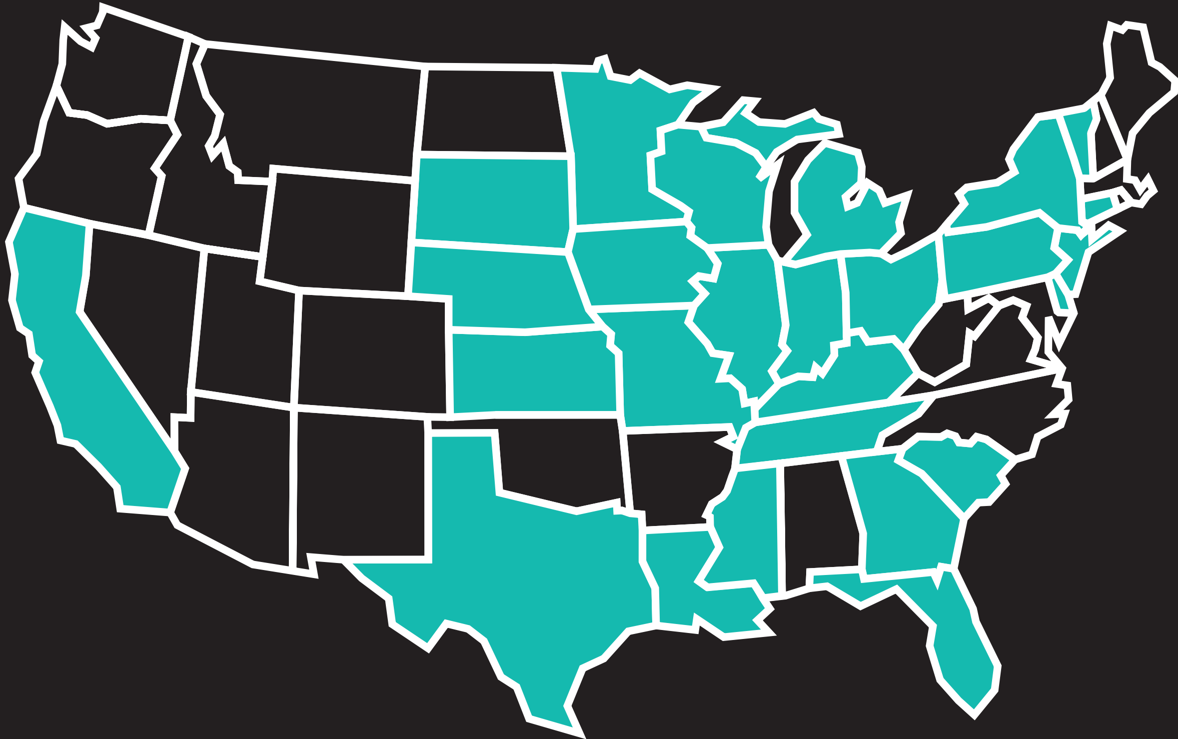
SEMCO ENERGY

Annual Report 2000

Meeting Customer Needs

SEMCO ENERGY, Inc. Annual Report 2000

Shading indicates states
in which SEMCO ENERGY operates



1 Company Profile
2 Financial and Operating Highlights
3 Letter to the Shareholders
11 Business Review
12 Gas Distribution
18 Engineering and Construction Services
22 Propane, Pipelines and Storage
24 Information Technology Services
27 Financial Review & Statements
74 Investor Information
IBC Company Officers, Board of Directors

SEMCO ENERGY, Inc. *is a diversified energy and infrastructure company that distributes natural gas to more than 367,000 customers in Michigan and Alaska. It owns and operates businesses involved in gas engineering and quality assurance services, construction services, propane distribution, intrastate pipelines and natural gas storage in various regions of the United States. In addition, it provides information technology and outsourcing services, specializing in the mid-range computer market.*

GAS DISTRIBUTION

This business segment provides natural gas and associated services and products to more than 262,000 residential, commercial and industrial customers in Michigan. Its chief markets are in the populous southeastern, central, western and northern regions of Michigan. In Anchorage, Alaska, this business is the sole provider of natural gas and associated services to more than 105,000 customers, and its service area encompasses approximately half of the total Alaskan population.

ENGINEERING AND CONSTRUCTION SERVICES

This segment caters to utilities and other companies, more and more of which desire to outsource construction of underground gas pipeline, water and cable facilities to larger contractors. Services include engineering, design and installation of pipelines, meter/compressor stations and distribution systems; field services such as project management, survey/global positioning, pipe/cable locating services; and pipeline quality assurance during manufacturing. Full turnkey capability, from design through construction of infrastructure for the energy and telecommunication industries, is a specialty.

PROPANE, PIPELINES AND STORAGE

This segment owns intrastate gas transmission pipelines and underground natural gas storage in Michigan. The propane business annually distributes five million gallons in the Upper Peninsula of Michigan, one of the area's largest suppliers.

INFORMATION TECHNOLOGY

This segment specializes in outsourcing infrastructure and technical expertise in the IBM AS 400 and other mid-range computer platforms. Markets include automotive component suppliers located primarily in the Midwest, municipalities, utilities, construction services, engineering services companies and other organizations using mid-range computers. IT outsourcing services include: platform operations; application operations; applications management; network management; Internet services; and desk top services for personal computers, client/server, LAN and WAN networks.

Years ended December 31,	**2000**	1999	1998
Financial Information (000's)			
Net Income			
As reported	**$ 16,693**	$ 17,659	$ 10,040
Weather-normalized	**$ 20,688**	$ 21,299	$ 17,220
Operating Revenue	**$ 422,593**	$ 384,763	$ 637,485
Operating income			
As reported	**$ 65,258**	$ 41,890	$ 24,195
Weather-normalized	**$ 71,840**	$ 47,480	$ 35,270
Total Assets	**$ 851,223**	$ 815,183	$ 489,662
Total capitalization	**$ 582,776**	$ 312,340	$ 305,483
Return on average common equity			
As reported	**12.0%**	12.9%	8.8%
Weather-normalized	**14.9%**	15.5%	15.1%
Common Stock Information [(a)]			
Earnings per share – basic			
As reported	**$ 0.93**	$ 1.00	$ 0.63
Weather-normalized	**$ 1.15**	$ 1.20	$ 1.08
Earnings per share – diluted			
As reported	**$ 0.90**	$ 1.00	$ 0.63
Weather-normalized	**$ 1.11**	$ 1.20	$ 1.08
Dividends per share [(b)]	**$ 0.835**	$ 0.863	$ 0.744
Closing stock price at year end	**$ 15.56**	$ 11.81	$ 16.31
Book value per share at year end	**$ 7.50**	$ 7.95	$ 7.61
Average common shares outstanding (000's)	**17,999**	17,697	15,906
Common shares outstanding at year end (000's)	**18,056**	17,909	17,382
Business Segment Information (000's, except volumes of gas and customers)			
Gas Distribution			
Operating income			
As reported	**$ 62,876**	$ 40,134	$ 22,363
Weather-normalized	**$ 69,366**	$ 45,434	$ 33,163
Percent colder (warmer) than normal	**(5.9%)**	(6.7%)	(19.7%)
Volumes of gas sold (MMcf)	**61,054**	39,245	32,247
Volumes of gas transported (MMcf)	**48,706**	32,417	23,791
Customers at year end	**367,157**	357,378	247,950
Construction Services			
Operating income	**$ 3,676**	$ 2,611	$ (102)
Feet of pipe installed	**7,969**	6,208	4,531
Engineering Services			
Operating income	**$ 25**	$ (513)	$ 2,938
Billed hours	**292**	359	586
Propane, Pipelines and Storage			
Operating income	**$ 1,530**	$ 2,341	$ 1,585
Gallons of propane sold	**4,492**	4,332	2,367

(a) Adjusted to give retroactive effect to a 5% stock dividend in May 1998.

(b) 1999 dividends include a special one-time dividend of $0.05 per share.

> From left to right
William L. Johnson, Chairman, President & CEO
Sebastian Coppola, Chief Financial Officer

DEAR SHAREHOLDER:

The year 2000 was a difficult and challenging one for our Company. A third consecutive warm winter and other business events prevented the Company from realizing its true earning power. Yet, some major accomplishments were made, positioning SEMCO ENERGY well for a brighter future—with a little help from the weather!

Because we are primarily a distributor of natural gas, our earnings will fluctuate with the weather patterns of our market areas in Michigan and Alaska. Our transformation into a more diversified company with businesses in Engineering and Construction and Information Technology (IT) services will help reduce dependence on cold weather as these businesses grow and become more profitable over time.

Now, a few of our key accomplishments. Weather impact aside, our Michigan gas utility had significant customer and revenue growth, while continuing to reduce operating costs. We were successful in refinancing the 1999 acquisition of ENSTAR with long-term debt and equity capital in difficult financial markets. This financing was not only innovative and tax-efficient for a company our size; it also deferred and potentially reduces the issuance of additional common shares in the future. We also began to realize the anticipated cost and revenue synergies at ENSTAR. The acquisition of ENSTAR was a major strategic undertaking for SEMCO. The full financial benefits of achieving larger scale of operations will continue to accrue in the coming years.

In 2000, we also undertook a major technology project to upgrade our accounting and business systems into a common platform for all our companies. Called the Enterprise Business Application, its development will be completed and fully implemented in the first half of 2001, a significant accomplishment in less than 18 months. The new system facilitates the consolidation of our Engineering and Construction business headquartered in Houston under the brand name NATCOMM. In the spring of 2000, we also launched Aretech Information Services, an information technology business with considerable growth potential.

Consistent with our policy, in May 2000, we increased the cash dividend to an annual rate of $.84. Most importantly, we saw the stock price rebound and finish the year up more than 30 percent from the end of 1999.

FINANCIAL RESULTS

Earnings for 2000 were $16.7 million, or $ .90 per share, down approximately $1 million from 1999. On a per share basis, we reported $ .90 versus $1.00 in 1999.

This decrease was the result of warmer weather in both Michigan and Alaska, which depressed Gas Distribution operating income. Although weather in the fourth quarter in Michigan swung to some colder temperatures, the past year was still above normal on average. If we adjust 2000 results to normal weather, earnings per share for the year would have been $1.11. Engineering and construction project delays, caused by inclement weather and other events in the latter part of the year, also had a negative impact on earnings. Rest assured that, despite three consecutive warmer-than-normal years and disappointing earnings, the earning power of the Company remains strong. In fact, it has more than doubled since 1996. What we need are more normal winters to show what we can earn.

SEMCO ENERGY's stock price was up 31 pecent in 2000, compared to a decrease of 28 percent for 1999. We believe our announcement of a strategic review, more favorable stock market conditions and our Company's long-term business prospects were all contributing factors to the increase in the stock price in 2000. The increase in stock price in 2000 was supplemented by the cash dividend and provided shareholders with a total return of nearly 40 percent for the year. Although 2000 showed much improvement, SEMCO stock has not provided a competitive total return to shareholders during the past five years, despite more than a doubling of the earning power of the Company.

STRATEGIC OUTLOOK

To address the overriding issue of shareholder value, in July 2000 we undertook a review of strategic alternatives, including a possible merger or sale of our Company. After six months of intensive work evaluating various strategic combinations and potential transactions, we found, as have others in the utility industry, that the market for utility assets at this particular time was inadequate to create added value for our shareholders. Our situation was further complicated by the decision of the Regulatory Commission of Alaska (RCA) to undertake a review of rates at ENSTAR. That development created significant uncertainty for prospective partners or buyers, which was difficult to overcome.

Thus, having found that the best path to maximizing shareholder value was to continue implementing our plan, in December we reaffirmed our intent to execute our Strategic Plan, increase earnings and improve profitability. As always, should other opportunities or offers that maximize shareholder value be presented, we will evaluate them fully.

Our Strategic Vision: SEMCO ENERGY will be a leading diversified energy infrastructure company. We will be a significant regional provider of natural gas services and one of the largest providers of underground engineering and construction services. We will develop a world-class information technology business focused predominately on mid-range computer applications.

Our Strategic Plan continues to reflect this vision: SEMCO ENERGY will be a leading diversified energy infrastructure company. We will be a significant regional provider of natural gas services and one of the largest providers of underground engineering and construction services in North America. We will develop a world-class Information Technology business focused predominantly on mid-range computer applications. We will provide high-quality and valued services to our customers and a total return to our shareholders above the median of our peer group.

The first leg of our strategy is the Gas Distribution business, which continues to deliver an impressive performance despite the warm trend of the last few winters. Our strategic advantage is our ability to operate gas distribution properties more efficiently than our peers. We will seek to increase gas distribution revenue particularly through customer growth and additionally by serving power generation markets. For example, new electric generation projects, such as the 830-megawatt gas-fired Mirant Corporation plant in western Michigan will create $23 million in new gas transportation revenue over the next 12 years. Other potential Michigan power generation projects total 2,800 megawatts, requiring 80 billion cubic feet of natural gas annually in various locations. These projects also provide profitable opportunities for NATCOMM, our Engineering and Construction business.

Although a significant distance from Michigan, the operating characteristics of our ENSTAR division in Alaska are similar to our Michigan utility. This situation provides us with opportunities to achieve significant revenue and cost synergies. In addition, there may be opportunities to expand the Alaska gathering and transmission system, as well as the distribution system, to cities such as Homer and Seward. We are confident that proceedings with the Regulatory Commission of Alaska during 2001 will determine that ENSTAR's rates, which are among the lowest in the country, are just and reasonable.

From a strategic perspective, appealing as gas distribution is, it's still a business in a mature industry. Although our Gas Distribution business is adding customers at more than twice the industry rate, this growth alone is insufficient to provide a competitive total return to shareholders.

Therefore, the second leg of our strategy remains the building of an industry leading Engineering and Construction business that further accelerates our earnings growth. In addition to focusing on internal

revenue growth, part of our strategy in this business is to continue making selective acquisitions of a size consistent with our ability to raise capital efficiently. These acquisitions will help grow our existing lines of business and expand our offering of services on a national scale.

The third leg of our strategy is the Information Technology business. In creating Aretech, our intention was to extend our Information Technology (IT) infrastructure and technical expertise in the IBM AS 400 and other mid-range computer platforms to non-affiliated customers and new markets. The IT function had been a Cost Center. By leveraging the services provided to affiliated customers to a market desirous of outsourcing IT functions, Aretech has transformed the IT function into a Value Center, which can provide additional earnings growth.

During the last four years, we have repositioned SEMCO ENERGY to achieve higher profitability and growth. Our utility operations enjoy higher-than-average customer growth rates. Our modern distribution systems cost less to maintain and expand. In addition, our diversified, non-regulated businesses in Engineering and Construction and Information Technology are positioned to make a larger contribution to earnings growth as they mature further.

By executing our strategy, we're confident we can achieve superior earnings per share growth, pay an attractive and growing cash dividend, and provide a competitive total return to shareholders.

As we have fulfilled the important needs of our customers in many ways in 2000, I am confident that we have positioned the Company to meet the expectations of our shareholders in the future. On behalf of the Board of Directors, and all our employees, thank you for your confidence and investment in SEMCO ENERGY.

William L. Johnson
Chairman of the Board, President
& Chief Executive Officer

SEMCO ENERGY is playing a key role in supplying this Power Generation facility, which will use advanced natural gas, combined-cycle technology and state-of-the-art equipment to maximize efficiency and environmental performance.

Carl Van Ingen
SEMCO ENERGY GAS COMPANY Employee

MIRANT CORPORATION

In May of 2000, Mirant Corporation, a subsidiary of Southern Company, America's largest generator of electricity, decided to bring what will become, in two phases, an 830-megawatt generating plant to Zeeland, Michigan, to help supply the growing demand for electricity in the upper Midwest. SEMCO ENERGY was selected to construct, operate and own the pipeline serving the new generating plant. NATCOMM, a SEMCO ENERGY subsidiary, handled the complete turnkey construction project. SEMCO ENERGY GAS COMPANY, the SEMCO ENERGY utility division serving 262,000 industrial, commercial and residential customers in Michigan, initially will deliver to the plant up to 186,000 Mcf of natural gas daily. This "Total Business Solutions" approach to meeting customers' needs is integral to SEMCO's plan to expand its gas markets, particularly in fueling power generation plants.

Meeting Customer Needs

Eldon Stamps
VECO Corporation Employee

As a Green Star Award winner for demonstrated environmental responsibility, VECO recognizes that business objectives must be balanced with environmental stewardship. Natural gas from ENSTAR met their needs.

VECO CORPORATION

VECO Corporation delivers engineering, procurement and construction, operation and maintenance services to the energy industry globally. The company specializes in projects where terrain and climactic conditions require unique equipment and personnel. When VECO needed natural gas service during the construction and assembly phase of an oil production platform in the port of Anchorage, Alaska, during the winter of 2000-2001, it turned to ENSTAR Natural Gas Company, a division of SEMCO ENERGY. ENSTAR serves 105,000 industrial, commercial and residential customers in Anchorage. Finding new market niches to expand the use of natural gas is an essential part of ENSTAR's marketing plan.

Meeting Customer Needs

Neal Monroe
Iowa Pipeline Associates Employee

Iowa Pipeline's commitment to high-quality construction and operating standards has earned it a reputation for meeting deadlines and consistent, reliable customer service.

MIDAMERICAN ENERGY

When MidAmerican Energy Company, Iowa's largest natural gas and electricity provider, planned an extensive natural gas main and service renewal program, Iowa Pipeline Associates was selected for the project. Iowa Pipeline Associates is a high-quality, low-cost underground construction specialist for local natural gas distribution companies and one of 11 engineering and construction companies recently integrated by SEMCO ENERGY under the brand name NATCOMM. "Iowa Pipeline is uniquely equipped within its consolidated group of engineering and construction companies to "bundle" services in a cost-effective, unparalleled package," said Tom Anderson, MidAmerican's Midwest Manager, Distribution Operations Support.

Meeting Customer Needs

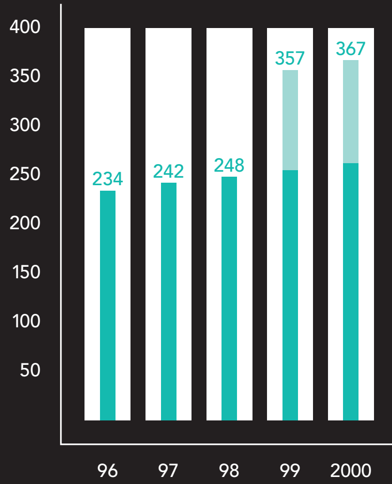
E. Brooke Matthews
Metaldyne Industries Employee

The use of IT outsourcing has grown in the last five years and will continue growing as companies continue focusing on the strategic aspects of their businesses. Aretech is ready to meet this market need.

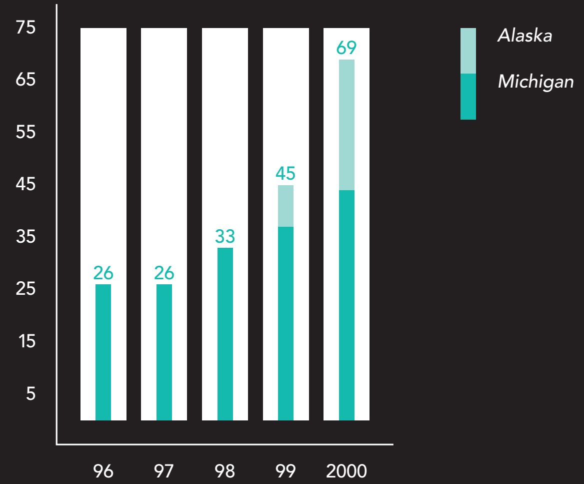
METALDYNE INDUSTRIES

Aretech Information Services' expertise allows international automotive supplier Metaldyne to focus on its key strategic activities of designing and developing precision-engineered and innovative automotive engine and chassis components. Aretech's expert services include housing and operating Metaldyne's AS/400 hardware and software, the heart of Metaldyne's enterprise software and electronic data interchange, allowing them to interact seamlessly with the world's major auto manufacturers. "There are really only two choices for many companies: learn how to manage numerous, complex IT projects in-house, devoting staff, resources and time that could be spent on maximizing productivity, quality and profitability, or outsource to a reliable service provider. Metaldyne chose Aretech," said Dick Lefebvre, Vice President of Information Technology for Metaldyne.

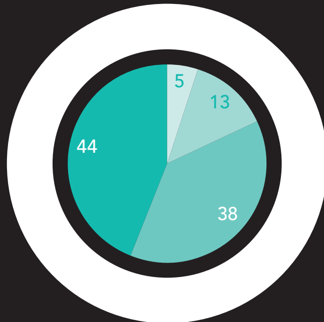
NUMBER OF GAS DISTRIBUTION CUSTOMERS AT YEAR-END
(thousands)



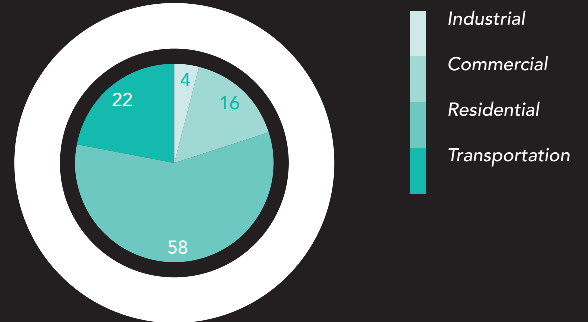
GAS DISTRIBUTION OPERATING INCOME, WEATHER-NORMALIZED
($ in millions)



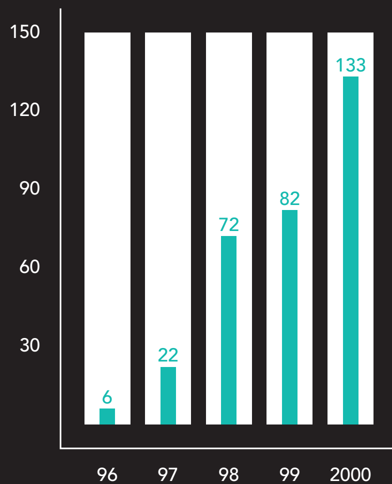
GAS DISTRIBUTION DELIVERIES MIX
(% of 109,760 MMcf)



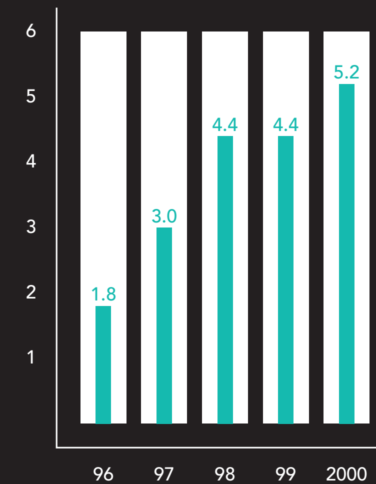
GAS DISTRIBUTION MARGIN MIX
(% of $142 million)



DIVERSIFIED BUSINESS REVENUES
($ in millions)



DIVERSIFIED BUSINESS OPERATING INCOME
($ in millions)



The scale of our natural gas distribution operations was significantly increased in 1999 when we acquired ENSTAR Natural Gas Company and Alaska Pipeline Company, which now have completed a full year of operations as part of SEMCO ENERGY.

The Gas Distribution business had a superb year despite the impact of warmer-than-normal weather. Operating income was $62.9 million, up approximately $22.8 million, or 57 percent. Adjusted for normal weather, Operating Income would have been $69.3 million, up 53 percent from 1999. Other indicators show that the Gas Distribution segment continues to perform extremely well. Customer growth remains at an above average pace of 2.5 to 3 percent. In the last four years, a total of 31,000 customers have been added, bringing the customer base to 367,000. Market opportunities, including new power generation projects, abound. Cost cutting and deployment of technology are integral to its operations. With the pace of change in the gas distribution industry increasing, SEMCO ENERGY has succeeded in this more competitive environment. Our focus on cost reduction now allows us to serve about 700 customers per employee in Michigan and more than 800 customers per employee in Alaska.

