MGE ENERGY INC
Form 10-Q
November 03, 2017

United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended:

September 30, 2017

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

For the transition period from _______________ *to* _______________

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

(a Wisconsin Corporation)

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 [X] 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 [X] 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 [X]

Number of Shares Outstanding of Each Class of Common Stock as of October 31, 2017

MGE Energy, Inc.	Common stock, $1.00 par value, 34,668,370 shares outstanding.
Madison Gas and Electric Company	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' 2016 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 7 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
NGV Fueling Services	NGV Fueling Services, LLC

Other Defined Terms:

AFUDC	Allowance for Funds Used During Construction
ATC	American Transmission Company LLC
ATC Holdco	ATC Holdco, LLC
Blount	Blount Station
CAVR	Clean Air Visibility Rule
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
Elm Road Units	Elm Road Generating Station
EPA	United States Environmental Protection Agency
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FTR	Financial Transmission Rights
GAAP	Generally Accepted Accounting Principles
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_2	Nitrogen Dioxide
NOx	Nitrogen Oxides
PGA	Purchased Gas Adjustment clause, a regulatory mechanism used to reconcile natural gas costs recovered in rates to actual costs
PJM	PJM Interconnection, LLC (a regional transmission organization)
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
SO2	Sulfur Dioxide
Stock Plan	Direct Stock Purchase and Dividend Reinvestment Plan of MGE Energy
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 September 30,		Nine Months Ended September 30,	
	2017	**2016**	**2017**	**2016**
Operating Revenues:				
Electric revenues	$ 120,761	$ 119,147	$ 321,540	$ 313,452
Gas revenues	18,778	17,570	101,285	92,368
Total Operating Revenues	139,539	136,717	422,825	405,820
Operating Expenses:				
Fuel for electric generation	15,829	20,505	39,938	47,567
Purchased power	15,984	9,167	48,058	38,698
Cost of gas sold	5,094	4,314	50,109	43,247
Other operations and maintenance	41,529	40,146	128,143	123,839
Depreciation and amortization	13,372	11,212	39,606	33,358
Other general taxes	4,730	4,846	14,509	14,841
Total Operating Expenses	96,538	90,190	320,363	301,550
Operating Income	43,001	46,527	102,462	104,270
Other income, net	3,939	2,105	9,004	6,726
Interest expense, net	(4,727)	(5,038)	(14,507)	(14,995)
Income before income taxes	42,213	43,594	96,959	96,001
Income tax provision	(15,584)	(15,714)	(35,487)	(34,943)
Net Income	$ 26,629	$ 27,880	$ 61,472	$ 61,058
Earnings Per Share of Common Stock (basic and diluted)	$ 0.77	$ 0.80	$ 1.77	$ 1.76
Dividends per share of common stock	$ 0.323	$ 0.308	$ 0.938	$ 0.898
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 September 30,		Nine Months Ended September 30,	
	2017	**2016**	**2017**	**2016**
Net Income	$ 26,629	$ 27,880	$ 61,472	$ 61,058
Other comprehensive income, net of tax:				
Unrealized gain (loss) on available-for-sale securities, net of tax (($40) and ($8), and ($127) and $96, respectively)	60	11	189	(143)
Comprehensive Income	$ 26,689	$ 27,891	$ 61,661	$ 60,915

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)

	Nine Months Ended September 30, 2017	2016
Operating Activities:		
Net income	$ 61,472	$ 61,058
Items not affecting cash:		
Depreciation and amortization	39,606	33,358
Deferred income taxes	4,810	15,041
Provision for doubtful receivables	650	583
Employee benefit plan cost	778	165
Equity earnings in ATC	(7,432)	(6,023)
Gain on sale of property	(1,581)	-
Other items	1,071	693
Changes in working capital items:		
Decrease in current assets	18,161	33,740
Decrease in current liabilities	(17,615)	(3,147)
Dividends from ATC	6,142	4,214
Cash contributions to pension and other postretirement plans	(9,717)	(13,134)
Other noncurrent items, net	2,671	2,644
Cash Provided by Operating Activities	99,016	129,192
Investing Activities:		
Capital expenditures	(66,286)	(62,273)
Capital contributions to investments	(6,863)	(2,036)
Proceeds from sale of property	2,399	-
Other	(364)	(310)
Cash Used for Investing Activities	(71,114)	(64,619)
Financing Activities:		
Cash dividends paid on common stock	(32,502)	(31,115)
Repayment of long-term debt	(33,260)	(3,192)
Issuance of long-term debt	40,000	-
Proceeds from short-term debt	7,000	-
Other	(366)	(65)
Cash Used for Financing Activities	(19,128)	(34,372)
Change in cash and cash equivalents	8,774	30,201
Cash and cash equivalents at beginning of period	95,959	81,384
Cash and cash equivalents at end of period	$ 104,733	$ 111,585

Supplemental disclosures of cash flow information:		
Significant noncash investing activities:		
Accrued capital expenditures	$ 12,469	$ 10,603

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

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MGE Energy, Inc.

Consolidated Balance Sheets (unaudited)

(In thousands)

ASSETS		**September 30, 2017**		**December 31, 2016**
Current Assets:				
Cash and cash equivalents	$	104,733	$	95,959
Accounts receivable, less reserves of $2,950 and $3,017, respectively		38,129		39,887
Other accounts receivable, less reserves of $372 and $426, respectively		7,588		8,530
Unbilled revenues		21,764		29,846
Materials and supplies, at average cost		21,835		18,561
Fossil fuel, at average cost		10,017		9,757
Stored natural gas, at average cost		14,758		12,819
Prepaid taxes		12,406		26,636
Regulatory assets - current		7,377		6,414
Assets held for sale		6,707		14,813
Other current assets		10,043		12,293
Total Current Assets		255,357		275,515
Regulatory assets		146,006		158,485
Pension and other postretirement benefit asset		3,471		2,020
Other deferred assets and other		6,311		6,691
Property, Plant, and Equipment:				
Property, plant, and equipment, net		1,270,124		1,245,269
Construction work in progress		42,276		36,790
Total Property, Plant, and Equipment		1,312,400		1,282,059
Investments		86,455		76,290
Total Assets	$	1,810,000	$	1,801,060
LIABILITIES AND CAPITALIZATION				
Current Liabilities:				
Long-term debt due within one year	$	4,428	$	4,333
Short-term debt		7,000		-
Accounts payable		31,519		47,799
Accrued interest and taxes		4,750		5,495
Accrued payroll related items		9,981		11,892
Regulatory liabilities - current		6,353		6,910
Derivative liabilities		8,288		7,620
Other current liabilities		12,263		19,456
Total Current Liabilities		84,582		103,505
Other Credits:				
Deferred income taxes		389,179		383,813
Investment tax credit - deferred		885		947

