into an agreement with WPL under which MGE may acquire up to 50 MW of capacity in a gas-fired generating plant to be constructed by WPL at its Riverside Energy Center in Beloit, Wisconsin, during the five-year period following the in-service date of the plant. The plant is expected to be completed by early 2020. MGE and WPL have negotiated an amendment to the existing Columbia joint operating agreement, effective January 1, 2017, under which MGE will reduce its obligation to pay certain capital expenditures (other than SCR-related expenditures) at Columbia prior to the expected in-service date of the Riverside gas-fired generating plant in exchange for a proportional reduction in MGE's ownership in Columbia. On January 1 of each year, that began in 2017 and will end June 1, 2020, the ownership percentage will be adjusted, through a partial sale, based on the amount of capital expenditures foregone. During the three and six months ended June 30, 2018, MGE accrued less than \$0.1 million and \$1.4 million, respectively, of 2018 foregone capital expenditures as part of the ownership transfer agreement with WPL. During 2017, MGE accrued \$8.8 million of 2017 foregone capital expenditures. As of June 30, 2018, and December 31, 2017, MGE classified \$1.4 million and \$8.8 million, respectively, of Columbia assets as held-for-sale on the consolidated balance sheets. In January 2018, MGE reduced its ownership interest in Columbia from 20.4% to 19.4% as a result of the partial sale of plant assets to WPL. By June 2020, MGE's ownership in Columbia is forecasted to be approximately 19%, a decrease of 3% from the 22% ownership interest held by MGE on January 1, 2016.

Future Generation - Utility Solar: In May 2018, MGE and Wisconsin Public Service Corporation filed a joint application with the PSCW to seek approval to acquire 300 MW of solar generating capacity from two large solar projects in Wisconsin. MGE's combined ownership share of the two projects is expected to be 100 MW. If approved by the PSCW, construction of the projects is expected to begin in 2019. MGE's share of the total cost is expected to be approximately \$130 million.

The following discussion is based on the business segments as discussed in Footnote 14 of the Notes to Consolidated Financial Statements in this Report.

Results of Operations

Results of operations include financial information prepared in accordance with GAAP and electric and gas margins which are non-GAAP measures. Electric margin (electric revenues less fuel for electric generation and purchase power costs) and gas margin (gas revenues less cost of gas sold) are non-GAAP measures because they exclude nonregulated operating revenues, other operations and maintenance expense, depreciation and amortization expense, and other general taxes expense and thus are not measures determined in accordance with GAAP.

Management believes that electric and gas margins provide a meaningful basis for evaluating and managing utility operations since fuel for electric generation, purchase power costs, and cost of gas sold are passed through to customers in current rates. As a result, management uses electric and gas margins internally when assessing the operating performance of our segments. The presentation of utility electric and gas margins herein is intended to provide supplemental information for investors regarding operating performance. These electric and gas margins may not be comparable to how other entities calculate utility electric and gas margin or similar measures. Furthermore, these measures are not intended to replace operating income as determined in accordance with GAAP as an indicator

of operating performance.

Three Months Ended June 30, 2018 and 2017

The following table provides a calculation of electric and gas margins (non-GAAP), along with a reconciliation to the most comparable GAAP measure, operating income:

<i>(In millions)</i>	Three Months Ended June 30,		
	2018	2017	\$ Change
Electric revenues	\$ 99.1	\$ 102.3	\$ (3.2)
Fuel for electric generation	15.3	11.9	3.4
Purchased power	13.0	16.7	(3.7)
Total Electric Margins	70.8	73.7	(2.9)
Gas revenues	25.0	24.1	0.9
Cost of gas sold	9.6	9.2	0.4
Total Gas Margins	15.4	14.9	0.5
Other operating revenues	0.2	0.1	0.1
Other operations and maintenance	43.4	44.9	(1.5)
Depreciation and amortization	13.9	13.3	0.6
Other general taxes	4.9	4.9	-
Operating Income	\$ 24.2	\$ 25.6	\$ (1.4)

Electric sales and revenues

The following table compares MGE's electric revenues and electric kWh sales by customer class for each of the periods indicated:

<i>(In thousands, except cooling degree days)</i>	Revenues			Sales (kWh)		
	Three Months Ended June 30,			Three Months Ended June 30,		
	2018	2017	% Change	2018	2017	% Change
Residential	\$ 32,217	\$ 31,634	1.8 %	200,224	177,644	12.7 %
Commercial	50,174	54,721	(8.3)%	470,504	449,876	4.6 %
Industrial	4,630	4,516	2.5 %	46,237	53,098	(12.9)%
Other-retail/municipal	8,527	9,661	(11.7)%	98,147	103,626	(5.3)%
Total retail	95,548	100,532	(5.0)%	815,112	784,244	3.9 %
Sales to the market	2,795	1,050	*n.m.%	85,937	16,830	*n.m.%
Other revenues	454	562	(19.2)%	-	-	- %
Adjustments to revenues	270	162	66.7 %	-	-	- %
Total	\$ 99,067	\$ 102,306	(3.2)%	901,049	801,074	12.5 %

Cooling degree days (normal 184)	247	172	43.6 %
	(*n.m.: not meaningful)		

Electric margin, a non-GAAP measure, decreased \$2.9 million for the three months ended June 30, 2018, compared to the same period in 2017, due to the following:

<i>(In millions)</i>	
Revenue subject to refund, net	\$ (8.8)
Increase in volume	3.0
Decreased fuel costs	2.4
Other	0.5
Total	\$ (2.9)

Revenue subject to refund. For cost recovery mechanisms, any over-collection of the difference between actual costs incurred and the amount of costs collected from customers is recorded as a reduction of revenue in the period incurred.

