

MANAGEMENT DISCUSSION AND ANALYSIS

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

Financial Statement Overview

This discussion and analysis provides an overview of the financial performance of Wisconsin Public Power Inc. (WPPI) for the years ended December 31, 2006 and December 31, 2005. The information presented should be read in conjunction with WPPI's financial statements and the accompanying notes.

WPPI follows the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission. The financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles.

WPPI's financial statements include the Statement of Net Assets, the Statement of Revenues, Expenses, and Changes in Net Assets, and the Statement of Cash Flows. The Statement of Net Assets provides information about the nature and amount of assets and obligations (liabilities) of WPPI as of the end of the year. The Statement of Revenues, Expenses, and Changes in Net Assets reports revenues and expenses for the current year. The Statement of Cash Flows reports cash receipts, cash payments, and net changes in cash resulting from operating, noncapital financing, investing, and capital and related financing activities.

Financial Changes in 2006 From 2005

The following table summarizes the financial position of WPPI as of December 31, 2006 and 2005:

Condensed Statement of Net Assets

Assets	2006	2005	Dollar change	Percentage change
Current assets	\$ 127,654,044	\$ 102,961,808	\$ 24,692,236	24.0%
Noncurrent assets	218,672,191	256,907,013	(38,234,822)	-14.9%
Deferred costs	30,870,133	29,974,277	895,856	3.0%
Capital assets, net of accumulated depreciation	<u>182,050,527</u>	<u>152,374,780</u>	<u>29,675,747</u>	19.5%
Total assets	<u>\$ 559,246,895</u>	<u>\$ 542,217,878</u>	<u>\$ 17,029,017</u>	3.1%
Liabilities and Net Assets				
Current liabilities	\$ 34,413,191	\$ 42,282,486	\$ (7,869,295)	-18.6%
Deferred credits and other liabilities	51,710,182	48,626,022	3,084,160	6.3%
Long-term debt	<u>389,024,923</u>	<u>393,566,716</u>	<u>(4,541,793)</u>	-1.2%
Total liabilities	<u>475,148,296</u>	<u>484,475,224</u>	<u>(9,326,928)</u>	-1.9%
Net assets				
Invested in capital assets, net of related debt	(64,967,255)	(75,014,998)	10,047,743	-13.4%
Restricted	109,501,473	107,860,039	1,641,434	1.5%
Unrestricted	<u>39,564,381</u>	<u>24,897,613</u>	<u>14,666,768</u>	58.9%
Total net assets	<u>84,098,599</u>	<u>57,742,654</u>	<u>26,355,945</u>	45.6%
Total liabilities and net assets	<u>\$ 559,246,895</u>	<u>\$ 542,217,878</u>	<u>\$ 17,029,017</u>	3.1%

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The condensed Statement of Net Assets in this discussion and analysis is discussed in more detail in the following sections. All amounts have been rounded to the nearest \$0.1 million.

Total Assets

Total assets increased by \$17.0 million due primarily to WPPI receiving one-time revenues of \$15.4 million from refunds related to the sale of the Kewaunee Nuclear Power Plant by two of WPPI's suppliers and a rate case settlement with Alliant Energy.

Current Assets

Current assets increased \$24.7 million, from \$103.0 million in 2005 to \$127.7 million in 2006. This change is primarily due to the net of the following factors:

Cash and investments increased \$4.6 million, from \$18.2 million in 2005 to \$22.8 million in 2006, partially as a result of the receipt of the refunds and rate case settlement mentioned above, offset by use of funds in 2006 to pay in full the \$6.5 million balance on WPPI's outstanding line of credit.

Restricted cash and investments increased \$22.3 million, from \$51.2 million in 2005 to \$73.5 million in 2006, primarily due to reclassification of construction funds for the Elm Road Units 1 and 2 ("Elm Road") from noncurrent assets to current assets in anticipation of construction obligations in 2007.

Power sales accounts receivable decreased \$6.1 million, from \$27.6 million in 2005 to \$21.5 million in 2006. The decrease is attributable to lower sales during December 2006, which resulted from lower costs of purchased power.

Restricted interest receivable increased \$2.6 million, from \$1.5 million in 2005 to \$4.1 million in 2006, primarily reflecting interest earnings through December 31, 2006 on the proceeds of the Series 2005 A and B bonds issued in November 2005 and held for the full year of 2006.

Inventories increased by \$0.2 million, from \$3.4 million in 2005 to \$3.6 million in 2006, as a result of fuel stock increases at Boswell 4.

Prepayments increased \$0.7 million, rising from \$0.4 million in 2005 to \$1.1 million in 2006, primarily as a result of contributions to a WPPI defined benefit plan becoming effective in 2007.

Other changes to current assets had a cumulative effect of increasing current assets \$0.4 million in 2006.

Noncurrent Assets

Noncurrent assets decreased by \$38.2 million, from \$256.9 million in 2005 to \$218.7 million in 2006. The change in noncurrent assets is primarily due to the net of the following factors:

Noncurrent restricted cash and investments decreased \$49.5 million, from \$223.9 million in 2005 to \$174.4 million in 2006. Fifty-seven million was transferred from long-term to current assets for construction and debt service obligations for 2007. The Renewals and Replacements Fund increased by \$6.1 million from \$5.9 million in 2005 to \$12.0 million in 2006. The Debt Service Fund, Self Insurance Fund, Rate Stabilization Fund and Decommissioning Fund collectively increased \$1.4 million in 2006.

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Investment in the American Transmission Company (ATC) increased \$11.0 million, from \$32.3 million in 2005 to \$43.3 million in 2006. This results from \$9.4 million in capital contributions by WPPI during 2006 and \$1.6 million in earnings remaining invested in ATC.

Other changes to noncurrent assets had a cumulative effect of increasing noncurrent assets \$0.3 million in 2006.