Regulatory liabilities		28,253		22,173
Accrued pension and other postretirement benefits		65,616		74,347
Derivative liabilities		34,890		42,970
Other deferred liabilities and other		63,942		66,426
Total Other Credits		582,765		590,676
Capitalization:				
Common shareholders' equity		753,247		724,088
Long-term debt		389,406		382,791
Total Capitalization		1,142,653		1,106,879
Commitments and contingencies (see Footnote 7)				
Total Liabilities and Capitalization	$	1,810,000	$	1,801,060

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
2016						
Beginning balance - December 31, 2015	34,668	$ 34,668	$ 316,268	$ 339,165	$ 357	$ 690,458
Net income				61,058		61,058
Other comprehensive loss					(143)	(143)
Common stock dividends declared ($0.898 per share)				(31,115)		(31,115)
Ending balance - September 30, 2016	34,668	$ 34,668	$ 316,268	$ 369,108	$ 214	$ 720,258
2017						
Beginning balance - December 31, 2016	34,668	$ 34,668	$ 316,268	$ 372,950	$ 202	$ 724,088
Net income				61,472		61,472
Other comprehensive income					189	189
Common stock dividends declared ($0.938 per share)				(32,502)		(32,502)
Ending balance - September 30, 2017	34,668	$ 34,668	$ 316,268	$ 401,920	$ 391	$ 753,247

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 September 30, 2017	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016
Operating Revenues:				
Electric revenues	$ 120,760	$ 119,152	$ 321,543	$ 313,470
Gas revenues	18,779	17,576	101,294	92,390
Total Operating Revenues	139,539	136,728	422,837	405,860
Operating Expenses:				
Fuel for electric generation	15,828	20,507	39,939	47,574
Purchased power	15,985	9,171	48,061	38,709
Cost of gas sold	5,094	4,320	50,117	43,269
Other operations and maintenance	41,327	40,003	127,355	123,117
Depreciation and amortization	13,372	11,212	39,606	33,334
Other general taxes	4,730	4,846	14,509	14,841
Income tax provision	14,059	14,934	32,080	32,488
Total Operating Expenses	110,395	104,993	351,667	333,332
Operating Income	29,144	31,735	71,170	72,528
Other Income and Deductions:				
AFUDC - equity funds	310	253	875	777
Equity earnings in MGE Transco	-	1,451	-	5,451
Income tax provision	(663)	(606)	(754)	(2,315)
Other expense, net	1,488	(62)	1,301	(298)
Total Other Income and Deductions	1,135	1,036	1,422	3,615
Income before interest expense	30,279	32,771	72,592	76,143
Interest Expense:				
Interest on long-term debt	4,995	5,079	15,051	15,284
Other interest, net	54	112	150	163
AFUDC - borrowed funds	(123)	(82)	(295)	(253)
Net Interest Expense	4,926	5,109	14,906	15,194
Net Income	$ 25,353	$ 27,662	$ 57,686	$ 60,949
Less: Net Income Attributable to Noncontrolling Interest, net of tax	(5,439)	(5,695)	(16,224)	(17,899)
Net Income Attributable to MGE	$ 19,914	$ 21,967	$ 41,462	$ 43,050

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 September 30,		Nine Months Ended September 30,	
	2017	**2016**	**2017**	**2016**
Net Income	$ 25,353	$ 27,662	$ 57,686	$ 60,949
Other comprehensive income, net of tax:				
Unrealized (loss) gain on available-for-sale securities, net of tax ($5 and ($5), and $26 and $21, respectively)	(7)	8	(38)	(31)
Comprehensive Income	$ 25,346	$ 27,670	$ 57,648	$ 60,918
Less: Comprehensive Income Attributable to Noncontrolling Interest, net of tax	(5,439)	(5,695)	(16,224)	(17,899)
Comprehensive Income Attributable to MGE	$ 19,907	$ 21,975	$ 41,424	$ 43,019

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)

	Nine Months Ended September 30,	
	2017	**2016**
Operating Activities:		
Net income	$ 57,686	$ 60,949
Items not affecting cash:		
Depreciation and amortization	39,606	33,334
Deferred income taxes	2,255	13,997
Provision for doubtful receivables	650	583
Employee benefit plan cost	778	165
Equity earnings in MGE Transco	-	(5,451)
Gain on sale of property	(1,581)	-
Other items	1,344	1,056
Changes in working capital items:		
Decrease in current assets	17,536	32,557
Decrease in current liabilities	(16,670)	(1,783)
Dividends from MGE Transco	-	4,214
Cash contributions to pension and other postretirement plans	(9,717)	(13,134)
Other noncurrent items, net	2,479	2,472
Cash Provided by Operating Activities	94,366	128,959
Investing Activities:		
Capital expenditures	(66,286)	(62,273)
Capital contributions to investments	-	(1,598)
Proceeds from sale of property	1,751	-
Other	(570)	(536)
Cash Used for Investing Activities	(65,105)	(64,407)
Financing Activities:		
Cash dividends paid to parent by MGE	(35,000)	(40,000)
Distributions to parent from noncontrolling interest	(16,500)	(18,113)
Equity contribution received from noncontrolling interest	-	1,598
Repayment of long-term debt	(33,260)	(3,192)
Issuance of long-term debt	40,000	-
Proceeds from short-term debt	7,000	-
Other	(315)	(47)
Cash Used for Financing Activities	(38,075)	(59,754)

Change in cash and cash equivalents		(8,814)		4,798
Cash and cash equivalents at beginning of period		10,768		26,760
Cash and cash equivalents at end of period	$	1,954	$	31,558
Supplemental disclosures of cash flow information:				
Significant noncash investing activities:				
Accrued capital expenditures	$	12,469	$	10,603

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

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Madison Gas and Electric Company

Consolidated Balance Sheets (unaudited)

(In thousands)

ASSETS		**September 30, 2017**		**December 31, 2016**
Current Assets:				
Cash and cash equivalents	$	1,954	$	10,768
Accounts receivable, less reserves of $2,950 and $3,017, respectively		38,129		39,887
Affiliate receivables		683		539
Other accounts receivable, less reserves of $372 and $426, respectively		7,529		6,363
Unbilled revenues		21,764		29,846
Materials and supplies, at average cost		21,835		18,561
Fossil fuel, at average cost		10,017		9,757
Stored natural gas, at average cost		14,758		12,819
Prepaid taxes		12,524		25,798
Regulatory assets - current		7,377		6,414
Assets held for sale		6,707		14,813
Other current assets		10,010		12,268
Total Current Assets		153,287		187,833
Affiliate receivable long-term		3,839		4,236
Regulatory assets		146,006		158,485
Pension and other postretirement benefit asset		3,471		2,020
Other deferred assets and other		4,066		4,353
Property, Plant, and Equipment:				
Property, plant, and equipment, net		1,270,153		1,244,648
Construction work in progress		42,276		36,790
Total Property, Plant, and Equipment		1,312,429		1,281,438
Investments		423		487
Total Assets	$	1,623,521	$	1,638,852
LIABILITIES AND CAPITALIZATION				
Current Liabilities:				
Long-term debt due within one year	$	4,428	$	4,333
Short-term debt		7,000		-
Accounts payable		31,508		47,790
Accrued interest and taxes		5,717		5,440
Accrued payroll related items		9,981		11,892
Regulatory liabilities - current		6,353		6,910
Derivative liabilities		8,288		7,620
Other current liabilities		12,079		19,347
Total Current Liabilities		85,354		103,332
Other Credits:				