o

Tax Act. MGE received a PSCW order in January 2018 to defer the over-collection of income tax expense collected in customer rates as a result of the Tax Act reduction in federal income tax rate to 21 percent. During the three months ended June 30, 2018, electric customers received a credit on their bill of \$3.1 million related to the tax credit.

o

Fuel-related costs. MGE's fuel-related costs subject to refund decreased \$3.1 million. Under fuel rules, MGE is required to defer electric fuel-related costs that fall outside a 2% cost tolerance band around the amount used in the most recent rate proceeding. Beginning in 2018, over-collection of fuel-related costs outside the tolerance band are reflected as a reduction of revenue in the period incurred. Under-collection of costs outside the tolerance band is reflected as a reduction of purchase power expense in the period incurred. Any potential recovery of excess fuel costs will be recorded in the period received. Prior to adoption of the new revenue recognition guidance, effective January 1, 2018, deferred fuel-related costs were reflected in purchased power expense, with potential refunds associated with fuel savings increasing that expense and potential recovery of excess fuel costs decreasing that expense.

o

Transmission. MGE's transmission costs subject to refund decreased \$1.8 million primarily related to a one-time refund received in June 2018.

o

Operating Costs. MGE's electric plant operating costs subject to refund decreased \$1.4 million primarily related to lower leased generation costs due to the reduction in tax rate.

o

Other. MGE has other cost recovery mechanisms subject to refund.

Volume. During the three months ended June 30, 2018, there was a 12.7% increase in residential electric sales volumes compared to the same period in the prior year driven by favorable weather conditions. During the three months ended June 30, 2018, there was a 12.9% decrease in industrial retail electric sales volumes compared to the same period in the prior year as a result of a large industrial customer relocating its operations out of state.

Fuel costs. Fuel costs decreased during the three months ended June 30, 2018, primarily as a result of a scheduled plant outage in 2017 and a reduction in purchased power. The purchase of the Forward Wind Energy Center in April 2018 replaced an existing purchase power agreement that was previously recorded as purchased power expense in fuel costs.

Gas deliveries and revenues

The following table compares MGE's gas revenues and gas therms delivered by customer class for each of the periods indicated:

<i>(In thousands, except HDD and average rate per therm of retail customer)</i>	Revenues			Therms Delivered		
	Three Months Ended June 30,			Three Months Ended June 30,		
	2018	2017	% Change	2018	2017	% Change
Residential	\$ 15,620	\$ 15,140	3.2 %	15,344	11,915	28.8 %
Commercial/Industrial	8,206	7,842	4.6 %	15,649	12,842	21.9 %
Total retail	23,826	22,982	3.7 %	30,993	24,757	25.2 %
Gas transportation	1,053	991	6.3 %	16,534	15,186	8.9 %
Other revenues	101	108	(6.5)%	-	-	- %
Total	\$ 24,980	\$ 24,081	3.7 %	47,527	39,943	19.0 %
Heating degree days (normal 803)				939	757	24.0 %
Average rate per therm of retail customer	\$ 0.769	\$ 0.928	(17.1)%			

Gas margin, a non-GAAP measure, increased \$0.5 million for the three months ended June 30, 2018, compared to the same period in 2017, due to the following:

<i>(In millions)</i>	
Increase in volume	\$ 1.1
Revenue subject to refund/tax credit	(0.6)
Total	\$ 0.5

Volume. For the three months ended June 30, 2018, retail gas deliveries increased 25.2% compared to the same period in the prior year primarily related to customer growth and more favorable weather conditions in the current year.

Revenue subject to refund/tax credit. MGE received a PSCW order in January 2018 to defer the over-collection of income tax expense collected in customer rates as a result of the Tax Act reduction in federal income tax rate to 21 percent. Any over-collection of the difference between actual costs incurred and the amount of costs collected from customers is recorded as a reduction of revenue in the period incurred. During the three months ended June 30, 2018, gas customers received a credit on their bill of \$1.0 million related to the tax credit.

Consolidated operations and maintenance expenses

For the three months ended June 30, 2018, operations and maintenance expenses decreased \$1.5 million, compared to the same period in the prior year. The following contributed to the net change:

<i>(In millions)</i>	
Decreased transmission costs	\$ (1.7)
Increased other costs	0.2
Total	\$ (1.5)

For the three months ended June 30, 2018, decreased transmission costs are primarily related to a decrease in transmission rates as a result of a one-time refund received in June 2018. The lower transmission rate is reflected in customer revenue as revenue subject to refund.

Nonregulated Energy Operations - MGE Energy and MGE

The nonregulated energy operations are conducted through MGE Energy's subsidiaries: MGE Power Elm Road (the Elm Road Units) and MGE Power West Campus (WCCF), which have been formed to own and lease electric generating capacity to assist MGE. For the three months ended June 30, 2018 and 2017, net income at the nonregulated energy operations segment was \$5.0 million and \$4.7 million, respectively. The decrease in tax rate from 35% to 21%, effective January 1, 2018, lowered lease revenues and income tax expense for the three months ended 2018. Income tax expense is a factor used in the formula to calculate lease rates.

Transmission Investment Operations - MGE Energy

Transmission investment other income

For the three months ended June 30, 2018 and 2017, other income at the transmission investment segment was \$1.9 million and \$2.5 million, respectively. The decrease in tax rate from 35% to 21%, effective January 1, 2018, lowered earnings from ATC and income tax expense for the three months ended 2018. Income tax expense is a factor used in the calculation of ATC's transmission rates. The transmission investment segment holds our interest in ATC and ATC Holdco, and its income reflects our equity in the earnings of those investments. ATC Holdco was formed in December 2016. In the near term, it is expected that ATC Holdco will be pursuing transmission development opportunities that typically have long development and investment lead times before becoming operational. See Footnote 4 of the Notes to Consolidated Financial Statements in this Report and "Other Matters" below for additional information concerning ATC and summarized financial information regarding ATC.