Deferred Costs

Deferred costs increased \$0.9 million, from \$30.0 million in 2005 to \$30.9 million in 2006. This was primarily due to the mark-to-market gain of \$1.7 million on WPPI's floating-to-fixed swap transactions with Bear Stearns and JP Morgan in connection with WPPI's Series 2003 B and C and Series 2005 B revenue bonds ("Swaps"). Other deferred costs were reduced \$0.8 million due primarily to scheduled amortization of the Kaukauna and Menasha capacity buyout contracts.

Capital Assets

Capital assets, net of accumulated depreciation, increased \$29.7 million, from \$152.4 million in 2005 to \$182.1 million in 2006. The change in capital assets is primarily due to the net of the following factors:

Construction work in progress increased by \$34.4 million, from \$28.7 million in 2005 to \$63.1 million in 2006, primarily related to the construction work in progress on Elm Road. Excluding construction work in progress, capital assets net of accumulated depreciation decreased by \$4.7 million in 2006, resulting from \$1.4 million in plant additions and \$6.1 million in normal depreciation.

Total Liabilities

Total liabilities decreased by \$9.3 million due primarily to WPPI's line of credit balance of \$6.5 million being paid in full in 2006, and a reduction in net long-term debt of \$7.0 million during 2006. These decreases were partially offset by other liabilities that are discussed in more detail below.

Current Liabilities

Current liabilities decreased \$7.9 million, from \$42.3 million in 2005 to \$34.4 million in 2006. The decrease is primarily due to the net of the following factors:

Accrued interest increased by \$2.1 million, from \$3.4 million in 2005 to \$5.5 million in 2006 because the Series 2005 A and B bonds were outstanding all of 2006.

The line of credit balance of \$6.5 million in 2005 was paid in full in 2006.

Current maturities of long-term debt decreased \$2.5 million, from \$8.6 million in 2005 to \$6.1 million in 2006.

Other current liabilities decreased by \$1.0 million, from \$1.1 million in 2005 to \$0.1 million in 2006. The majority of the decrease is attributable to the reduction in Minnesota property taxes.

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Deferred Credits and Other Liabilities

Deferred credits and other liabilities increased by \$3.1 million, from \$48.6 million in 2005 to \$51.7 million in 2006. The change is primarily due to the net of the following factors:

Operating reserves and other liabilities increased by \$1.7 million, from \$9.7 million in 2005 to \$11.4 million in 2006. The provision for long-term maintenance in the Renewals and Replacements Fund increased \$0.4 million, from \$5.8 million in 2005 to \$6.2 million in 2006, as a result of deposits during 2006. The arbitrage rebate provision for the 2005 bond issues increased by \$0.8 million in 2006. Other reserves increased by \$0.5 million in 2006.

The Rate Stabilization Fund increased \$0.8 million, from \$35.8 million in 2005 to \$36.6 million in 2006 due to deposits from new WPPI members.

The fair value of the Swaps of \$1.2 million in 2005 was written off in 2006 due to WPPI's implementation of Regulatory Asset & Liability Accounting. Pursuant to these accounting standards, a regulatory liability of \$1.7 million was established in 2006 to defer the gain in fair value of WPPI's Swaps accounted for as a Deferred Cost in 2006.

The Asset Retirement Obligation for retirement of the Boswell 4 ash ponds, also known as the Decommissioning Fund, increased \$0.1 million, from \$1.9 million in 2005 to \$2.0 million in 2006 due to accrual of accretion expense.

Long -Term Debt

Revenue bonds net of unamortized premium decreased by \$4.5 million, from \$393.5 million in 2005 to \$389.0 million in 2006, due to the reclassification of long-term debt to current maturities, amortizations of premiums and amortizations of losses on reacquired debt.

Net Assets

Total net assets increased \$26.4 million, from \$57.7 million in 2005 to \$84.1 million in 2006. The increase was a result of the increase in net assets during 2006 from continuing operations, including the aforementioned \$15.4 million in one-time revenues from refunds related to the sale of the Kewaunee Nuclear Power Plant by two of WPPI's suppliers and a refund from an Alliant Energy rate case, \$6.3 million in net earnings to provide 145% coverage of debt service from operations, and \$4.6 million in additional investment earnings from WPPI's portfolio of investment securities and its investment in ATC.

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The following table summarizes the changes in financial position for WPPI for the years ended December 31, 2006 and 2005:

Condensed Statements of Revenues, Expenses, and Changes in Net Assets for the Periods Ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>	<u>Dollar change</u>	<u>Percentage change</u>
Operating revenues	\$ 294,716,783	\$ 306,111,928	\$ (11,395,145)	-3.7%
Operating expenses	<u>272,552,743</u>	<u>296,977,487</u>	<u>(24,424,744)</u>	-8.2%
Operating income	22,164,040	9,134,441	13,029,599	142.6%
Net investment income, and equity in earnings of ATC, and unrealized gain(loss) on interest rate swaps	20,341,296	7,846,430	12,494,866	159.2%
Interest expense and debt-related expenses	(16,226,796)	(10,920,999)	(5,305,797)	48.6%
Other nonoperating expenses	<u>(32,759)</u>	<u>(81,129)</u>	<u>48,370</u>	-59.6%
Change in net assets before future recoverable costs	26,245,781	5,978,743	20,267,038	339.0%
Future costs to be (returned) recovered	(1,116,678)	650,611	(1,767,289)	-271.6%
Cumulative effect of change in acctg principle	<u>1,226,841</u>	—	<u>1,226,841</u>	N/A
Change in net assets	26,355,944	6,629,354	19,726,590	297.6%
Net assets, beginning of year	<u>57,742,654</u>	<u>51,113,300</u>	<u>6,629,354</u>	13.0%
Net assets, end of year	<u>\$ 84,098,598</u>	<u>\$ 57,742,654</u>	<u>\$ 26,355,944</u>	45.6%

Operating Revenues

Included in operating revenues are sales to members, sales to others, and other income. All amounts have been rounded to the nearest \$0.1 million.