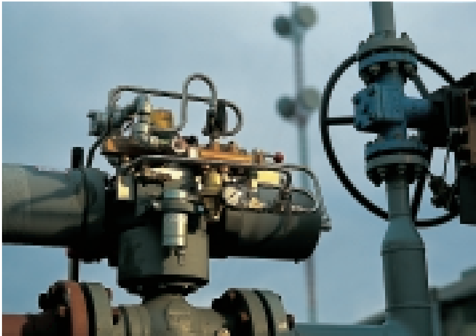
We have reduced operating costs by investing in new technology such as automated meter reading and through early retirement programs. We have enhanced customer service and introduced new services to customers. These and other initiatives will increase margins and profitability.

ENSTAR is the sole distributor of natural gas to Anchorage, Alaska. The utility's 2,297 miles of gas mains serve more than 105,000 customers in Anchorage. ENSTAR's residential and commercial rates are among the lowest in the country and gas usage per residential customer is the highest among investor-owned utilities in the U.S.

Alaska Pipeline is the only natural gas transmission system in the Anchorage/Kenai area and its 394 miles of pipeline move an average of 128 MMcf per day for ENSTAR and certain large end-users. The pipeline's capacity is 410 MMcf/day. There is increased gas and oil exploration and drilling in the Cook Inlet area. Opportunities also may exist to expand transmission and distribution systems to the communities of Seward and Homer, southwest of Anchorage.

GAS MARKETS

Our Gas Distribution business is well positioned and has many advantages over other fuels. In addition to its environmental benefits, natural gas enjoys the advantages of being as much as two- to three-times less costly than competing fuels. Its delivery system provides unmatched convenience. Despite the fact that increasing demand and declining production produced a volatile market for gas as we entered 2000, by year's end, three-quarters of all drilling rigs operating in the U.S. were looking specifically for gas, and storage levels were only slightly below the five-year national average. Increased exploration and rising production levels will replenish the supply base to meet demand for many future decades. Nationwide demand is expected to grow by a cumulative 30 percent by 2015, which bodes well for the industry. Nearly every new home built in our market area uses natural gas as its primary fuel. In 2000, the Michigan Gas Distribution business achieved a customer growth rate of nearly 3 percent, surpassing the industry average of approximately 1 percent. Despite the fact that new housing starts were down slightly in Michigan in 2000, 7,552 customers, representing $1.6 million in added annual margin, were added. Aggressive on-main and near-main marketing efforts were responsible for this increase.



> We have combined a responsive organization with a skilled workforce, focused on efficient operations and customer satisfaction. In Michigan, we are now able to serve approximately 700 customers per employee; in Alaska, we serve approximately 870. This ratio places SEMCO ENERGY among the best run companies in the gas distribution industry.

In Alaska, natural gas customer growth is averaging nearly 3 percent annually. More than 2,500 customers were added in 2000. ENSTAR's largest customers are Anchorage Municipal Light and Power, military bases, gas marketer Aurora Power Resources, Marathon Oil and the Chugach Electric Association. These and other transportation customers account for 24.4 Bcf of natural gas deliveries, or approximately 52 percent of total deliveries. Anchorage is the financial and goods distribution center for Alaska and is a major warehousing and distribution hub for Pacific Rim countries. The area has been experiencing positive trends for building occupancy rates, employment, new retail space and industrial diversification. The local economy has been fueled by North Slope investments, expansion of its airport and the vitality of the communications, health industry, tourism and construction segments.

The industrial markets in Michigan and Alaska present a significant opportunity for growth. Natural gas accounts for nearly one-third of all industrial energy consumption. Successful new technologies have allowed natural gas to supply new markets. Today, about 90 percent of the new power generation facilities under construction in the continental states are gas-fired. On-site power generation, fueled by natural gas at industrial and commercial facilities, continues to be viable and cost-effective for a number of potential customers. Gas-fired peaking facilities, designed to augment coal-fired and other forms of electric power generation, are growing in number. Conversion of coal- and oil-fired manufacturing processes to gas co-firing provide additional market growth opportunities. The first phase of a new 550-megawatt power generation plant in western Michigan will increase transportation volumes by an additional 32 Bcf and potentially as much as 72 Bcf annually, representing $23 million in revenue over a 12-year contract term. The potential for new generating plants to be located in Albion, China Township and Dowagiac, Michigan, representing nearly 1,000 MW combined, also exists. Two new on-site co-generators and other Michigan power plant prospects, totalling over 2,800 megawatts in power generation and 80 Bcf/year, offer the potential for higher gas transportation revenues.

This past year in Michigan, 7,552 customers, representing $1.6 million in added annual margin, were added. Aggressive on-main and near-main marketing efforts were responsible for this increase.

OPERATING MODEL

We have developed an approach to gas distribution that combines a responsive organization with a skilled work force, focused on efficient operations and customer satisfaction. In Michigan, we are now able to serve approximately 700 customers per employee; in Alaska, we serve approximately 870 per employee. This ratio places SEMCO ENERGY among the best run companies in the Gas Distribution industry.

Technological improvements, such as Automated Meter Reading (AMR), are tools that allow us to be more efficient and achieve increasing levels of customer satisfaction. The AMR system, while increasing our efficiency, has the added advantage of virtually eliminating bothersome estimated bills. In 2000, we converted all of ENSTAR's customers to the AMR system. We have outsourced certain work processes and closed low-traffic customer business offices in Michigan, where practical. These, as well as other measures, have reduced operating and maintenance costs in Michigan by $5 million over four years.

Realizing that operational changes can impact perceptions of customer service, we have continued to measure customer satisfaction. The average score of all Michigan customers who responded to a recent survey is remarkably high—a rating of 8.4 out of 10. We have not rested on these results. In 1999, based on knowledge of our customers' expectations, we introduced five Customized Services, one of which includes a compensatory payment to customers if we do not install a service line on time. Payouts have been minimal. Thus, we continue to focus on ways that will maintain or improve customer satisfaction so we earn the loyalty of new and existing customers.

Surveys indicate that consumers want access to alternative gas suppliers, even though participation levels in Customer Choice programs have dropped. Marketers have been faced with narrowing margins and have returned participants to system sales. Research has shown that 61 percent of Michigan residents like having a choice of natural gas suppliers. Our own June 2000 customer satisfaction study shows that nearly three-quarters of our customers would remain with SEMCO ENERGY if given the opportunity to choose a different supplier.

> About 90 percent of new power generation facilities under construction in the continental states are gas-fired. Gas-fired peaking facilities, designed to augment coal-fired and other forms of electric power generation, are another growing opportunity.

GAS SUPPLY/REGULATION

The Company's cost of gas for its Michigan distribution system results in a more competitive position among gas suppliers. Coupled with a gas distribution charge among the lowest in Michigan, this gives us a competitive edge to retain and add customers. Critical to this effort is our contract with TransCanada Gas Services, Inc. TransCanada is managing all of SEMCO's gas supply and transportation capacity on five pipelines feeding into the Michigan distribution system and 15 Bcf of underground gas storage capacity. The result is significant cost reduction. In fact, we have been able to offer customers gas supply at a fixed rate of $3.24/Mcf, which is much lower than current market prices. The program saved customers $70 million in their gas bills in 2000 alone.

Along with a lower cost of gas, we were able to implement a program in Michigan that allows us to earn a profit on the sale of the gas commodity if we are able to buy gas at lower costs. Previously, the cost of gas was a pass-through expense, and our only source of profit was the distribution charge. This accomplishment is reflective of the supportive and mutually effective relationship we have built with Michigan regulators by putting incentive-based rates into effect. Additionally, an incentive rate structure provides for profit-sharing with customers. The profit-sharing mechanism requires sharing 50 percent of the return on equity between 12.76 percent and 16.75 percent, and 75 percent sharing with customers above 16.75 percent. Given that only half of any gas cost savings go into this calculation, SEMCO is able to earn an effective return much higher than 12.75 percent before triggering sharing. Thus, both customers and the Company benefit from these incentives.

ENSTAR's gas supply is purchased under long-term contracts with Marathon Oil Company, Chevron, Phillips Alaska and the Municipality of Anchorage and indexed to changes in the price of crude oil or a base price subject to adjustment based on a percentage of the change in certain inflation measures. In June and November of 2000 ENSTAR signed two new gas supply contracts that provide for a portion of the company's requirements through 2016 at a cost that will help ENSTAR maintain its competitive stance compared to other fuels. Deliveries under these contracts will not begin until 2002 and 2004. ENSTAR's weighted average delivered cost of gas in 2000 was $1.62. Gas supply costs are passed through to customers and ENSTAR has no take-or-pay liabilities.

In Alaska, natural gas customer growth is averaging nearly 3 percent annually. More than 2,500 customers were added in 2000 and all customers were converted to the Automatic Meter Reading system.

In 2001, we face both a challenge and opportunity at ENSTAR. The Regulatory Commission of Alaska (RCA) has determined that the studies filed in April of 2000 generally complied with the requirements for the change of control order. In November 2000, the RCA issued an order requiring ENSTAR to file additional information regarding ENSTAR's revenue requirements and cost of service to determine if its rates are just and reasonable. We anticipated regulatory review when we acquired ENSTAR, although not in this timeframe. This presents an opportunity to work with the RCA to demonstrate that our rates are equitable. ENSTAR's current rates are among the lowest in the country. SEMCO has a track record of success in implementing innovative and mutually beneficial rate designs.

Our Gas Distribution business is well positioned organizationally and competitively to prosper. We expect to continue to achieve an above-average customer growth rate in the foreseeable future. We are finding innovative regulatory approaches that enhance our profit potential. We also recognize that the key to success is to find new sources of revenue and to hold the line on costs. More than ever, we are focused on translating this imperative into action.

Consolidation of the natural gas industry has created a need for larger contractors with experienced and trained personnel. NATCOMM, our Engineering and Construction business is headquartered in Houston, establishing a strong presence in a key hub of industry activity.

The Engineering and Construction services business reported $3.7 million of operating income, up from $2.1 million in 1999. Revenues were up $50.1 million, reaching $125.9 million in 2000, as a full year of results were recorded from acquisitions during 1999 and additional projects were awarded. Revenues and income, however, could have been better if inclement weather in the Midwest and other events had not delayed scheduled projects and reduced profitability. A slowdown in cable and telecommunications work in the second half of 2000 also affected results.

SEMCO ENERGY entered the Engineering and Construction business beginning in 1997 as a complement to its existing Gas Distribution business. The Company has acquired regional operations with a goal of reaching a critical mass and gaining a competitive advantage. This advantage exists by offering an array of high-quality, low-cost services, the capacity to finance larger projects and lower administrative costs from the consolidation of back office operations. Consolidation of the natural gas industry has created a need for larger contractors with experienced and trained personnel to complete larger and more complex projects. Now known as NATCOMM, the Engineering and Construction business is headquartered in Houston, establishing a strong presence in a key hub of industry activity.

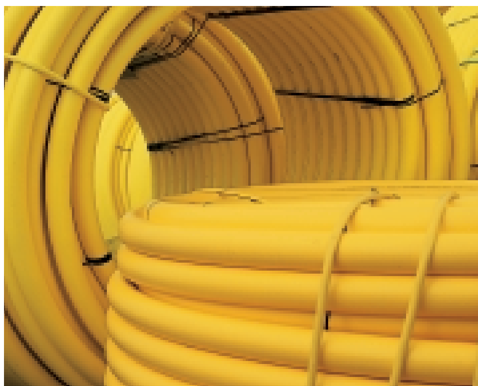
NATCOMM's goal is to grow both by capturing more business from existing and new customers, as well as through acquisitions, and by expanding the breadth of its product offerings, including directional drilling, electric, water and telecommunications services. NATCOMM expects to become a major player in the engineering and construction industry within five years, providing services to companies in the natural gas, telecommunication and other industries.

ENGINEERING SERVICES

Our Engineering Services business has a skilled and experienced workforce that is capable of providing services to companies constructing underground facilities. Capabilities can be applied to the natural gas, petroleum liquids, product pipeline, water and telecommunications industries. Work can be done on portions of an individual project or as a complete turnkey project. Our array of service offerings includes engineering design, distribution system design, testing and certification, global positioning surveys, inspection, route feasibility and construction project management. Other expertise is marketed as quality assurance services required to comply with industry standards during manufacturing, fabrication, testing and construction of energy industry facilities. Services include quality control of line piping, coatings and tubular goods, and fabricated and engineered materials for refinery and petrochemical processing. These capabilities are provided onshore and offshore as well as internationally.

During 2000, the availability of SEMCO ENERGY's financial resources allowed NATCOMM to engineer and construct a 7.5-mile, 16-inch natural gas line to serve a new power generating plant in western Michigan. This turnkey project would have been beyond the scope of smaller, independent firms. We anticipate that turnkey services will be an increasing portion of our work.

The engineering services industry is a large, highly fragmented industry, with a small group of major companies and a significant number of smaller regional



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and local companies. The engineering services industry currently provides approximately $900 million annually of services to the natural gas industry. The U.S. natural gas pipeline construction market is in excess of $8.5 billion. The total market for engineering and construction services, when the oil, water and telecommunications industries are included, is many times larger. There are significant changes within each industry, which are creating increased demand for services from financially strong engineering firms. Chief among them are downsizing of in-house engineering staffs by companies in the natural gas industry, increased demand for fiber cables in telecommunication and a preference for engineering companies that perform and manage all phases of the project from design to installation and final inspection. These changes have created additional opportunities for attractive financial returns above typical industry margins.

NATCOMM's goal is to grow revenue in the Engineering Services business by 20 percent per year and supplement that organic growth with turnkey project services. We envision that revenue from this business segment could potentially exceed $100 million in five years from a current base of $20.7 million. The growth strategy for our Construction business is a combination of 10 percent organic growth and additional expansion from acquisitions consistent with our ability to raise capital efficiently, potentially reaching $350 million in five years. The combined potential of the Engineering & Construction business could establish NATCOMM as a major industry player.

CONSTRUCTION SERVICES

Our Construction Services business has a skilled and experienced management team and a field workforce that is extremely capable in constructing underground gas pipelines and facilities for gas distribution companies. As an example of the broad array of services offered, this past year, NATCOMM began modifying several compressor stations for a major interstate pipeline company throughout the Southeast. Work consisting of modifications to seven facilities is scheduled well into 2001. Our Midwest division, which spans a wide geographical area, completed extensive main and service installations in Illinois, Nebraska, Kansas and South Dakota, for many gas and water utilities. In the southwest, a 29-mile leg of cross-country fiber optic cable was installed for a telecommunications company. We currently provide construction services to gas utilities in Michigan, Indiana, Wisconsin, Missouri, New Jersey,

The natural gas pipeline construction market is in excess of $8.5 billion in the U.S. The total market for engineering and construction services, when the oil, water and telecommunications industries are included, is many times larger.

Tennessee, Georgia, Florida, Louisiana, Texas, Iowa, Illinois, South Dakota and Kansas.

This geographic breadth and other capabilities, including sophisticated underground directional drilling, can easily be applied to installation of pipelines and cable in many regions for a variety of industries.

Playing to our strength, customers, such as gas utilities and interstate pipelines, are demonstrating a preference for larger contractors that have the experience and trained personnel to handle larger or more complex projects, stronger financing capabilities and a lower price given their economies of scale. The trend is to outsource in-house work due to downsizing or lack of skilled personnel. Combined with growing demand in the natural gas, telecommunications and other industries for underground facilities, this bodes well for the future of the construction industry.

We established the Construction Services business in 1997 with the acquisition of Sub-Surface Construction Company and have since added six more companies through acquisitions. Integral to our business strategy is the further acquisition of companies that broaden our geographic scope, particularly in the western areas of the U.S., and which increase our offering of services to new and existing customers.

> With larger quantities of gas expected to move through the Great Lakes area, we plan to pursue additional pipeline and storage investment opportunities.

For 2000, the Propane, Pipelines & Storage business reported $6.9 million of operating revenues and $1.5 million of operating income.

We entered the propane business with the acquisition of Hotflame Gas, Inc. in 1998. We are currently one of the largest propane providers in the Upper Peninsula of Michigan, selling approximately five million gallons in a normal weather year. The Michigan retail market consumes approximately 700 million gallons of propane annually. Propane is easily transportable in pressurized containers. Although frequently more expensive than natural gas in urban areas, propane is the fuel of choice in rural areas where natural gas pipelines do not exist or are not economical to build. Currently, the propane business requires considerable scale of operations to extract product supply and operating cost advantages to compete effectively.

A series of warm winters lowered gross margins and created considerable competitive pressures to retain and add customers. We have adapted by eliminating unprofitable services and selectively cutting costs. In 2001, we will continue to assess the strategic fit of the propane operations within our portfolio of businesses.

The Pipelines & Storage business consists of three pipelines (Greenwood Pipeline, Eaton Rapids Pipeline and Litchfield Lateral) and the Eaton Rapids Gas Storage System, all of which are located in Michigan. The Company has partial ownership interests or equity interests in certain of these operations.

The Greenwood Pipeline is a 100 percent owned 18.5-mile 18-inch diameter intrastate pipeline connecting two interstate pipelines with the Detroit Edison Greenwood Power Plant. The pipeline provides transportation services to the Greenwood Power Plant and to SEMCO Gas' Port Huron service area. Construction of the pipeline was completed in 1991 and received upgrades in 1999. The 1999 upgrades allow us to serve additional peak load generation units at the Greenwood site.

The Eaton Rapids Pipeline is a 100 percent owned 37-mile, 6-inch diameter line that connects Albion and Battle Creek, Michigan, with the Eaton Rapids Gas Storage System. The original 30-mile line was purchased

The Pipelines & Storage business consists of the Greenwood Pipeline, Eaton Rapids Pipeline and Litchfield Lateral and the Eaton Rapids Gas Storage System, all located in Michigan.

in 1986. The seven-mile extension to the Eaton Rapids Gas Storage System was completed in 1990.

SEMCO ENERGY VENTURES, a wholly-owned subsidiary, owns a 33 percent interest in and has a long-term lease agreement with ANR Pipeline for use of SEMCO's interest in the Litchfield Lateral pipeline. The Litchfield Lateral is a 31-mile 12-inch diameter natural gas pipeline connecting the Eaton Rapids Gas Storage System with ANR Pipeline Company's natural gas transmission system. Customers of Eaton Rapids Gas Storage System use the Litchfield Lateral to move gas directly between the storage field and ANR Pipeline to facilitate summer injections and ANR deliveries of winter withdrawals.

The Eaton Rapids Gas Storage System is a 50 percent owned depleted gas field near Eaton Rapids, Michigan, that was converted to a gas storage field by ANR Pipeline and SEMCO ENERGY Gas Storage Company as equal owners of the operation. The Eaton Rapids Gas Storage System has a working capacity of 12.8 Bcf of natural gas.

SEMCO ENERGY GAS COMPANY leases a portion of the capacity of the Eaton Rapids storage field. Through intrastate pipelines, this facility can be used to augment daily interstate pipeline deliveries of gas that supply areas in SEMCO's Lower Peninsula service territory.

With large quantities of natural gas anticipated to move through the Great Lakes area, additional opportunities to invest in pipeline and storage projects will be pursued.

Aretech extends our Information Technology infrastructure and technical expertise in the IBM AS 400 and other mid-range computer platforms to non-affiliated customers and new markets, providing another element of SEMCO's future growth.

If nothing else, the "Y2K bug" culminated a five-year period in which thousands of firms learned that managing numerous, complex Information Technology (IT) projects internally can drastically reduce focus on the strategic aspects of their businesses. The wisdom of devoting management attention, resources and staff time that could be better spent maximizing revenues, quality and profitability came under close scrutiny. Thus, many have taken, or are taking, steps to outsource IT functions to IT partners. In our own case, growth, diversification and commitment to computerized business enterprise systems necessitated significant IT investment.

In 1999, we began the task of harnessing the entrepreneurial expertise of our IT management team and the commitment of our IT staff professionals to high-quality service and a state-of-the-art technology center. The mission was to provide commercial-quality services to meet SEMCO ENERGY's technology goals, not only in our utility operations in Michigan and Alaska, but also for the operations of NATCOMM in various states. In the spring of 2000, we expanded our objectives to the IT services marketplace by launching Aretech Information Services.

In creating Aretech, our intention is to extend our Information Technology infrastructure and technical expertise in the IBM AS 400 and other mid–range computer platforms to non-affiliated customers and new markets. The IT function had been a Cost Center. By leveraging the technology infrastructure needed for affiliated customers to a market desirous of outsourcing IT functions, Aretech has transformed the IT function into a Value Center and provides another element of SEMCO's future growth.

Annual sales of mid-range AS 400 computers exceed 70,000 units. The versatile platform is capable of supporting 30,000 applications, making it the choice of 95 percent of Fortune 500 companies. More than 650,000 AS 400 computers are in use worldwide; and there are more than 35,000 installed in the Midwest with more than 8,000 in Michigan. The trend for outsourcing large, mainframe computing services, which created a $100 billion market, now is moving toward mid-range computers. This new trend is accelerating as a result of the scarcity of technical personnel and increased demand for technical services.

Aretech is implementing IT solutions with an internal staff with 200 years of experience with IBM's AS400 mid-range computer systems. Aretech's management also has a proven track record of building other successful and profitable IT outsourcing businesses.

Aretech's business strategy is focused on four primary areas: IT infrastructure outsourcing services; application service provider services; business-to-consumer internet services; and business-to-business Internet commerce.

Target markets include automotive component suppliers located primarily in the Midwest, municipalities, utilities, construction services, engineering services companies and other organizations using mid-range computers. In providing IT outsourcing, Aretech lowers customers' IT costs, significantly improves service, and introduces significant technological improvements at reasonable cost. IT outsourcing services include: platform operations, application operations, applications management, network management, and desk top

services for personal computers, client/server, LAN and WAN networks.

Metaldyne, an international automotive supplier of precision-engineered and innovative engine and chassis components, became Aretech's customer in 2000. Aretech houses and operates Metaldyne's central AS400 computer and software, the heart of the company's business enterprise software and electronic data interchange, allowing it to interact seamlessly with the world's original equipment manufacturers it supplies. A number of other prospects are expected to sign as customers in 2001.

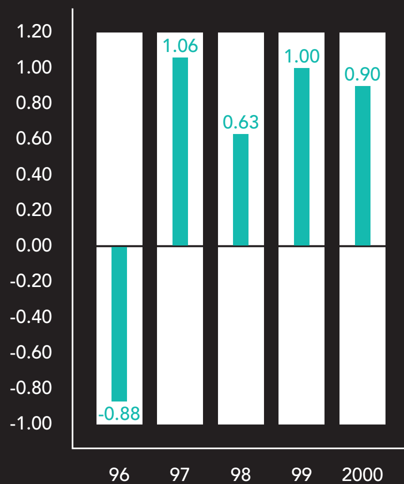
Aretech has a third party "Application Hosting Agreement" with J.D. Edwards for the utility industry throughout the U.S. and for auto suppliers in the central and mid-Atlantic region. Aretech is one of very few ASP organizations that meet stringent operational and organizational requirements to be a J.D. Edwards Business Partner. Aretech offers the full suite of J.D. Edwards Enterprise Resource Planning (ERP) products and capabilities to organizations that cannot afford the large investment required to own and operate an in-house ERP system. Aretech hosts the ERP system and customers rent the ERP software applications they need.