Consolidated Income Taxes - MGE Energy and MGE

Although effective tax rates have been lowered as a result of the Tax Act, regulated revenues have been affected as tax expense is a factor in the determination of rates for electric and gas service, and rates held by our investment in transmission. See Footnote 5 of the Notes to Consolidated Financial Statements for effective tax rate reconciliation.

Noncontrolling Interest, Net of Tax - MGE

The noncontrolling interest, net of tax, reflects the accounting required for MGE Energy's interest in MGE Power Elm Road (the Elm Road Units) and MGE Power West Campus (WCCF). MGE Energy owns 100% of MGE Power Elm Road and MGE Power West Campus; however, due to the contractual agreements for these projects with MGE, the entities are considered VIEs with respect to MGE and their results are consolidated with those of MGE, the primary beneficiary of the VIEs. The following table shows MGE Energy's noncontrolling interest, net of tax, reflected on MGE's consolidated statement of income:

<i>(In millions)</i>	Three Months Ended	
	June 30,	
	2018	2017
MGE Power Elm Road	\$ 3.8	\$ 3.6
MGE Power West Campus	1.7	1.8

Six Months Ended June 30, 2018 and 2017

The following table provides a calculation of electric and gas margins (non-GAAP), along with a reconciliation to the most comparable GAAP measure, operating income:

<i>(In millions)</i>	Six Months Ended June 30,		
	2018	2017	\$ Change
Electric revenues	\$ 193.5	\$ 200.6	\$ (7.1)
Fuel for electric generation	27.2	24.1	3.1
Purchased power	30.0	32.1	(2.1)
Total Electric Margins	136.3	144.4	(8.1)
Gas revenues	87.7	82.5	5.2
Cost of gas sold	49.2	45.0	4.2
Total Gas Margins	38.5	37.5	1.0
Other operating revenues	0.7	0.1	0.6
Other operations and maintenance	87.8	88.6	(0.8)
Depreciation and amortization	27.5	26.2	1.3
Other general taxes	9.8	9.8	-
Operating Income	\$ 50.4	\$ 57.4	\$ (7.0)

Electric sales and revenues

The following table compares MGE's electric revenues and electric kWh sales by customer class for each of the periods indicated:

<i>(In thousands, except cooling degree days)</i>	Revenues			Sales (kWh)		
	Six Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	% Change	2018	2017	% Change
Residential	\$ 65,476	\$ 64,987	0.8 %	407,375	375,318	8.5 %
Commercial	97,626	104,885	(6.9)%	911,395	883,265	3.2 %
Industrial	7,525	8,731	(13.8)%	89,104	104,863	(15.0)%
Other-retail/municipal	16,814	18,682	(10.0)%	187,392	195,713	(4.3)%
Total retail	187,441	197,285	(5.0)%	1,595,266	1,559,159	2.3 %
Sales to the market	4,829	2,022	*n.m.%	118,496	52,692	*n.m.%
Other revenues	924	991	(6.8)%	-	-	- %
Adjustments to revenues	264	332	(20.5)%	-	-	- %
Total	\$ 193,458	\$ 200,630	(3.6)%	1,713,762	1,611,851	6.3 %
Cooling degree days (normal 184)				247	172	43.6 %
			(*n.m.: not meaningful)			

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Electric margin, a non-GAAP measure, decreased \$8.1 million for the six months ended June 30, 2018, compared to the same period in 2017, due to the following:

<i>(In millions)</i>	
Revenue subject to refund, net	\$ (12.9)
Other	(0.4)
Increase in volume	4.0
Decreased fuel costs	1.2
Total	\$ (8.1)

Revenue subject to refund. For cost recovery mechanisms, any over-collection of the difference between actual costs incurred and the amount of costs collected from customers is recorded as a reduction of revenue in the period incurred.

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Tax Act. MGE received a PSCW order in January 2018 to defer the over-collection of income tax expense collected in customer rates as a result of the Tax Act reduction in federal income tax rate to 21 percent. During the six months ended June 30, 2018, MGE recorded a \$2.0 million reduction in retail electric revenues and recorded a corresponding regulatory liability. During the six months ended June 30, 2018, electric customers received a credit on their bill of \$3.1 million related to the tax credit.

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Fuel-related costs. MGE's fuel-related costs subject to refund decreased \$3.4 million. Under fuel rules, MGE is required to defer electric fuel-related costs that fall outside a 2% cost tolerance band around the amount used in the most recent rate proceeding. Beginning in 2018, over-collection of fuel-related costs outside the tolerance band are reflected as a reduction of revenue in the period incurred. Under-collection of costs outside the tolerance band is reflected as a reduction of purchase power expense in the period incurred. Any potential recovery of excess fuel costs will be recorded in the period received. Prior to adoption of the new revenue recognition guidance, effective January 1, 2018, deferred fuel-related costs were reflected in purchased power expense, with potential refunds associated with fuel savings increasing that expense and potential recovery of excess fuel costs decreasing that expense.

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Transmission. MGE's transmission costs subject to refund decreased \$2.2 million primarily related to a one-time refund received in June 2018.

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Operating Costs. MGE's electric plant operating costs subject to refund decreased \$2.3 million primarily related to lower leased generation costs due to the reduction in tax rate.

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Other. MGE has other cost recovery mechanisms subject to refund.

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Volume. During the six months ended June 30, 2018, there was an 8.5% increase in residential sales volumes compared to the same period in the prior year driven by favorable weather conditions. During the six months ended June 30, 2018, there was a 15.0% decrease in industrial retail sales volumes compared to the same period in the prior year as a result of a large industrial customer relocating its operations out of state.

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Fuel costs. Fuel costs decreased during the six months ended June 30, 2018, primarily as a result of a reduction in purchased power. The purchase of the Forward Wind Energy Center in April 2018 replaced an existing purchase power agreement.