Total operating revenues decreased \$11.4 million, or -3.7%, from \$306.1 million in 2005 to \$294.7 million in 2006. Purchased power costs moderated somewhat in 2006 from their rise in 2005 which in turn reduced operating revenues from members.

Sales to members decreased \$2.3 million or -0.9%, from \$254.0 million in 2005 to \$251.7 million in 2006. Megawatt hour (MWh) sales to members (including new members beginning service in 2006) increased 83,311 MWh or 1.7%, from 4,941,385 MWh in 2005 to a total of 5,024,696 MWh in 2006. Without sales to new members of 90,421 MWh, WPPI's megawatt hour sales to members would have decreased slightly in 2006.

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Sales to others decreased \$24.7 million, or 48.3%, from \$51.2 million in 2005 to \$26.5 million in 2006. Revenue associated with the Midwest Independent System Operator (MISO) Day 2 Market was \$8.7 million lower. Revenue from WPPI's power sales to Wisconsin Power and Light under the Combustion Turbine Agreements was \$8.4 million lower in 2006 due to MISO dispatching the units less frequently. The remaining \$7.6 million decrease in sales in 2006 is a cumulative effect of fewer power sales to various other companies.

Other income increased \$15.6 million driven primarily by the receipt of \$15.4 million in one time refund revenues as described above.

Operating Expenses

Total operating expenses decreased \$24.4 million, or 8.2%, from \$297.0 million in 2005 to \$272.6 million in 2006. The decrease in operating expenses was driven primarily by lower purchased power expense.

Purchased power expense, which includes purchased power and transmission expenses, decreased \$14.3 million, or -5.8%, from \$245.9 million in 2005 to \$231.6 million in 2006. Excluding transmission expenses, purchased power expenses decreased \$17.1 million, or -7.7%, from \$221.8 million in 2005 to \$204.7 million in 2006, primarily due to lower fuel adjustment clause charges from WPPI's power suppliers. Transmission expenses increased \$2.8 million, or 11.7%, from \$24.0 million in 2005 to \$26.8 million in 2006, primarily due to an increase in network service rates.

Fuel expense decreased \$10.5 million, from \$25.1 million in 2005 to \$14.6 million in 2006. The decrease is attributable to a decrease in megawatt production from WPPI generation units in 2006. Boswell 4 produced 744,197 MWh in 2006 versus 798,177 MWh in 2005 because of a scheduled outage for duty cycle maintenance. South Fond du Lac Units 1 and 4 produced a combined 21,551 MWh in 2006 versus a combined 79,344 MWh in 2005. The Island Street Peaking Plant produced 24,661 MWh in 2006 versus 37,094 MWh in 2005. The lower production at both South Fond du Lac Units 1 and 4 and the Island Street Peaking Plant are a result of MISO dispatching the units less frequently in 2006 compared to 2005.

Administrative and general expense increased \$1.1 million, or 9.4%, from \$11.8 million in 2005 to \$12.9 million in 2006. The primary factors driving the increase were the costs of additional energy conservation incentives, growth in number of employees, and salary and benefits adjustments.

Tax expense decreased \$0.9 million, from \$2.6 million in 2005 to \$1.7 million in 2006, because of a decrease in the accrual for property tax for Boswell 4.

Other operating expenses increased by \$0.2 million in 2006.

Nonoperating Revenues (Expenses)

Investment income increased \$7.6 million, from \$4.1 million in 2005 to \$11.7 million in 2006. The majority of the increase was from interest earnings on the unspent portion of the Series 2005 A and B bond proceeds held in the construction and debt service funds for a full year.

Equity in earnings of ATC increased \$1.5 million, from \$5.1 million in 2005 to \$6.6 million in 2006. WPPI maintains an ownership share of approximately 5.4% in ATC. ATC earnings increased in 2006 due to higher earnings at ATC as more new transmission projects were placed into rate base.

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Unrealized gain (loss) on the Swaps increased \$2.6 million, from a loss of \$0.9 million in 2005 to a gain of \$1.7 million in 2006. The unrealized gain is the net result of mark-to-market calculations for WPPI's Swaps.

Net increase (decrease) in fair value of investments increased \$0.8 million, from negative \$0.4 million in 2005 to \$0.4 million in 2006. WPPI has an investment policy of purchasing highly rated fixed income investments and holding them to maturity. The investment portfolio is structured in a ladder format to have investments of varying maturity dates.

Interest expense increased \$5.3 million, from \$9.0 million in 2005 to \$14.3 million in 2006. The increase was due to a full year of interest expense on WPPI's Series 2005 A and B bonds.

Future Costs to Be (Returned) Recovered

Future costs to be returned or recovered decreased \$1.8 million, from \$0.7 million in 2005 to negative \$1.1 million in 2006. Future recoverable costs, as allowed under Statement of Financial Accounting Standards No. 71 – "Accounting for Certain Types of Regulation" is a calculation designed to ensure that revenues are properly recognized in periods consistent with rate-making strategies and that ratepayers are not charged for both depreciation on an asset and principal payments on the bonds issued to acquire the asset in the same year. As previously discussed, in 2006, due to the adoption of Financial Accounting Standard 71 for regulatory asset and liability accounting, a cost to be returned in the amount of \$1.7 million was recognized as the offsetting entry to the \$1.7 million gain for marking WPPI's Series 2003 B and C and Series 2005 B swap transactions to market value.

Cumulative Effect of Change in Accounting Principle

As noted above, WPPI adopted the principle of regulatory asset and liability accounting in accordance with SFAS No. 71 to record unrealized gains and losses from the annual mark to market calculations on the interest rate swaps. In 2006, \$1.2 million that was expensed in prior years was included in income.

Change in Net Assets

Change in net assets increased by \$19.7 million, from \$6.6 million in 2005 to \$26.3 million in 2006. The change is the net result of revenues and other income minus expenses and other costs as described in the sections above.