Deferred income taxes		346,278		343,117
Investment tax credit - deferred		885		947
Regulatory liabilities		28,253		22,173
Accrued pension and other postretirement benefits		65,616		74,347
Derivative liabilities		34,890		42,970
Other deferred liabilities and other		63,942		66,426
Total Other Credits		539,864		549,980
Capitalization:				
Common shareholder's equity		493,508		487,084
Noncontrolling interest		115,389		115,665
Total Equity		608,897		602,749
Long-term debt		389,406		382,791
Total Capitalization		998,303		985,540
Commitments and contingencies (see Footnote 7)				
Total Liabilities and Capitalization	$	1,623,521	$	1,638,852

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

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Madison Gas and Electric Company

Consolidated Statements of Common Equity (unaudited)

(In thousands)

	Common Stock Shares	Common Stock Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Non-Controlling Interest	Total
2016							
Beginning balance - Dec. 31, 2015	17,348	$ 17,348	$ 192,417	$ 291,888	$ 23	$ 140,308	$ 641,984
Net income				43,050		17,899	60,949
Other comprehensive loss					(31)		(31)
Cash dividends paid to parent by MGE				(40,000)			(40,000)
Equity contribution received from noncontrolling interest						1,598	1,598
Distributions to parent from noncontrolling interest						(18,113)	(18,113)
Deconsolidation of noncontrolling interest						(25,486)	(25,486)
Ending balance - September 30, 2016	17,348	$ 17,348	$ 192,417	$ 294,938	$ (8)	$ 116,206	$ 620,901
2017							
Beginning balance - Dec. 31, 2016	17,348	$ 17,348	$ 192,417	$ 277,300	$ 19	$ 115,665	$ 602,749
Net income				41,462		16,224	57,686
Other comprehensive loss					(38)		(38)
Cash dividends paid to parent by MGE				(35,000)			(35,000)
Distributions to parent from noncontrolling interest						(16,500)	(16,500)
Ending balance - September 30, 2017	17,348	$ 17,348	$ 192,417	$ 283,762	$ (19)	$ 115,389	$ 608,897

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

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

Notes to Consolidated Financial Statements (unaudited)

September 30, 2017

1.

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 2016 Annual Report on Form 10-K (the 2016 Annual Report on Form 10-K).

Prior to December 1, 2016, MGE Transco was jointly owned by MGE Energy and MGE. MGE's ownership interest in MGE Transco declined below a majority in July 2016. As a result of the change in majority ownership in MGE Transco in July 2016, MGE deconsolidated MGE Energy's proportionate share of the equity in MGE Transco. The change in consolidation was applied prospectively by reducing its investment and noncontrolling interest on MGE's consolidated financial statements. On December 1, 2016, MGE's ownership interest in MGE Transco was transferred to MGE Energy. See Footnote 3 for further discussion.

The accompanying consolidated financial statements as of September 30, 2017, and for the three and nine 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 2016 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 104 of the 2016 Annual Report on Form 10-K.

2.

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 nine months ended September 30, 2017 and 2016, 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.

On January 13, 2017, MGE issued $40 million of 3.76% senior unsecured notes due January 15, 2052. MGE used the net proceeds from the sale of senior notes to refinance $30 million of medium-term notes, which matured in January 2017, and assist with the financing of additional capital expenditures. The long-term debt carries an interest rate of 3.76% per annum over its 35-year term. The covenants of this debt are substantially consistent with MGE's existing unsecured long-term debt.

On October 2, 2017, MGE issued $30 million of 3.11% senior unsecured notes due October 1, 2027. MGE will use the net proceeds from the sale of senior notes to cover capital expenditures and other corporate obligations. The long-term debt carries an interest rate of 3.11% per annum over its 10-year term. The covenants of this debt are substantially consistent with MGE's existing unsecured long-term debt.

3.

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, as of December 1, 2016, is owned solely 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.

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 nine months ended September 30, 2017 and 2016, MGE Transco recorded the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2017	2016	2017	2016
Equity earnings from investment in ATC	$ 2,338	$ 2,023	$ 7,432	$ 6,023
Dividends from ATC[(a)]	2,070	1,486	4,070	4,214
Capital contributions to ATC	710	888	3,018	1,598

(a)

As of December 31, 2016, MGE Transco recorded a $2.1 million receivable from ATC for a cash dividend received in January 2017.

ATC Holdco's activities commenced in late December 2016 and had an immaterial impact on results of operations, cash flows, and financial condition.

At September 30, 2017, and December 31, 2016, MGE Transco held a 3.6% ownership interest in ATC. At September 30, 2017, and December 31, 2016, MGEE Transco held a 4.4% and 4.0% ownership interest in ATC Holdco, respectively.

In June 2016, the PSCW required MGE to transfer its interest in ATC to MGE Energy, which was to be completed by December 31, 2022. The requirement arose in the context of requests for regulatory approvals by several owners of ATC in connection with a reorganization of ATC. MGE's ownership interest in ATC, held through MGE Transco, was transferred net of deferred tax liabilities to MGE Energy by way of a dividend in kind of $15.8 million as of December 1, 2016. As a result of the transfer, MGE's ownership interest in MGE Transco was completely eliminated in favor of MGE Energy. The change had no effect on MGE Energy's consolidated financial statements.

ATC's summarized financial data for the three and nine months ended September 30, 2017 and 2016, is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2017	2016	2017	2016
Operating revenues	$ 171,123	$ 158,126	$ 522,402	$ 476,591
Operating expenses	(85,063)	(80,271)	(250,116)	(241,034)
Other income, net	796	1,128	1,615	2,563
Interest expense, net	(28,273)	(24,624)	(81,188)	(73,714)
Earnings before members' income taxes	$ 58,583	$ 54,359	$ 192,713	$ 164,406

MGE receives transmission and other related services from ATC. During the three and nine months ended September 30, 2017, MGE recorded $7.3 million and $21.9 million, respectively, for transmission services received compared to $7.4 million and $22.1 million for the comparable periods in 2016. MGE also provides a variety of operational, maintenance, and project management services for ATC, which is reimbursed by ATC. As of September 30, 2017, and December 31, 2016, MGE had a receivable due from ATC of $0.1 million.

4.

Taxes - MGE Energy and MGE.

MGE Energy's effective income tax rate for the three months ended September 30, 2017 and 2016, was 36.9% and 36.1%, respectively. MGE's effective income tax rate for the three months ended September 30, 2017 and 2016, was 36.7% and 36.0%, respectively. For both MGE Energy and MGE, the increase in the effective tax rate is due in part to lower estimated federal tax credits.

