Expanded Horizons

1988 Annual Report
San Diego Gas & Electric

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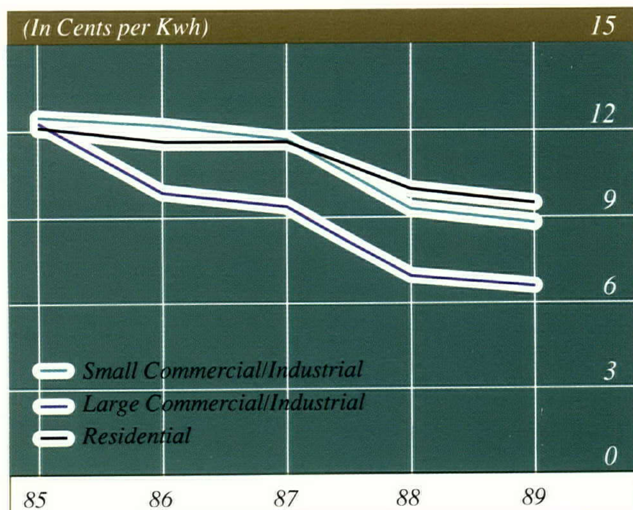
■ ***November 30.*** SDG&E entered into an agreement with SCEcorp and its Southern California Edison subsidiary providing for the merger of SDG&E into Edison.

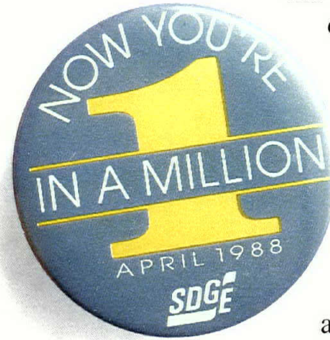
Under the terms of the agreement, each share of SDG&E common stock will be converted into 1.3 shares of the common stock of SCEcorp. In addition, each share of SDG&E's preferred and preference stock will be converted into one share of SCEcorp preferred and preference stock. The SCEcorp preferred and preference stock will have higher dividend rates than current rates on the stock, while liquidation values and redemption prices will remain essentially the same.

Regulatory approvals are now required by the California Public Utilities Commission and the Federal Energy Regulatory Commission, and approval by the shareholders of both SDG&E and SCEcorp is also required.