Total net assets at the end of 2006 were \$84.1 million, up from \$57.7 million at the end of 2005.

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Financial Changes in 2005 From 2004

The following table summarizes the financial position of WPPI as of December 31, 2005 and 2004:

Condensed Balance Sheets

Assets	<u>2005</u>	<u>2004</u>	<u>Dollar change</u>	<u>Percentage change</u>
Current assets	\$ 102,961,808	\$ 44,639,286	\$ 58,322,522	130.7%
Noncurrent assets	256,907,013	82,119,841	174,787,172	212.8%
Deferred costs	29,974,277	27,171,118	2,803,159	10.3%
Capital assets, net of accumulated depreciation	<u>152,374,780</u>	<u>129,727,892</u>	<u>22,646,888</u>	17.5%
Total assets	<u>\$ 542,217,878</u>	<u>\$ 283,658,137</u>	<u>\$ 258,559,741</u>	91.2%
Liabilities and Net Assets				
Current liabilities	\$ 42,282,486	\$ 27,974,279	\$ 14,308,207	51.1%
Other deferred credits and liabilities	12,869,345	11,168,980	1,700,365	15.2%
Long-term debt	393,566,716	158,273,732	235,292,984	148.7%
Rate stabilization	<u>35,756,677</u>	<u>35,127,846</u>	<u>628,831</u>	1.8%
Total liabilities	<u>484,475,224</u>	<u>232,544,837</u>	<u>251,930,387</u>	108.3%
Net assets				
Invested in capital assets, net of related debt	(75,014,998)	(35,639,020)	(39,375,978)	110.5%
Restricted	107,860,039	53,218,725	54,641,314	102.7%
Unrestricted	<u>24,897,613</u>	<u>33,533,595</u>	<u>(8,635,982)</u>	-25.8%
Total net assets	<u>57,742,654</u>	<u>51,113,300</u>	<u>6,629,354</u>	13.0%
Total liabilities and net assets	<u>\$ 542,217,878</u>	<u>\$ 283,658,137</u>	<u>\$ 258,559,741</u>	91.2%

Total Assets

Total assets increased by approximately \$258.6 million due primarily to WPPI issuing \$236.92 million in bonds, including a premium of approximately \$5.2 million, for total proceeds of approximately \$242.1 million, to fund the acquisition of an approximately 51 MW share in each of Elm Road Generating Station Units 1 and 2 that are being constructed in Oak Creek, Wisconsin. Construction started in mid-2005 and is expected to continue through mid-2009 for Unit 1 and mid-2010 for Unit 2. WPPI has budgeted \$210.5 million for estimated construction costs and contingencies, which will be funded by bond proceeds of approximately \$193.4 million and interest earnings on the bond proceeds of approximately \$17.1 million. The remainder of the bonds were issued to cover capitalized interest of approximately \$37.0 million, a debt service reserve of approximately \$8.2 million, and costs of issuance of approximately \$3.5 million.

Each line item that is part of the condensed balance sheets in this audit is discussed in more detail in the following sections. All amounts have been rounded to the nearest \$0.1 million.

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Current Assets

Cash and investments increased approximately \$3.1 million, from approximately \$15.1 million in 2004 to approximately \$18.2 million in 2005. The total included \$6.5 million from WPPI's line of credit with Chase Bank.

Restricted cash and investments increased approximately \$45.3 million, from approximately \$6.0 million in 2004 to approximately \$51.3 million in 2005. The increase was attributable to cash from bond proceeds for construction funds expected to be used within 12 months of December 31, 2005 of approximately \$32.8 million, and capitalized interest due within 12 months of December 31, 2005 of approximately \$12.5 million.

Power sales accounts receivable increased approximately \$9.8 million, from approximately \$17.8 million in 2004 to approximately \$27.6 million in 2005. The increase was attributable to the higher cost of purchased power during December 2005 which was reflected on member invoices.

Other receivables decreased by approximately \$2.1 million, from slightly less than \$2.5 million in 2004 to approximately \$0.3 million in 2005. The decrease is a result of receivables from Members who joined in 2001 and 2002 being paid off in an amount of approximately \$0.7 million, and a decrease of approximately \$1.6 million in miscellaneous receivables consisting primarily of approximately \$1.4 million from Alliant Energy for overhaul costs of South Fond du Lac Combustion Turbine 4 and the remainder in numerous other smaller items.

Unrestricted interest receivable decreased by approximately \$0.1 million, from approximately \$0.4 million in 2004 to approximately \$0.3 million in 2005, primarily as a result of interest on the 2003 A B and C Debt Service Reserve Funds, which goes to the Revenue Fund, not being received by year end 2004, but being received as the close of business in 2005.

Restricted interest receivable increased approximately \$1.5 million, from just over \$0.0 million in 2004 to approximately \$1.5 million in 2005, primarily reflecting the reinvestment of interest earnings through December 31, 2005 on the 2005 A & B funds, which is restricted to those funds.

Inventories increased by approximately \$0.8 million, from approximately \$2.6 million in 2004 to approximately \$3.4 million in 2005 as a result of fuel stock increases at Boswell 4 and the Island Street Peaking Plant.

Prepayments increased less than \$0.1 million, rising from just over \$0.3 million in 2004 to just under \$0.4 million in 2005 primarily as a result of just over \$70,000 in January 2006 health insurance premiums paid in December 2005.

Noncurrent Assets

Total noncurrent assets increased by approximately \$174.8 million, from approximately \$82.1 million in 2004 to approximately \$256.9 million in 2005, consisting of an increase of approximately \$175.6 million in non-current cash and investments, a decrease of less than \$0.1 million in interest receivable, a decrease of approximately \$5.9 million in investments held, an increase of approximately \$5.3 million in the investment in the American Transmission Company, and a decrease of approximately \$0.2 million in Rate Stabilization Contributions receivable from members, as discussed in the following paragraphs.