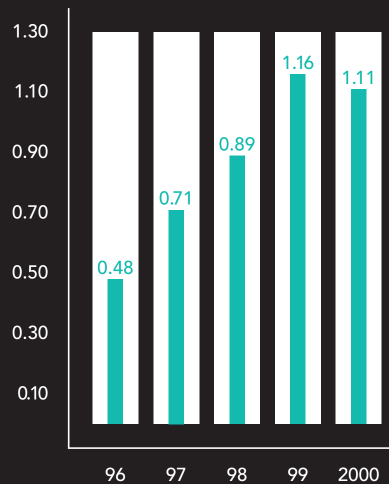
In offering Internet Service Provider (ISP) services, Aretech has a large potential consumer base of 367,000 natural gas distribution customers, a well developed brand name in SEMCO ENERGY and those of its affiliated companies and an existing state-of-the-art IT infrastructure. The first phase of the ISP strategy began when Aretech acquired the equipment and customers of an existing ISP in one of our gas distribution markets. The more than 367,000 natural gas customers who already know and rely on SEMCO are the growth engine for the ISP business. Aretech can provide very competitive pricing and reliable service to these and other customers.

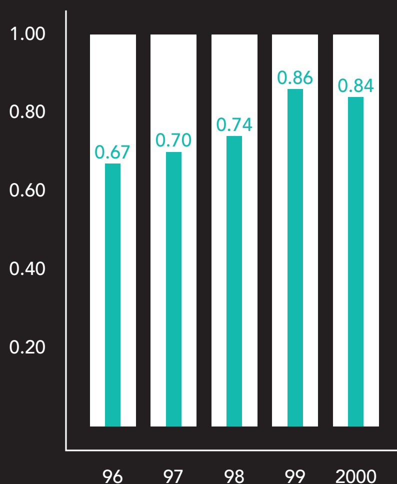
Companies are finding that the Internet is a tool to interact with customers. The Internet also provides a standard, reasonably reliable and secure universal communications system with which companies can transact business. In offering business-to-consumer services, on-line bill presentation and payment was introduced to 262,000 customers of SEMCO ENERGY's Michigan utility division in late 2000. The provision of Internet service was introduced at the same time, and many subscribers who also are customers of our utility operation will take advantage of on-line bill payment.

Aretech is poised to capitalize on its IT business product offerings and its relationships in the utility industry and among automotive suppliers, to create low-cost, high value-added supplier exchanges. Aretech's electronic bill presentation and payment capability and Internet web support services are significant value-added services.

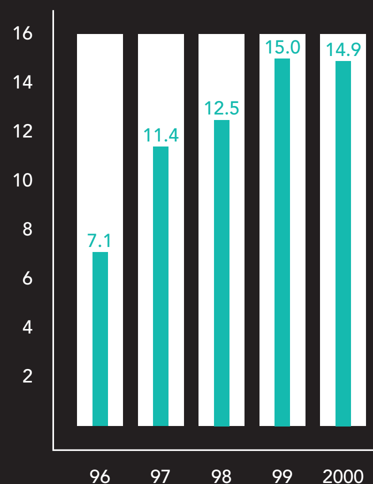
Aretech's strategy includes making selective acquisitions to help grow the existing base of business, expanding the offering of services and supplementing the staff of skilled IT professionals. Capitalizing on the accelerating outsourcing trend for IT services and proven entrepreneurial record of Aretech's management, we envision this business reaching $100 million in revenues over the next five years from a current revenue base of close to $10 million.







Note: 1999 dividends include a special one-time dividend of $0.05 per share.



Note: Normalized earnings and return on equity exclude the impact of warmer-than-normal weather, business divestitures, and certain unusual items.

28 Management's Discussion and Analysis
43 Consolidated Statements of Income
44 Consolidated Statements of Cash Flows
45 Consolidated Statements of Financial Position
46 Consolidated Statements of Capitalization
47 Consolidated Statements of Changes in Common Shareholders' Equity
48 Notes to the Consolidated Financial Statements
69 Report of Independent Public Accountants
70 Selected Financial Data
72 Summary of Gas Sales and Statistics

RESULTS OF OPERATIONS

Net Income | SEMCO Energy, Inc. and its subsidiaries (the "Company") had consolidated net income of $16.7 million in 2000, $17.7 million in 1999 and $10.0 million in 1998. Earnings per share ("EPS") on a diluted basis were $0.90, $1.00 and $0.63 in 2000, 1999 and 1998, respectively. For information related to the calculation of diluted EPS, refer to Note 12 of the Notes to the Consolidated Financial Statements. Warmer than normal weather had a significant impact on earnings during these years. On a weather-normalized basis, net income would have been approximately $20.7 million in 2000, approximately $21.3 million in 1999 and approximately $17.2 million in 1998.

The following table shows the Company's consolidated operating results, as well as the impact of warmer than normal weather, and certain other unusual items on net income and earnings per share for the past three years.

Net income, excluding the impact of the unusual items noted in the table below, would have been $20.7 million, $20.6 million and $14.2 million for 2000, 1999 and 1998, respectively. The business segment analyses and other discussions on the next several pages provide additional information regarding the variations in operating results when comparing 2000, 1999 and 1998.

Years ended December 31,	***2000***	*1999*	*1998*
(000's, except per share amounts)			
Operating revenues	**$ 422,593**	$ 384,763	$ 637,485
Operating expenses	**357,335**	342,873	613,290
Operating income	**$ 65,258**	$ 41,890	$ 24,195
Other income and (deductions)	**(31,955)**	(16,826)	(9,120)
Income taxes	**(11,606)**	(7,405)	(6,320)
Income before dividends on trust preferred securities and cumulative effect of accounting method change and extraordinary charge	**$ 21,697**	$ 17,659	$ 8,755
Dividends on trust preferred securities, net of income tax	**(5,004)**	–	–
Accounting method change and extraordinary charge, net of income tax	**–**	–	1,285
Net income available to common shareholders	**$ 16,693**	$ 17,659	$ 10,040
Earnings per share ("EPS")			
Basic	**$ 0.93**	$ 1.00	$ 0.63
Diluted	**$ 0.90**	$ 1.00	$ 0.63
Average common shares outstanding			
Basic	**17,999**	17,697	15,906
Diluted	**18,619**	17,720	15,935
Impact on net income of the following:			
Warmer than normal weather[a]	**$ (3,995)**	$ (3,640)	$ (7,180)
Gains on divestitures of businesses	**$ –**	$ 729	$ 1,708
Change in accounting method and extraordinary charge	**$ –**	$ –	$ 1,285
Net income excluding the foregoing items	**$ 20,688**	$ 20,570	$ 14,227
EPS excluding the foregoing items			
Basic	**$ 1.15**	$ 1.16	$ 0.89
Diluted	**$ 1.11**	$ 1.16	$ 0.89

[a] The Company determines the impact of weather on its operating results by comparing actual gas usage per customer during a year to the average of weather-normalized customer gas usage during previous years. The weather-normalized customer gas usage is determined by adjusting actual customer gas usage during a particular year by a ratio, the numerator of which is an average of degree days during the prior fifteen years, and the denominator of which is the actual degree days for that year. The Company determines the percent (%) that weather is warmer or colder than normal for a particular year by computing the deviation of actual degree days for that year from the average of degree days during the prior fifteen years and dividing the deviation by such fifteen year average.

Pro Forma Information | On November 1, 1999, the Company acquired the assets and certain liabilities of ENSTAR Natural Gas Company and the outstanding stock of Alaska Pipeline Company (together known as "ENSTAR"). Note 3 of the Notes to the Consolidated Financial Statements includes additional information regarding the acquisition as well as a discussion of how the following pro forma amounts were developed.

The pro forma amounts reflect what the Company's financial results would have been if the acquisition of ENSTAR had occurred on January 1, 1999, but do not reflect any potential cost savings or operating synergies that may be realized following the acquisition.

	Actual		*Pro Forma*	
Years ended December 31,	***2000***	*1999*	***2000***	*1999*
(000's, except per share amounts)				
Operating revenue	**$ 422,593**	$ 384,763	**$ 422,593**	$ 461,705
Consolidated net income	**16,693**	17,659	**16,451**	15,594
Basic earnings per share	**0.93**	1.00	**0.91**	0.88

SUMMARY OF BUSINESS SEGMENTS

The Company operates four business segments: (1) gas distribution; (2) construction services; (3) engineering services; and (4) propane, pipelines and storage. The latter three segments are sometimes referred to together as the "diversified businesses." Refer to Note 11 of the Notes to the Consolidated Financial Statements for further information regarding each business segment. The Company sold the subsidiary comprising its energy marketing business effective March 31, 1999.

The following table shows the operating revenues and operating income of each business segment as well as a reconciliation ("Corporate and other") of the segment information to the applicable line in the consolidated financial statements. Corporate and other includes intercompany eliminations, corporate-related expenses not allocated to the business segments and the results of other smaller operations.

Years ended December 31,	***2000***	*1999*	*1998*
(000's)			
Operating revenues			
Gas distribution	**$ 307,851**	$ 216,831	$ 184,221
Construction services	**105,231**	58,272	25,904
Engineering services	**20,655**	17,486	41,366
Propane, pipelines and storage	**6,949**	6,284	4,852
Energy marketing	**–**	96,904	397,888
Corporate and other	**(18,093)**	(11,014)	(16,746)
Total operating revenues	**$ 422,593**	$ 384,763	$ 637,485
Operating income (loss)			
Gas distribution	**$ 62,876**	$ 40,134	$ 22,363
Construction services	**3,676**	2,611	(102)
Engineering services	**25**	(513)	2,938
Propane, pipelines and storage	**1,530**	2,341	1,585
Energy marketing	**–**	(341)	(696)
Corporate and other	**(2,849)**	(2,342)	(1,893)
Total operating income	**$ 65,258**	$ 41,890	$ 24,195

Each business segment is discussed separately on the following pages. The Company evaluates the performance of its business segments based on the operating income generated. Operating income does not include income taxes, interest expense, extraordinary items, changes in accounting methods or other non-operating income and expense items. A review of the non-operating items follows the business segment discussions.

GAS DISTRIBUTION

The Company's gas distribution business segment consists of operations in Michigan and Alaska. ENSTAR, the Alaska-based operation, was acquired on November 1, 1999. The acquisition of ENSTAR was accounted for as a purchase and, therefore, the consolidated financial statements and the table below include the results of ENSTAR's operations since November 1, 1999. The Michigan gas distribution operation and ENSTAR are referred to together as the "Gas Distribution Business".

Warm weather during the past three years has had a significant impact on operating income. Weather was approximately 6%, 7% and 20% warmer than normal during 2000, 1999 and 1998, respectively. Under normal weather conditions, operating income during 2000, 1999 and 1998 would have been higher by approximately $6.5 million, $5.3 million and $10.8 million, respectively. The impact of weather on operating income during 2000 was larger than during 1999, despite cooler weather in 2000. This is due to the increase in customer base as a result of the ENSTAR acquisition. A significant increase in customer base causes any variation from normal weather to have a more pronounced impact on operating results.

Years ended December 31,	***2000***	*1999*	*1998*
(Dollars in 000's)			
Gas sales revenues	**$ 273,312**	$ 191,169	$ 166,700
Cost of gas sold	**161,945**	117,789	109,388
Gas sales margin	**$ 111,367**	$ 73,380	$ 57,312
Gas transportation revenue	**30,783**	22,368	14,832
Other operating revenue	**3,756**	3,294	2,689
Gross margin	**$ 145,906**	$ 99,042	$ 74,833
Operating expenses	**83,030**	58,908	52,470
Operating income	**$ 62,876**	$ 40,134	$ 22,363
Weather-normalized operating income	**$ 69,366**	$ 45,434	$ 33,163
Volumes of gas sold (MMcf)	**61,054**	39,245	32,247
Volumes of gas transported (MMcf)	**48,706**	32,417	23,791
Number of customers at year end	**367,157**	357,378	247,950
Average number of customers			
Gas sales customers	**353,168**	258,406	241,070
Transportation and ATS customers	**8,253**	9,183	3,105
	361,421	267,589	244,175
Degree Days	**7,293**	6,650	5,566
Percent warmer than normal	**(5.9)%**	(6.7)%	(19.7)%

The amounts in the above table include intercompany transactions.

Gas Sales Margin | During 2000, gas sales margin increased by $38.0 million (or 52%) when compared to 1999. The increase includes approximately $28.6 million of gas sales margin from ENSTAR. The remaining $9.4 million of the increase is attributable to the Michigan gas distribution operation and is due in part to an increase in sales margins earned on the sale of the gas commodity as a result of gas supply and storage arrangements with TransCanada Gas Services, Inc. ("TransCanada") and an increase in gas sales as a result of cooler weather compared to 1999. The increase was also due to gas sales margins from new customers and customers switching from the Company's aggregated transportation service ("ATS") program back to general gas sales service.

The third-party gas supply and storage arrangements with TransCanada pertain to the Michigan gas distribution operation. Under the terms of the agreements, TransCanada provides the Company's natural gas requirements and manages the Company's natural gas supply and the supply aspects of transportation and storage operations in Michigan for the three-year period that began April 1, 1999. Also effective April 1, 1999, and as authorized in a September 1998 Michigan Public Service Commission ("MPSC") order, the Michigan operation reduced and froze in its base rate a gas charge of $3.24 per thousand cubic feet ("Mcf") and suspended its gas cost recovery ("GCR") clause for a period of three years. TransCanada supplies the gas and related services to the Company at a cost below the $3.24 per Mcf that the Company is authorized to charge its Michigan customers for gas. As a result of suspending the GCR clause and contractually fixing the cost of gas below the $3.24 charged to customers, the Michigan gas distribution operation retains the sales margin on the sale of gas, subject to a customer profit sharing mechanism also approved in the MPSC order. Prior to the suspension of the GCR clause on April 1, 1999, gas sales margin was generated primarily from distribution and customer fees because the Michigan operation was not allowed to earn profits from the sale of the gas commodity. See Note 2 in the Notes to the Consolidated Financial Statements for additional information on the MPSC order and the gas supply management arrangement with TransCanada.

The ATS program, which was effective April 1, 1998, provides all Michigan commercial and industrial customers the opportunity to purchase their gas from a third-party supplier, while allowing the Gas Distribution Business to continue charging the existing distribution fees and customer fees. Distribution and customer fees associated with customers who switch to third-party gas suppliers are recorded in gas transportation revenue rather than gas sales revenue because the Company is acting as a transporter for those customers. In 1998 and 1999, many customers participated in the ATS program. However, due to an increase in the market price of natural gas in late 1999 and 2000, customers who previously switched to the ATS program have begun switching back to the Company's general gas sales service to take advantage of the Company's frozen gas charge of $3.24 per Mcf discussed previously.

During 2000, the Company's average number of gas sales customers increased by 94,762. Approximately 83,200 of the increase is a result of having ENSTAR's customers for the entire year while 1,770 of the increase was due to customers switching from the ATS program back to general gas sales service. The remaining increase of approximately 9,800 represents the average number of new gas sales customers added to the Company's distribution system.

In 1999, gas sales margin increased by $16.1 million (or 28%) when compared to 1998. $11.6 million of the increase was attributable to ENSTAR. The remainder of the increase was attributable to the Michigan gas distribution operation, and was due in part to sales margins earned on the sale of the gas commodity and to additional gas sales, which resulted from cooler weather and the addition of new customers. These items were offset partially by a decrease in gas sales margin of approximately $4.2 million due primarily to customers switching from general gas sales service to transportation service as a result of their participation in the Company's ATS program.

The Company's average number of gas sales customers increased by 17,336 during 1999. A portion of the increase was due to the addition of an average of 6,363 new gas sales customers in Michigan, offset partially by an average of 5,932 gas sales customers who switched from gas sales service to the ATS program. The remainder of the increase relates to owning ENSTAR for two months in 1999.

Gas Transportation Revenue | In 2000, gas transportation revenue increased by $8.4 million when compared to 1999. A full year of ENSTAR's transportation revenues represent an increase of $10.7 million. The increase generated by ENSTAR was partially offset by the impact of ATS customers switching from the ATS program back to the Company's general gas sales service, as discussed previously. Gas transportation revenue increased by $7.5 million in 1999, when compared to

1998. $4.2 million of the increase was due to revenues from customers participating in the ATS program, and the remainder was attributable primarily to gas transportation revenues of ENSTAR. As discussed above, the ATS program has essentially no impact on operating income because the Company charges ATS customers the same distribution fees and customer fees that are charged to general gas sales service customers.

Other Operating Revenue | During 2000, other operating revenue increased by $.5 million when compared to 1999. The primary reason for the increase was a bonus received for completing on schedule the installation of a large-diameter transmission pipeline for a power plant under construction, offset partially by a reduction in ATS balancing fees as a result of ATS customers switching back to general gas sales service. Other operating revenue increased in 1999 by $.6 million over the prior year. The increase was due primarily to an increase in balancing charges and various miscellaneous fees charged to customers.

Operating Expenses | During 2000, operating expenses of the Gas Distribution Business increased by $24.1 million (or 41%) when compared to 1999. A full year of operations from ENSTAR increased operating expenses by $26.4 million. The offsetting $2.3 million decrease in operating expenses is attributable to the Michigan operation and includes a number of offsetting increases and decreases in expenses.

The decreases in expenses at the Michigan operation include approximately $1.5 million in reduced employee-related expenses, including reduced incentive compensation and reduced pension and retiree medical expenses. Pension and retiree medical expenses decreased due to better than expected historical experience, changes in actuarial assumptions between years and a settlement credit related to an early retirement program offered to employees in 2000. See Note 9 of the Notes to the Consolidated Financial Statements for more information related to pension and retiree medical costs. General business taxes also decreased by approximately $2.0 million. The decrease is due in part to a $2.1 million reduction in property taxes recorded in 2000 based on pending appeals of prior years' personal property tax assessments in Michigan ("prior year tax appeals") and new property valuation tables approved by the State of Michigan in 1999 ("new property tax tables"). In addition, property taxes for 2000 also decreased as a result of the new property tax tables, and sales tax expense was lower due to refunds received during 2000. These decreases in general business taxes are offset partially by a $1.3 million reduction in property taxes recorded in 1999 based on the prior year tax appeals. The Company filed the appeals over the past several years claiming that its Michigan utility property was over-assessed. The new property tax tables approved by the State of Michigan are consistent with the Company's claim regarding its utility property assessments, and thus significantly increase the likelihood of recovering the overpaid property taxes.

The above decreases were offset by an increase of approximately $1.0 million in depreciation and amortization expense. The increase was due primarily to additional property, plant and equipment placed in service.

In 1999, the operating expenses of the Gas Distribution Business increased by $6.4 million (or 12%) when compared to 1998. Operating expenses attributable to ENSTAR for November and December of 1999 account for $6.0 million of the increase. The operating expenses of the Michigan operations increased by $.4 million (or less than 1%) when compared to 1998.

The $.4 million increase in the Michigan operation's 1999 operating expenses includes a number of offsetting increases and decreases. The decreases include approximately $1.0 million attributable to an overall reduction in general and administrative expenses due to cost cutting measures undertaken during 1999, and reductions in compensation and employee benefit expenses due primarily to lower employee levels, as a result of the 1998 early retirement program, and changes to the Company's employee benefit plans. See Note 9 in the Notes to the Consolidated Financial Statements for more information on the 1998 early retirement program. The decreases also include approximately $.4 million due to lower uncollectible gas customer accounts and approximately $.4 million relating to general taxes. The decrease in general taxes is made up of a reduction of $1.3 million in property taxes, based on the prior year tax appeals discussed previously, offset partially by an increase in property taxes associated with additional property, plant and equipment placed in service, and an increase in Michigan business tax.

The above decreases in operating expenses of the Michigan operation were offset by a number of increases. Information technology expense, primarily year 2000 (or "Y2K") computer remediation, increased in 1999, when compared to 1998, by approximately $1.0 million, and incentive compensation increased by approximately $.4 million due primarily to

lower incentive compensation in the prior year as a result of lower Company earnings. Depreciation expense also increased in 1999 by $.8 million as a result of additional property, plant and equipment placed in service.

Outlook | The Company's strategy for the Gas Distribution Business is to expand its distribution system through aggressive marketing to on-main and near-main potential customers. The Company will also try to capitalize on other market opportunities, including new power generation projects. In 2000, the number of customers in Michigan and at ENSTAR increased by approximately 2.7%. The customer growth rate for the U.S. gas distribution industry has averaged approximately 1% annually during the last three years. However, average annual gas usage per customer has been decreasing slightly because new homes and appliances are more energy efficient.

Operating expenses have been reduced through the early retirement program offered during 1998, and future operating expenses are expected to decrease as a result of the early retirement program offered in 2000. The increased use of technology has also created operating efficiencies. The gas distribution business will continue its efforts to control or reduce operating expenses.

With the approval of profit incentive and sharing mechanisms by the MPSC in 1998, the Michigan operation is allowed to retain a portion of its earnings in excess of its authorized return, if any, and credit the remainder to customers. Specifically, if the Company's return on equity for its Michigan-based natural gas distribution business exceeds 12.75%, amounts equal to 50% of the excess return between 12.76% and 16.75%, plus amounts equal to 75% of the excess over 16.75%, would be credited to customers, i.e., would be reflected prospectively in reduced rates. For purposes of the profit incentive and sharing mechanisms, 50% of any gas cost savings generated as a result of the TransCanada arrangements are excluded from the calculation of return on equity. As a result, the Company's actual reported earnings can generate a return on equity in excess of 12.75% before triggering profit sharing with customers. Based on results for 2000, the Company reduced its earnings by approximately $50,000 to reflect amounts expected to be credited to customers. In 1999, the Company was not required to credit any amounts to its customers.

In 1998, the MPSC also authorized the Company to, among other things, suspend its GCR clause and freeze for three years in its base rate a gas charge of $3.24 per Mcf. The GCR suspension and new rate took effect in April 1999 and generally extend through March 2002. The Gas Distribution Business was able to offer this GCR suspension and rate freeze partly as a result of agreements reached with TransCanada. Under the agreements, TransCanada provides the Company's natural gas requirements and manages the Company's natural gas supply and the supply aspects of transportation and storage operations in Michigan for the same three-year period at a cost below the $3.24 charged to customers. As a result of the MPSC order and the TransCanada agreements, the Michigan gas distribution operation retains any gas cost savings on the sale of gas, subject to the customer profit sharing mechanism described previously. Also, as a result of the TransCanada agreements, the Company and its Michigan natural gas customers are currently not affected by the significant increases in the market price for natural gas that have occurred in North America over the past year. The Company is currently exploring the possibility for an extension of the GCR-suspension period through 2004 and a fixed customer gas rate through the same period. See Note 2 of the Notes to the Consolidated Financial Statements for additional information on the MPSC order and the TransCanada agreements.

During 2000, the Company filed certain revenue requirement and cost of service information with the Regulatory Commission of Alaska ("RCA") as required by the October 1999 RCA order approving the transfer of ownership of ENSTAR. In November 2000, the RCA issued an order requesting additional information in order to ensure that ENSTAR's rates are just and reasonable. The order also appointed a hearing examiner and set a prehearing conference in February 2001. The order indicates that, if changes in ENSTAR's existing rates are required, such changes would be applied on a prospective basis. The Company believes that it can demonstrate to the RCA that ENSTAR's rates are just and reasonable; however, the actual outcome is uncertain. See Note 2 of the Notes to the Consolidated Financial Statements for more information on the RCA orders.

The Michigan gas distribution operation competes with suppliers of alternative energy sources such as coal and #6 and #2 fuel oil to meet the energy requirements of its industrial customers. This competition did not have a material impact on the financial results of the Company in 2000. To lessen the possibility of a fuel switch by industrial customers, the Company offers flexible contract terms and additional services, such as gas storage and balancing, in addition to a more environmentally friendly fuel. ENSTAR supplies natural gas in its service territory at prices that currently preclude

substitution of alternative energy sources. At present, the residential energy cost of natural gas in Alaska is less than half the cost of fuel oil, the next most economical energy choice.