Gas deliveries and revenues

The following table compares MGE's gas revenues and gas therms delivered by customer class for each of the periods indicated:

<i>(In thousands, except HDD and average rate per therm of retail customer)</i>	Revenues			Therms Delivered		
	Six Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	% Change	2018	2017	% Change
Residential	\$ 52,171	\$ 49,043	6.4 %	65,056	54,953	18.4 %
Commercial/Industrial	33,158	30,890	7.3 %	57,956	50,018	15.9 %
Total retail	85,329	79,933	6.8 %	123,012	104,971	17.2 %
Gas transportation	2,189	2,341	(6.5)%	38,475	36,222	6.2 %
Other revenues	227	233	(2.6)%	-	-	- %
Total	\$ 87,745	\$ 82,507	6.3 %	161,487	141,193	14.4 %
Heating degree days (normal 4,282)				4,525	3,887	16.4 %
Average rate per therm of retail customer	\$ 0.694	\$ 0.761	(8.8)%			

Gas margin, a non-GAAP measure, increased \$1.0 million for the six months ended June 30, 2018, compared to the same period in 2017, due to the following:

<i>(In millions)</i>	
Increase in volume	\$ 2.9
Other	0.1
Revenue subject to refund/tax credit	(2.0)
Total	\$ 1.0

Volume. For the six months ended June 30, 2018, retail gas deliveries increased 17.2% compared to the same period in the prior year primarily related to customer growth and more favorable weather conditions in the current year.

Revenue subject to refund/tax credit. MGE received a PSCW order to defer the over-collection of income tax expense collected in customer rates as a result of the Tax Act reduction in federal income tax rate to 21 percent. During the six months ended June 30, 2018, gas customers received a credit on their bill of \$1.0 million related to the tax credit. For

the six months ended June 30, 2018, MGE recorded a \$1.0 million reduction in retail gas revenues and recorded a corresponding regulatory liability.

Consolidated operations and maintenance expenses

For the six months ended June 30, 2018, operations and maintenance expenses decreased \$0.8 million, compared to the same period in the prior year. The following contributed to the net change:

<i>(In millions)</i>	
Decreased transmission costs	\$ (2.1)
Increased other costs	0.4
Increased administrative and general costs	0.3
Increased customer accounts costs	0.3
Increased electric production expenses	0.3
Total	\$ (0.8)

For the six months ended June 30, 2018, decreased transmission costs are primarily related to a decrease in transmission rates as a result of a one-time refund received in June 2018. The lower transmission rate is reflected in customer revenue as revenue subject to refund.

Consolidated depreciation expense

Depreciation expense increased \$1.3 million for the six months ended June 30, 2018, compared to the same period in the prior year primarily related to an increase in depreciable assets.

Nonregulated Energy Operations - MGE Energy and MGE

The nonregulated energy operations are conducted through MGE Energy's subsidiaries: MGE Power Elm Road (the Elm Road Units) and MGE Power West Campus (WCCF), which have been formed to own and lease electric generating capacity to assist MGE. For the six months ended June 30, 2018 and 2017, net income at the nonregulated energy operations segment was \$10.1 million and \$9.4 million, respectively. The decrease in tax rate from 35% to 21%, effective January 1, 2018, lowered lease revenues and income tax expense for the six months ended 2018. Income tax expense is a factor used in the formula to calculate lease rates.

Transmission Investment Operations - MGE Energy

Transmission investment other income

For the six months ended June 30, 2018 and 2017, other income at the transmission investment segment was \$4.3 million and \$5.0 million, respectively. The decrease in tax rate from 35% to 21%, effective January 1, 2018, lowered earnings from ATC and income tax expense for the six months ended 2018. Income tax expense is a factor used in the calculation of ATC's transmission rates. The transmission investment segment holds our interest in ATC and ATC Holdco, and its income reflects our equity in the earnings of those investments. ATC Holdco was formed in December 2016. In the near term, it is expected that ATC Holdco will be pursuing transmission development opportunities that typically have long development and investment lead times before becoming operational. See Footnote 4 of the Notes to Consolidated Financial Statements in this Report and "Other Matters" below for additional information concerning ATC and summarized financial information regarding ATC.

Consolidated Income Taxes - MGE Energy and MGE

Although effective tax rates have been lowered as a result of the Tax Act, regulated revenues have been affected as tax expense is a factor in the determination of rates for electric and gas service, and rates held by our investment in transmission. See Footnote 5 of the Notes to Consolidated Financial Statements for effective tax rate reconciliation.

Noncontrolling Interest, Net of Tax - MGE

The noncontrolling interest, net of tax, reflects the accounting required for MGE Energy's interest in MGE Power Elm Road (the Elm Road Units) and MGE Power West Campus (WCCF). MGE Energy owns 100% of MGE Power Elm Road and MGE Power West Campus; however, due to the contractual agreements for these projects with MGE, the entities are considered VIEs with respect to MGE and their results are consolidated with those of MGE, the primary

beneficiary of the VIEs. The following table shows MGE Energy's noncontrolling interest, net of tax, reflected on MGE's consolidated statement of income:

<i>(In millions)</i>	Six Months Ended	
	June 30,	
	2018	2017
MGE Power Elm Road	\$ 7.8	\$ 7.2
MGE Power West Campus	3.5	3.6

Contractual Obligations and Commercial Commitments - MGE Energy and MGE

There were no material changes, other than from the normal course of business, to MGE Energy's and MGE's contractual obligations (representing cash obligations that are considered to be firm commitments) and commercial commitments (representing commitments triggered by future events) during the six months ended June 30, 2018, except as noted below. Further discussion of the contractual obligations and commercial commitments is included in Footnote 17 of Notes to Consolidated Financial Statements and "Contractual Obligations and Commercial Commitments for MGE Energy and MGE" under "Management's Discussion and Analysis of Financial Condition and Results of Operations" in MGE Energy's and MGE's 2017 Annual Report on Form 10-K.