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Noncurrent restricted cash and investments increased from approximately \$48.3 million in 2004 to approximately \$223.9 million in 2005, or a total of \$175.6 million, primarily due to the issue of the series 2005 A and 2005 B bonds. Changes in the composition of noncurrent restricted cash and investments detailed in Footnote 2 are discussed in the paragraphs that follow.

Cash and investments in the Renewal and Replacement Fund increased by approximately \$3.6 million from approximately \$2.3 million in 2004 to approximately \$5.9 million in 2005 as a result of deposits made during 2005 for Boswell 4, the South Fond du Lac units, and the Island Street Peaking Plant.

Cash and investments in the Self Insurance Fund increased by approximately \$1.0 million from approximately \$2.1 million in 2004 to approximately \$3.1 million in 2005 due to deposits to the Self Insurance Fund out of 2004 net earnings that occurred in 2005, and from interest earnings that are retained in the fund.

Cash and investments in the Rate Stabilization Fund increased by approximately \$1.7 million, from approximately \$33.7 million in 2004 to approximately \$35.4 million in 2005. The increase in cash was a result of deposits made for new Members of approximately \$0.6 million, plus continuing deposits of approximately \$0.8 million from Members joined WPPI several years prior who opted to make Rate Stabilization Fund deposits on a schedule, and a deposit of approximately \$0.4 million from year end 2004 deferrals of net income. The increases were offset slightly by mark to market calculations on investments held in the Rate Stabilization Fund which decreased the fund by approximately \$0.2 million, resulting in the net increase, after rounding, of approximately \$1.7 million in 2005.

Cash and investments in the Decommissioning Fund increased by approximately \$0.2 million, including approximately \$0.1 million deposited from member revenues and \$0.1 million deposited from interest earnings. These deposits brought the balance to approximately \$2.3 million in 2005 from approximately \$2.1 million in 2004.

Noncurrent Construction Fund cash and investments increased by approximately \$135.0 million, from \$0.0 in 2004 to approximately \$135.0 million in 2005. These funds came from bond proceeds for the Elm Road Generating Station project.

Noncurrent Debt Service Funds cash and investments increased by approximately \$25.3 million, from \$0.0 in 2004 to approximately \$25.3 million in 2005. These funds came from bond proceeds for the Elm Road Generating Station project.

Noncurrent Debt Service Reserve Funds cash and investments increased by approximately \$8.8 million, from approximately \$8.1 million in 2004 to approximately \$16.9 million in 2005. These funds came from approximately \$8.2 million bond proceeds for the Elm Road Generating Station project and approximately \$0.6 million in interest earnings on the 2003 Series A, B and C, and 2005 Series A and B Debt Service Reserve Funds.

Noncurrent unrestricted investments decreased by approximately \$5.9 million, from approximately \$6.6 million in 2004 to approximately \$0.7 million in 2005, as a result of investments being held closer to maturity, which reclassifies them from the non current investment category to the current assets category.

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Investment in the American Transmission Company increased by approximately \$5.3 million, from approximately \$27.0 million in 2004 to approximately \$32.3 million in 2005. The increase came from approximately \$4.1 million in capital contributions by WPPI during 2005, with the remainder of approximately \$1.2 million representing 2005 earnings allocations that were retained by ATC and increased WPPI's ownership.

Noncurrent receivables from Members decreased by approximately \$0.2 million, from approximately \$0.2 million to just above \$0. The decrease was attributable to Plymouth Utilities making its final payments to the Rate Stabilization Fund as a new Member. Payments to the fund due from Oconto Falls, Prairie du Sac and Reedsburg were moved to current receivables because they will be collected in 2006.

Deferred Costs

Unamortized bond issuance costs increased approximately \$3.3 million, from approximately \$2.6 million in 2004 to approximately \$5.9 million in 2005 as a result of approximately \$3.5 million in unamortized costs from the 2005 A and B bond issues, less approximately \$0.2 million in 2003 A B and C costs that were amortized in 2005.

Future recoverable costs represent the difference between depreciation and amortization of assets financed with bond proceeds and the related principal recovered in rates in the present period. These costs will be recovered in future periods when the principal amounts exceed the related depreciation and amortization, as allowed through the application of provisions under SFAS No. 71. Future recoverable costs increased by approximately \$0.7 million during 2005.

Other deferred charges decreased by approximately \$1.1 million, from approximately \$4.2 million in 2005 to approximately \$3.1 million in 2004, primarily as the result of amortizing approximately \$0.8 million for termination of a power purchase agreement with Menasha Utilities that started being amortized in 2005 on a 55 month amortization schedule, \$0.2 million in amortization for a capacity buyout agreement with Kaukauna Utilities that started in 2002 and is being amortized over 60 months.

Capital Assets

Capital assets net of accumulated depreciation increased by approximately \$22.6 million. Within this category, electric plant and equipment increased a net of \$0.1 million from approximately \$208.9 million in 2004 to \$209.0 million in 2005. The increase was attributable primarily to the purchase of a van to WPPI's second metering technician with a vehicle and metering equipment for WPPI metering points.

Accumulated depreciation and amortization increased from approximately \$79.2 million in 2004 to approximately \$85.3 million in 2005, or approximately \$6.1 million. Major components of this increase include approximately \$2.6 million in accumulated depreciation for Boswell 4, approximately \$1.1 million in accumulated depreciation for South Fond du Lac 1, approximately \$1.2 million in accumulated depreciation for South Fond du Lac 4, approximately \$0.8 million in accumulated depreciation for the Island Street Peaking Plant, approximately \$0.1 million in accumulated depreciation for the Worthington Wind Turbines, and approximately \$0.4 million in accumulated depreciation for computer equipment.