Consistent with other gas distribution utilities, there is a potential risk for industrial and electric generating plants on the Company's gas distribution system, and also located in close proximity to interstate natural gas pipelines, to bypass the Company and connect directly to such pipelines. However, management is currently unaware of any significant bypass efforts by the Company's customers. The Company has addressed and would continue to address any such efforts by offering special services and rate arrangements designed to retain these customers on the Company's system.

For information on environmental matters, regulatory matters and the application of SFAS 71, "Accounting for the Effects of Certain Types of Regulation," refer to Notes 2 and 14 of the Notes to the Consolidated Financial Statements.

CONSTRUCTION SERVICES

The Company's construction services segment ("Construction Services") does business in the midwestern, southern and southeastern areas of the United States. The businesses that make up Construction Services have all been acquired since mid-1997 and each acquisition has been accounted for using the purchase method of accounting. As a result, Construction Services' operating results for 2000, 1999 and 1998 include the results of each of the acquired businesses for the periods subsequent to their acquisition dates.

Company	*Acquisition Date*
Sub-Surface Construction Co. ("Sub-Surface")	August 1997
King Energy & Construction Co. ("King")	May 1998
K&B Construction, Inc. ("K&B")	February 1999
Iowa Pipeline Associates, Inc. ("Iowa")	April 1999
Flint Construction Co. ("Flint")	September 1999
Long's Underground Technologies, Inc. ("Long")	September 1999
KLP Construction Co. ("KLP")	May 2000

Refer to Note 3 of the Notes to the Consolidated Financial Statements for information regarding the amount paid for each of the above acquisitions.

Construction Services also started an overhead-line construction company in Florida in January 1998. However, the operations of this start-up business were halted in mid-1998 in response to lower than expected business levels and earnings. The start-up business generated an operating loss of $.9 million during 1998.

Construction Services generates the majority of its sales revenue from the installation of underground natural gas mains and service lines. The Company also provides underground construction services to other industries such as telecommunications and water supply. Underground construction businesses are seasonal in nature. As a result, Construction Services generally incurs operating losses during the winter and spring months when underground construction is inhibited, and generates the majority of its operating income during the summer and fall months.

Years ended December 31,	***2000***	*1999*	*1998*
(000's)			
Operating revenues	**$ 105,231**	$ 58,272	$ 25,904
Operating expenses	**101,555**	55,661	26,006
Operating income (loss)	**$ 3,676**	$ 2,611	$ (102)
Feet of pipe installed	**7,969**	6,208	4,531

The amounts in the above table include intercompany transactions.

Operating Revenues | Construction Services' operating revenues increased to $105.2 million during 2000, a $47.0 million (or 81%) increase over 1999. The increase during 2000 was due primarily to a full year of revenues from Iowa, Flint and Long and an increase in construction projects. Operating revenues were $58.3 million during 1999 compared to $25.9 million during 1998. The increase of $32.4 million (or 125%) was due primarily to the revenues of K&B, Iowa, Flint and Long, which were all acquired during 1999, and a $3.9 million increase in the revenues of Sub-Surface.

Operating Income | Construction Services had operating income of $3.7 million in 2000, $2.6 million in 1999 and an operating loss of $.1 million in 1998. Construction Services' operating income for 1998, excluding the start-up business mentioned previously, would have been $.8 million. The $1.1 million increase in operating income in 2000, when compared to 1999, was due primarily to a full year of operating results from Iowa, Flint and Long, offset partially by additional operating costs incurred on various construction projects as a result of some project delays, increased fuel costs and other factors. The increase in operating income in 1999, when compared to 1998, is due primarily to operating income attributable to the businesses acquired in 1999 and the increase in operating revenues of Sub-Surface, offset partially by an increase in Sub-Surface's operating expenses. The increase in operating expenses in each of 1999 and 2000 was due primarily to operating expenses from businesses acquired in these periods plus the additional expenses noted previously.

Outlook | Management believes there are opportunities for growth in the pipeline construction industry. Management views the industry as large but highly fragmented and believes that customer preference is shifting from smaller construction companies to much larger contractors. Management also believes there is a trend in the utility industry towards outsourcing services such as those provided by Construction Services, and management's goal is to position Construction Services to take advantage of this trend.

Construction Services competes with small- and medium-size regional underground facilities contractors who provide similar services and utilize comparable equipment and installation techniques. There is also competition from in-house construction operations of existing or prospective customers. The Company's goal is to expand Construction Services' market share by acquiring established construction companies that have a strong customer base. Acquisitions will be of a size consistent with the Company's ability to raise capital efficiently. Achieving these goals is dependent upon the availability of good acquisition candidates and, among other things, the Company's ability to successfully integrate such acquisitions.

ENGINEERING SERVICES

The Company's engineering services business ("Engineering Services") is comprised of two companies, Maverick Pipeline Services, Inc. ("Maverick") and Oilfield Materials Consultants, Inc. ("OMC"). The acquisition of Maverick, in December 1997, was accounted for as a purchase. The acquisition of OMC, in November 1998, was accounted for as a pooling of interests and, accordingly, the consolidated financial statements and the table below have been restated to include the financial results of OMC as if it were part of the Company for all periods presented.

Years ended December 31,	***2000***	*1999*	*1998*
(000's, except billed hours)			
Operating revenues	**$ 20,655**	$ 17,486	$ 41,366
Operating expenses	**20,630**	17,999	38,428
Operating income (loss)	**$ 25**	$ (513)	$ 2,938
Billed hours	**292,000**	359,000	586,000

The amounts in the above table include intercompany transactions.

Maverick purchased the assets and certain liabilities of Drafting Services, Inc. ("DSI") in September 1999 and Pinpoint Locators, Inc. ("Pinpoint") in October 1999. Both acquisitions were accounted for using the purchase method of accounting, and are operated as divisions of Maverick. Refer to Note 3 of the Notes to the Consolidated Financial Statements for information regarding the amount paid for each of the above acquisitions.

Operating Revenues | Engineering Services' operating revenues increased by $3.2 million (or 18%) in 2000, when compared to 1999. The operating revenues of Engineering Services were $17.5 million in 1999 compared to $41.3 million in 1998. The increase in revenues in 2000 was primarily the result of a full year of revenues from DSI and Pinpoint and increased turnkey revenues, offset partially by lower pipeline inspection revenues. The decrease in operating revenues during 1999, compared to 1998, was due primarily to lower revenues from turnkey projects and lower pipeline inspection revenues as a result of a slowdown and deferral of pipeline projects and engineering work in various sectors of the energy industry. The downturn in oil prices in late 1998 and early 1999 led to the reduction in pipeline construction and inspection projects in 1999. Despite a recovery in oil prices in late 1999 and 2000, these types of projects have not returned to previous levels. There also has been a reduction or deferral of new engineering projects for the gas distribution industry due to the cash flow impact on the industry of the warm weather during the past three years. Operating revenues for 1998 include approximately $20 million related to a large turnkey project.

Operating Income | Engineering Services had break-even operating income in 2000, incurred an operating loss of $.5 million in 1999 and had operating income of $2.9 million in 1998. The increase in operating income in 2000 was due primarily to more profitable projects compared to 1999 and a full year of operations from DSI and Pinpoint, offset partially by the impact of the decrease in pipeline inspection projects. The significant decrease in operating income in 1999 was due primarily to decreases in operating revenues and corresponding project costs as a result of the slowdown and deferral of projects, as noted previously, and unanticipated ground restoration and clean-up costs incurred in 1999 associated with a large pipeline turnkey project completed in 1998.

Outlook | The Company's goal is to expand Engineering Services in North America and select foreign countries through the growth of its existing operations. Management believes there is a trend in the utility industry towards outsourcing services such as those provided by Engineering Services, and management's goal is to position Engineering Services to take advantage of this trend. It is also anticipated that the demand for turnkey services will increase, and the Company plans to aggressively pursue such projects. In addition to providing services to the gas and petroleum industries, Engineering Services also plans to market its services to customers in telecommunications and other industries.

Engineering Services competes with regional, national and international firms as well as in-house engineering and field service departments. Because of the minimal initial capital requirements, it is likely that new competition will arise from other firms that possess the professional requirements and qualifications. The Company's strategic objective is to build a sizable underground facilities engineering business that provides a wide array of services to utilities and other companies installing underground pipe, cable and other facilities in North America.

There was a reduction in oil and gas production and related activities due to the downturn in oil prices in late 1998 and early 1999. This resulted in a significant decrease in the amount of Engineering Services' pipeline inspection and quality assurance projects. Despite a recovery in oil prices in late 1999 and 2000, these types of projects have not returned to previous levels. There also has been a reduction or deferral of new engineering projects for the gas distribution industry due to the cash flow impact of the warm weather during the past three years. Management believes that the level of available projects and business will increase as gas distribution companies start releasing new engineering projects and pipeline construction and inspection projects become available.

PROPANE, PIPELINES AND STORAGE

The Company's pipeline and storage operations consist of several pipelines and an ownership interest in a gas storage facility, all of which are located in Michigan. The Company entered the propane distribution business with the acquisition of Hotflame Gas, Inc. and Hotflame Transport Co., Inc. (together known as "Hotflame") on March 31, 1998. The acquisition of Hotflame was accounted for as a purchase and, therefore, only the results of operations since April 1998 are included in the consolidated financial statements and the table below. Hotflame's 1998 operating results do not include the winter heating months of January through March.

Years ended December 31,	***2000***	*1999*	*1998*
(000's)			
Operating revenues	**$ 6,949**	$ 6,284	$ 4,852
Operating expenses	**5,419**	3,943	3,267
Operating income	**$ 1,530**	$ 2,341	$ 1,585

Operating Revenues | Operating revenues were $6.9 million in 2000, compared to $6.3 million in 1999 and $4.9 million in 1998. The increase in revenues in 2000, compared to 1999, was due primarily to higher propane distribution revenues, offset partially by slightly lower pipeline revenues. Pipeline revenues decreased in 2000 due to the absence of revenues from a pipeline that was sold in mid-1999. The increase in revenues in 1999, when compared to 1998, was due primarily to the operating revenue of Hotflame, which was acquired on March 31, 1998.

Operating Income | The Company's Propane, Pipelines and Storage segment had operating income during 2000, 1999 and 1998 of $1.5 million, $2.3 million and $1.6 million, respectively. The decrease during 2000, when compared to 1999, was caused primarily by higher propane costs, which reduced propane margins, and the absence of operating income from the pipeline that was sold in mid-1999. The increase in operating income during 1999, when compared to 1998, was due primarily to pipeline expense reductions and a full year of operations at Hotflame. As discussed above, the operating results for 1998 include the operating income of Hotflame earned after its acquisition on March 31, 1998. In addition, Hotflame's profit margins were slightly lower in 1999 and 2000 as a result of customer price reductions caused by increased competition in the propane industry.

Weather in Hotflame's market area was warmer than normal in 2000, 1999 and 1998. Operating income on a weather-normalized basis would have been higher by approximately $.1 million during 2000 and by approximately $.3 million for both 1999 and the period of April through December of 1998. The impact of weather on the operating income of the propane, pipelines and storage segment relates entirely to the propane business.

Outlook | Management believes that the gas pipeline and storage operations could experience opportunities for growth with the increased deregulation of gas markets. As gas markets expand or are deregulated, management feels that the quantity of gas moving through the Great Lakes Region will increase, which could create additional pipeline and storage opportunities.

The Company's propane business competes with other regional propane providers and with other energy sources such as natural gas, fuel oil and electricity. The propane business has become increasingly competitive and less profitable, which necessitates large-scale operations to be successful in the long term. The Company will continue to assess the strategic fit of this business over the coming years.

ENERGY MARKETING

The Company sold the subsidiary comprising its gas marketing business ("Energy Services") effective March 31, 1999. The business was sold because management concluded that it did not fit the Company's new strategic direction due to

the high risks and generally poor returns associated with the business. The Company recognized a gain on the sale. The gain is reported in other income (discussed in the subsequent section), and thus is not reflected in the operating results in the following table.

Years ended December 31, *(000's)*	**2000**	1999	1998
Operating revenues	**$ –**	$ 96,904	$ 397,888
Cost of gas marketed	**–**	95,681	393,762
Gas marketing margin	**$ –**	$ 1,223	$ 4,126
Operating expenses	**–**	1,564	4,822
Operating loss	**$ –**	$ (341)	$ (696)

Gas Marketing Margin | Gas marketing margin for 1999, when compared to 1998, decreased by $2.9 million. There were no gas marketing revenues subsequent to March 31, 1999, the effective date of the sale of Energy Services, which is the primary reason for the decrease in margin.

Operating Income | Energy Services had an operating loss of $.3 million in 1999 compared to an operating loss of $.7 million in 1998. The smaller operating loss in 1999 was due primarily to the results of restructuring activities undertaken in 1998 and the timing of the sale of Energy Services. Energy Services was sold effective March 31, 1999, and therefore, the 1999 operating loss of $.3 million includes results from January through March only.

OTHER INCOME AND DEDUCTIONS

Years ended December 31, *(000's)*	**2000**	1999	1998
Divestiture of energy marketing business	**$ –**	$ 1,122	$ –
Divestiture of NOARK investment	**–**	–	5,048
Interest expense	**(34,913)**	(20,575)	(14,811)
Other income	**2,958**	2,627	643
Total other income (deductions)	**$ (31,955)**	$ (16,826)	$ (9,120)

Divestiture of Energy Marketing Business | The Company sold the subsidiary comprising its energy marketing business effective March 31, 1999. The divestiture resulted in a gain of $1.1 million ($.7 million after-tax).

Divestiture of NOARK Investment | On January 14, 1998, the Company sold its entire interest in the NOARK Pipeline System Partnership ("NOARK"). The sale generated a gain of $1.7 million (after-tax) in 1998, after write-downs of the investment in prior years.

Interest Expense | The Company's 2000 interest expense increased $14.3 million (or 70%) when compared to 1999. The increase was due primarily to increases in debt levels to finance the Company's capital expenditure and business acquisition programs and for general corporate purposes. The increases during 2000 were offset partially by $2.1 million of income recognized on interest rate swaps terminated in 2000. The most significant increase in debt levels occurred on November 1, 1999, when the Company incurred $290 million of additional short-term debt to finance the acquisition of ENSTAR ("bridge loan"). The bridge loan was repaid during 2000 with the proceeds of several securities offerings and borrowings from the Company's bank lines of credit, which are all discussed in Note 5 of the Notes to the Consolidated Financial Statements.

Interest expense increased by $5.8 million (or 39%) in 1999, when compared to 1998, due to an increase in the level of debt outstanding from 1998 to 1999. The Company incurred the additional debt, including the bridge loan, to finance

its ongoing capital expenditure and business acquisition programs and for general corporate purposes. See Note 5 of the Notes to the Consolidated Financial Statements for more information on debt issues and refinancings.

Other | During 2000, other income increased by $.3 million, when compared to 1999. The increase was due primarily to an increase in allowances for funds used during construction ("AFUDC") associated with several large construction projects, an increase in equity income from an investment in a gas storage partnership (a portion of which is likely to be non-recurring) and gains on property sales. These increases were offset partially by the absence in 2000 of life insurance proceeds received in 1999 upon the death of a retired Company executive.

In 1999, other income increased by $1.7 million when compared to 1998. Approximately $.8 million of the increase relates to the previously mentioned life insurance proceeds received upon the death of a retired Company executive, and $.4 million relates to gains on the sale of pipeline property and other equipment. In addition, $.2 million relates to an increase in equity income from partnership investments, and the remainder is attributable to higher miscellaneous non-operating income.

INCOME TAXES

Income taxes for 2000, 1999 and 1998 were $11.6 million, $7.4 million and $6.3 million, respectively. The change in income taxes, when comparing one year to another, is due primarily to changes in income before income taxes and dividends on trust preferred securities, and any adjustments necessary for compliance with tax laws and regulations.

DIVIDENDS ON TRUST PREFERRED SECURITIES

The Company issued trust preferred securities and FELINE PRIDES during 2000. These securities are described in Note 5 of the Notes to the Consolidated Financial Statements. During 2000, dividends on these securities, net of income tax, were $5.0 million.

ACCOUNTING METHOD CHANGE AND EXTRAORDINARY ITEM

The Company changed its method of accounting for property taxes during 1998. The cumulative effect of the change in accounting method increased 1998 earnings by $1.8 million. The Company also incurred an extraordinary charge of $.5 million after-tax during 1998 for the early redemption of all of its outstanding 8.625% debentures due April 15, 2017. Refer to Note 1 of the Notes to the Consolidated Financial Statements for more information on these items.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows From Investing | The Company's single largest use of cash is capital investments. The following table identifies investments for the past three years:

Years ended December 31,	***2000***	*1999*	*1998*
(000's)			
Capital investments			
Property additions – gas distribution	**$ 47,466**	$ 22,761	$ 23,029
Property additions – diversified businesses	**19,170**	12,258	2,246
Business acquisitions [(a)]	**1,784**	305,142	20,356
	$ 68,420	$ 340,161	$ 45,631

(a) Includes net cash paid, deferred payments and the value, at the time of issuance, of Company stock issued for acquisitions.

Property additions for the Gas Distribution Business represent primarily new customer service lines and, to a lesser extent, gas main and service line replacements. However, during 2000 the Michigan gas distribution operation incurred approximately $7.9 million to construct a large diameter transmission pipeline to supply a power generation plant currently under construction. In addition, the Company invested approximately $11.9 million, $2.4 million and $4.5 million in technology in 2000, 1999 and 1998, respectively. This technology consists of automated meter reading, automated dispatch and scheduling, in-truck computer terminals and other computer system and infrastructure improvements which have increased customer service and operational efficiency. Business acquisitions were approximately $1.8 million, $305.1 million and $20.4 million in 2000, 1999 and 1998, respectively. The significant increase in 1999 was due to the acquisition of ENSTAR for approximately $290 million.

In 2001, the Company plans to spend approximately $47 million on property additions for the Gas Distribution and Diversified Businesses. In addition, the Company plans to incur additional expenditures for business acquisitions during 2001.

Cash Flows from Operations | The Company's net cash provided from operating activities totaled $49.0 million in 2000, $41.2 million in 1999 and $24.7 million in 1998. The change in operating cash flows is influenced significantly by changes in the level and cost of gas in underground storage, changes in accounts receivable and accrued revenue and other working capital changes. The changes in these accounts are largely the result of how the Company manages the timing of cash receipts and payments.

The Company uses significant amounts of short-term borrowings to finance natural gas purchases for storage during the non-heating season. The Company owns and leases natural gas storage facilities in Michigan with available capacity approximating 35% to 40% of the Company's average annual Michigan gas sales. Generally, gas is stored during the months of April through October and withdrawn for sale from November through March.

Cash Flows from Financing | The Company received net cash from financing activities of $13.6 million, $287.4 million and $4.9 million in 2000, 1999 and 1998, respectively.

Years ended December 31,	***2000***	*1999*	*1998*
(000's)			
Cash provided by financing activities			
Issuance of common stock, net of repurchases	**$ 865**	$ 3,726	$ 32,570
Issuance of trust preferred securities	**134,885**	–	–
Issuance of long-term debt, net of redemptions	**136,569**	–	4,887
Net cash change in notes payable	**(243,708)**	302,347	(20,561)
Redemption of preferred stock	**–**	(3,281)	–
Payment of dividends	**(15,033)**	(15,442)	(12,029)
	$ 13,578	$ 287,350	$ 4,867

The Company's net funds borrowed (paid) on notes payable were ($243.7 million), $302.3 million and ($20.6 million) in 2000, 1999 and 1998, respectively. On November 1, 1999, the Company financed the acquisition of ENSTAR with a $290 million unsecured bridge loan. In 2000, the Company utilized the proceeds of several securities offerings and its short-term bank lines of credit to repay the bridge loan. During 2000, 1999 and 1998, the Company made payments of $.8 million, $3.1 million and $9.2 million, respectively, on a note payable associated with the sale of NOARK ("NOARK note") (see Note 15 of the Notes to the Consolidated Financial Statements). The net change in notes payable includes the combined cash borrowed or paid on the Company's short-term lines of credit with banks, the ENSTAR bridge loan and the NOARK note.

The Company redeemed certain of its securities and issued various debt and equity securities during the past three years. Refer to Note 5 of the Notes to the Consolidated Financial Statements for information regarding these redemptions and issues.

Cash dividends paid per share for common shareholders were $.835, $.863 and $.744 in 2000, 1999 and 1998, respectively. The 1999 dividends include a one-time special cash dividend of $.05 per share.

Non-Cash Financing Activities | The Company issued .1 million shares, .2 million shares and 1.3 million shares of its common stock to the shareholders of businesses acquired during 2000, 1999 and 1998, respectively. Of the shares issued

in 1998, .9 million were for the acquisition of OMC, which was accounted for using the pooling of interests method of accounting. See Note 3 of the Notes to the Consolidated Financial Statements for more information on the OMC acquisition. As part of a business acquisition in 1999, the Company owes $.8 million to the shareholders of the business acquired. The $.8 million plus interest must be paid on or before April 2002.

Future Financing | In general, the Company funds its capital expenditure program and dividend payments with operating cash flows and the utilization of short-term lines of credit. When appropriate, the Company will refinance its short-term lines with long-term debt, common stock or other long-term financing instruments. During 2000, the Company increased its short-term lines of credit with banks to $160 million, $140 million of which is committed facilities. At December 31, 2000, the unused portion of the Company's lines of credit was $26.7 million.

In March 2000, a registration statement on Form S-3 ("registration statement") filed by the Company and SEMCO Capital Trust I, SEMCO Capital Trust II and SEMCO Capital Trust III ("Capital Trusts") with the Securities and Exchange Commission became effective. The Company and Capital Trusts registered up to $500 million of securities under the registration statement, of which $276 million was utilized to issue securities during 2000. Refer to Note 5 of the Notes to the Consolidated Financial Statements for additional information regarding the registration statement and securities issued.

The Company expects to acquire additional businesses in 2001, and likely will raise the required capital through a combination of utilizing short-term lines of credit and issuing long-term debt or equity.

The Company's ratio of earnings to fixed charges was 1.60, 2.18 and 2.17 for 2000, 1999 and 1998, respectively. If you assume that common stock of the Company was issued in place of the FELINE PRIDES, the ratio of earnings to fixed charges for 2000 would have been 1.80.

MARKET RISK INFORMATION

The Company's primary market risk arises from fluctuations in commodity prices and interest rates. See Note 8 of the Notes to the Consolidated Financial Statements for additional information on the Company's risk management activities.

The Company's exposure to commodity price risk arises from changes in natural gas and propane prices throughout the United States and in eastern Canada, where the Company conducts sales and purchase transactions. The Company does not currently use derivative instruments to manage its exposure to commodity price risk, since all of the natural gas requirements of the Company's Michigan gas distribution operations are covered under the TransCanada supply arrangement, and ENSTAR's natural gas requirements are primarily covered by two long-term supply arrangements and an RCA-approved mechanism that passes commodity costs through to its customers. Prior to the sale of Energy Services on March 31, 1999, the Company entered into various long-term sales commitments which extended up to 60 months into the future. The Company also utilized derivative financial and commodity instruments, including futures contracts, options and swaps, to reduce market risk associated with fluctuations in the price of gas. Since the sale of Energy Services, the Company no longer uses these types of instruments.