Purchase Contracts - MGE Energy and MGE

See Footnote 9.c. of Notes to Consolidated Financial Statements in this Report for a description of commitments at June 30, 2018, that MGE Energy and MGE have entered with respect to various commodity supply and transportation contracts to meet their obligations to deliver electricity and natural gas to customers and the Saratoga wind project.

Long-term Debt - MGE Energy and MGE

MGE issued \$40 million of long-term unsecured debt and committed to \$60 million of long-term unsecured debt in July 2018. The proceeds of these debt financings will be used to assist with the financing of additional capital expenditures, such as the Saratoga Wind Farm, and refinance \$20 million of long-term debt upon its maturity in September 2018. See Footnote 7 of the Notes to Consolidated Financial Statements in this Report for further discussion of these debt issuances.

Liquidity and Capital Resources

MGE Energy and MGE have adequate liquidity to fund future operations and capital expenditures over the next twelve months. Available resources include cash and cash equivalents, operating cash flows, liquid assets, borrowing capacity under revolving credit facilities, and access to equity and debt capital markets. See "Credit Facilities" under Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources in MGE Energy's and MGE's 2017 Annual Report on Form 10-K for information regarding MGE Energy's and MGE's credit facilities.

Cash Flows

The following summarizes cash flows for MGE Energy and MGE during the six months ended June 30, 2018 and 2017:

<i>(In thousands)</i>	MGE Energy		MGE	
	2018	2017	2018	2017
Cash provided by/(used for):				
Operating activities	\$ 91,618	\$ 67,016	\$ 90,047	\$ 64,019
Investing activities	(103,071)	(46,874)	(100,811)	(42,104)
Financing activities	(374)	(13,805)	8,487	(27,472)

Cash Provided by Operating Activities**MGE Energy**

MGE Energy's consolidated net cash provided by operating activities is derived mainly from the electric and gas operations of its principal subsidiary, MGE.

Cash provided by operating activities for the six months ended June 30, 2018, was \$91.6 million, an increase of \$24.6 million when compared to the same period in the prior year, primarily reflecting changes in working capital items between periods.

MGE Energy's net income increased \$3.5 million for the six months ended June 30, 2018, when compared to the same period in the prior year.

MGE Energy's federal and state taxes paid decreased \$6.0 million for the six months ended June 30, 2018, when compared to the same period in the prior year.

Working capital accounts (excluding prepaid and accrued taxes) resulted in \$17.6 million in cash provided by operating activities for the six months ended June 30, 2018, primarily due to decreased unbilled revenues, decreased accounts receivable, decreased gas inventories, and increased other current liabilities, partially offset by decreased accounts payable.

Working capital accounts (excluding prepaid and accrued taxes) resulted in \$2.0 million in cash used for operating activities for the six months ended June 30, 2017, primarily due to decreased accounts payable and decreased other current liabilities, partially offset by decreased unbilled and decreased accounts receivable.

A decrease in pension contribution resulted in an additional \$5.6 million in cash provided by operating activities for the six months ended June 30, 2018, when compared to the same period in the prior year. Pension contributions reflect amounts required by law and discretionary amounts.

MGE

Cash provided by operating activities for the six months ended June 30, 2018, was \$90.0 million, an increase of \$26.0 million when compared to the same period in the prior year, primarily reflecting changes in working capital items between periods.

Net income increased \$2.5 million for the six months ended June 30, 2018, when compared to the same period in the prior year.

MGE's federal and state taxes paid decreased \$6.0 million for the six months ended June 30, 2018, when compared to the same period in the prior year.

Working capital accounts (excluding prepaid and accrued taxes) resulted in \$19.7 million in cash provided by operating activities for the six months ended June 30, 2018, primarily due to decreased unbilled revenues, decreased accounts receivable, decreased gas inventories, and increased other current liabilities, partially offset by decreased accounts payable.

Working capital accounts (excluding prepaid and accrued taxes) resulted in \$2.1 million in cash used for operating activities for the six months ended June 30, 2017, primarily due to decreased accounts payable and decreased other current liabilities, partially offset by decreased unbilled revenues and decreased accounts receivable.

A decrease in pension contribution resulted in an additional \$5.6 million in cash provided by operating activities for the six months ended June 30, 2018, when compared to the same period in the prior year. Pension contributions reflect amounts required by law and discretionary amounts.

Cash Used for Investing Activities

MGE Energy

MGE Energy's cash used for investing activities increased \$56.2 million for the six months ended June 30, 2018, when compared to the same period in the prior year.

Capital expenditures for the six months ended June 30, 2018, were \$100.4 million. This amount represents an increase of \$58.2 million from the expenditures made in the same period in the prior year. This increase primarily reflects expenditures on the construction of the Saratoga wind project and the purchase of Forward Wind.

Capital contributions to ATC and other investments decreased \$2.3 million for the six months ended June 30, 2018, when compared to the same period in the prior year.

MGE

MGE's cash used for investing activities increased \$58.7 million for the six months ended June 30, 2018, when compared to the same period in the prior year.

Capital expenditures for the six months ended June 30, 2018, were \$100.4 million. This amount represents an increase of \$58.2 million from the expenditures made in the same period in the prior year. This increase primarily reflects expenditures on the construction of the Saratoga wind project and the purchase of Forward Wind.

Cash Provided by/(Used for) Financing Activities

MGE Energy

Cash used for MGE Energy's financing activities was \$0.4 million for the six months ended June 30, 2018, compared to \$13.8 million of cash used for MGE Energy's financing activities for the same period in the prior year.

For the six months ended June 30, 2018, dividends paid were \$22.4 million compared to \$21.3 million in the prior year. This increase was a result of a higher dividend per share (\$0.645 vs. \$0.615).