MGE Energy's effective income tax rate for the nine months ended September 30, 2017 and 2016, was 36.6% and 36.4%, respectively. MGE's effective income tax rate for the nine months ended September 30, 2017 and 2016, was 36.3% and 36.4%, respectively.

5.

Pension and Other Postretirement Plans - MGE Energy and MGE.

MGE maintains qualified and nonqualified pension plans, health care, and life insurance benefits. Additionally, MGE has defined contribution 401(k) benefit plans.

The following table presents the components of net periodic benefit costs recognized for the three and nine months ended September 30, 2017 and 2016. A portion of the net periodic benefit cost is capitalized within the consolidated balance sheets.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2017	2016	2017	2016
Pension Benefits				
Components of net periodic benefit cost:				
Service cost	$ 1,351	$ 1,413	$ 4,043	$ 4,358
Interest cost	3,168	3,161	9,481	9,744
Expected return on assets	(5,762)	(5,724)	(17,244)	(17,646)
Amortization of:				
Prior service (credit) cost	(4)	3	(12)	8
Actuarial loss	1,594	1,388	4,769	4,278
Net periodic benefit cost	$ 347	$ 241	$ 1,037	$ 742

Postretirement Benefits

Components of net periodic benefit cost:				
Service cost	$ 315	$ 361	$ 944	$ 1,084
Interest cost	678	753	2,034	2,258
Expected return on assets	(722)	(787)	(2,165)	(2,360)
Amortization of:				
Transition obligation	1	1	2	3
Prior service credit	(667)	(744)	(2,001)	(2,233)
Actuarial loss	190	178	570	533
Net periodic benefit credit	$ (205)	$ (238)	$ (616)	$ (715)

6.

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 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 set performance period.

In January 2017, 4,032 units were granted under the Director Incentive Plan and are subject to a three-year graded vesting schedule. In March 2017, 14,704 units were granted under the Performance Unit Plan and are subject to a five-year graded vesting schedule. On the grant date, MGE Energy and MGE measure the cost of the director or employee services received in exchange for a performance unit award based on the current market value of MGE Energy common stock. The fair value of the awards is re-measured quarterly, including at September 30, 2017, 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.

During the three and nine months ended September 30, 2017, MGE recorded $0.3 million and $1.0 million, respectively, in compensation expense as a result of awards under the plans compared to $0.2 million and $2.0 million for the comparable periods in 2016. In January 2017, cash payments of $2.0 million were distributed according to the terms of the awards granted earlier under the plans that had reached their payment dates. No forfeitures of units occurred during the three and nine months ended September 30, 2017 and 2016. At September 30, 2017, $5.1 million of outstanding awards are vested, and of this amount, no cash settlements have occurred.

7.

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 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 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 rules 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. Given the pending legal proceedings, and the EPA's recent 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.

Federal and state air quality regulations impose restrictions on various emissions including emissions of sulfur dioxide (SO_2), nitrogen dioxide (NO_2), and other pollutants, and may require permits for operation of emission sources.

The EPA's rule to regulate ambient levels of a pollutant through the Ozone National Ambient Air Quality Standards (NAAQS). 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. Oral arguments in this case were delayed following a request by the EPA. The EPA missed its regulatory deadline to designate areas as attainment or nonattainment under the 2015 standard. MGE will continue to monitor the EPA's progress on attainment designations to assess potential impacts at our facilities, particularly our Elm Road Units.

Rules regulating nitrogen oxide (NO_x) and SO_2 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, 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 developed a preliminary implementation schedule for meeting the various deadlines spelled out in the rule. Costs at Columbia will be dependent on what is determined during the evaluation stage.

The matters in the bullet points above are discussed further in Footnote 17.c. in the Financial Statements of the 2016 Annual Report on Form 10-K.

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 has entered into various commodity supply, transportation, and storage contracts to meet its obligation to deliver electricity and natural gas to customers. Management expects to recover these costs in future customer rates. As of September 30, 2017, the future commitments related to these purchase contracts were as follows:

(In thousands)		**2017**	**2018**	**2019**	**2020**	**2021**	**Thereafter**
Coal[(a)]	$	6,402 $	19,685 $	13,497 $	3,445 $	- $	-
Natural gas							
Transportation & storage[(b)]		6,073	20,839	19,680	15,423	8,660	24,373
Supply[(c)]		11,243	11,817	-	-	-	-
	$	23,718 $	52,341 $	33,177 $	18,868 $	8,660 $	24,373

(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)

MGE's natural gas transportation and storage contracts require fixed monthly payments for firm supply pipeline transportation and storage capacity. The pricing components of the fixed monthly payments for the transportation and storage contracts are established by FERC but may be subject to change.

(c)

These commitments include market-based pricing.

d.

Other Commitments - MGE Energy.

In May 2017, MGE Energy entered into a subscription agreement to invest in a nonpublic venture capital fund. From time to time, this entity will require capital infusions from its investors. MGE Energy has committed to contribute $5 million in capital for such infusions. The timing of these infusions is dependent on the needs of the investee and is therefore uncertain at this time.

8.

Rate Matters - MGE Energy and MGE.

a.

Rate Proceedings.

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 is 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 is 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.

In July 2015, the PSCW approved MGE's request to extend the current accounting treatment for transmission related costs through 2016, conditioned upon MGE not filing a base rate case for 2016. MGE did not file a base rate case for 2016.

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 August 2015, the PSCW approved a $0.00256/kWh fuel credit that began on September 1, 2015, and continued throughout 2016. MGE returned $2.6 million of electric fuel-related savings to customers through bill credits during the period from September 1, 2015, through December 31, 2015. MGE returned $8.3 million of electric fuel-related savings during the year ended December 31, 2016.

In July 2016, 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 September 2016, MGE returned $15.5 million to customers through bill credits.

In July 2017, the PSCW issued a final order in the fuel rules proceedings requiring MGE to refund $6.0 million of additional fuel savings realized during 2015 and 2016 to its retail electric customers over a one-month period in October 2017.

As of September 30, 2017, MGE has deferred $3.3 million of 2017 fuel savings. The 2017 fuel savings will be subject to the PSCW's annual review of 2017 fuel costs, expected to be completed in 2018.

9.

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:

	September 30, 2017	December 31, 2016
Commodity derivative contracts	634,605 MWh	393,395 MWh
Commodity derivative contracts	7,924,500 Dth	4,195,000 Dth
FTRs	3,552 MW	2,251 MW
PPA	2,800 MW	3,250 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 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 September 30, 2017, and December 31, 2016, the fair value of exchange traded derivatives and FTRs exceeded their cost basis by $0.9 million and $1.3 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 September 30, 2017, and December 31, 2016, reflects a loss position of $43.1 million and $50.6 million, respectively. The actual cost will be recognized in purchased power expense in the month of purchase.