The Company is subject to interest rate risk in connection with the issuance of variable- and fixed-rate debt. In order to manage interest costs, the Company used interest rate swap agreements and exchanged fixed- and variable-rate interest payment obligations over the life of the agreements, without exchange of the underlying principal amounts. These interest rate swap agreements were terminated in March 2000 and the Company received $3.2 million. The portion designated as a hedge has been deferred and is being recognized in earnings (as an offset to interest expense) ratably over the term of the debt. The non-hedge portion of $2.1 million was recognized in earnings during 2000 as an offset to interest expense. The Company did not have any interest rate swap agreements or similar instruments as of December 31, 2000.

IMPACT OF INFLATION

The cost of gas sold by ENSTAR is recovered from natural gas distribution customers on a current basis through its purchased gas adjustment ("PGA") clause. Prior to April 1, 1999, the cost of gas sold by the Michigan gas distribution operation was recovered from natural gas distribution customers on a current basis through its GCR clause. The MPSC authorized the Company to suspend its GCR clause and freeze for three years in its base rate a gas charge of $3.24

per Mcf. The GCR suspension and rate freeze took effect in April 1999, and generally extend through March 2002. See Note 2 of the Notes to the Consolidated Financial Statements for more information regarding the Michigan rate freeze.

Increases in other utility operating costs are recovered through the regulatory process of a rate case and, therefore, may adversely affect the results of operations in inflationary periods due to the time lag involved in this process. The Company attempts to minimize the impact of inflation by controlling costs, increasing productivity and filing rate cases on a timely basis.

NEW ACCOUNTING STANDARDS

In June of 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," which was subsequently amended by SFAS No. 137 and SFAS No. 138 (hereinafter collectively referred to as "SFAS 133"). SFAS 133 is effective for fiscal years beginning after June 15, 2000, and establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the Consolidated Statement of Financial Position as either an asset or liability measured at its fair value. SFAS 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement, and requires that a company must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting.

SFAS 133, which has been adopted by the Company on January 1, 2001, must be applied to (a) derivative instruments and (b) certain derivative instruments embedded in hybrid contracts. With respect to hybrid instruments, a company may elect to apply SFAS 133, as amended, to (1) all hybrid contracts, (2) only those hybrid instruments that were issued, acquired, or substantively modified after December 31, 1997, or (3) only those hybrid instruments that were issued, acquired, or substantively modified after December 31, 1998. The Company has completed the process of identifying all derivative instruments, determining fair market values of derivatives, designating and documenting hedge relationships, and evaluating the effectiveness of those hedge relationships.

Certain gas purchase contracts qualify under the provisions of SFAS 133 and will require the recognition of those derivatives at their fair value in the Consolidated Statement of Financial Position as an asset or liability. Management estimates that the effect of adopting SFAS 133 will increase both assets and liabilities by approximately $1.4 million.

FORWARD LOOKING STATEMENTS

This document contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that are based on current expectations, estimates and projections. Statements that are not historical facts, including statements about the Company's outlook, beliefs, plans, goals, and expectations, are forward-looking statements. These statements are subject to potential risks and uncertainties and, therefore, actual results may differ materially. The Company undertakes no obligation to update publicly any forward-looking statements whether as a result of new information, future events or otherwise. Factors that may impact forward-looking statements include, but are not limited to, the following: (i) the effects of weather and other natural phenomena; (ii) the economic climate and growth in the geographical areas where the Company does business; (iii) the capital intensive nature of the Company's business; (iv) increased competition within the energy industry as well as from alternative forms of energy; (v) the timing and extent of changes in commodity prices for natural gas and propane; (vi) the effects of changes in governmental and regulatory policies, including income taxes, environmental compliance and authorized rates; (vii) the Company's ability to bid on and win construction, engineering and quality assurance contracts; (viii) the impact of energy prices on the amount of projects and business available to Engineering Services; (ix) the nature, availability and projected profitability of potential investments available to the Company; (x) the Company's ability to accomplish its financing objectives in a timely and cost-effective manner in light of changing conditions in the capital markets and (xi) the Company's ability to operate and integrate acquired businesses in accordance with its plans.

CONSOLIDATED STATEMENTS OF INCOME

Years ended December 31, *(000's, except per share amounts)*	***2000***	*1999*	*1998*
Operating revenues			
Gas sales	**$ 273,312**	$ 191,169	$ 166,700
Gas transportation	**30,783**	22,369	14,832
Construction services	**95,537**	49,965	16,621
Engineering services	**12,268**	14,841	40,937
Gas marketing	**–**	96,855	390,817
Other	**10,693**	9,564	7,578
	422,593	384,763	637,485
Operating expenses			
Cost of gas sold	**161,945**	117,789	109,388
Cost of gas marketed	**–**	95,632	386,691
Operations and maintenance	**152,040**	100,822	92,696
Depreciation and amortization	**33,472**	20,006	15,349
Property and other taxes	**9,878**	8,624	9,166
	357,335	342,873	613,290
Operating income	**65,258**	41,890	24,195
Other income (deductions)			
Interest expense	**(34,913)**	(20,575)	(14,811)
Divestiture of energy marketing business	**–**	1,122	–
Divestiture of NOARK investment	**–**	–	5,048
Other	**2,958**	2,627	643
	(31,955)	(16,826)	(9,120)
Income before income taxes and dividends on trust preferred securities	**33,303**	25,064	15,075
Income taxes	**11,606**	7,405	6,320
Net income before dividends on trust preferred securities	**21,697**	17,659	8,755
Dividends on trust preferred securities, net of income taxes of $2,695	**5,004**	–	–
Net income before cumulative effect of accounting method change and extraordinary charge	**16,693**	17,659	8,755
Cumulative effect of change in accounting method for property taxes, net of income taxes of $960	**–**	–	1,784
Extraordinary charge due to early retirement of debt, net of income taxes of $269	**–**	–	(499)
Net income available to common shareholders	**$ 16,693**	$ 17,659	$ 10,040
Basic earnings per share	**$ 0.93**	$ 1.00	$ 0.63
Diluted earnings per share	**$ 0.90**	$ 1.00	$ 0.63
Cash dividends paid per share	**$ 0.835**	$ 0.863	$ 0.744
Average common shares outstanding	**17,999**	17,697	15,906

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, *(000's)*	***2000***	*1999*	*1998*
Cash flows from operating activities			
Net income available to common shareholders	**$ 16,693**	$ 17,659	$ 10,040
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation and amortization	**33,472**	20,006	15,349
Divestiture of energy marketing business	**–**	(1,122)	–
Divestiture of NOARK investment	**–**	–	(5,048)
Extraordinary charge	**–**	–	499
Changes in assets and liabilities, net of effects of acquisitions, divestitures and other changes as shown below	**(1,203)**	4,661	3,848
Net cash from operating activities	**48,962**	41,204	24,688
Cash flows from investing activities			
Property additions – gas distribution	**(47,466)**	(22,761)	(23,029)
Property additions – diversified businesses	**(19,170)**	(12,258)	(2,246)
Proceeds from property sales, net of retirement costs	**15**	1,657	871
Proceeds from business divestiture	**–**	6,579	–
Acquisitions of businesses, net of cash acquired	**(784)**	(300,638)	26
Advances to equity investees	**–**	–	(4,284)
Net cash from investing activities	**(67,405)**	(327,421)	(28,662)
Cash flows from financing activities			
Issuance of common stock, net of expenses	**865**	6,110	32,570
Repurchase of common stock and related expenses	**–**	(2,384)	–
Issuance of trust preferred securities, net of expenses	**134,885**	–	–
Net cash change in notes payable and related expenses	**(243,708)**	302,347	(20,561)
Issuance of long-term debt, net of expenses	**136,619**	–	29,390
Repayment of long-term debt and related expenses	**(50)**	–	(24,503)
Redemption of preferred stock	**–**	(3,281)	–
Payment of dividends	**(15,033)**	(15,442)	(12,029)
Net cash from financing activities	**13,578**	287,350	4,867
Cash and temporary cash investments			
Net increase (decrease)	**(4,865)**	1,133	893
Beginning of period	**6,086**	4,953	4,060
End of period	**$ 1,221**	$ 6,086	$ 4,953
Changes in assets and liabilities, net of effects of acquisitions, divestitures and other changes:			
Receivables, net	**$ 7,161**	$ (39,488)	$ 21,095
Accrued revenue	**(6,832)**	13,497	6,083
Materials, supplies and gas in underground storage	**4,065**	23,349	(1,710)
Gas charges recoverable from customers	**311**	8,547	8,375
Accounts payable	**(3,780)**	(2,143)	(24,449)
Customer advances and amounts payable to customers	**(4,036)**	4,189	1,594
Deferred taxes and investment tax credit	**6,877**	1,651	1,832
Other	**(4,969)**	(4,941)	(8,972)
	$ (1,203)	$ 4,661	$ 3,848

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

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

December 31, (000's)	**2000**	*1999*
Current assets		
Cash and temporary cash investments, at cost	**$ 1,221**	$ 6,086
Receivables, less allowances of $1,436 and $1,080	**73,139**	79,587
Accrued revenue	**32,212**	25,380
Prepaid expenses	**14,309**	14,231
Gas in underground storage	**8,739**	11,723
Materials and supplies, at average cost	**5,065**	6,146
Gas charges recoverable from customers	**2,698**	3,009
Accumulated deferred income taxes	**6,994**	3,528
Other	**946**	844
	145,323	150,534
Property, plant and equipment		
Gas distribution	**585,628**	542,505
Diversified businesses	**79,167**	61,434
	664,795	603,939
Less – accumulated depreciation	**154,769**	129,593
	510,026	474,346
Deferred charges and other assets		
Goodwill, less amortization of $9,117 and $5,052	**169,692**	162,691
Deferred retiree medical benefits	**10,790**	11,689
Unamortized debt expense	**6,966**	7,644
Other	**8,426**	8,279
	195,874	190,303
Total assets	**$ 851,223**	$ 815,183
Current liabilities		
Notes payable	**$ 134,142**	$ 376,629
Accounts payable	**32,300**	35,725
Customer advance payments	**13,068**	13,885
Accrued interest	**8,020**	4,527
Amounts payable to customers	**3,097**	5,715
Other	**10,774**	11,701
	201,401	448,182
Deferred credits and other liabilities		
Accumulated deferred income taxes	**36,385**	25,774
Customer advances for construction	**14,444**	15,045
Unamortized investment tax credit	**1,713**	1,980
Other	**14,504**	11,862
	67,046	54,661
Capitalization		
Long-term debt	**307,930**	170,000
Company-obligated mandatorily redeemable trust preferred securities of subsidiaries holding solely debt securities of SEMCO Energy, Inc.	**139,374**	–
Common shareholders' equity	**135,472**	142,340
	582,776	312,340
Total liabilities and capitalization	**$ 851,223**	$ 815,183

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

CONSOLIDATED STATEMENTS OF CAPITALIZATION

December 31,	***2000***	*1999*
(000's, except share amounts)		
Long-term debt		
6.83% notes due 2002	**$ 30,000**	$ 30,000
8.00% notes due 2004	**55,000**	55,000
7.20% notes due 2007	**30,000**	30,000
8.00% notes due 2010	**31,011**	–
8.32% notes due 2024	**25,000**	25,000
6.50% medium-term notes due 2005	**15,000**	15,000
6.40% medium-term notes due 2008	**5,000**	5,000
7.03% medium-term notes due 2013	**10,000**	10,000
8.95% notes due 2008, remarketable 2003	**106,919**	–
	$ 307,930	$ 170,000
Company-obligated mandatorily redeemable trust preferred securities of subsidiaries holding solely debt securities of SEMCO Energy, Inc.		
10.25% cumulative trust preferred securities – 1,600,000 shares issued and outstanding	**$ 38,374**	$ –
FELINE PRIDES – 10,100,000 shares issued and outstanding	**101,000**	–
	$ 139,374	$ –
Common shareholders' equity		
Common stock, par value $1 per share - 40,000,000 shares authorized; 18,055,639 and 17,908,616 shares outstanding	**$ 18,056**	$ 17,909
Capital surplus	**115,186**	123,861
Retained earnings	**2,230**	570
	$ 135,472	$ 142,340
Total capitalization	**$ 582,776**	$ 312,340

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

CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDERS' EQUITY

Years ended December 31, *(000's)*	***2000***	*1999*	*1998*
Common stock			
Beginning of year	**$ 17,909**	$ 17,382	$ 14,066
5% stock dividend in May 1998	**–**	–	726
Issuance of common stock for acquisitions, the DRIP and other	**147**	686	770
Issuance of common stock through public offering	**–**	–	1,820
Repurchase of common stock	**–**	(159)	–
End of year	**$ 18,056**	$ 17,909	$ 17,382
Common stock capital surplus			
Beginning of year	**$ 123,861**	$ 116,663	$ 81,086
5% stock dividend in May 1998	**–**	–	(726)
Issuance of common stock for acquisitions, the DRIP and other	**1,718**	9,423	12,243
Issuance of common stock through public offering	**–**	–	24,060
Repurchase of common stock	**–**	(2,225)	–
Costs related to FELINES PRIDES (see Note 5)	**(10,393)**	–	–
End of year	**$ 115,186**	$ 123,861	$ 116,663
Retained earnings (deficit)			
Beginning of year	**$ 570**	$ (1,817)	$ (21)
Net income	**16,693**	17,659	10,040
Cash dividends on common stock	**(15,033)**	(15,272)	(11,836)
End of year	**$ 2,230**	$ 570	$ (1,817)

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

1. SIGNIFICANT ACCOUNTING POLICIES

Company Description | SEMCO Energy, Inc., is an investor-owned company. SEMCO Energy, Inc. and its subsidiaries (the "Company") operate four business segments: (1) gas distribution; (2) pipeline construction services; (3) engineering services; and (4) propane, pipelines and storage. The latter three segments together are referred to as the "Diversified Businesses." The Company's gas distribution business segment distributes and transports natural gas to approximately 262,000 customers in the state of Michigan and approximately 105,000 customers in the state of Alaska. The Alaska-based operation and the Michigan-based operation are known together as the "Gas Distribution Business" and operate as divisions of SEMCO Energy, Inc. SEMCO Energy Gas Company, which had conducted the Michigan gas distribution operation, was merged into SEMCO Energy, Inc. on December 31, 1999. The construction services segment ("Construction Services") conducts business in the midwestern, southern and southeastern areas of the United States. Its primary service is the installation of underground natural gas mains and service lines. Construction Services also provides underground construction services to other industries such as telecommunications and water supply. The engineering services segment ("Engineering Services") has offices in New Jersey, Michigan, Louisiana and Texas, and provides a variety of energy-related engineering and quality assurance services in several states. The propane, pipelines and storage segment sells approximately 5 million gallons of propane annually to retail customers in Michigan's upper peninsula and northeast Wisconsin and operates natural gas transmission, gathering and storage facilities in Michigan. The Company also created an information technology business during 2000. The Company's other business segments are currently the primary customers of the information technology business. The Company sold the subsidiary comprising its energy marketing business ("Energy Services") effective March 31, 1999.

Basis of Presentation | The financial statements of the Company were prepared in conformity with generally accepted accounting principles. In connection with the preparation of the financial statements, management was required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Principals of Consolidation | The consolidated financial statements include the accounts of SEMCO Energy, Inc. and its wholly-owned subsidiaries. Investments in unconsolidated companies at least 20% owned, but not greater than 50% owned, are reported using the equity method of accounting.

Certain of the Company's diversified businesses, primarily Construction Services, Engineering Services and the Company's new information technology business (Aretech Information Services, Inc.), supply services at a profit to the Company's regulated gas distribution business. In these situations, intercompany profits remaining in the assets of the regulated business at a particular date are not eliminated since it is probable that, through the ratemaking process, the cost will be recovered through future revenue. As a result, $.9 million, $.4 million and $.6 million of profit on revenues earned from the Company's regulated business by the Company's diversified businesses was not eliminated during consolidation in 2000, 1999 and 1998, respectively. All other significant intercompany transactions have been eliminated.

Reclassifications | Certain reclassifications have been made to prior years' financial statements to conform to the 2000 presentation.

Rate Regulation | The rates of gas distribution customers located in the City of Battle Creek, Michigan, and surrounding communities are subject to the jurisdiction of the City Commission of Battle Creek. The Michigan Public Service Commission ("MPSC") authorizes the rates charged to all of the remaining Michigan customers. The gas distribution operation in Alaska is subject to regulation by the Regulatory Commission of Alaska ("RCA") which has jurisdiction over, among other things, rates, accounting procedures, and standards of service.

Property, Plant, Equipment and Depreciation | The Company's property, plant and equipment ("property") is recorded at cost. The Company provides for depreciation on a straight-line basis over the estimated useful lives of the related property. The ratio of depreciation to the average balance of property approximated 4.7%, 4.0% and 3.9% for the years

2000, 1999 and 1998, respectively. Certain investments in unconsolidated companies recorded using the equity method are reported in the property of the diversified businesses. See Note 13 for further discussion.

Gas in Underground Storage | The gas inventory held by the Battle Creek division of the Gas Distribution Business is stated at last-in, first-out ("LIFO") cost. At December 31, 2000, the replacement cost of the Battle Creek division's gas inventory exceeded the LIFO cost by $0.1 million. The replacement cost did not exceed the LIFO cost of the gas inventory held by the Battle Creek division at December 31, 1999. The remainder of gas inventory is reported at average cost.

In general, commodity costs and variable transportation costs are capitalized as gas in underground storage. Fixed costs, primarily pipeline demand charges and storage charges, are expensed as incurred through cost of gas.

Goodwill | Goodwill represents the excess of purchase price and related costs over the value assigned to the net tangible assets of businesses acquired. Goodwill is amortized on a straight-line basis over periods of up to 40 years. Periodically, the Company reviews the recoverability of goodwill. The measurement of possible impairment is based primarily on the ability to recover the balance of the goodwill from expected future operating cash flows on an undiscounted basis. In management's opinion, no impairment existed at December 31, 2000. Amortization expense was approximately $4.0 million in 2000, $1.6 million in 1999 and $.5 million in 1998. Amortization expense in 2000 was significantly higher due to the November 1999 acquisition of the Alaska-based gas distribution operation.

Revenue Recognition | The Gas Distribution Business bills monthly on a cycle basis and follows the industry practice of recognizing accrued revenue for gas services rendered to its customers but not billed at month end. Engineering Services and Construction Services recognize revenues as services are rendered and recognize accrued revenue for services rendered but not billed at month end. The propane business recognizes propane sales in the same period that the propane is delivered to customers. Prior to its sale, Energy Services recognized marketing revenues, and any related hedging gains or losses, in the same period natural gas was delivered to customers.

Cost of Gas | Prior to April 1, 1999, the Company's Michigan-based gas distribution operation had a regulator-approved gas cost recovery ("GCR") mechanism for the geographic areas subject to the regulatory jurisdiction of the MPSC, and a purchased gas adjustment ("PGA") mechanism for the geographic areas subject to the jurisdiction of the City Commission of Battle Creek, which allowed for the adjustment of rates charged to customers in response to increases and decreases in the cost of gas purchased. Effective April 1, 1999, the MPSC authorized the Company to suspend its GCR clause and freeze for three years in its base rates a gas charge of $3.24 per Mcf. The GCR freeze and new rates generally extend through March 2002. See Note 2 for more information.

The Alaska-based gas distribution operation also has a regulator-approved PGA mechanism which allows for the adjustment of rates charged to customers for increases and decreases in the cost of gas purchased. All gas sales rates are adjusted annually to reflect changes in the operation's cost of purchased gas based on estimated costs for the upcoming 12-month period. The PGA may be adjusted quarterly if it is determined that there are significant variances from the estimates used in the annual determination. Any difference between actual cost of gas purchased and the RCA's approved rate adjustment is deferred and included with applicable carrying charges in the next PGA.

In accordance with the GCR and PGA mechanisms, the Company had $2.7 million recorded in current assets at December 31, 2000 for gas charges recoverable from customers. Also at December 31, 2000, the Company had $3.1 million recorded in current liabilities for amounts payable to customers in accordance with these mechanisms.

Income Taxes | Investment tax credits ("ITC") utilized in prior years for income tax purposes are deferred for financial accounting purposes and are amortized through credits to the income tax provision over the lives of the related property. The Company files a consolidated federal income tax return and income taxes are allocated among the subsidiaries within each business segment based on their separate taxable income.

Extraordinary Charge | During 1998, the Company redeemed all of its outstanding 8.625% debentures due April 15, 2017 at a redemption price of 104% of the principle amount of $23.5 million. The payment of the call premium and the unamortized debt expense associated with the diversified businesses of the Company is reflected in the Consolidated Statement of Income for 1998 as an extraordinary charge of $.5 million after-tax.

Change in Method of Accounting | During 1998, the Company implemented a change in its method of accounting for property taxes, so that such taxes are expensed monthly during the fiscal period of the taxing authority for which the taxes are levied. This change provides a better matching of property tax expense with both the payment of services and those services provided by the taxing authority. Prior to 1998, the Company expensed property taxes monthly during the year following the assessment date. The cumulative effect of this change in accounting for property taxes increased 1998 earnings by $1.8 million after-tax. The pro forma effect on prior years' consolidated net income, of retroactively recording property taxes as if the new method of accounting had been in effect for all periods presented, was not material.

Statements of Cash Flows | For purposes of the Consolidated Statements of Cash Flows, the Company considers all highly liquid investments purchased with original maturities of three months or less to be cash and temporary cash investments. Supplemental cash flow information for the years ended December 31, 2000, 1999 and 1998, is summarized in the table below.

Years ended December 31,	***2000***	*1999*	*1998*
(000's)			
Cash paid during the year for:			
Interest	**$ 29,153**	$ 16,686	$ 14,423
Income taxes, net of refunds	**$ 4,160**	$ 7,479	$ 2,100
Non-cash investing and financing activities:			
Capital stock issued for acquisitions	**$ 1,000**	$ 3,699	$ 6,309 [a]
Deferred payments for acquisitions	**$ –**	$ 805	$ –
Details of acquisitions:			
Fair value of assets acquired	**$ 3,364**	$ 346,103	$ 10,301
Fair value of liabilities assumed	**(1,576)**	(37,250)	(3,992)
Deferred payments	**–**	(805)	–
Company stock issued	**(1,000)**	(3,699)	(6,309)
Cash paid	**$ 788**	$ 304,349	$ –
Less cash acquired	**4**	3,711	26
Net cash paid for (acquired via) acquisitions	**$ 784**	$ 300,638	$ (26)

[a] Does not include $14,073 of Company stock issued for the acquisition of Oilfield Materials Consultants, Inc. because the acquisition was accounted for as a pooling of interests. Refer to Note 3 for more information.

2. REGULATORY MATTERS

1999 RCA Order | In July 1999, the Company entered into a definitive purchase and sale agreement to acquire the assets and certain liabilities of ENSTAR Natural Gas Company and the outstanding stock of Alaska Pipeline Company (together known as "ENSTAR") from Ocean Energy, Inc ("Ocean Energy"). In October 1999, the Company received an order from the RCA approving a joint application for the transfer of the Certificate of Public Convenience and Necessity held by ENSTAR Natural Gas Company and for a transfer of controlling interest in Alaska Pipeline Company. The RCA's order contained certain conditions, including the obligation to file by July 1, 2000 certain revenue requirement and cost of service information and the prohibition from encumbering ENSTAR's assets for financing of non-utility business activities.

2000 RCA Order | In November 2000, the Company's ENSTAR Division received an order requesting additional information in order to ensure that ENSTAR's rates are just and reasonable. The order also appointed a hearing examiner

and set a prehearing conference in February 2001. The order indicates that if changes in ENSTAR's existing rates are required, such changes would be applied on a prospective basis.