AVERAGE ELECTRIC PRICES



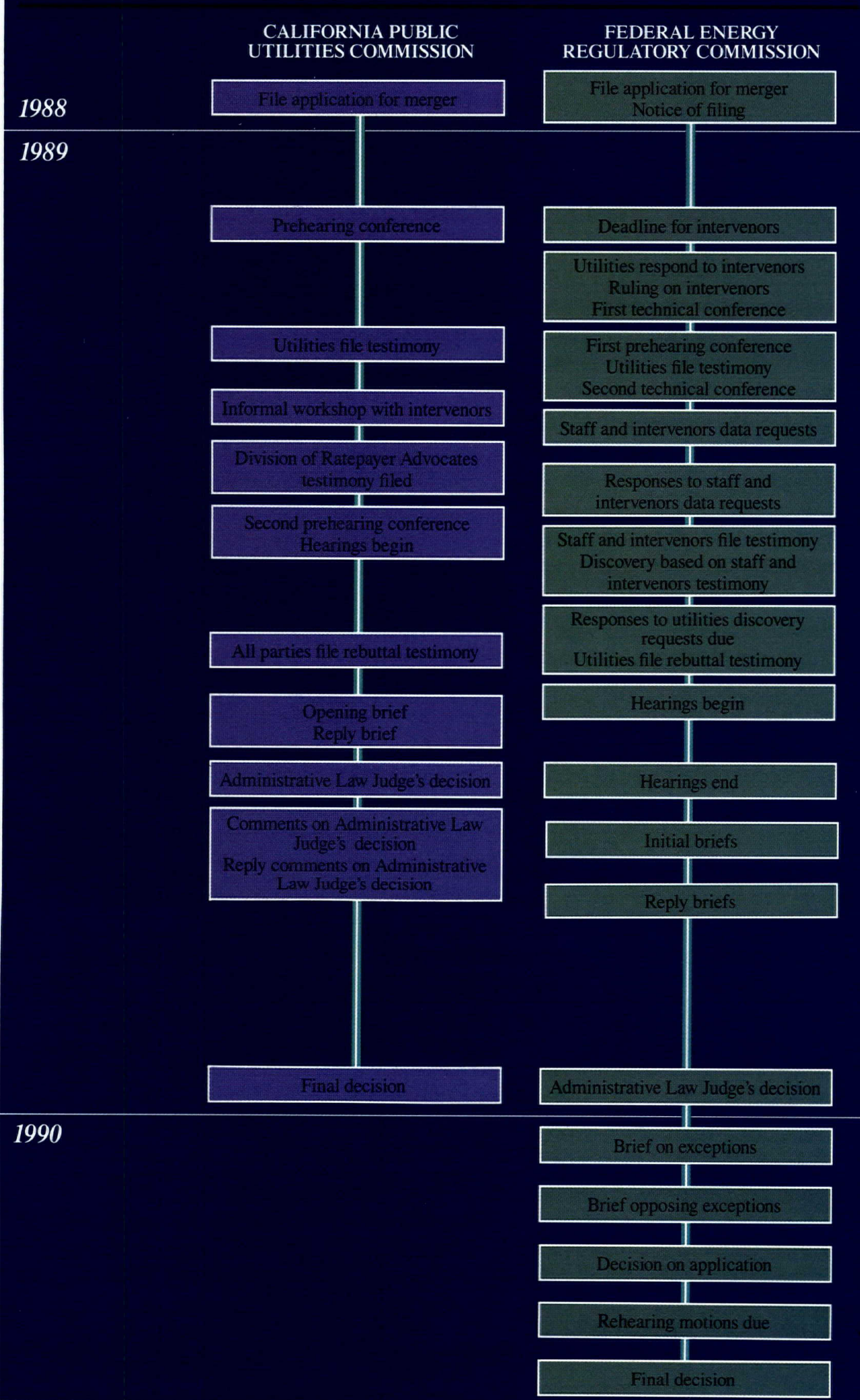
■ ***April 21.*** "Now You're One In A Million!" was the celebration theme as SDG&E added its one millionth electric customer to the system. The company now connects more than 100 new customers each day. In ceremonies held throughout the company's service area, one home in each of SDG&E's seven service districts was chosen as an honorary one millionth customer and commemorative plaques were affixed to their electric meters, marking the occasion.



■ ***September 29.*** Ending 2½ years of effort on SDG&E's part and many months of negotiations, the U.S. Navy, the company's largest customer, signed an agreement to continue to receive its electricity from SDG&E for at least 10 years, abandoning plans to cogenerate its own power. Under the agreement, the Navy will save $1.25 million in the first year, and all other customers will avoid the higher costs that would have been necessary had the Navy left the system. Lower fuel costs, rigorous internal cost-cutting efforts and a restructuring of rates all were essential elements in the successful efforts to match the annual savings the Navy estimates it would have realized by building a cogeneration system.

■ ***December 19.*** In an age when prices almost never go down, a utility company asking for a rate decrease was history in the making. At the request of SDG&E, the California Public Utilities Commission approved a reduction of $134 million in customer electric rates beginning January 1, 1989. This decision by the CPUC was remarkable for three reasons: 1) It marked the first time in 25 years a major California utility has asked for a general rate decrease; 2) The reduced rate structure gives San Diego Gas & Electric the lowest electric rates for all classes of customer since 1981; and 3) The rate cut allowed the company to meet an important goal and fulfill a pledge to customers—the average monthly residential gas and electric bill was brought below $60, from $61.77 to $58.86 a month.