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 September 30, 2017, and December 31, 2016, the receivable margin account balance of $1.5 million and $1.3 million, respectively, is shown net of any collateral posted against derivative positions.

(In thousands)	Derivative Assets	Derivative Liabilities	Balance Sheet Location
September 30, 2017			
Commodity derivative contracts[a]	$ 857	$ 560	Other current assets[b]
Commodity derivative contracts[a]	112	122	Other deferred charges
FTRs	567	-	Other current assets
PPA	N/A	8,240	Derivative liability (current)
PPA	N/A	34,890	Derivative liability (long-term)
December 31, 2016			
Commodity derivative contracts[a]	$ 1,227	$ 164	Other current assets
Commodity derivative contracts[a]	157	54	Other deferred charges
FTRs	143	-	Other current assets
PPA	N/A	7,620	Derivative liability (current)
PPA	N/A	42,970	Derivative liability (long-term)

(a)

As of September 30, 2017, and December 31, 2016, no collateral was posted against and netted with derivative liability positions on the consolidated balance sheets.

(b)

As of September 30, 2017, $0.1 million was presented as current derivative liabilities 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

(In thousands)	Gross Amounts	Gross Amounts Offset in Balance Sheets	Collateral Posted Against Derivative Positions	Net Amount Presented in Balance Sheets
September 30, 2017				
Commodity derivative contracts	$ 969	$ (634)	$ -	$ 335
FTRs	567	-	-	567
December 31, 2016				
Commodity derivative contracts	$ 1,384	$ (218)	$ -	$ 1,166
FTRs	143	-	-	143

Offsetting of Derivative Liabilities

(In thousands)	Gross Amounts	Gross Amounts Offset in Balance Sheets	Collateral Posted Against Derivative Positions	Net Amount Presented in Balance Sheets
September 30, 2017				
Commodity derivative contracts	$ 682	$ (634)	$ -	$ 48
PPA	43,130	-	-	43,130

December 31, 2016								
Commodity derivative contracts	$	218	$	(218)	$	-	$	-
PPA		50,590		-		-		50,590

The following tables summarize the unrealized and realized gains (losses) related to the derivative instruments on the consolidated balance sheets at September 30, 2017 and 2016, and the consolidated income statements for the three and nine months ended September 30, 2017 and 2016.

	2017				2016			
(In thousands)		Current and Long-Term Regulatory Asset		Other Current Assets		Current and Long-Term Regulatory Asset		Other Current Assets
Three Months Ended September 30:								
Balance at July 1,	$	45,316	$	618	$	50,521	$	659
Unrealized gain		(1,277)		-		(663)		-
Realized (loss) gain reclassified to a deferred account		(313)		313		17		(17)
Realized (loss) gain reclassified to income statement		(1,450)		(57)		(304)		46
Balance at September 30,	$	42,276	$	874	$	49,571	$	688
Nine Months Ended September 30:								
Balance at January 1,	$	49,281	$	230	$	54,082	$	1,208
Unrealized (gain) loss		(3,698)		-		1,128		-
Realized (loss) gain reclassified to a deferred account		(935)		935		(1,417)		1,417
Realized loss reclassified to income statement		(2,372)		(291)		(4,222)		(1,937)
Balance at September 30,	$	42,276	$	874	$	49,571	$	688

	Realized Losses (Gains)			
	2017		2016	
(In thousands)	Fuel for Electric Generation/ Purchased Power	Cost of Gas Sold	Fuel for Electric Generation/ Purchased Power	Cost of Gas Sold
Three Months Ended September 30:				
Commodity derivative contracts	$ 362	$ 18	$ 45	$ -
FTRs	(224)	-	(703)	-
PPA	1,351	-	916	-
Nine Months Ended September 30:				
Commodity derivative contracts	$ 764	$ 227	$ 1,469	$ 1,814
FTRs	(1,349)	-	(635)	-
PPA	3,021	-	3,511	-

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 September 30, 2017, 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 September 30, 2017, certain counterparties were in a net liability position of less than $0.1 million. As of December 31, 2016, no counterparties were in a net liability position.

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 September 30, 2017, no counterparties have defaulted.

10.

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.

At September 30, 2017, and December 31, 2016, 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 at September 30, 2017, and December 31, 2016. Since long-term debt is not traded in an active market, it is classified as Level 2. The estimated fair market values of financial instruments are as follows:

	September 30, 2017		December 31, 2016	
(In thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
MGE Energy				
Assets:				
Cash and cash equivalents	$ 104,733	$ 104,733	$ 95,959	$ 95,959
Liabilities:				
Short-term debt - commercial paper	7,000	7,000	-	-
Long-term debt[(a)]	397,981	444,195	391,242	430,122
MGE				
Assets:				
Cash and cash equivalents	$ 1,954	$ 1,954	$ 10,768	$ 10,768
Liabilities:				
Short-term debt - commercial paper	7,000	7,000	-	-
Long-term debt[(a)]	397,981	444,195	391,242	430,122

(a) Includes long-term debt due within one year. Excludes debt issuance costs and unamortized discount of $4.1 million at September 30, 2017, and December 31, 2016.

b.

Recurring Fair Value Measurements.

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

Fair Value as of September 30, 2017

(In thousands)	Total	Level 1	Level 2	Level 3
MGE Energy				
Assets:				
Derivatives	$ 1,536	$ 673	$ -	$ 863
Exchange-traded investments	816	816	-	-
Total Assets	$ 2,352	$ 1,489	$ -	$ 863
Liabilities:				
Derivatives	$ 43,812	$ 190	$ -	$ 43,622
Deferred compensation	3,150	-	3,150	-
Total Liabilities	$ 46,962	$ 190	$ 3,150	$ 43,622
MGE				
Assets:				
Derivatives	$ 1,536	$ 673	$ -	$ 863
Exchange-traded investments	78	78	-	-
Total Assets	$ 1,614	$ 751	$ -	$ 863
Liabilities:				
Derivatives	$ 43,812	$ 190	$ -	$ 43,622
Deferred compensation	3,150	-	3,150	-
Total Liabilities	$ 46,962	$ 190	$ 3,150	$ 43,622

	Fair Value as of December 31, 2016			
(In thousands)	Total	Level 1	Level 2	Level 3
MGE Energy				
Assets:				
Derivatives	$ 1,527	$ 1,041	$ -	$ 486
Exchange-traded investments	500	500	-	-
Total Assets	$ 2,027	$ 1,541	$ -	$ 486
Liabilities:				
Derivatives	$ 50,808	$ 16	$ -	$ 50,792
Deferred compensation	3,039	-	3,039	-
Total Liabilities	$ 53,847	$ 16	$ 3,039	$ 50,792
MGE				
Assets:				
Derivatives	$ 1,527	$ 1,041	$ -	$ 486
Exchange-traded investments	143	143	-	-
Total Assets	$ 1,670	$ 1,184	$ -	$ 486
Liabilities:				
Derivatives	$ 50,808	$ 16	$ -	$ 50,792
Deferred compensation	3,039	-	3,039	-
Total Liabilities	$ 53,847	$ 16	$ 3,039	$ 50,792

No transfers were made in or out of Level 1 or Level 2 for the nine months ended September 30, 2017.