1998 MPSC Order | In September 1998, the division of the Gas Distribution Business, subject to the jurisdiction of the MPSC, received authority from the MPSC, to: (1) implement an experimental residential gas customer choice program; (2) suspend its GCR clause; (3) roll into its base rate and freeze for three years a gas charge of $3.24 per thousand cubic feet ("Mcf"); (4) freeze distribution rate adjustments for the same three-year period, with exceptions; (5) suspend an income sharing mechanism adopted in October 1997 and adopt a new income sharing mechanism for use during the 1999, 2000 and 2001 calendar years; and (6) establish gas service performance criteria. The new rates took effect in April 1999 and generally extend through March 2002.

Under the experimental residential gas customer choice program and a similar program in Battle Creek, up to approximately 8,300 residential customers per year will be allowed to choose their own gas supplier during the three year period that began April 1, 1999. As a result, up to 25,000 residential customers, 10% of the Michigan residential customer base, will be allowed to choose their own gas supplier by the third year of the programs. This alternative gas supply is delivered to customers under a tariff similar to an existing transportation service tariff used to provide such service to commercial and industrial customers. The program has not, and is not expected to, significantly affect the income of the Gas Distribution Business because the approved rates for transportation service are designed to recover all costs other than the cost of gas and provide a return in approximately the same amounts as from Michigan residential customers, for whom the Company is the natural gas supplier.

Several of the changes in the MPSC order are interrelated. The $3.24 gas charge represents a reduction of approximately $.33 per Mcf from the rates prior to April 1999. The suspension of the GCR clause means that customers will pay $3.24 per Mcf regardless of the Company's actual cost of gas. The Gas Distribution Business was able to offer this Michigan GCR suspension and rate freeze mainly as a result of agreements reached with TransCanada Gas Services, Inc. ("TransCanada"). Under the agreements, TransCanada provides the Company's natural gas requirements, and manages the Company's natural gas supply and the supply aspects of transportation and storage operations in Michigan for the three-year period that began April 1, 1999, at a cost below the $3.24 price charged to customers. As a result, the Michigan gas distribution operation retains the sales margin on the sale of gas, subject to a customer profit sharing mechanism described below.

Included in receivables at December 31, 2000, is approximately $19.1 million representing amounts ultimately due the Company under the terms of the TransCanada agreements. Under the agreements, the Company does not have title to gas in its leased storage facilities and it must remit payments to TransCanada in accordance with a contractual delivery schedule that is designed to include the gas delivered to the leased storage facilities. Differences between these scheduled deliveries and actual deliveries to the Company's distribution system or Company-owned storage facilities result in an amount due the Company. This amount is settled between TransCanada and the Company after each anniversary date (April 1) of the agreements.

The MPSC order is applicable only in the geographic areas subject to the regulatory jurisdiction of the MPSC, and, therefore, does not govern rates regulated by the City of Battle Creek, Michigan. However, the Gas Distribution Business voluntarily reduced its Battle Creek gas charge to the $3.24 level to correspond with its gas charge under the MPSC order.

There are two exceptions to the three-year distribution rate freeze: first, the profit incentive and sharing mechanism described in the following paragraph, and second, rate revisions arising in response to unanticipated legislative or accounting actions.

The new profit incentive and sharing mechanism substantially matches mechanisms approved by the MPSC for two other major natural gas utilities in Michigan and provides for a higher threshold than was previously applicable (i.e. 12.75% return on equity). Under the mechanism, if the Company's return on equity for its Michigan-based natural gas distribution business exceeds 12.75%, amounts equal to 50% of the excess return between 12.76% and 16.75%, plus amounts equal to 75% of the excess over 16.75% would be credited to customers, i.e., would be reflected prospectively in reduced rates. For purposes of the profit incentive and sharing mechanisms, 50% of any gas costs savings generated as a result of the TransCanada arrangements are excluded from the calculation of return on equity. As a result, the Company's actual reported earnings can generate a return on equity in excess of 12.75% before triggering profit sharing with customers.

Four safety and reliability performance measures need to be met in order not to reduce the return on equity threshold used in the income sharing mechanism.

Regulatory Assets and Liabilities | The Gas Distribution Business is subject to the provisions of Statements of Financial Accounting Standards ("SFAS") 71, "Accounting for the Effects of Certain Types of Regulation." As a result, the actions of regulators affect when revenues and expenses are recognized. Regulatory assets represent incurred costs to be recovered from customers through the ratemaking process. Regulatory liabilities represent benefits to be refunded to customers. The following table summarizes the regulatory assets and liabilities recorded in the Consolidated Statements of Financial Position.

December 31, *(000's)*	**2000**	1999
Regulatory assets		
Deferred retiree medical benefits	**$ 10,790**	$ 11,689
Gas charges recoverable from customers	**2,698**	3,009
Unamortized loss on retirement of debt	**2,371**	2,664
Other	**2,188**	2,028
	$ 18,047	$ 19,390
Regulatory liabilities		
Unamortized investment tax credit	**$ 1,958**	$ 2,323
Tax benefits amortizable to customers	**3,811**	4,222
Amounts payable to customers (gas cost overrecovery)	**3,097**	5,715
	$ 8,866	$ 12,260

In the event the Company determines that the Gas Distribution Business no longer meets the criteria for following SFAS 71, the accounting impact would be an extraordinary, non-cash charge to operations of an amount that could be material. Criteria that give rise to the discontinuance of SFAS 71 include (1) increasing competition that restricts the ability of the Gas Distribution Business to establish prices to recover specific costs, and (2) a significant change in the manner in which rates are set by regulators from cost-based regulation to another form of regulation. The Company's periodic review of these criteria currently supports the continuing application of SFAS 71.

3. MERGERS AND ACQUISITIONS

ENSTAR Acquisition and Pro Forma Information | On November 1, 1999, the Company acquired ENSTAR from Ocean Energy, Inc. for approximately $290 million in cash, which included adjustments for working capital and the purchase of $58.7 million of ENSTAR's debt held by Ocean Energy, plus the accrued interest thereon. The acquisition has been accounted for using the purchase method of accounting. Accordingly, the purchase price has been allocated to the assets purchased and the liabilities assumed based on their estimated fair values at the date of the acquisition, with the amount of purchase price in excess of these estimated fair values classified as goodwill. The goodwill is being amortized on a straight-line basis over 40 years.

The following pro forma amounts for operating revenue, consolidated net income and earnings per share have been determined as if the acquisition of ENSTAR occurred on January 1, 1999, and illustrate the effects of: (1) the elimination of activities between ENSTAR and Ocean Energy or its predecessor, Seagull Energy, Inc. that occurred prior to the closing of the acquisition by the Company; (2) the adjustments resulting from the acquisition by the Company including increases in depreciation and amortization expense due primarily to the amortization, over a 40 year period, of the goodwill associated with the acquisition; and (3) the public issuance of $135 million of debentures, $40 million of trust preferred securities and $101 million of FELINE PRIDES (Note 5 contains additional information about these issuances), the utilization of short-term lines of credit to fund the remaining purchase price, and the resulting adjustments to interest expense and trust preferred dividends from these securities issues and transactions (the "Financing Transactions"). The pro forma amounts include the

effects of the Financing Transactions as though they occurred on January 1, 1999, and exclude the effects of the $290 million short-term bridge loan actually utilized in the ENSTAR acquisition. The net proceeds from the Financing Transactions were primarily used to retire the bridge loan. The pro forma amounts do not reflect any potential cost savings or operating synergies that may be realized following the acquisition of ENSTAR.

	Actual		*Pro Forma*	
Years ended December 31,	***2000***	*1999*	***2000***	*1999*
(000's, except per share amounts)				
Operating revenue	**$ 422,593**	$ 384,763	**$ 422,593**	$ 461,705
Consolidated net income	**16,693**	17,659	**16,451**	15,594
Basic earnings per share	**0.93**	1.00	**0.91**	0.88

Diversified Business Acquisitions | The Company has expanded in recent years with several diversified business acquisitions which are summarized in the table below.

Company	*Business Segment*	*Acquisition Date*
Sub-Surface Construction Co. ("Sub-Surface")	Construction Services	August 1997
Maverick Pipeline Services, Inc. ("Maverick")	Engineering Services	December 1997
Hotflame Gas, Inc. ("Hotflame")	Propane, Pipelines & Storage	March 1998
King Energy and Construction Co. ("King")	Construction Services	May 1998
Oilfield Materials Consultants, Inc. ("OMC")	Engineering Services	November 1998
K&B Construction, Inc. ("K&B")	Construction Services	February 1999
Iowa Pipeline Associates, Inc. ("Iowa")	Construction Services	April 1999
Flint Construction Co. ("Flint")	Construction Services	September 1999
Long's Underground Technologies, Inc. ("Long")	Construction Services	September 1999
Drafting Services, Inc. ("DSI")	Engineering Services	September 1999
Pinpoint Locators, Inc. ("Pinpoint")	Engineering Services	October 1999
KLP Construction Co. ("KLP")	Construction Services	May 2000

The acquisition of OMC was accounted for under the pooling of interests accounting method, and accordingly, the consolidated financial statements for the periods prior to the merger were restated to include the financial results of OMC. For the periods preceding the merger of the Company and OMC, there were no intercompany transactions which required elimination from the combined results of operations, and there were no adjustments necessary to conform the accounting practices of the two companies.

The remainder of the diversified business acquisitions have been accounted for using the purchase method of accounting. As a result, the Company's operating results for 2000, 1999 and 1998 include the results of these businesses for the period subsequent to their acquisition dates. Any goodwill associated with these acquisitions is being amortized on a straight line method over a period of up to 40 years. There were no adjustments necessary to the accounting practices of these companies to conform with the practices of the Company.

In addition to the consideration shown below, the acquisition of Sub-Surface included non-compete agreements requiring payments of $235,000 per year during the two years following the acquisition and $160,000 per year during the third through fifth year following the acquisition. The Hotflame acquisition also included non-compete agreements requiring payments of approximately $67,000 per year during the three years following the acquisition. In addition to the consideration shown below, the acquisitions of K&B and Pinpoint provide for additional amounts to be paid if certain post-acquisition operating results are achieved. See Note 14 for further information.

	Consideration issued to the prior owners of the acquired businesses		
Company	*Cash*	*Common shares of the Company*	*Deferred Payments*
(000's)			
Sub-Surface	$ 15,634	–	$ –
Maverick	50	26	–
Hotflame	–	353	–
King	–	18	–
OMC	–	905	–
K&B	1,000	–	805
Iowa	–	138	–
Flint	6,500	–	–
Long	1,889	108	–
DSI	1,000	–	–
Pinpoint	154	–	–
KLP	788	83	–

4. INCOME TAXES

SFAS No. 109 | The Company accounts for income taxes in accordance with SFAS 109, "Accounting For Income Taxes." SFAS 109 requires an annual measurement of deferred tax assets and deferred tax liabilities based upon the estimated future tax effects of temporary differences and carry forwards.

Provision for Income Taxes | The table below summarizes the components of the Company's provision for income taxes.

Years ended December 31,	***2000***	*1999*	*1998*
(000's)			
Federal income taxes:			
Currently payable	**$ 3,065**	$ 5,749	$ 5,511
Deferred to future periods	**5,935**	1,529	1,767
Investment tax credits ("ITC")	**(267)**	(267)	(267)
State income taxes:			
Currently payable	**(473)**	466	–
Deferred to future periods	**651**	(72)	–
Total income taxes	**$ 8,911**	$ 7,405	$ 7,011
Less amounts included in:			
Dividends on trust preferred securities	**(2,695)**	–	–
Cumulative effect of change in accounting method	**–**	–	960
Extraordinary charge	**–**	–	(269)
Income taxes, excluding amounts shown separately	**$ 11,606**	$ 7,405	$ 6,320

Reconciliation of Statutory Rate to Effective Rate | The table below provides a reconciliation of the difference between the Company's provision for income taxes and income taxes computed at the statutory rate.

Years ended December 31, *(000's)*	***2000***	*1999*	*1998*
Net income	**$ 16,693**	$ 17,659	$ 10,040
Add back:			
Preferred dividends	**–**	325	193
Income taxes	**8,911**	7,405	7,011
Pre-tax income	**$ 25,604**	$ 25,389	$ 17,244
Computed federal income taxes	**$ 8,961**	$ 8,886	$ 6,035
Amortization of deferred ITC	**(267)**	(267)	(267)
Amortization of non-deductible amounts resulting from acquisitions	**237**	221	216
State income tax expense, net of federal tax benefit	**79**	256	–
Other	**(99)**	(1,691)	1,027
Total income taxes	**$ 8,911**	$ 7,405	$ 7,011

Deferred Income Taxes | Deferred income taxes arise from temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. At December 31, 2000 and 1999 there was no valuation allowance recorded against deferred tax assets. The table below shows the principal components of the Company's deferred tax assets (liabilities).

December 31, *(000's)*	***2000***	*1999*
Property	**$ (25,183)**	$ (24,074)
Retiree medical benefit obligation	**1,803**	3,245
Retiree medical benefit regulatory assets	**(3,776)**	(4,091)
Gas in underground storage	**4,994**	2,530
ITC	**955**	1,131
Unamortized debt expense	**(1,167)**	(1,275)
Gas cost overrecovery (underrecovery)	**487**	846
Property taxes	**(2,055)**	(1,713)
Goodwill	**(4,625)**	(523)
Other	**(824)**	1,678
Total deferred taxes	**$ (29,391)**	$ (22,246)
Gross deferred tax liabilities	**$ (63,379)**	$ (44,714)
Gross deferred tax assets	**33,988**	22,468
Total deferred taxes	**$ (29,391)**	$ (22,246)

5. CAPITALIZATION

Registration Statement | In March 2000, a registration statement on Form S-3 ("registration statement") filed by the Company and SEMCO Capital Trust I, SEMCO Capital Trust II and SEMCO Capital Trust III ("Capital Trusts") with the Securities and Exchange Commission became effective. The registration statement was for the registration of senior and subordinated debt securities, preferred stock, common stock, stock purchase contracts and stock purchase units of the Company and trust preferred securities of the Capital Trusts and related guarantees in any combination up to $500 million.

Common Stock Equity | During 2000, the Company's Direct Stock Purchase and Dividend Reinvestment Plan ("DRIP") purchased Company common stock on the open market to meet the dividend reinvestment and stock purchase requirements of its participants. The Company issued 374,000 shares and 367,000 shares of its common stock in 1999 and 1998, respectively, to meet the dividend reinvestment and stock purchase requirements of the DRIP. In 1999, the Company purchased 159,000 shares of its common stock on the open market to offset the number of shares sold through the DRIP during the same period.

The Company issued 83,000 shares, 246,000 shares and 1,276,000 shares of its common stock to the shareholders of businesses acquired during 2000, 1999 and 1998, respectively. Of the shares issued in 1998, 905,000 were for the acquisition of OMC that was accounted for using the pooling of interests method of accounting.

The Company issued approximately 52,000, 44,000 and 30,000 shares of Company common stock to certain of the Company's employee benefit plans in 2000, 1999 and 1998, respectively.

In August 1998, the Company sold 1.8 million shares of its common stock in a public offering. The proceeds of the offering were $26.2 million after underwriting discounts but before expenses. The Company used the net proceeds from the stock issuance to repay short-term debt and for general corporate purposes.

The Company issued a five percent stock dividend in May 1998. Earnings per share of common stock, cash dividends per share of common stock and average number of common shares outstanding were restated to reflect the stock dividends.

Company-Obligated Mandatorily Redeemable Trust Preferred Securities of Subsidiaries | The Company's Capital Trusts were established for the sole purpose of issuing trust preferred securities and lending the gross proceeds to the Company. The sole assets of the Capital Trusts are debt securities of the Company with terms similar to the terms of the related trust preferred securities. The Capital Trusts are subsidiaries of the Company.

In April 2000, SEMCO Capital Trust I issued 1.6 million shares of 10.25% cumulative trust preferred securities ("10.25% TPS") in a public offering at a price of $25 per security. SEMCO Capital Trust I used the $40 million in proceeds from the issuance of the 10.25% TPS to invest in subordinated debentures of the Company bearing an interest rate of 10.25%. The 10.25% TPS are subject to mandatory redemption upon repayment of the subordinated debentures at maturity or their earlier redemption. The subordinated debentures mature in 2040, but may be redeemed at any time after April 19, 2005, or at any time within 90 days following the occurance of certain special events. The Company used the entire net proceeds from the sale of the subordinated debentures to repay a portion of the bridge loan utilized in the ENSTAR acquisition.

Also during 2000, the Company issued 10.1 million FELINE PRIDES in a public offering at a price of $10 per security. Each FELINE PRIDES consists of a stock purchase contract of the Company and a 9% trust preferred security of SEMCO Capital Trust II due 2005 with a stated face value per security of $10 ("9% TPS"). SEMCO Capital Trust II used the $101 million in proceeds to invest in 9% senior deferrable notes of the Company due 2005. The Company used the net proceeds from the sale of the senior deferrable notes to repay a portion of the bridge loan utilized for the acquisition of ENSTAR and to repay a portion of its short-term lines of credit.

Under the terms of each stock purchase contract (which is a component of a FELINE PRIDES unit), the FELINE PRIDES holder is obligated to purchase, and the Company is obligated to sell, between .7794 and .8651 shares of Company common stock in August 2003. The actual number of shares of common stock to be sold will depend on the average market value of a share of common stock in August 2003. In addition to payments on the 9% TPS, the Company is also obligated to pay the FELINE PRIDES holders a quarterly contract adjustment payment on each stock purchase contract at an annual rate of 2% of $10. The present value of the contract adjustment payments, or $5.6 million, has been recorded as a liability and as a reduction to common stock capital surplus. In addition, common stock capital surplus has been reduced by $4.6 million for the issuance costs of the FELINE PRIDES.

Cumulative Convertible Preferred Stock | In November 1999, the Company called for redemption all outstanding shares of its $2.3125, Series A Convertible Cumulative Preferred Stock. Holders of the 6,168 outstanding shares of $2.3125, Series A Convertible Cumulative Preferred Stock had the option of receiving $25 in cash for each share redeemed or converting each share into 4.11 shares of the Company's common stock. 1,055 shares were redeemed for cash and 5,113 shares were converted to common stock.

Cumulative Preferred Stock of Subsidiary | In November 1999, the Company redeemed all outstanding shares of the Series A, B, C, and D Cumulative Preferred Stock of its subsidiary, SEMCO Energy Gas Company. The Company paid cash of $105 per share to holders of the 31,000 outstanding shares of Series A, B, C, and D Cumulative Preferred Stock. A premium of approximately $.2 million was paid as part of the redemption of the Cumulative Preferred Stock and is reflected in other deductions in the Consolidated Statement of Income for 1999.

Long-term Debt | In April 2000, the Company sold $30 million of 8% Senior Notes due 2010 ("Senior Notes") in a public offering. Interest on the Senior Notes is paid semi-annually. The Senior Notes contain provisions that give the estates or heirs of deceased Senior Note holders the right to request that the Company redeem their Senior Notes. During 2000, the Company redeemed $50,000 of Senior Notes in accordance with these provisions.

The Company also sold $105 million of 8.95% Remarketable or Redeemable Securities ("ROARS") in a public offering in June 2000. The ROARS were issued at a discount of approximately $.3 million. Interest on the ROARS is payable semi-annually. The ROARS mature in July 2008; however, the Company may purchase, or be required to purchase, all of the ROARS in July 2003 if they are not remarketed as discussed below. In conjunction with the sale of the ROARS, the Company entered into a remarketing agreement with Banc of America Securities LLC ("BAS") under which BAS has the option to purchase all the ROARS in July 2003 or any subsequent remarketing date. The Company received an option premium of approximately $2.5 million for the remarketing option which is included with the ROARS in long-term debt in the Company's Consolidated Statements of Financial Position. The option premium is being amortized to income over the life of the ROARS.

If BAS purchases the ROARS in July 2003, they will remarket the ROARS at a new interest rate in accordance with the terms of the ROARS. If BAS does not exercise its option to purchase the ROARS in July 2003 then the Company is required to redeem all of the ROARS at that time.

The Company used the entire net proceeds from the sale of the Senior Notes and ROARS to repay a portion of the bridge loan utilized for the acquisition of ENSTAR.

In April 1998, the Company redeemed all of its outstanding 8.625% debentures due April 15, 2017 at a redemption price of 104% of the principle amount of $23.5 million. The redemption was accomplished using short-term debt. Later in 1998, the Company issued $30 million of medium-term notes with interest rates ranging from 6.40% to 7.03%. The net proceeds from the issuance of the notes were used to repay short-term debt and for general corporate purposes.

The Company has long-term and short-term debt arrangements that contain restrictive financial covenants including, among others, limits on the payment of dividends beyond certain levels. The Company is currently in compliance with all of the covenants in these agreements.

There are no annual sinking fund requirements for the Company's existing debt over the next five years. Debt maturing over the next five years includes the maturity of $30 million of 6.83% notes in 2002, $55 million of 8.0% notes in 2004 and $15 million of 6.5% medium-term notes in 2005. In addition, the Company may purchase, or be required to purchase, the $105 million of ROARS in July 2003 if they are not remarketed as discussed above.

6. SHORT-TERM BORROWINGS

The Company currently maintains unsecured lines of credit with banks totaling $160 million, of which $140 million is committed facilities. The outstanding balances owed by the Company on these lines of credit at December 31, 2000, 1999 and 1998 were $133.4 million, $84.6 million and $59.8 million, respectively. Interest on all such lines are at variable rates, which do not exceed the banks' prime lending rates. These arrangements are set to expire during 2001 and the Company expects they will be renegotiated at comparable terms. In addition, the Company had a $290 million short-term unsecured bridge loan which was used to acquire ENSTAR on November 1, 1999. The interest rate on the bridge loan could range from 100 to 150 basis points above the London Interbank Offered Rate ("LIBOR"). The bridge loan was repaid during 2000. The Company also had a note payable in connection with the sale of its investment in the NOARK Pipeline System Partnership ("NOARK") (see Note 15) which was paid off in 2000.

Years ended December 31,	***2000***	*1999*	*1998*
(000's)			
Notes payable balance at year end	**$ 134,142**	$ 376,629	$ 63,576
Unused lines of credit at year end	**$ 26,650**	$ 25,400	$ 50,200
Average interest rate at year end	**7.3%**	7.1%	5.6%
Maximum borrowings at any month-end	**$ 371,621**	$ 377,585	$ 78,668
Average borrowings	**$ 214,813**	$ 91,279	$ 49,418
Weighted average cost of borrowings	**7.2%**	6.5%	6.5%

7. FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each significant class of financial instruments:

Cash, Temporary Cash Investments, Accounts Receivables, Payables and Notes Payable | The carrying amount approximates fair value because of the short maturity of those instruments.

Long-Term Debt | The fair values of the Company's long-term debt are estimated based on quoted market prices for the same or similar issues or, where no market quotes are available, based on discounted future cash flows using current interest rates at which similar loans would be made to borrowers with similar credit ratings and remaining maturities. Although the current fair value of the long-term debt may differ from the current carrying amount, settlement of the reported debt is generally not expected until maturity.

The table below shows the estimated fair values of the Company's long-term debt as of December 31, 2000 and 1999.

December 31,	***2000***	*1999*
(000's)		
Long-term debt		
Carrying amount	**$ 307,930**	$ 170,000
Fair value	**319,214**	167,972

8. RISK MANAGEMENT ACTIVITIES AND DERIVATIVE TRANSACTIONS

The Company is subject to interest rate risk in connection with the issuance of variable and fixed-rate debt. In order to manage interest costs, the Company used interest rate swap agreements and exchanged fixed- and variable-rate interest payment obligations over the life of the agreements, without exchange of the underlying principal amounts. The notional amount of the Company's interest rate swaps was $85 million at December 31, 1999. These swap agreements were terminated in March 2000 and the Company received $3.2 million. The portion designated as a hedge has been deferred and is being recognized in earnings (as an offset to interest expense) ratably over the term of the debt. The non-hedge portion of $2.1 million was recognized in earnings during 2000 as an offset to interest expense. The Company currently does not use derivative instruments to manage its exposure to commodity price risk since all of the natural gas requirements of the Company's Michigan gas distribution operations are covered under the TransCanada supply arrangement and ENSTAR's natural gas requirements are primarily covered by two long-term supply arrangements and an RCA-approved PGA mechanism that passes commodity costs through to its customers.