During the six months ended June 30, 2017, MGE issued \$40.0 million of senior unsecured notes, which was used to refinance \$30.0 million of maturing medium-term notes and assist with financing additional capital expenditures.

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For the six months ended June 30, 2018, net short-term borrowings were \$24.2 million. There were no short-term borrowings for the six months ended June 30, 2017. The increase in net short-term borrowings primarily reflects expenditures on the construction of the Saratoga wind project and the purchase of Forward Wind.

MGE

During the six months ended June 30, 2018, cash provided by MGE's financing activities was \$8.5 million, compared to \$27.5 million of cash used for MGE's financing activities for the same period in the prior year.

Dividends paid from MGE to MGE Energy were \$25.0 million for the six months ended June 30, 2017. There were no dividends from MGE to MGE Energy for the six months ended June 30, 2018.

Distributions to parent from noncontrolling interest, which represent distributions from MGE Power Elm Road and MGE Power West Campus to MGE Energy, were \$13.5 million for the six months ended June 30, 2018, compared to \$10.0 million in the prior year.

During the six months ended June 30, 2017, MGE issued \$40.0 million of senior unsecured notes, which was used to refinance \$30.0 million of maturing medium-term notes and assist with financing additional capital expenditures.

For the six months ended June 30, 2018, net short-term borrowings were \$24.2 million. There were no short-term borrowings for the six months ended June 30, 2017. The increase in net short-term borrowings primarily reflects expenditures on the construction of the Saratoga wind project and the purchase of Forward Wind.

Capitalization Ratios

MGE Energy's capitalization ratios were as follows:

	MGE Energy	
	June 30, 2018	December 31, 2017
Common shareholders' equity	63.9%	64.6%
Long-term debt ^(a)	33.8%	35.1%
Short-term debt	2.3%	0.3%

(a)

Includes the current portion of long-term debt.

MGE Energy's and MGE's Capital Requirements

MGE Energy's and MGE's liquidity are primarily affected by their capital requirements. During the six months ended June 30, 2018, capital expenditures for MGE Energy and MGE totaled \$100.4 million, which included \$96.9 million of utility capital expenditures primarily related to the construction of the Saratoga wind project and the purchase of Forward Wind.

Credit Ratings

MGE Energy's and MGE's access to the capital markets, including, in the case of MGE, the commercial paper market, and their respective financing costs in those markets, may depend on the credit ratings of the entity that is accessing the capital markets.

None of MGE Energy's or MGE's borrowings are subject to default or prepayment as a result of a downgrading of credit ratings, although a downgrading of MGE's credit ratings could increase fees and interest charges under both MGE Energy's and MGE's credit agreements.

Environmental Matters

There were no material updates or developments in environmental matters that occurred during the six months ended June 30, 2018. Further discussion of environmental matters is included in MGE Energy's and MGE's 2017 Annual Report on Form 10-K and Footnote 9.a. of Notes to Consolidated Financial Statements in this Report.

Other Matters

ATC

In 2013, several parties filed a complaint with the FERC seeking to reduce the base return on equity (ROE) used by MISO transmission owners, including ATC, "due to changes in the capital markets." The complaint alleged that the MISO ROE should not exceed 9.15%, the equity components of hypothetical capital structures should be restricted to 50%, and the relevant incentive ROE adders should be discontinued. At the time, MISO's base ROE was 12.38% and ATC's base ROE was 12.2%. In February 2015, a second complaint was filed for the period February 2015 through May 2015 with the FERC requesting a reduction in the base ROE used by MISO transmission owners, including ATC, to 8.67%, with a refund effective date retroactive to the filing date of the complaint. In June 2016, an administrative law judge issued an initial decision for the second complaint that would reduce the transmission owner's base ROE to 9.7%. The initial decision will be reviewed by FERC. It is anticipated FERC will issue an order on this issue in 2019. On September 28, 2016, FERC issued an order on the first complaint, for the period November 2013 through February 2015, reducing the base ROE to 10.32%. This base ROE also became effective September 28, 2016, and will apply to future periods until FERC rules in the second complaint, at which time the base ROE ordered by FERC in the second complaint will prospectively become the authorized base ROE. Any change to ATC's ROE could result in lower equity earnings and distributions from ATC in the future.

In January 2015, FERC accepted the transmission owner's request for a 50 basis-point incentive ROE adder for participating in MISO. The adder became effective January 6, 2015.

Our share of ATC's earnings reflects a pre-tax adjustment of \$0.1 million and \$0.2 million for the three and six months ended June 30, 2017, respectively, recorded by ATC for these matters representing its estimate of its refund liability. We derived approximately 7.5% and 8.7% of our net income for the six months ended June 30, 2018 and 2017, respectively, from our investment in ATC.

Adoption of Accounting Principles and Recently Issued Accounting Pronouncements

See Footnote 2 of Notes to Consolidated Financial Statements in this Report for discussion of new accounting pronouncements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

MGE Energy and MGE are potentially exposed to market risk associated with interest rates, commodity prices, and equity returns. MGE currently has no exposure to foreign currency risk. MGE manages some risk exposure through risk management policies and the use of derivative instruments. MGE's risk management policy prohibits speculative trading transactions.

Commodity Price Risk

MGE has commodity price risk exposure with respect to the price of natural gas, electricity, coal, emission credits, and oil. MGE's electric operations burn natural gas in several of its peaking power plants and, in many cases, the cost of purchased power is tied to the cost of natural gas. MGE employs established policies and procedures to reduce the market risks associated with changing commodity prices. MGE's commodity risks are somewhat mitigated by the current ratemaking process in place for recovering electric fuel cost, purchased energy costs, and the cost of natural gas.