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 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 9) 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.

	Model Input	
Significant Unobservable Inputs	September 30, 2017	December 31, 2016
Basis adjustment:		
On peak	92.4%	91.9%
Off peak	94.2%	93.4%
Counterparty fuel mix:		
Internal generation	55% - 75%	55% - 75%
Purchased power	45% - 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. 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.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2017	2016	2017	2016
Beginning balance	$ (45,605)	$ (51,883)	$ (50,305)	$ (53,501)
Realized and unrealized gains (losses):				
Included in regulatory liabilities	2,846	1,455	7,547	3,073
Included in other comprehensive income	-	-	-	-
Included in earnings	(1,478)	(278)	(2,614)	(4,250)
Included in current assets	(14)	-	(111)	-
Purchases	6,299	5,814	18,481	16,751
Sales	-	-	-	-
Issuances	-	-	-	-
Settlements	(4,807)	(5,537)	(15,757)	(12,502)
Transfers in and/or out of Level 3	-	-	-	-
Balance as of September 30,	$ (42,759)	$ (50,429)	$ (42,759)	$ (50,429)
Total gains (losses) included in earnings attributed to the change in unrealized gains (losses) related to assets and liabilities held at September 30,(b)	$ -	$ -	$ -	$ -

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2017	2016	2017	2016
Purchased Power Expense	$ (1,460)	$ (278)	$ (2,377)	$ (4,250)
Cost of Gas Sold Expense	(18)	-	(237)	-
Total	$ (1,478)	$ (278)	$ (2,614)	$ (4,250)

(b)

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.

11.

Joint Plant Ownership - MGE Energy and MGE.

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, beginning in 2017 and ending June 1, 2020, the ownership percentage will be 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 2016, MGE accrued $14.8 million of 2016 capital expenditures that MGE has forgone as part of the ownership transfer agreement with WPL. As of December 31, 2016, MGE classified $14.8 million of Columbia assets as held-for-sale on the consolidated balance sheets. In January 2017, MGE reduced its ownership interest in Columbia from 22.0% to 20.4% through the partial sale of plant assets to WPL.

During three and nine months ended September 30, 2017, MGE accrued $1.6 million and $6.7 million, respectively, of 2017 capital expenditures that MGE has forgone subject to the ownership transfer agreement. As of September 30, 2017, MGE classified $6.7 million of Columbia assets as held-for-sale on the consolidated balance sheets. The assets recognized as held-for-sale are subject to a partial sale of plant assets to WPL, expected to occur in January 2018.

12.

Adoption of Accounting Principles and Recently Issued Accounting Pronouncements - MGE Energy and MGE.

a.

Revenue from Contracts with Customers.

In May 2014, 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 objective of the new standard is to provide a single, comprehensive revenue recognition model for all contracts with customers to improve comparability within industries, across industries and across capital markets. 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.

MGE Energy and MGE have been assessing the impact of this guidance on revenue streams within the scope of the new standard. All retail electric and gas revenues are tariff rates approved by the PSCW. Based on our evaluation of the new standard, retail revenues will be recognized within the period in which utility service is provided to the customer and the performance obligation is fulfilled, consistent with our current revenue recognition model. Electric revenues for sales to the market represent wholesale sales made to third parties who are not ultimate users of the electricity. These sales may also include bilateral sales to other utilities or power marketers. Revenues for sales to the market will be recognized when the sale is completed within the market operated by MISO, similar to the recognition under our current revenue recognition model. In addition, revenues from the transportation of gas will continue to be recognized upon the performance of services for the respective customer. Based on our assessment of the new standard, revenue recognition for retail revenues, sales to the market, and transportation of gas will be materially consistent with our current revenue recognition model. However, additional disclosures regarding the nature, amount, timing, and uncertainty of these revenue streams and related cash flows arising from contracts with customers will be required as a result of the new standard. Management continues to analyze newly-released interpretative guidance and assess the related impacts to the current revenue recognition model.

This authoritative guidance will become effective January 1, 2018, and MGE Energy and MGE anticipate adopting 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 are continuing to assess the permitted implementation methods and the impact on our financial statements.

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b.

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 will become effective January 1, 2018, and will require 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 any other comprehensive income related to equity investments. This standard will be applied using a modified retrospective approach, with a cumulative effect adjustment recorded to opening retained earnings as of the beginning of all prior periods presented. As of September 30, 2017, MGE Energy had $0.4 million and MGE had less than $0.1 million of accumulated other comprehensive income related to equity investments within the scope of this standard.

c.

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 consolidated 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 from that applied under current GAAP.

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.

d.

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. The new standard was issued to eliminate a current diversity in practice for the accounting treatment of restricted cash. Under the new guidance, reporting entities will be 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 will be 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 will become effective January 1, 2018. Upon the effective date, MGE Energy and MGE will change the presentation of restricted cash to reflect this change in accounting guidance. MGE Energy and MGE will also retrospectively apply the guidance to all prior periods presented. As of September 30, 2017, and December 31, 2016, MGE Energy and MGE had $4.5 million and $5.1 million, respectively, of restricted cash classified within other current assets on the consolidated balance sheets.

e.

Pension and Other Postretirement Benefits.

In March 2017, the FASB issued authoritative guidance within the 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 will become 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. Operating income will decrease and other income will increase $6.6 million and $5.0 million for the years ended December 31, 2016 and 2015, 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 current GAAP, all components of net benefit cost are eligible for capitalization). MGE Energy and MGE are currently evaluating the impact of how the change in components of net benefit cost eligible for capitalization will affect our financial statements.

13.

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 2016 Annual Report on Form 10-K for additional discussion of each of these segments.