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Construction work in progress increased by approximately \$28.6 million, from approximately \$0.1 million in 2004 to approximately \$28.7 million in 2005. Approximately \$28.1 million of the increase was construction work in progress on Elm Road Generating Station Units 1 and 2, approximately \$0.5 million of the increase was costs of preliminary work on the Prairie State Generating Project, and approximately \$0.1 million of the increase was construction work in progress on Boswell 4.

Total Liabilities

Total liabilities increased by approximately \$251.9 million due primarily to WPPI issuing \$236.92 million in bonds to fund the acquisition of an approximately 51 MW share in each of Elm Road Generating Station Units 1 and 2. WPPI has budgeted \$210.5 million for estimated construction costs and contingencies, which will be funded by bond proceeds of approximately \$193.4 million and interest earnings on the bond proceeds of approximately \$17.1 million. The remainder of the bonds were issued to cover capitalized interest of approximately \$37.0 million, a debt service reserve of approximately \$8.2 million, and costs of issuance of approximately \$3.5 million. Each line item that is part of the condensed balance sheets is discussed in more detail in the following sections.

Current Liabilities

Current maturities of long term debt increased approximately \$3.0 million, from approximately \$5.6 million in 2004 to approximately \$8.6 million in 2005. Increases in the account reflected reclassification of approximately \$8.6 million in 2003 Series A, B and C maturities from long term debt to short term debt, and retirement of approximately \$5.6 million in 2003 Series A, B and C maturities.

Interest accrued increased by approximately \$1.1 million, from approximately \$2.3 million in 2004 to approximately \$3.4 million in 2005. This amount increased by approximately \$1.5 million for interest expense for 2005 Series A&B, offset by a decrease of approximately \$0.4 million for interest expense due on 2003 Series A, B and C.

The line of credit balance outstanding increased by \$6.5 million, from \$0.0 million in 2004 to \$6.5 million in 2005. WPPI established a \$5.0 million line of credit in June 2004 with Chase Bank, and increased it to \$10.0 million in March 2005.

Accounts Payable increased by approximately \$6.5 million, from approximately \$16.2 million in 2004 to approximately \$22.3 million in 2005. The increase was attributable to the higher purchased power expense in the second half of 2005. WPPI also accrued approximately \$0.3 million for the Prairie State Energy Campus project for payment required with the Initial Interest Acquisition Notice which was issued on December 30, 2005.

Other current liabilities decreased by approximately \$2.7 million, from approximately \$3.9 million in 2004 to approximately \$1.1 million in 2005. The majority of the decrease was due to the payment in 2005 of \$2.5 million to Menasha Utilities for the buyout of an output contract, and a lowering of the SEP-IRA Retirement Plan contribution liability of approximately \$0.2 million due to a shift in 2005 to monthly deposits from bi-annual deposits.

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Other Deferred Credits and Liabilities

Operating reserves and accrued liabilities increased approximately \$0.7 million, from approximately \$9.1 million in 2004 to approximately \$9.7 million in 2005. Increases included Renewal and Replacement Fund deposits for South Fond du Lac 1 of approximately \$0.7 million, South Fond du Lac 4 of approximately \$0.4 million, and the Self Insurance Fund of approximately \$0.1 million, and Post Retirement Obligation and other miscellaneous accruals of approximately \$0.2 million. Decreases included use of approximately \$0.5 million in the Renewal and Replacement Fund for Boswell 4 for repairs during 2005, and Employee Retention Plan Fund payments.

The fair value of interest rate swap agreements decreased approximately \$0.9 million, from approximately negative \$0.3 million to approximately negative \$1.2 million as a result of a combination of swap value changes and recording of the 2005 B swap. The 2003 B swap increased in market value by approximately \$0.6 million, from approximately negative \$1.2 million in 2004 to approximately negative \$0.6 million in 2005. The 2003 C swap increased in market value by approximately \$0.3 million, from approximately \$0.9 million in 2004 to approximately \$1.2 million in 2005. The 2005 B swap was recorded at an initial value of approximately negative \$1.9 million on December 31, 2005. The value of the swaps to WPPI reflects changes in interest rates. If interest rates rise, the swaps will generally gain value, and if interest rates fall, the swaps will generally lose value.

The asset retirement obligation, which is the accrual of funds for retirement of the ash ponds at Boswell 4, increased approximately \$0.1 million as a result of monthly deferrals to the fund from ongoing revenue, plus interest earnings on the funds which remain in the fund.

Long-Term Debt

Revenue bonds net of unamortized premium increased by approximately \$235.3 million, from approximately \$158.3 million in 2004 to \$393.6 million in 2005. This increase included approximately \$236.9 million in new long term debt for 2005 Series A and B, and approximately \$5.2 million for unamortized premium for Series 2005 A and B, amortization of the loss on reacquired debt for 2003 Series A, B and C of approximately \$1.3 million, the amortization of the loss on reacquired debt for 1993 Series A and B of approximately \$1.3 million. Decreases in the account included approximately \$0.9 million for amortization of the premium on Series 2003 A and the reclassification of approximately \$8.6 million in 2003 Series A, B and C principal to short term debt.

Rate Stabilization Fund

The Rate Stabilization Fund increased by approximately \$0.6 million, from approximately \$35.1 million in 2004 to approximately \$35.8 million in 2005, due to payments from new Members.

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Net Assets

Net Assets invested in capital assets, net of related debt decreased by approximately \$46.5 million, from approximately negative \$35.6 million in 2004 to approximately negative \$82.1 million in 2005. The change was a result of an a decrease in net electric plant and equipment of approximately \$6.0 million, a decrease in the amount of the fair value of interest swaps of approximately \$0.9 million, and an increase in long term debt of approximately \$236.1 million, offset by an increase in construction work in progress of approximately \$28.7 million and an increase in funds available for construction of approximately \$167.8 million.