MGE's electric fuel costs are subject to fuel rules established by the PSCW. The fuel rules require the PSCW and Wisconsin utilities to defer electric fuel-related costs that fall outside a symmetrical cost tolerance band. Any over/under recovery of the actual costs in a year outside of the symmetrical cost tolerance band is determined in the following year and is then reflected in future billings to electric retail customers. Under the electric fuel rules, MGE is required to defer the benefit of lower costs if the actual electric fuel costs fall outside the lower end of the range and is required to defer costs, less any excess revenues, if the actual electric fuel costs exceed the upper end of the range. Excess revenues are defined as revenues in the year in question that provide MGE with a greater return on common equity than authorized by the PSCW in MGE's latest rate order. The range is defined by the PSCW and has been modified throughout the years based on market conditions and other relevant factors. Currently, MGE is subject to a plus or minus 2% range. MGE assumes the risks and benefits of variances that are within the cost tolerance band. For 2018, fuel and purchased power costs included in MGE's fuel monitoring level rates are \$102.4 million. See Footnote 10.b. of the Notes to Consolidated Financial Statements in this Report for additional information.

MGE recovers the cost of natural gas in its gas utility segment through the purchased gas adjustment clause (PGA). Under the PGA, MGE is able to pass through to its gas customers the cost of gas.

MGE also reduces price risk caused by market fluctuations via physical contracts and financial derivative contracts, including futures, swaps, options, forwards, and other contractual commitments. The maximum length of time over which cash flows related to energy commodities can be hedged under applicable PSCW approvals is four years.

MGE has financial gas and electric commodity contracts to hedge commodity price risk in the gas and electric utility segments. These contracts are primarily comprised of exchange-traded option and future contracts. MGE also holds financial transmission rights (FTRs), which are used to hedge the risk of increased transmission congestion charges. At June 30, 2018, the fair value of these instruments exceeded their cost basis by \$1.8 million. Under the PGA clause and electric fuel rules, MGE may include the costs and benefits of the aforementioned fuel price risk management tools in the costs of fuel (natural gas or power). Because these costs/benefits are recoverable, the related unrealized loss/gain has been deferred on the consolidated balance sheets as a regulatory asset/liability.

MGE has also entered into a purchased power agreement that provides MGE with firm capacity and energy that began on June 1, 2012, and ends on May 31, 2022 (the "base term"). The agreement also allows MGE an option to extend the contract after the base term. The agreement is considered a derivative contract and is recognized at its fair value on the consolidated balance sheets. However, the derivative qualifies for regulatory deferral and is recognized with a corresponding regulatory asset or liability depending on whether the fair value is in a loss or gain position. The fair value of the contract at June 30, 2018, reflects a loss position of \$38.8 million.

Interest Rate Risk

Both MGE Energy and MGE may have short term borrowings at varying interest rates. MGE issues commercial paper for its short-term borrowings, while MGE Energy draws from its current credit facility to meet its short-term borrowing needs. Borrowing levels vary from period to period depending upon capital investments and other factors. Future short-term interest expense and payments will reflect both future short-term interest rates and borrowing levels. MGE Energy and MGE manage interest rate risk by limiting their variable rate exposure and continually monitoring the effects of market changes on interest rates. MGE is not exposed to changes in interest rates on a substantial portion of its long-term debt until that debt matures and is refinanced at market rates.

Equity Price Risk - Pension-Related Assets

MGE currently funds its liabilities related to employee benefits through trust funds. These funds, which include investments in debt and equity securities, are managed by various investment managers. Changes in market value of these investments can have an impact on the future expenses related to these liabilities.

Credit Risk - Counterparty

Credit risk is the loss that may result from counterparty nonperformance. MGE is exposed to credit risk primarily through its merchant energy business. MGE uses credit policies to manage its credit risk, which include utilizing an established credit approval process, monitoring counterparty limits, employing credit mitigation measures such as collateral or prepayment arrangements, and using netting agreements.

Due to the possibility of extreme volatility in the prices of energy commodities and derivatives, the market value of contractual positions with individual counterparties could exceed established credit limits or collateral provided by those counterparties. If such a counterparty were then to fail to perform its obligations under its contract (for example, fail to deliver the electricity MGE originally contracted for), MGE could sustain a loss that could have a material impact on its financial results.

Additionally, if a counterparty were to default and MGE were to liquidate all contracts with that entity, MGE's credit loss would include the loss in value of mark-to-market contracts; the amount owed for settled transactions; and additional payments, if any, to settle unrealized losses. As of June 30, 2018, no counterparties have defaulted.

MGE is obligated to provide service to all electric and gas customers within its respective franchised territories. MGE's franchised electric territory includes a 316 square-mile area in Dane County, Wisconsin, and MGE's franchised

gas territory includes a service area covering 1,682 square miles in Wisconsin. Based on results for the year ended December 31, 2017, no one customer constituted more than 10% of total operating revenues for MGE Energy and MGE. Credit risk for electric and gas is managed by MGE's credit and collection policies, which are consistent with state regulatory requirements.

Cash, cash equivalents, and customer accounts receivable are the financial instruments that potentially subject MGE Energy and MGE to concentrations of credit risk. MGE Energy and MGE place their cash and cash equivalents with high credit-quality financial institutions. MGE has limited concentrations of credit risk from customer accounts receivable because of the large number of customers and relatively strong economy in its service territory.

Item 4. Controls and Procedures.

During the second quarter of 2018, each registrant's management, including the principal executive officer and principal financial officer, evaluated its disclosure controls and procedures related to the recording, processing, summarization, and reporting of information in its periodic reports that it files with the SEC. These disclosure controls and procedures have been designed to ensure that material information relating to that registrant, including its subsidiaries, is accumulated and made known to that registrant's management, including these officers, by other employees of that registrant and its subsidiaries as appropriate to allow timely decisions regarding required disclosure, and that this information is recorded, processed, summarized, evaluated, and reported, as applicable, within the time periods specified in the SEC's rules and forms. Due to the inherent limitations of control systems, not all misstatements may be detected. These inherent limitations include the realities that judgments in decision making can be faulty and breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. Also, MGE Energy does not control or manage certain of its unconsolidated entities and thus, its access and ability to apply its procedures to those entities is more limited than is the case for its consolidated subsidiaries.