MERGER TIMELINE



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Company Description

San Diego Gas & Electric is an energy management company. It operates a gas and electric utility that serves more than 2.5 million people in Southern California. Through its subsidiary, Pacific Diversified Capital, it owns four companies in other industries.

Dear Shareholder:
Sometimes things that seem to be going wrong turn out right. Confusing? Then you will have an appreciation for what your company has gone through this past year. We started with our proposal to merge with Tucson Electric Power and ended with an offer from SCEcorp to merge.

The experiences of 1988 make us realize that we don't always have complete control over our destiny. But, as it turns out, what happened to SDG&E in 1988 was no accident.

For a number of years we have held the conviction that the most successful utility companies in the 1990s will be large, regional firms that have access to long-distance transmission lines. They will be able to buy, produce and sell energy from a wide range of sources. They will be companies that can manage growth, and be low-cost producers through improved management of their assets.

This conviction was outlined to you last year in the publication *TOWARD 2000/Our Strategies*, when we described our plan for the future: "We plan to uncover new service and sales opportunities . . . and enter new energy markets."

As we entered 1988, it seemed to the company's board of directors and senior management that it was time to take action. A merger with Tucson Electric Power Company, we believed, would give powerful impetus to our efforts to meet the energy management challenges of the 1990s. The merger agreement with Tucson, announced in June, represented a logical extension of SDG&E's philosophy—to remain an aggressive leader in the evolution of the utility industry, for the benefit of our shareholders and customers alike.

Then, in late July, we received a letter from SCEcorp, parent company of Southern California Edison, offering to acquire the stock of SDG&E and merge our company into the Edison system. Under their initial offer, shareholders of SDG&E common stock would have received 1.15 shares of SCEcorp common stock for each of their SDG&E shares. The offer was contingent on our dropping the Tucson Electric merger effort.

In mid-August, SCEcorp increased its exchange ratio to 1.2 SCEcorp shares for each SDG&E share. The board rejected this offer. While we believed that the SCEcorp offer represented a potential short-term benefit to SDG&E's common shareholders, the long-term benefits expected from our continuing to pursue our own strategy, including the merger with Tucson, would outweigh any short-term gain. Two weeks later, SCEcorp again increased its offer from 1.2 shares to 1.225 shares, but we responded on September 1 by announcing the board's unanimous decision to proceed with the Tucson merger.

However, on November 3, we agreed to terminate the proposed merger with Tucson because of difficulties we had in agreeing on a joint approach to defeating SCEcorp's efforts to block the merger. We also anticipated SCEcorp's efforts would significantly complicate the regulatory processes.

Then, in late November, SCEcorp increased its offer to 1.3 shares for each SDG&E common share. The board needed to make an extremely difficult decision in an emotionally charged atmosphere. On November 30, the board voted 6-2, with one director absent, to approve the SCEcorp offer. We signed a merger agreement and the two directors voting against the merger resigned from the board.

Here is how we view the consequences of the proposed merger for each group of individuals most directly affected:

Shareholders. Holders of SDG&E common stock will receive 1.3 shares of SCEcorp common stock for each of their SDG&E shares. Holders of SDG&E preferred and preference stock will receive one share of SCEcorp preferred or preference stock for each share they hold. The SCEcorp preferred and preference stock will have higher dividend rates than current rates on the stock, while liquidation values and redemption prices will remain substantially the same.