Prior to the sale of Energy Services in March of 1999, the Company entered into sales commitments that extended up to 60 months into the future. The Company also utilized derivative financial and commodity instruments, including futures contracts, options and swaps, to reduce market risk associated with fluctuations in the price of natural gas.

9. PENSION PLANS AND OTHER POSTRETIREMENT BENEFITS

Pensions | The Company has defined benefit pension plans that cover the employees of certain companies in the consolidated group. Pension plan benefits are generally based upon years of service or a combination of years of service and compensation during the final years of employment. The Company's funding policy is to contribute amounts annually to the plans based upon actuarial and economic assumptions designed to achieve adequate funding of projected benefit obligations. The Company also has a supplemental executive retirement plan ("SERP"), which is an unfunded defined benefit pension plan. The Company's prepaid pension benefit costs at December 31, 2000 and 1999 are net of accrued benefit costs of approximately $1.5 million and $.8 million, respectively, related to the SERP.

On December 31, 1997, the pension plans that cover primarily the employees of the Company's Michigan-based gas distribution business and corporate offices were amended to provide a special frozen benefit to all employees with at least two years of service on December 31, 1997. This special frozen benefit added both three years of service and three years of age to all eligible employees for purposes of computing accrued pension benefits at December 31, 1997. In conjunction with the amendment, the Company offered an early retirement program to all eligible employees with at least two years of service on December 31, 1997. The program was open from January 14, 1998 through February 27, 1998 and offered employees the additional options of receiving either a lump-sum pension benefit payment or an immediate annuity. One hundred and one employees accepted the early retirement offer. As a result of the 1998 early retirement program, and in accordance with the provisions of SFAS 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits", the Company incurred a one-time gain which reduced 1998 net periodic pension costs by approximately $1.6 million. This reduction was partially offset by a one-time charge in the net retiree medical costs discussed below.

During 2000, certain pension plans covering employees at the Company's gas distribution operations and corporate offices in Michigan and Alaska were amended. The amendments to certain of the plans included a special frozen benefit for certain eligible employees. In conjunction with the amendments, the Company offered early retirement programs to certain eligible employees. The programs gave the employees the options of receiving either a lump-sum pension benefit payment or an immediate annuity. Sixty-three employees elected to take the early retirement offer. As a result of the 2000 early retirement program, the Company incurred a one-time gain which reduced 2000 net periodic pension costs by approximately $.4 million.

Other Postretirement Benefits | The Company has postretirement benefit plans that provide certain medical and prescription drug benefits to qualified retired employees, their spouses and covered dependents. Determination of benefits is based on a combination of the retiree's age and years of service at retirement. The Company accounts for retiree medical benefits in accordance with SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." This standard requires the full accrual of such costs during the years that the employee renders service to the Company until the date of full eligibility.

In 2000, 1999 and 1998, the Company expensed retiree medical costs of $ 1.5 million, $1.4 million and $3.9 million, respectively. The retiree medical expense for each of those years includes $.9 million of amortization of previously deferred retiree medical costs. Prior to getting regulatory approval for the recovery of retiree medical benefits in rates, the Michigan gas distribution operation deferred, as a regulatory asset, any portion of retiree medical expense that was not yet provided for in customer rates. After receiving rate approval for recovery of such costs, the Company began amortizing, as retiree medical expense, the amounts previously deferred. The 1998 retiree medical expense also includes a one-time charge of $1.3 million related to the 1998 early retirement program.

The Company established certain Voluntary Employee Benefit Association ("VEBA") trusts to fund its retiree medical benefits and contributed $3.0 million, $2.5 million and $2.3 million to the trusts in 2000, 1999 and 1998, respectively. The Company also partially funds retiree medical benefits on a discretionary basis through an Internal Revenue Code Section 401(h) account. In 1998, the Company made cash contributions to the 401(h) account of $.1 million. No cash contributions were made in 1999 and 2000.

The following two tables provide reconciliations of the plan benefit obligations, plan assets, funded status of the plans and components of net periodic benefit costs.

	Pension Benefits		Other Postretirement Benefits	
(000's)	**2000**	1999	**2000**	1999
Change in benefit obligation				
Benefit obligation at January 1	**$ 57,218**	$ 44,837	**$ 33,350**	$ 31,312
Acquisition of ENSTAR	**–**	14,512	**–**	2,133
Service cost	**1,988**	1,514	**364**	358
Interest cost	**4,076**	3,157	**2,235**	2,137
Actuarial (gain) loss	**(713)**	(4,021)	**184**	(1,102)
Benefits paid from plan assets	**(2,952)**	(2,781)	**–**	–
Benefits paid from corporate assets, net of participant contributions	**–**	–	**(1,316)**	(1,488)
Plan amendments	**940**	–	**(3,992)**	–
(Gain) loss from reduction in workforce	**440**	–	**3,498**	–
Lump sums paid for reduction in workforce	**(8,501)**	–	**–**	–
Special termination benefits	**4,688**	–	**–**	–
Benefit obligation at December 31	**$ 57,184**	$ 57,218	**$ 34,323**	$ 33,350
Change in plan assets				
Fair value of plan assets at January 1	**$ 76,036**	$ 51,821	**$ 20,991**	$ 15,940
Acquisition of ENSTAR	**–**	19,293	**–**	–
Actual return on plan assets	**(2,004)**	7,703	**(1,140)**	2,551
Company contributions	**–**	–	**3,000**	2,500
Benefits paid from plan assets	**(2,952)**	(2,781)	**–**	–
Lump sums paid for reduction in workforce	**(8,501)**	–	**–**	–
Fair value of plan assets at December 31	**$ 62,579**	$ 76,036	**$ 22,851**	$ 20,991
Reconciliation of funded status of the plans				
Funded (unfunded) status	**$ 5,395**	$ 18,818	**$ (11,472)**	$ (12,359)
Unrecognized net (gain) loss	**(3,725)**	(13,771)	**(8,571)**	(15,370)
Unrecognized prior service cost (benefit)	**980**	146	**–**	–
Unrecognized net transition obligation	**118**	171	**11,058**	15,970
Prepaid (accrued) benefit cost	**$ 2,768**	$ 5,364	**$ (8,985)**	$ (11,759)
Weighted average assumptions as of December 31				
Discount rate	**7.50%**	7.50%	**7.50%**	7.50%
Expected long-term rate of return on plan assets	**9.75%**	9.50%	**9.75%**	9.50%
Rate of compensation increase	**4.00–5.00%**	4.00–5.00%	**4.00–5.00%**	4.00–5.00%

	Pension Benefits			*Other Postretirement Benefits*		
Years ended December 31,	***2000***	*1999*	*1998*	***2000***	*1999*	*1998*
(000's)						
Components of net benefit cost						
Service cost	**$ 1,988**	$ 1,514	$ 738	**$ 364**	$ 358	$ 447
Interest cost	**4,076**	3,157	3,070	**2,235**	2,137	2,004
Expected return on plan assets	**(6,600)**	(4,547)	(3,775)	**(1,967)**	(1,514)	(1,055)
Amortization of transition obligation	**53**	161	77	**920**	1,228	1,250
Amortization of prior service costs	**106**	73	51	**–**	–	–
Amortization of net (gain) or loss	**(502)**	(727)	(24)	**(950)**	(1,712)	(946)
Amortization of regulatory asset	**–**	–	–	**899**	899	899
Net (gain) loss due to settlements, curtailments and special termination benefits	**(354)**	–	(1,641)	**–**	–	1,298
Net benefit cost (credit)	**$ (1,233)**	$ (369)	$ (1,504)	**$ 1,501**	$ 1,396	$ 3,897

The 2000 postretirement medical costs were developed based on the health care plan in effect at January 1, 2000. As of December 31, 2000, the actuary assumed that retiree medical cost increases in 2001 would be 7.0% and prescription drug cost increases in 2001 would be 8.8%. The actuary also assumed that the rate of increase in retiree medical costs and prescription drug costs would decrease uniformly to 5.5% in 2005 and thereafter. The health care cost trend rate assumption significantly affects the amounts reported. For example, a one percentage point increase in each year would increase the accumulated retiree medical obligation as of December 31, 2000 by $4.3 million and the aggregate of the service and interest cost components of net periodic retiree medical costs for 2000 by $.4 million.

401(K) Plans and Profit Sharing Plans | The Company has defined contribution plans, commonly referred to as 401(k) plans, covering the employees of certain of its businesses or divisions. Certain of the 401(k) plans contain provisions for Company matching contributions. The amount expensed for the Company match provisions was $1.1 million, $.7 million and $.5 million in 2000, 1999 and 1998, respectively.

The Company has profit sharing plans, covering the employees of certain of its businesses or divisions. Annual contributions are generally discretionary or determined by a formula which contains minimum contribution requirements. Profit sharing expense was $.3 million for 2000 and $.5 million for 1999. There was no profit sharing expense in 1998.

10. STOCK-BASED COMPENSATION

At the Company's 1997 annual meeting, the shareholders approved a long-term incentive plan providing for the issuance of up to 500,000 shares of non-qualified common stock options over the next ten years adjusted for any subsequent stock dividends and stock splits. During 2000, the Company's Board of Directors approved a second such plan that provides for the issuance of non-qualified stock options up to an amount not to exceed five percent of the total outstanding shares of the Company. The options are reserved for the executives and directors of the Company and are awarded based upon both the Company's and individual's performance. The options vest at the rate of 33 1/3% per year beginning one year after the date of grant and expire ten years after the grant date.

The exercise price of all the options granted is equal to the average of the high and low market price on the options' grant date. Both the number of options granted and the exercise price are adjusted accordingly for any stock dividends and stock splits occurring during the options' life. Fair value of the options was estimated at the date of grant using a Black-Scholes option pricing model and the weighted average assumptions shown in the table below.

	2000	*1999*	*1998*
Risk-free investment rate	**6.55%**	5.28%	5.55%
Dividend yield	**6.98%**	5.29%	6.11%
Volatility	**24.96%**	20.84%	22.97%
Average expected term (years)	**5**	5	5
Fair value of options granted	**$ 1.80**	$ 2.20	$ 2.26

Employee stock options available for grant were 1,011,000 and 257,000 at December 31, 2000 and 1999, respectively. The following table shows the stock option activity during the past three years and the number of stock options exercisable under the Company's plans at the end of each such year.

	*Number of Shares**	*Average Price per Share ($)**
Outstanding at December 31, 1997	130,462	16.68
Granted	102,948	16.01
Exercised	–	–
Canceled	(15,780)	16.11
Outstanding at December 31, 1998	217,630	16.40
Granted	111,501	15.54
Exercised	–	–
Canceled	(11,345)	16.11
Outstanding at December 31, 1999	317,786	16.16
Granted	192,701	12.07
Exercised	–	–
Canceled	(44,707)	14.18
Outstanding at December 31, 2000	465,780	14.65
Options exercisable at December 31, 1998	29,394	16.97
Options exercisable at December 31, 1999	95,088	16.39
Options exercisable at December 31, 2000	200,924	16.38

* Adjusted to give retroactive effect to the 5% stock dividends in May 1997 and 1998.

In October 1995, the Financial Accounting Standards Board ("FASB") issued SFAS 123, "Accounting for Stock-Based Compensation." In general, SFAS 123 recommends that all stock-based compensation given to employees in exchange for their services be expensed based on the fair value of the options granted. The Company has chosen to continue accounting for these transactions under previously existing accounting standards as allowed in SFAS 123. However, if expense had been determined in a manner consistent with the provisions of SFAS 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated in the table below.

Years ended December 31,	***2000***	*1999*	*1998*
(000's, except per share amounts)			
Net income			
As reported	**$ 16,693**	$ 17,659	$ 10,040
Pro forma	**$ 16,517**	$ 17,501	$ 9,940
Earnings per share – basic			
As reported	**$ 0.93**	$ 1.00	$ 0.63
Pro forma	**$ 0.92**	$ 0.99	$ 0.62
Earnings per share – diluted			
As reported	**$ 0.90**	$ 1.00	$ 0.63
Pro forma	**$ 0.89**	$ 0.99	$ 0.62

11. BUSINESS SEGMENTS

The Company adopted SFAS 131, "Disclosure about Segments of an Enterprise and Related Information," during 1998. SFAS 131 established standards for reporting information about operating segments ("business segments") in annual financial statements and requires selected information in interim financial statements. Business segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, to make decisions on how to allocate resources and to assess performance. The Company's chief operating decision making group is the Chief Executive Officer ("CEO") and certain other executive officers who report directly to the CEO. The operating segments are organized and managed separately because each segment offers different products or services. The Company evaluates the performance of its business segments based on the operating income generated. Operating income does not include income taxes, interest expense, extraordinary charges, changes in accounting method and non-operating income and expense items.

Under SFAS 131, an operating segment that does not exceed certain quantitative levels is not considered a reportable segment. Instead, the results of all segments that do not exceed the quantitative thresholds are combined and reported as one segment and referred to as "all other." The Company's propane, pipelines and storage business segment did not meet these quantitative thresholds and could have been grouped into the "all other" category. However, the Company has decided to voluntarily disclose information on this business segment.

The Company's new information technology ("IT") business also did not meet the quantitive thresholds of SFAS 131. In addition, the majority of the operating revenue of the IT business during 2000 was generated from affiliated business segments of the Company and, therefore, eliminated in consolidation. As a result, the Company is not separately disclosing information on this business segment.

The Company currently operates four reportable business segments. They are gas distribution, construction services, engineering services, and propane, pipelines and storage. The Company sold the subsidiary comprising its energy marketing business effective March 31, 1999. Refer to Note 1 for a brief description of each business segment.

The accounting policies of the operating segments are the same as those described in Note 1 except that intercompany transactions have not been eliminated in determining individual segment results. The following table provides business segment information as well as a reconciliation ("Corporate and other") of the segment information to the applicable line in the consolidated financial statements. Corporate and other includes corporate related expenses not allocated to segments, intercompany eliminations and results of other smaller operations.

Years ended December 31,	***2000***	*1999*	*1998*
(000's)			
Operating revenues			
Gas distribution	**$ 307,851**	$ 216,831	$ 184,221
Construction services	**105,231**	58,272	25,904
Engineering services	**20,655**	17,486	41,366
Propane, pipelines and storage	**6,949**	6,284	4,852
Energy marketing	**–**	96,904	397,888
Corporate and other [a]	**(18,093)**	(11,014)	(16,746)
Total consolidated revenues	**$ 422,593**	$ 384,763	$ 637,485
Depreciation and amortization			
Gas distribution	**$ 26,272**	$ 14,955	$ 12,110
Construction services	**5,360**	3,076	1,903
Engineering services	**421**	421	182
Propane, pipelines and storage	**999**	1,092	793
Energy marketing	**–**	36	44
Corporate and other	**420**	426	317
Total consolidated depreciation	**$ 33,472**	$ 20,006	$ 15,349
Operating income (loss)			
Gas distribution	**$ 62,876**	$ 40,134	$ 22,363
Construction services	**3,676**	2,611	(102)
Engineering services	**25**	(513)	2,938
Propane, pipelines and storage	**1,530**	2,341	1,585
Energy marketing	**–**	(341)	(696)
Corporate and other	**(2,849)**	(2,342)	(1,893)
Total consolidated operating income	**$ 65,258**	$ 41,890	$ 24,195
Assets at year end			
Gas distribution	**$ 741,593**	$ 713,900	$ 359,592
Construction services	**69,276**	52,620	20,471
Engineering services	**8,837**	9,477	8,897
Propane, pipelines and storage	**24,827**	28,399	27,175
Energy marketing	**–**	–	65,017
Corporate and other	**6,690**	10,787	8,510
Total consolidated assets	**$ 851,223**	$ 815,183	$ 489,662
Capital investments [b]			
Gas distribution	**$ 47,466**	$ 312,653	$ 23,029
Construction services	**15,318**	21,720	1,076
Engineering services [c]	**209**	2,499	14,586
Propane, pipelines and storage	**251**	1,318	6,285
Energy marketing	**–**	–	–
Corporate and other	**5,176**	1,971	655
Total consolidated capital investments [c]	**$ 68,420**	$ 340,161	$ 45,631

(a) Includes the elimination of intercompany engineering services revenue of $8,387,000, $2,645,000 and $429,000 for 2000, 1999 and 1998, respectively. Includes the elimination of intercompany construction services revenue of $9,694,000, $8,307,000 and $9,283,000 for 2000, 1999 and 1998, respectively. Includes the eliminations of intercompany energy marketing revenues of $49,000 and $7,071,000 for 1999 and 1998, respectively.

(b) Capital investments include net amounts paid for business acquisitions, including non-cash amounts such as deferred payments and Company stock issued as part of the acquisitions.

(c) The 1998 capital investments, shown in the above table, include $14,073,000 of Company stock issued as part of the acquisition of OMC. The acquisition of OMC was accounted for as a pooling of interests. Therefore, the supplemental cash flow information in Note 1 does not include the stock issued for the OMC acquisition.

12. EARNINGS PER SHARE

The Company computes earnings per share ("EPS") in accordance with SFAS 128, "Earnings per Share." SFAS 128 requires the computation and presentation of two EPS amounts, basic and diluted. Basic EPS is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the period. The computation of diluted EPS is similar to that of basic EPS except that the weighted average number of common shares outstanding is increased to include any shares that would be available if outstanding stock options, stock purchase contracts, warrants, or convertible securities ("dilutive securities") were exercised. Accordingly, income available to common shareholders is also adjusted for any changes to income that would result from the assumed conversion of the dilutive securities. The diluted EPS calculation excludes the effect of stock options when their exercise prices exceed the average market price over the period.

The following table provides the computations of basic and diluted earnings per share for the years ended December 31, 2000, 1999 and 1998.

Years ended December 31,	***2000***	*1999*	*1998*
(000's, except per share amounts)			
Basic earnings per share computation			
Income before accounting change and extraordinary charge	**$ 16,693**	$ 17,659	$ 8,755
Cumulative effect of change in accounting method	**–**	–	1,784
Extraordinary charge	**–**	–	(499)
Net income	**$ 16,693**	$ 17,659	$ 10,040
Weighted average common shares outstanding	**17,999**	17,697	15,906
Earnings per share – basic			
Income before accounting change and extraordinary charge	**$ 0.93**	$ 1.00	$ 0.55
Cumulative effect of change in accounting method	**–**	–	0.11
Extraordinary charge	**–**	–	(0.03)
Net income	**$ 0.93**	$ 1.00	$ 0.63
Diluted earnings per share computation			
Income before accounting change and extraordinary charge	**$ 16,693**	$ 17,659	$ 8,755
Adjustment for effect of assumed conversions:			
Preferred convertible stock dividends	**–**	13	15
Adjusted income before accounting change and extraordinary charge	**16,693**	17,672	8,770
Cumulative effect of change in accounting method	**–**	–	1,784
Extraordinary charge	**–**	–	(499)
Net income	**$ 16,693**	$ 17,672	$ 10,055
Weighted average common shares outstanding	**17,999**	17,697	15,906
Incremental shares from assumed conversions of:			
FELINE PRIDES	**599**	–	–
Preferred convertible stock	–	22	26
Stock options	**21**	1	3
Diluted weighted average common shares outstanding	**18,619**	17,720	15,935
Earnings per share – diluted			
Income before accounting change and extraordinary charge	**$ 0.90**	$ 1.00	$ 0.55
Cumulative effect of change in accounting method	**–**	–	0.11
Extraordinary charge	**–**	–	(0.03)
Net income	**$ 0.90**	$ 1.00	$ 0.63

13. INVESTMENTS IN AFFILIATES

The equity method of accounting is used for interests in affiliates 20% to 50% owned. At December 31, 2000, the Company's only investment in affiliates was a 50% ownership interest in the Eaton Rapids Gas Storage System. During 2000, the Company sold its 50% interest in the Michigan Intrastate Lateral System and its 50% interest in the Michigan Intrastate Pipeline System. The table below summarizes the combined financial information for investments in affiliates.

(000's)	**2000**	1999	1998
Net sales	**$ 5,806**	$ 6,071	$ 8,199
Operating income	**$ 3,579**	$ 3,486	$ 2,100
Net income (loss)	**$ 2,372**	$ 1,956	$ 285
The Company's share of net income (loss)	**$ 1,186**	$ 978	$ 160
Current assets	**$ 1,435**	$ 1,637	$ 2,796
Non-current assets	**22,767**	26,903	28,092
Total assets	**$ 24,202**	$ 28,540	$ 30,888
Current liabilities	**$ 2,024**	$ 4,266	$ 2,784
Non-current liabilities	**13,023**	15,274	15,942
Equity	**9,155**	9,000	12,162
Total liabilities and equity	**$ 24,202**	$ 28,540	$ 30,888
The Company's equity investment	**$ 4,165**	$ 4,207	$ 4,522

14. COMMITMENTS AND CONTINGENCIES

Capital Investments | The Company's plans for expansion and improvement of its business properties are continually reviewed. Aggregate capital expenditures for property in 2001 are projected at approximately $47 million. In addition, the Company is planning to incur additional expenditures for business acquisitions in 2001.

Lease Commitments | The Company leases buildings, vehicles and equipment. The resulting leases are classified as operating leases in accordance with SFAS 13, "Accounting for Leases." Vehicle leases comprise a significant portion of total lease expense. Leases on the majority of the Company's new vehicles are for a minimum of twelve months. The Company has the right to extend each vehicle lease annually and to cancel the extended lease at any time.

The Company's future minimum lease payments that have initial or remaining noncancelable lease terms in excess of one year at December 31, 2000 totaled $5.2 million consisting of (in millions): 2001 – $1.2; 2002 – $.9; 2003 – $.8; 2004 – $.8; 2005 – $.7 and thereafter – $.8. Total lease expense approximated $2.3 million, $2.3 million and $2.2 million in 2000, 1999 and 1998, respectively. The annual future minimum lease payments are substantially less than the lease expense incurred in 1998 through 2000 because most of the vehicle leases at December 31, 2000 were on a month-to-month basis and were subject to cancellation at any time. However, management expects to renew or replace substantially all leases.

Environmental Issues | Prior to the construction of major natural gas pipelines, gas for heating and other uses was manufactured from processes involving coal, coke or oil. The Gas Distribution Business owns seven Michigan sites which formerly housed such manufacturing facilities and expects that it will ultimately incur investigation and remedial action costs at some of these sites, and a number of other sites. The Gas Distribution Business has submitted plans to the appropriate environmental regulatory authority in the State of Michigan to close one site and begin work at another site. The extent of the Company's liabilities and potential costs in connection with these sites cannot be reasonably estimated at this time. In accordance with an MPSC accounting order, any environmental investigation and remedial action costs will be deferred and amortized over ten years. Rate recognition of the related amortization expense will not begin until after a prudence review in a general rate case.

Contingencies | The terms of certain of the Company's acquisition agreements in 1999 provided for additional consideration to be paid if certain results were achieved. The former owners of PinPoint Locators, Inc. and K&B Construction, Inc. were given the opportunity to receive additional consideration if future results of operations exceed certain targeted levels. Approximately $0.1 million of additional consideration was paid in 2000 and no additional consideration was paid in 1999.