As of June 30, 2018, each registrant's principal executive officer and principal financial officer concluded that its disclosure controls and procedures were effective. Each registrant intends to strive continually to improve its disclosure controls and procedures to enhance the quality of its financial reporting.

During the quarter ended June 30, 2018, there were no changes in either registrant's internal controls over financial reporting that materially affected, or are reasonably likely to affect materially, that registrant's internal control over financial reporting.

PART II. OTHER INFORMATION.**Item 1. Legal Proceedings.*****MGE Energy and MGE***

MGE Energy and its subsidiaries, including MGE, from time to time are involved in various legal proceedings that are handled and defended in the ordinary course of business.

See Footnote 9.a. and 9.b. of Notes to Consolidated Financial Statements in this Report for more information.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**Issuer Purchases of Equity Securities**

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs*	Maximum number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Plans or Programs*
April 1-30, 2018	12,163	\$ 57.52	-	-
May 1-31, 2018	9,803	58.71	-	-
June 1-30, 2018	49,695	59.32	-	-
Total	71,661	\$ 58.93	-	-

* Under the MGE Energy, Inc. Direct Stock Purchase and Dividend Reinvestment Plan (Stock Plan), common stock shares deliverable to plan participants may be either newly issued shares or shares purchased on the open market, as determined from time to time by MGE Energy. MGE Energy's transfer agent uses open market purchases to provide shares to meet obligations to participants in the Stock Plan. The shares are purchased on the open market through the transfer agent's securities broker-dealer and then are reissued under the Stock Plan as needed to meet share delivery

requirements. The volume and timing of share repurchases in the open market depends upon the level of dividend reinvestment and optional share purchases being made from time to time by plan participants. As a result, there is no specified maximum number of shares to be repurchased and no specified termination date for the repurchases. All shares issued through the Stock Plan, whether newly issued or reissued following open market purchases, are issued and sold pursuant to a registration statement that was filed with the SEC and is currently effective.

Item 4. Mine Safety Disclosures.

Not applicable to MGE Energy and MGE.

Item 6. Exhibits.

Ex. No.	Exhibit Description
<u>4.1</u> *	Indenture of Mortgage and Deed of Trust between Madison Gas and Electric Company and U.S. Bank, N.A. (successor to First Wisconsin Trust Company), as Trustee
<u>10.5</u> *	Joint Power Supply Agreement (Exclusive of Exhibits) with Wisconsin Power and Light Company and Wisconsin Public Service Corporation.
<u>12.1</u> *	Statements regarding computation of ratio of earnings to fixed charges for MGE Energy, Inc.
<u>12.2</u> *	Statements regarding computation of ratio of earnings to fixed charges for Madison Gas and Electric Company.
<u>31.1</u> *	Certifications Pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934 filed by Jeffrey M. Keebler for MGE Energy, Inc.
<u>31.2</u> *	Certifications Pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934 filed by Jeffrey C. Newman for MGE Energy, Inc.
<u>31.3</u> *	Certifications Pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934 filed by Jeffrey M. Keebler for Madison Gas and Electric Company
<u>31.4</u> *	Certifications Pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934 filed by Jeffrey C. Newman for Madison Gas and Electric Company
<u>32.1</u> **	Certifications Pursuant to Section 1350 of Chapter 63 of Title 18 United States Code (Sarbanes-Oxley Act of 2002) filed by Jeffrey M. Keebler for MGE Energy, Inc.
<u>32.2</u> **	Certifications Pursuant to Section 1350 of Chapter 63 of Title 18 United States Code (Sarbanes-Oxley Act of 2002) filed by Jeffrey C. Newman for MGE Energy, Inc.
<u>32.3</u> **	Certifications Pursuant to Section 1350 of Chapter 63 of Title 18 United States Code (Sarbanes-Oxley Act of 2002) filed by Jeffrey M. Keebler for Madison Gas and Electric Company
<u>32.4</u> **	Certifications Pursuant to Section 1350 of Chapter 63 of Title 18 United States Code (Sarbanes-Oxley Act of 2002) filed by Jeffrey C. Newman for Madison Gas and Electric Company
101.INS*	XBRL Instance
101.SCH*	XBRL Taxonomy Extension Schema
101.CAL*	XBRL Taxonomy Extension Calculation
101.DEF*	XBRL Taxonomy Extension Definition
101.LAB*	XBRL Taxonomy Extension Labels
101.PRE*	XBRL Taxonomy Extension Presentation

* Filed herewith.

** Furnished herewith.

Signatures - MGE Energy, Inc.

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

MGE ENERGY, INC.

Date: August 7, 2018

/s/ Jeffrey M. Keebler
Jeffrey M. Keebler

President and Chief Executive Officer

(Duly Authorized Officer)

Date: August 7, 2018

/s/ Jeffrey C. Newman
Jeffrey C. Newman

Executive Vice President, Chief Financial Officer, Secretary and
Treasurer

(Chief Financial and Accounting Officer)

Signatures - Madison Gas and Electric Company

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

MADISON GAS AND ELECTRIC COMPANY

Date: August 7, 2018

/s/ Jeffrey M. Keebler
Jeffrey M. Keebler

President and Chief Executive Officer

(Duly Authorized Officer)

Date: August 7, 2018

/s/ Jeffrey C. Newman
Jeffrey C. Newman

Executive Vice President, Chief Financial Officer, Secretary and
Treasurer

(Chief Financial and Accounting Officer)