Restricted net assets increased by approximately \$54.6 million, from approximately \$53.2 million in 2004 to approximately \$107.9 in 2005. The change was a result of an increase in total non current restricted cash and investments of approximately \$175.6 million, an increase in restricted interest receivable of approximately \$1.5 million, and an increase in current restricted cash and investments of approximately \$45.3 million, less an increase for construction funds of approximately \$167.8 million, which must be subtracted because it is used to calculate net assets invested in capital assets, net of related debt.

Unrestricted net assets decreased by approximately \$1.5 million, from approximately \$33.5 million in 2004 to approximately \$32.0 million in 2005. This amount is the remainder of retained earnings after computing the value of net assets invested in capital assets, net of related debt and restricted net assets.

Total net assets increased by approximately \$6.6 million, from approximately \$51.1 million in 2004 to approximately \$57.7 million in 2005. The increase was a result of the change in net assets during 2005 from continuing operations. The change in net assets is described in further detail in the discussion of the Condensed Statements of Revenues, Expenses and Changes in Net Assets for 2005 and 2004.

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The following table summarizes the changes in financial position for WPPI for the years ended December 31, 2005 and 2004:

Condensed Statements of Revenues, Expenses, and Changes in Net Assets for the Periods Ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>	<u>Dollar change</u>	<u>Percentage change</u>
Operating revenues	\$ 306,111,928	\$ 223,028,979	\$ 83,082,949	37.3%
Operating expenses	<u>296,977,487</u>	<u>214,692,925</u>	<u>82,284,562</u>	38.3%
Operating income	9,134,441	8,336,054	798,387	9.6%
Net investment income, and equity in earnings of ATC, and unrealized gain(loss) on interest rate swaps	7,846,430	5,344,627	2,501,803	46.8%
Interest expense and debt-related expenses	(10,920,999)	(9,989,948)	(931,051)	9.3%
Other nonoperating expenses	<u>(81,129)</u>	<u>(147,092)</u>	<u>65,963</u>	-44.8%
Change in net assets before future recoverable costs	5,978,743	3,543,641	2,435,102	68.7%
Future recoverable costs	<u>650,610</u>	<u>556,359</u>	<u>94,251</u>	16.9%
Change in net assets	6,629,353	4,100,000	2,529,353	61.7%
Net assets, beginning of year	<u>51,113,300</u>	<u>47,013,300</u>	<u>4,100,000</u>	8.7%
Net assets, end of year	<u>\$ 57,742,653</u>	<u>\$ 51,113,300</u>	<u>\$ 6,629,353</u>	13.0%

Operating Revenues

2005 was a year which saw rapidly rising purchased power costs, particularly in the second half of the year. As WPPI purchased more expensive power to meet member demand, revenues increased correspondingly with those costs as WPPI billed members for the cost of purchased power. Total operating revenues increased approximately \$83.1 million, or approximately 37.3%, from approximately \$223.0 million in 2004 to approximately \$306.1 million in 2005.

Included in operating revenues are sales to member, sales to others, and other income. All amounts have been rounded to the nearest \$0.1 million.

Sales to members increased approximately \$57.5 million or approximately 29.2%, from approximately \$196.4 in 2004 million to approximately \$254.0 million in 2005. Megawatt hour sales to members increased approximately 7.8%, from 4,585,942 in 2004 to a total of 4,941,385 in 2005. New Members Juneau, New Glarus and Mt. Horeb accounted for approximately 2.0% of the megawatt hour increase, with the remaining 5.8% increase in megawatt hours attributable to requirements from existing members. Approximately \$42.0 million, or approximately 21.3%, of the increased revenue was attributable to billing for higher purchased power costs to serve members.

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There was no Rate Stabilization Fund use in 2005, whereas approximately \$3.0 million was utilized in 2004 to offset in part the cost of replacement power purchased during an unplanned outage at Boswell 4.

Sales to others increased approximately \$28.4 million, or approximately 124.8%, from approximately \$22.8 million in 2004 to approximately \$51.2 million in 2005. Sales of generation into the Midwest Independent System Operator Day 2 Market totaled approximately \$27.0 million, and accounted for the bulk of the increase. These sales occurred after the start of the Day 2 Market on April 1, 2005. Total sales to other customers accounted for the remaining approximately \$1.8 million increase in sales to others.

Other income increased approximately \$0.1 million driven primarily by an increase in revenue from the Worthington Wind Turbines of approximately \$0.1 million.

Operating Expenses

Total operating expenses increased approximately \$82.3 million, or approximately 38.3%, from approximately \$214.7 million in 2004 to approximately \$297.0 million in 2005. The increase in operating expenses was driven primarily by the higher purchased power costs.

Purchased power expense, which includes purchased power and transmission expenses, increased approximately \$64.7 million, or approximately 35.7%, from approximately \$181.2 million in 2004 to approximately \$245.9 million in 2005. The purchased power expense portion of this line item increased approximately \$61.6 million, or approximately 38.4%, from approximately \$160.2 million in 2004 to approximately \$221.8 million in 2005, primarily due to higher fuel prices. The transmission expense portion of this line item increased by approximately \$3.1 million, or approximately 15.0%, from approximately \$20.9 million in 2004 to approximately \$24.0 million in 2005, primarily due to an increase in rates.

Fuel expense increased approximately \$16.6 million, from approximately \$8.5 million in 2004 to approximately \$25.1 million in 2005. Part of the increase was attributable to WPPI's Boswell 4 and South Fond du Lac Units 1 and 4 returning to normal levels of operation in 2005, after experiencing unplanned outages that necessitated major repairs in 2004. Fuel expense was approximately \$18.0 million in 2003, which was a more typical year of operations. The additional increase in 2005 over the 2004 and 2003 levels was attributable to higher costs for natural gas.

Other power production expense decreased by approximately \$0.3 million, or approximately 6.0%, from approximately \$5.3 million in 2004 to approximately \$4.9 million in 2005. The reduction reflected lower maintenance costs at Boswell 4 and South Fond du Lac Units 1 and 4 due to the extensive maintenance performed in 2004.