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 September 30, 2017							
Operating revenues	$ 120,649	$ 18,778	$ 112	$ -	$ -	$ -	$ 139,539
Interdepartmental revenues	(110)	3,892	11,130	-	-	(14,912)	-
Total operating revenues	120,539	22,670	11,242	-	-	(14,912)	139,539
Depreciation and amortization	(9,256)	(2,258)	(1,858)	-	-	-	(13,372)
Other operating expenses	(78,886)	(18,940)	(50)	(9)	(193)	14,912	(83,166)
Operating income (loss)	32,397	1,472	9,334	(9)	(193)	-	43,001
Other income (deductions), net	1,440	358	-	2,258	(117)	-	3,939
Interest (expense) income, net	(2,760)	(795)	(1,371)	-	199	-	(4,727)
Income (loss) before taxes	31,077	1,035	7,963	2,249	(111)	-	42,213
Income tax (provision) benefit	(11,175)	(351)	(3,196)	(906)	44	-	(15,584)
Net income (loss)	$ 19,902	$ 684	$ 4,767	$ 1,343	$ (67)	$ -	$ 26,629
Three Months Ended September 30, 2016							
Operating revenues	$ 118,933	$ 17,570	$ 214	$ -	$ -	$ -	$ 136,717
Interdepartmental revenues	459	6,040	10,998	-	-	(17,497)	-
Total operating revenues	119,392	23,610	11,212	-	-	(17,497)	136,717
Depreciation and amortization	(7,332)	(2,047)	(1,833)	-	-	-	(11,212)
Other operating expenses	(77,010)	(19,292)	(33)	(13)	(127)	17,497	(78,978)
Operating income (loss)	35,050	2,271	9,346	(13)	(127)	-	46,527
Other income (deductions), net	178	13	-	2,023	(109)	-	2,105
Interest (expense) income, net	(2,855)	(818)	(1,436)	-	71	-	(5,038)
Income (loss) before taxes	32,373	1,466	7,910	2,010	(165)	-	43,594
Income tax (provision) benefit	(11,290)	(494)	(3,175)	(812)	57	-	(15,714)

Net income (loss)	$ 21,083	$ 972	$ 4,735	$ 1,198	$ (108)	$ -	$ 27,880
Nine Months Ended September 30, 2017							
Operating revenues	$ 321,279	$ 101,285	$ 261	$ -	$ -	$ -	$ 422,825
Interdepartmental revenues	(334)	11,708	33,307	-	-	(44,681)	-
Total operating revenues	320,945	112,993	33,568	-	-	(44,681)	422,825
Depreciation and amortization	(27,341)	(6,703)	(5,562)	-	-	-	(39,606)
Other operating expenses	(231,827)	(92,670)	(153)	(9)	(779)	44,681	(280,757)
Operating income (loss)	61,777	13,620	27,853	(9)	(779)	-	102,462
Other income (deductions), net	1,821	355	-	7,242	(414)	-	9,004
Interest (expense) income, net	(8,337)	(2,399)	(4,170)	-	399	-	(14,507)
Income (loss) before taxes	55,261	11,576	23,683	7,233	(794)	-	96,959
Income tax (provision) benefit	(18,753)	(4,576)	(9,505)	(2,909)	256	-	(35,487)
Net income (loss)	$ 36,508	$ 7,000	$ 14,178	$ 4,324	$ (538)	$ -	$ 61,472
Nine Months Ended September 30, 2016							
Operating revenues	$ 312,470	$ 92,368	$ 982	$ -	$ -	$ -	$ 405,820
Interdepartmental revenues	1,482	17,278	32,894	-	-	(51,654)	-
Total operating revenues	313,952	109,646	33,876	-	-	(51,654)	405,820
Depreciation and amortization	(21,754)	(6,043)	(5,537)	-	(24)	-	(33,358)
Other operating expenses	(230,680)	(88,328)	(115)	(17)	(706)	51,654	(268,192)
Operating income (loss)	61,518	15,275	28,224	(17)	(730)	-	104,270
Other income (deductions), net	492	(13)	-	6,023	224	-	6,726
Interest (expense) income, net	(8,421)	(2,425)	(4,348)	-	199	-	(14,995)
Income (loss) before taxes	53,589	12,837	23,876	6,006	(307)	-	96,001
Income tax (provision) benefit	(17,984)	(5,048)	(9,583)	(2,418)	90	-	(34,943)
Net income (loss)	$ 35,605	$ 7,789	$ 14,293	$ 3,588	$ (217)	$ -	$ 61,058

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

(In thousands) **MGE**	Electric	Gas	Nonregulated Energy	Transmission Investment[b]	Consolidation/ Elimination Entries	Consolidated Total
Three Months Ended September 30, 2017						
Operating revenues	$ 120,648	$ 18,779	$ 112	$ -	$ -	$ 139,539
Interdepartmental revenues	(109)	3,891	11,130	-	(14,912)	-
Total operating revenues	120,539	22,670	11,242	-	(14,912)	139,539
Depreciation and amortization	(9,256)	(2,258)	(1,858)	-	-	(13,372)
Other operating expenses[a]	(89,544)	(19,145)	(3,246)	-	14,912	(97,023)
Operating income[a]	21,739	1,267	6,138	-	-	29,144
Other income, net[a]	923	212	-	-	-	1,135
Interest expense, net	(2,760)	(795)	(1,371)	-	-	(4,926)
Net income	19,902	684	4,767	-	-	25,353
Less: Net income attributable to noncontrolling interest, net of tax	-	-	-	-	(5,439)	(5,439)
Net income attributable to MGE	$ 19,902	$ 684	$ 4,767	$ -	$ (5,439)	$ 19,914
Three Months Ended September 30, 2016						
Operating revenues	$ 118,938	$ 17,576	$ 214	$ -	$ -	$ 136,728
Interdepartmental revenues	454	6,034	10,998	-	(17,486)	-
Total operating revenues	119,392	23,610	11,212	-	(17,486)	136,728
Depreciation and amortization	(7,332)	(2,047)	(1,833)	-	-	(11,212)
Other operating expenses[a]	(88,282)	(19,781)	(3,208)	4	17,486	(93,781)
Operating income[a]	23,778	1,782	6,171	4	-	31,735
Other income, net[a]	160	8	-	868	-	1,036
Interest expense, net	(2,855)	(818)	(1,436)	-	-	(5,109)
Net income	21,083	972	4,735	872	-	27,662
Less: Net income attributable to noncontrolling interest, net of tax	-	-	-	-	(5,695)	(5,695)
Net income attributable to MGE	$ 21,083	$ 972	$ 4,735	$ 872	$ (5,695)	$ 21,967

Nine Months Ended September 30, 2017						
Operating revenues	$ 321,282	$ 101,294	$ 261	$ -	$ -	$ 422,837
Interdepartmental revenues	(337)	11,699	33,307	-	(44,669)	-
Total operating revenues	320,945	112,993	33,568	-	(44,669)	422,837
Depreciation and amortization	(27,341)	(6,703)	(5,562)	-	-	(39,606)
Other operating expenses[(a)]	(249,992)	(97,080)	(9,658)	-	44,669	(312,061)
Operating income[(a)]	43,612	9,210	18,348	-	-	71,170
Other income, net[(a)]	1,233	189	-	-	-	1,422
Interest expense, net	(8,337)	(2,399)	(4,170)	-	-	(14,906)
Net income	36,508	7,000	14,178	-	-	57,686
Less: Net income attributable to noncontrolling interest, net of tax	-	-	-	-	(16,224)	(16,224)
Net income attributable to MGE	$ 36,508	$ 7,000	$ 14,178	$ -	$ (16,224)	$ 41,462
Nine Months Ended September 30, 2016						
Operating revenues	$ 312,488	$ 92,390	$ 982	$ -	$ -	$ 405,860
Interdepartmental revenues	1,464	17,256	32,894	-	(51,614)	-
Total operating revenues	313,952	109,646	33,876	-	(51,614)	405,860
Depreciation and amortization	(21,754)	(6,043)	(5,537)	-	-	(33,334)
Other operating expenses[(a)]	(248,566)	(93,348)	(9,698)	-	51,614	(299,998)
Operating income[(a)]	43,632	10,255	18,641	-	-	72,528
Other income (deductions), net[(a)]	394	(41)	-	3,262	-	3,615
Interest expense, net	(8,421)	(2,425)	(4,348)	-	-	(15,194)
Net income	35,605	7,789	14,293	3,262	-	60,949
Less: Net income attributable to noncontrolling interest, net of tax	-	-	-	-	(17,899)	(17,899)
Net income attributable to MGE	$ 35,605	$ 7,789	$ 14,293	$ 3,262	$ (17,899)	$ 43,050