In the normal course of business, the Company may be a party to certain lawsuits and administrative proceedings before various courts and government agencies. These lawsuits and proceedings may involve personal injury, property damage, contractual issues and other matters. Management cannot predict the ultimate outcome of any pending or threatening litigation or of actual or possible claims; however, management believes resulting liabilities, if any, will not have a material adverse impact upon the Company's financial position or results of operations.

15. DIVESTITURE OF NOARK INVESTMENT

The Company sold its entire interest in NOARK to ENOGEX Arkansas Pipeline Corporation ("EAPC") in 1998 and recorded a gain of $1.7 million after-tax. Pursuant to terms included in the sales agreement, the Company paid EAPC $.8 million, $3.1 million and $9.2 million in April of 2000, 1999 and 1998, respectively. The sale released the Company from all debt obligations and guarantees related to NOARK. The Company will receive annual payments of $.8 million from EAPC for 17 years beginning in the year 2004.

16. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

In the opinion of the Company, the following quarterly information includes all adjustments necessary for a fair statement of the results of operations for such periods. Earnings and dividends per share for each quarter are calculated based upon the weighted average number of shares outstanding during each quarter. As a result, adding the earnings or dividends per share for each quarter of a year may not equal annual earnings or dividends per share due to changes in shares outstanding throughout the year. Due to the seasonal nature of the Company's gas distribution business, the results of operations reported on a quarterly basis show substantial variations.

Quarters	*First*	*Second*	*Third*	*Fourth*
(000's, except per share amounts)				
2000				
Operating revenue	**$ 130,302**	**$ 76,478**	**$ 70,326**	**$ 145,487**
Operating income (loss)	**26,269**	**4,673**	**4,023**	**30,293**
Net income (loss)	**11,994**	**(3,074)**	**(4,749)**	**12,522**
Earnings (loss) per share – basic	**0.67**	**(0.17)**	**(0.26)**	**0.69**
Earnings (loss) per share – diluted	**0.67**	**(0.17)**	**(0.26)**	**0.65**
Cash dividends per share	**0.205**	**0.210**	**0.210**	**0.210**
1999				
Operating revenue	$ 183,880	$ 51,229	$ 39,997	$ 109,657
Operating income (loss)	17,347	3,468	(1,266)	22,341
Net income (loss)	10,403	121	(2,165)	9,300
Earnings (loss) per share – basic and diluted	0.60	0.01	(0.12)	0.52
Cash dividends per share	0.200	0.255[a]	0.205	0.204

[a] Includes a special one-time dividend of $0.05 per share.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To SEMCO Energy, Inc.:

We have audited the accompanying consolidated statements of financial position and capitalization of SEMCO Energy, Inc. (a Michigan corporation) and subsidiaries as of December 31, 2000 and 1999, and the related consolidated statements of income, changes in common shareholders' equity and cash flows for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of SEMCO Energy, Inc. and subsidiaries as of December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

ARTHUR ANDERSEN LLP
Detroit, Michigan
January 30, 2001

SELECTED FINANCIAL DATA

Years ended December 31,	***2000***	*1999*	*1998*
Income statement data (000's)			
Operating revenue	**$ 422,593**	$ 384,763	$ 637,485
Operating expenses			
Cost of gas and propane sold	**$ 161,945**	$ 117,789	$ 109,388
Cost of gas marketed	**–**	95,632	386,691
Operations and maintenance	**152,040**	100,822	92,696
Depreciation	**33,472**	20,006	15,349
Property and other taxes	**9,878**	8,624	9,166
	$ 357,335	$ 342,873	$ 613,290
Operating Income	**$ 65,258**	$ 41,890	$ 24,195
Other income (deductions)	**(31,955)**	(16,826)	(7,835)[f][g]
Income (loss) before income taxes and dividends on trust preferred securities	**$ 33,303**	$ 25,064	$ 16,360
Income taxes	**11,606**	7,405	6,320
Dividends on trust preferred securities, net of income tax	**5,004**	–	–
Net income (loss)	**$ 16,693**	$ 17,659	$ 10,040[f][g]
Common dividends	**15,033**	15,272	11,836
Earnings (deficit) reinvested in the business	**$ 1,660**	$ 2,387	$ (1,796)
Common stock data			
Average shares outstanding (000's)[a]			
Basic	**17,999**	17,697	15,906
Diluted[b]	**18,619**	17,720	[b]
Earnings (loss) per share[a]			
Basic	**$ 0.93**	$ 1.00	$ 0.63[f][g]
Diluted[b]	**$ 0.90**	$ 1.00	$ 0.63[f][g]
Dividends paid per share[a]	**$ 0.835**	$ 0.863[i]	$ 0.744
Dividend payout ratio	**90.1%**	86.5%	117.9%
Book value per share[a][c]	**$ 7.50**	$ 7.95	$ 7.61
Market value per share[a][c][d]	**$ 15.56**	$ 11.81	$ 16.31
Number of registered common shareholders[c]	**9,517**	9,217	9,336
Balance sheet data (000's)[c]			
Total assets	**$ 851,223**	$ 815,183	$ 489,662
Capitalization			
Long-term debt[e]	**$ 307,930**	$ 170,000	$ 170,000
Company-obligated mandatorily redeemable trust preferred securities of subsidiaries	**139,374**	–	–
Preferred stock	**–**	–	3,255
Common equity	**135,472**	142,340	132,228
	$ 582,776	$ 312,340	$ 305,483
Financial ratios			
Capitalization			
Long-term debt[e]	**52.8%**	54.4%	55.6%
Company-obligated mandatorily redeemable trust preferred securities of subsidiaries	**23.9%**	–	–
Preferred stock	**–**	–	1.1%
Common equity	**23.3%**	45.6%	43.3%
	100.0%	100.0%	100.0%
Return on average common equity	**12.0%**	12.9%	8.8%

(a) Adjusted to give effect to 5 percent stock dividends in May each year, 1990 through 1998.

(b) Prior to 1999, diluted average common shares outstanding were not materially different than basic average common shares outstanding. Therefore, there was no dilutive impact on earnings per share.

(c) At year end.

(d) Amounts prior to 1997 based on closing bid price. Amounts for 1997 and subsequent years, based on closing stock price.

(e) Includes current maturities of long-term debt.

(f) Includes $499 (net of tax) or $.03 per share, $1,286 (net of tax) or $.10 per share, $177 (net of tax) or $.01 per share, and $901 (net of tax) or $.08 per share in 1998, 1994, 1993 and 1992, respectively, attributable to extraordinary losses on the early extinguishment of debt.

1997	*1996*	*1995*	*1994*	*1993*	*1992*	*1991*	*1990*
$ 775,932	$ 547,910	$ 335,538	$ 372,430	$ 288,963	$ 251,526	$ 231,522	$ 228,339
$ 150,967	$ 151,135	$ 120,619	$ 135,669	$ 139,051	$ 121,643	$ 111,005	$ 110,705
518,157	308,619	130,087	153,973	67,474	52,347	46,237	47,703
55,209	43,211	36,217	35,558	34,496	33,590	33,425	34,149
12,877	11,334	12,035	11,549	12,468	12,344	12,138	10,729
9,555	8,777	7,966	8,186	8,446	7,729	7,193	6,798
$ 746,765	$ 523,076	$ 306,924	$ 344,935	$ 261,935	$ 227,653	$ 209,998	$ 210,084
$ 29,167	$ 24,834	$ 28,614	$ 27,495	$ 27,028	$ 23,873	$ 21,524	$ 18,255
(5,273) [h]	(44,702) [j]	(11,132)	(12,944) [f]	(11,789) [f]	(11,923) [f]	(10,791)	(9,856)
$ 23,894	$ (19,868)	$ 17,482	$ 14,551	$ 15,239	$ 11,950	$ 10,733	$ 8,399
8,469	(7,106)	6,151	4,559	5,676	3,640	3,432	2,372
–	–	–	–	–	–	–	–
$ 15,425 [h]	$ (12,762) [j]	$ 11,331	$ 9,992 [f]	$ 9,563 [f]	$ 8,310 [f]	$ 7,301	$ 6,027
10,225	9,814	9,230	8,656	7,419	6,875	6,385	5,940
$ 5,200	$ (22,576)	$ 2,101	$ 1,336	$ 2,144	$ 1,435	$ 916	$ 87
14,608	14,573	13,696	13,440	12,155	11,835	11,533	11,261
(b)	(b)	(b)	(b)	(b)	(b)	(b)	(b)
$ 1.06 [h]	$ (0.88) [j]	$ 0.83	$ 0.74 [f]	$ 0.79 [f]	$ 0.70 [f]	$ 0.63	$ 0.54
$ 1.06	$ (0.88)	$ 0.83	$ 0.74 [f]	$ 0.79 [f]	$ 0.70 [f]	$ 0.63	$ 0.54
$ 0.700	$ 0.673	$ 0.674	$ 0.644	$ 0.610	$ 0.581	$ 0.554	$ 0.527
66.0%	N/A	81.5%	86.6%	77.6%	82.7%	87.5%	98.6%
$ 6.44	$ 5.95	$ 7.99	$ 7.86	$ 6.94	$ 6.45	$ 6.07	$ 5.76
$ 17.26	$ 16.78	$ 15.54	$ 14.80	$ 17.24	$ 14.19	$ 10.84	$ 9.49
8,755	8,509	8,334	8,149	7,261	6,892	6,594	6,369
$ 507,160	$ 479,037	$ 378,523	$ 368,498	$ 348,813	$ 319,548	$ 294,933	$ 278,018
$ 163,548	$ 108,112	$ 107,325	$ 104,910	$ 117,022	$ 102,728	$ 95,656	$ 99,040
–	–	–	–	–	–	–	–
3,269	3,269	3,272	3,288	3,290	3,320	3,332	3,350
95,131	86,678	109,511	107,379	85,657	77,353	70,758	65,608
$ 261,948	$ 198,059	$ 220,108	$ 215,577	$ 205,969	$ 183,401	$ 169,746	$ 167,998
62.4%	54.6%	48.8%	48.7%	56.8%	56.0%	56.4%	59.0%
–	–	–	–	–	–	–	–
1.3%	1.6%	1.5%	1.5%	1.6%	1.8%	2.0%	2.0%
36.3%	43.8%	49.7%	49.8%	41.6%	42.2%	41.6%	39.0%
100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
17.0% [i]	(13.0%) [k]	10.4%	9.5%	11.6%	11.1%	10.6%	9.4%

(g) Includes income of $1,784 (net of tax) or $.11 per share attributable to a change in accounting method, and a gain of $1,708 (net of tax) or $.11 per share from the sale of the NOARK Investment.

(h) Includes income due to an adjustment to the reserve for the NOARK investment – $5,025 (net of tax) or $.34 per share.

(i) Excluding the adjustment to the reserve for the NOARK investment, return on average common equity was 11.8%.

(j) Includes the write-down of the NOARK investment – $21,000 (net of tax) or $1.44 per share.

(k) Excluding the write-down of the NOARK investment, return on average common equity was 7.6%.

(l) Includes a special one-time dividend of $0.05 per share.

SUMMARY OF GAS SALES AND STATISTICS

Years ended December 31,	***2000***	*1999*	*1998*
Operating revenues (000's)			
Gas sale revenues			
Residential	**$ 190,221**	$ 137,407	$ 118,220
Commercial	**62,354**	38,451	42,041
Industrial	**18,412**	6,763	6,439
	$ 270,987 [c]	$ 182,621 [c]	$ 166,700
Other operating revenues			
Gas transportation	**$ 30,783**	$ 22,369	$ 14,832
Construction services	**95,537**	49,965	16,621
Engineering services	**12,268**	14,841	40,937
Gas marketing	**–**	96,855	390,817
Other	**10,693**	9,564	7,578
	$ 149,281	$ 193,594	$ 470,785
	$ 420,268 [c]	$ 376,215 [c]	$ 637,485
Gas sold, transported and marketed (MMcf)			
Volumes sold			
Residential	**41,397**	28,583	21,946
Commercial	**14,591**	8,882	8,840
Industrial	**5,066**	1,780	1,461
	61,054 [c]	39,245 [c]	32,247
Volumes transported	**48,706**	32,417	23,791
Volumes marketed	**–**	43,387	166,197
Number of customers, annual average			
Residential	**318,479**	237,375	219,996
Commercial	**33,031**	20,301	20,378
Industrial	**1,658**	730	696
Transportation and ATS	**8,253**	9,183	3,105
	361,421	267,589	244,175
Averages per residential customer			
Volumes of gas sold (Mcf)	**130**	120	100
Revenues	**$ 597**	$ 579	$ 537
Revenue per Mcf	**$ 4.60**	$ 4.81	$ 5.37
Degree days			
Normal	**7,748**	7,131	6,930
Actual	**7,293**	6,650	5,566
Percent colder (warmer) than normal	**(5.9)%**	(6.7)%	(19.7)%
Cost of gas sold			
Purchased (000's) [a]	**$ 156,628**	$ 95,460	$ 115,472
(Injected) withdrawn from storage (000's)	**3,235** [c]	15,932 [c]	(6,084)
	$ 159,863 [c]	$ 111,392 [c]	$ 109,388
Average per Mcf	**$ 2.62**	$ 2.84	$ 3.39
Other information			
Gross plant (000's)	**$ 664,795**	$ 603,939	$ 400,051
Net plant – less depreciation reserve (000's)	**$ 510,026**	$ 474,346	$ 285,076
Payroll (000's) [b]	**$ 90,021**	$ 60,862	$ 44,549
Number of employees at year-end	**1,568**	1,632	860

[a] Does not include gas marketed and transported.

[b] Does not include fringe benefits.

[c] Does not include the sale of excess gas inventory to a third party.

1997	1996	1995	1994	1993	1992	1991	1990
$ 139,538	$ 138,644	$ 115,242	$ 121,066	$ 122,216	$ 110,173	$ 101,542	$ 97,668
66,577	65,509	54,763	59,413	61,379	53,770	49,100	47,811
12,065	15,218	14,019	15,481	16,049	14,953	15,139	16,633
$ 218,180	$ 219,371	$ 184,024	$ 195,960	$ 199,644	$ 178,896	$ 165,781	$ 162,112
$ 13,243	$ 12,358	$ 12,448	$ 11,999	$ 11,968	$ 11,918	$ 11,735	$ 10,945
7,484	–	–	–	–	–	–	–
5,660	2,961	–	–	–	–	–	–
526,962	308,703	133,396	158,284	70,991	54,595	48,497	49,525
4,403	4,517	5,670	6,187	6,360	6,117	5,509	5,757
$ 557,752	$ 328,539	$ 151,514	$ 176,470	$ 89,319	$ 72,630	$ 65,741	$ 66,227
$ 775,932	$ 547,910	$ 335,538	$ 372,430	$ 288,963	$ 251,526	$ 231,522	$ 228,339
25,968	26,703	24,676	23,437	23,302	22,352	20,773	20,062
13,483	13,670	12,738	12,469	12,608	11,890	11,116	10,959
2,534	3,385	3,373	3,464	3,500	3,513	3,707	4,193
41,985	43,758	40,787	39,370	39,410	37,755	35,596	35,214
21,373	20,532	23,849	21,293	19,073	22,147	22,357	20,913
199,689	129,429	82,504	78,082	31,501	29,637	28,636	27,620
213,850	206,512	200,368	194,663	189,567	184,394	180,099	175,706
21,941	21,453	21,088	20,575	20,103	19,584	19,075	18,468
820	837	847	844	852	861	854	873
183	151	145	130	115	109	103	95
236,794	228,953	222,448	216,212	210,637	204,948	200,131	195,142
121	129	123	120	123	121	115	114
$ 653	$ 671	$ 575	$ 622	$ 645	$ 597	$ 564	$ 556
$ 5.40	$ 5.20	$ 4.67	$ 5.17	$ 5.24	$ 4.93	$ 4.89	$ 4.87
6,882	6,795	6,799	6,698	6,715	6,732	6,874	6,925
6,838	7,099	7,158	6,861	7,053	6,882	6,397	6,513
(0.6)%	4.5%	5.3%	2.4%	5.0%	2.2%	(6.9)%	(5.9)%
$ 150,344	$ 158,808	$ 110,085	$ 135,850	$ 140,075	$ 131,743	$ 108,788	$ 121,709
623	(7,673)	10,534	(181)	(1,024)	(10,100)	2,217	(11,004)
$ 150,967	$ 151,135	$ 120,619	$ 135,669	$ 139,051	$ 121,643	$ 111,005	$ 110,705
$ 3.60	$ 3.45	$ 2.96	$ 3.45	$ 3.53	$ 3.22	$ 3.12	$ 3.14
$ 381,835	$ 357,165	$ 332,996	$ 310,916	$ 294,495	$ 278,884	$ 254,686	$ 232,333
$ 275,579	$ 256,011	$ 240,177	$ 226,755	$ 217,517	$ 209,100	$ 194,051	$ 176,354
$ 28,807	$ 22,736	$ 22,067	$ 21,758	$ 20,862	$ 21,010	$ 19,998	$ 19,115
760	574	524	541	533	557	576	594

Market Price and NYSE Listing | SEMCO ENERGY began trading on the NYSE on January 6, 2000, with the trading symbol "SEN." Prior to that date, the Company was traded on the NASDAQ with the trading symbol "SMGS." The quarterly cash dividends paid per share and the reported high and low quotation (as reported in the Wall Street Journal) of the Company's common stock for 2000 and 1999 were as follows:

1999	*High*	*Low*	*Quarterly Cash Dividends*
First Quarter	$ 17 1/2	$ 14 1/4	$ 0.20
Second Quarter[a]	16 7/8	13 1/4	0.255
Third Quarter	16	13	0.205
Fourth Quarter	15 3/8	11 5/16	0.204

2000	*High*	*Low*	*Quarterly Cash Dividends*
First Quarter	$ 14	$ 10 3/4	$ 0.205
Second Quarter	15	11 1/8	0.21
Third Quarter	16 15/16	12 1/4	0.21
Fourth Quarter	16 5/8	13 3/4	0.21

[a] Includes a special dividend of $0.05 per share.

2001 Annual Meeting | The Annual Meeting will be held Tuesday, April 17, 2001, at 2 p.m. Eastern Time at McMorran Place, 701 McMorran Blvd., Port Huron, MI 48060.

Financial Information | SEMCO ENERGY, Inc. (SEN) intends to keep investors well-informed on the Company's performance. Any of the following are available on request: Annual Report > Quarterly Reports > News Releases > Form 10-K > Form 10-Q > Fact Sheets. SEN has financial information on the Internet at address http://www.semcoenergy.com. For additional information, write or call:

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Independent Public Accountants
Arthur Andersen LLP
Suite 2700
500 Woodward Avenue
Detroit, MI 48226-3424

Stock Transfer, Registrar and Dividend Disbursing Agent | For SEN Common Stock, inquiries regarding transfer requirements, dividend checks, address changes, dividend reinvestment enrollment and lost stock certificates should be addressed to: Wells Fargo Bank Minnesota, N.A., P.O. Box 64863, St. Paul, MN 55164-0863, (877) 536-3549 toll free or (651) 450-4064

Direct Stock Purchase and Dividend Reinvestment Plan | The Direct Stock Purchase and Dividend Reinvestment Plan provides current and potential investors with a convenient way to purchase shares of Common Stock of the Company by making cash payments and/or reinvesting dividends without brokerage commissions. You do not need to be a current shareholder to participate.

Features:

- Initial investment of $250 up to $100,000
- Optional cash payments of as little as $25, and up to $100,000 annually
- Reinvest all or portion of dividends
- Direct electronic deposit of dividends not reinvested
- Automatic monthly electronic deductions for optional cash payments
- Deposit certificates into the plan for safekeeping
- Transfer all or a portion of plan shares to make a gift
- Sell shares through the plan

For a New Account Enrollment Form and a Plan Prospectus, please call Wells Fargo Bank toll free at (877) 536-3549.

COMPANY OFFICERS

SEMCO ENERGY, INC.

William L. Johnson
Chairman of the Board, President and Chief Executive Officer

Sebastian Coppola
Senior Vice President, Treasurer and Chief Financial Officer

Rudolfo D. Cifolelli
Senior Vice President and Chief Information Officer

Arnold R. Madigan
Senior Vice President and General Counsel

John E. Schneider
Senior Vice President of Corporate Development

Lila R. Bradley
Vice President of Human Resources & Public Affairs

Samuel B. Dallas
Vice President of Finance

Steven W. Warsinske
Vice President and Controller

Sherry L. Abbott
Corporate Secretary

SEMCO ENERGY GAS COMPANY*

Jon A. Kosht
President

Thomas S. East
Vice President of Technical Services

Stephen R. Makowski
Vice President of Operations

Ebrahim (Abby) M. Moradian
Vice President of Marketing

ENSTAR NATURAL GAS COMPANY*

Barrett Hatches
President

Barbara Akins
Vice President of Administration

Daniel M. Dieckgraeff
Vice President of Rates and Planning

Anthony M. Izzo
Vice President of Engineering & Operations

SEMCO ENERGY VENTURES, INC.
NATCOMM, INC.

Robert A. Stone
President

ARETECH INFORMATION SERVICES, INC.

Rudolfo D. Cifolelli
President

Rudolfo R. Cifolelli
Vice President of Sales and Marketing

Darcy L. McLane
Vice President of Information Technology

* division of SEMCO ENERGY, Inc.

SEMCO ENERGY BOARD OF DIRECTORS

John M. Albertine [1, 3]
Chairman and CEO
Albertine Enterprises, Inc.

Daniel A. Burkhardt [3, 4]
Principal
Edward Jones

Edward J. Curtis [2, 4]
President
E.J. Curtis Associates, Inc.

John T. Ferris [1, 2]
Senior Partner
Ferris & Schwedler, P.C.

Michael O. Frazer [3, 4]
Attorney

Marcus Jackson [1, 2]
Executive Vice President
Kansas City Power & Light Company and President of KCPL Power

William L. Johnson
Chairman, President and CEO
SEMCO ENERGY, Inc.

Harvey I. Klein [2, 4]
President
Global Strategies Group L.C.

Frederick S. Moore [1, 3]
Chairman and President
DSLT, Inc.

Edith A. Stotler [1, 3]
Partner
Stotler Grain Company

Donald W. Thomason [2]
Lead Director
SEMCO ENERGY, Inc.
Retired Executive Vice President
Kellogg Company

[1] Audit Committee
[2] Compensation Committee
[3] Finance Committee
[4] Nominating and Corporate Governance Committee

GLOSSARY

AMR: (Automated Meter Reading) A Meter Reading System that employs radio waves to collect consumption data **ATS:** (Aggregated Transportation Service) Program that allows commercial and industrial gas company customers to purchase their gas from third - party gas suppliers **Bcf:** A measure of natural gas volumes equivalent to one billion cubic feet **Degree Day:** A measure of coldness computed by the number of degrees the average daily temperature falls below 65 degrees fahrenheit **DRIP:** Direct Stock Purchase and Dividend Reinvestment Plan **FASB:** Financial Accounting Standards Board **FERC:** Federal Energy Regulatory Commission **Field Order System:** A computerized dispatching system for Field Service Calls **GCR:** (Gas Cost Recovery) A process by which the gas company, through annual gas cost proceedings before the MPCS, can recover the prudent and reasonable cost of gas sold **Mcf:** A measure of natural gas volumes equivalent to one thousand cubic feet **MMcf:** A measure of natural gas volumes equivalent to one million cubic feet **MPSC:** Michigan Public Service Commission **PGA:** (Purchased Gas Adjustment) A process by which the gas company, through annual gas cost proceedings before the RCA, can recover the prudent and reasonable cost of gas sold **RCA:** Regulatory Commission of Alaska **SFAS:** Statement of Financial Accounting Standards

SEMCO**ENERGY**

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