Administrative and general expense increased by approximately \$0.5 million, or approximately 4.2%, from approximately \$11.3 million in 2004 to approximately \$11.8 million in 2005. Salary and benefits made up approximately 59% of all administrative and general expense. Those categories increased by approximately 7.3% in 2005 over 2004 due to an increase of 2 staff members, increases in salaries, and health insurance premium increases of approximately 19.5%.

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Depreciation and amortization expense increased approximately \$0.6 million, from approximately \$6.0 million in 2004 to approximately \$6.6 million in 2005. The increase was due primarily to the Island Street Peaking Plant being in operation for all of 2005 - the plant was operational as a new plant for May through December of 2004. Island Street depreciation increased approximately \$0.4 million. Boswell 4 had an increase of approximately \$0.1 million, and other WPPI generation units accounted for the remaining approximately \$0.1 million increase.

Tax expense increased approximately \$0.1 million, from approximately \$2.5 million in 2004 to approximately \$2.6 million in 2005. The increase was a result of the Island Street Peaking Plant being in operation for all 12 months of 2005, after being operational as a new plant for only a partial year in 2004.

Nonoperating Revenues (Expenses)

Investment income increased approximately \$1.9 million, from approximately \$2.2 million in 2004 to approximately \$4.1 million in 2005. The majority of the increase was from the reinvestment of the 2005 A and B bond proceeds for the last two months of 2005. Reinvestment of bond proceeds increased investment income approximately \$1.6 million in 2005. The investment income from the bond proceeds is being used to fund the construction of Elm Road Generating Station Units 1 and 2, and pay for a portion of capitalized interest during construction of the units, as outlined in the plan of finance for the units. The remaining approximately \$0.3 million in increased investment income was attributable to WPPI investment activities. WPPI maintains a laddered portfolio of investments to maximize interest earnings. A portion of the total investments is scheduled to mature each year. In 2005, WPPI was able to reinvest the proceeds from matured investments at higher interest rates than those funds had previously been invested in, which generated additional investment income over the investment income in 2004.

Equity in earnings of ATC (American Transmission Company) increased by approximately \$0.8 million, from approximately \$4.2 million in 2004 to approximately \$5.1 million in 2005. WPPI maintains an ownership share of approximately 5.2%. WPPI's equity in the earnings of ATC increased in 2005 as a result of higher earnings at ATC during 2005 compared with 2004.

Unrealized loss on interest rate swap agreement increased by approximately \$0.1 million, from approximately \$0.8 million in 2004 to approximately \$0.9 million in 2005. The unrealized loss is the net result of mark to market calculations for WPPI's three floating to fixed rate swaps.

WPPI's 2003B transaction, which had an original notional amount of \$65.7 million, had a notional amount of \$65.1 million at the end of 2005. The fair value of this swap increased approximately \$0.6 million, from approximately negative \$1.2 million in 2004 to approximately negative \$0.6 million in 2005.

WPPI's 2003C transaction, which had an original notional amount of \$39.35 million, had a notional amount of \$37.925 million at the end of 2005. The fair value of this swap increased approximately \$0.3 million, from approximately \$0.9 million in 2004 to approximately \$1.2 million in 2005.

WPPI's 2005B transaction, which had an original notional amount of \$93.9 million, had a notional amount of \$93.9 million at the end of 2005. The fair value of this swap was recorded for the first time in 2005 at approximately negative \$1.9 million.

The net result of marking the three swap transactions to market as of December 31, 2005 was the recognition of an unrealized loss of approximately \$0.9 million in 2005.

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Net decrease in fair value of investments increased by approximately \$0.1 million, from approximately negative \$0.3 million in 2004 to approximately negative \$0.4 million in 2005. WPPI has an investment policy of purchasing highly rated investments and holding them to maturity. The investment portfolio is structured in a ladder format to have investments of varying maturity dates.

Interest expense increased approximately \$1.1 million, from approximately \$7.9 million in 2004 to approximately \$9.0 million in 2005. The increase was due to interest expense of approximately \$1.8 million on WPPI's Series 2005 A and B bonds, which were issued on November 2, 2005 to fund the Elm Road Generating Station construction project. This amount was offset by a slight decline in interest expense on WPPI's Series 2003 A, B and C issues due to scheduled retirement of bond principal, and approximately \$0.5 million in allowance for funds used during construction attributable to the Elm Road Generation Station construction. The amount is calculated by taking capitalized interest less interest earnings on the capitalized interest funds. The difference is recorded as income and an asset. The asset is then amortized over the life of the project that generated it. This helps to moderate rates, because the net cost of the capitalized interest is spread over the life of the project.

Amortization of debt related costs decreased by approximately \$0.1 million, from approximately \$2.1 million in 2004 to approximately \$2.0 million in 2005. The decrease was in accordance with amortization schedules for the Series 2003 A, B and C debt related costs.

Future Recoverable Costs

Future recoverable costs increased approximately \$0.1 million, from approximately \$0.6 million in 2004 to approximately \$0.7 million in 2005. Future recoverable costs is a calculation designed to ensure that rate payers are not charged for both depreciation on an asset and principal payments on the bonds issued to acquire the asset in the same year. The calculation ensures that the combination of interest payments, principal payments, and depreciation expense are levelized over the life of an asset. In that manner, rates to pay for the asset are relatively level from year to year. In the early years of an asset, the calculation will result in an addition to income and assets. As principal is retired, the calculation will result in a reduction to income and a reduction in the accrued asset. WPPI added new debt service accruals in 2005 for the 2005A and 2005B bonds, resulting in an increase in future recoverable costs of approximately \$0.1 million.

Change in Net Assets

Change in net assets increased by approximately \$2.5 million, from \$4.1 million in 2004 to approximately \$6.6 million in 2005. The change is the net result of revenues and other income minus expenses and other costs as described in the sections above.

Total net assets at the end of 2005 were approximately \$57.7 million, up from approximately \$51.1 million at the end of 2004.