(a) Amounts are shown net of the related tax expense, consistent with the presentation on the MGE Consolidated Statement of Income.
(b) As of July 31, 2016, MGE no longer consolidates MGE Energy's proportionate share of equity earnings in MGE Transco. See Footnote 3 for further discussion.

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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:

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Regulated electric utility operations, conducted through MGE,

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Regulated gas utility operations, conducted through MGE,

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Nonregulated energy operations, conducted through MGE Power and its subsidiaries,

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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 149,000 customers in Dane County, Wisconsin, including the city of Madison, and purchases and distributes natural gas to approximately 154,000 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. 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,

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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 2016 Annual Report on Form 10-K.

For the three months ended September 30, 2017, MGE Energy's earnings were $26.6 million or $0.77 per share compared to $27.9 million or $0.80 per share for the same period in the prior year. MGE's earnings for the three months ended September 30, 2017, were $19.9 million compared to $22.0 million for the same period in the prior year.

For the nine months ended September 30, 2017, MGE Energy's earnings were $61.5 million or $1.77 per share compared to $61.1 million or $1.76 per share for the same period in the prior year. MGE's earnings for the nine months ended September 30, 2017, were $41.5 million compared to $43.1 million for the same period in the prior year.

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

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
Business Segment:	2017	2016	2017	2016
Electric Utility	$ 19,902	$ 21,083	$ 36,508	$ 35,605
Gas Utility	684	972	7,000	7,789
Nonregulated Energy	4,767	4,735	14,178	14,293
Transmission Investments	1,343	1,198	4,324	3,588
All Other	(67)	(108)	(538)	(217)
Net Income	$ 26,629	$ 27,880	$ 61,472	$ 61,058

Our net income during the three and nine months ended September 30, 2017, compared to the same period in the prior year primarily reflects the effects of the following factors:

Electric Utility

For the three months ended, electric net income decreased primarily resulting from cooler weather. The average temperature in August 2017 was 67 degrees compared to 73 in August 2016. For the nine months ended, electric net income increased primarily related to efforts to manage the level of operating and maintenance costs.

Transmission Investments

Transmission investment income reflects our share of ATC's earnings and a favorable comparison to 2016, which included an expense reflecting ATC's establishment of a reserve covering its estimate of its refund liability associated with the return on equity complaint filed with FERC. See "Other Matters" below for additional information concerning ATC.

During the first nine months ended of 2017, the following events occurred:

2017 Rate Case Order: On December 15, 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 reflects 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 is 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.

Deferred Fuel Costs: As of September 30, 2017, MGE has deferred $3.3 million of 2017 fuel savings. These costs will be subject to the PSCW's annual review of 2017 fuel costs, expected to be completed in 2018.

Debt Issuance: MGE issued $40 million of long-term unsecured debt in January 2017. The debt carries an interest rate of 3.76% per annum over its 35-year term. The proceeds of this debt financing were used to refinance $30 million of medium-term notes, which matured in January 2017, and assist with the financing of additional capital expenditures. The covenants of this debt are substantially consistent with MGE's existing unsecured long-term debt.

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

2016 Annual Fuel Proceeding: In July 2017, the PSCW issued a final order in the fuel rules proceedings requiring MGE to refund $6.0 million of additional fuel savings realized during 2015 and 2016 to its retail electric customers over a one-month period in October 2017.

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 7.2% and 5.8% of our net income for the nine months ended September 30, 2017 and 2016, 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 43% of our electric generating capacity as of September 30, 2017. 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, beginning in 2017 and ending June 1, 2020, the ownership percentage will be adjusted, through a partial sale, based on the amount of capital expenditures foregone. During three and nine months ended September 30, 2017, MGE accrued $1.6 million and $6.7 million of 2017 capital expenditures that MGE has forgone as part of the ownership transfer agreement with WPL. During 2016, MGE accrued $14.8 million of 2016 capital expenditures forgone. As of September 30, 2017, and December 31, 2016, MGE classified $6.7 million and $14.8 million, respectively, of Columbia assets as held-for-sale on the consolidated balance sheets. In January 2017, MGE reduced its ownership interest in Columbia from 22.0% to 20.4% through the partial sale of plant assets to WPL. By June 2020, MGE's ownership in Columbia is forecasted to be approximately 19%.

Saratoga Wind Farm: In April 2017, MGE filed an application with the PSCW to seek approval to construct, own and operate a 66MW wind farm, consisting of 33 turbines, located near Saratoga, Iowa. If approved by the PSCW, construction of the project is expected to begin in early 2018, with an estimated capital cost of $107 million.

Forward Wind: In October 2017, MGE, along with two other utilities, entered into an agreement to purchase 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 is approximately $174 million of which MGE's proportionate share is 12.8%, or approximately $23 million. MGE currently purchases 12.8% of the facility's energy output under a purchase power agreement. The transaction is subject to PSCW and FERC approvals and is expected to close in the spring of 2018.

Debt Issuance: In October 2017, MGE issued $30 million of long-term unsecured debt to cover capital expenditures and other corporate obligations. The debt carries an interest rate of 3.11% per annum, over its 10-year term. The covenants of this debt are substantially consistent with MGE's existing unsecured long-term debt.

The following discussion is based on the business segments as discussed in Footnote 13 of the Notes to Consolidated Financial Statements in this Report.

Three Months Ended September 30, 2017 and 2016

Electric Utility Operations - MGE Energy and MGE

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:

(In thousands, except cooling degree days)	Revenues			Sales (kWh)		
	Three Months Ended September 30,			Three Months Ended September 30,		
	2017	2016	% Change	2017	2016	% Change
Residential	$ 39,905	$ 40,120	(0.5)%	225,992	259,529	(12.9)%
Commercial	64,036	55,232	15.9 %	505,771	517,253	(2.2)%
Industrial	4,555	4,122	10.5 %	48,896	61,362	(20.3)%
Other-retail/municipal	10,459	9,091	15.0 %	119,979	114,097	5.2 %
Total retail	118,955	108,565				