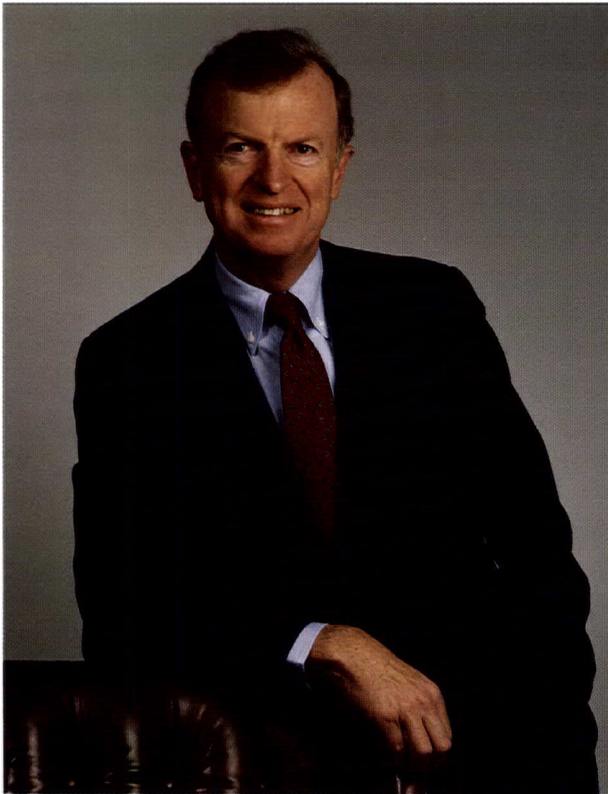
Customers. The combined SDG&E/Edison entity is estimated to be able to produce a savings of at least $100 million in operating costs and a probable $350 million decrease in capital costs. These savings will be defined more precisely in our regulatory presentations.

San Diego Community. The community has received a pledge from Edison to maintain SDG&E's charitable contributions and community support at current levels for at least five years after the merger, with specific increases spelled out for the first two years. In addition, purchasing relationships will be maintained with local businesses, assuming they maintain their availability, competitive pricing and quality. The name "San Diego Gas & Electric Company"

FINANCIAL HIGHLIGHTS

(In Thousands of Dollars Except Per Share Amounts)

	1988	1987	Percent Change
Operating revenues	**$2,076,087**	$1,904,228	+9.0
Operating expenses	**$1,803,860**	$1,642,449	+9.8
Net income (before preferred dividend requirements)	**$ 189,365**	$ 196,803	−3.8
Earnings applicable to common shares	**$ 177,649**	$ 183,058	−3.0
Average common shares outstanding (thousands)	**55,875**	55,849	—
Common stock shareholders (at December 31)	**69,873**	72,086	−3.1
Earnings per common share	**$ 3.18**	$ 3.28	−3.0
Dividends declared per common share	**$ 2.60**	$ 2.50	+4.0
Retail energy sales			
Electric (billions of kilowatt hours)	**12.7**	11.9	+6.7
Gas (millions of therms)	**583**	554	+5.2



will continue to be used for at least two years following the merger. SCEcorp also has agreed to operate an electric and gas division covering at least San Diego County that will be headquartered in San Diego. The San Diego Division will be the merged company's largest division.

We will have four directors on the SCEcorp and Edison boards. I will become the vice chairman of SCEcorp and president of the San Diego Division. We will have fair representation on committees of the boards for at least five years. We will be well represented in SCEcorp and Edison decisions concerning San Diego.

The merger agreement is a legal road map. Many other conditions and details remain to be concluded that could provide additional benefits to the San Diego community.

Employees. Employees will have career opportunities within a much larger organization. Edison is well-managed and has been noted as one of the top 100 companies to work for in the United States.

To achieve needed efficiencies, we have estimated a possible staff reduction of 1,000 people, which will come from both SDG&E and Edison. The current annual attrition of both companies already exceeds 1,000 people, so we should be able to accomplish this goal with little disruption.

In addition, SCEcorp has agreed that during the two-year period following the merger any reductions in the non-union utility work force of the merged companies will be made on a fair and equitable basis. Decisions will be made on the basis of the circumstances, the objectives to be achieved at the time, and previous work history, job experience and qualifications, without regard to whether the person has worked for SCEcorp, Edison or SDG&E.

The Joint Proxy Statement and Prospectus relating to SDG&E's April 1989 Annual Meeting describes the terms and conditions of the merger, the SCEcorp stock to be received by SDG&E shareholders, the board's reasons for approving the merger, our recommendations regarding the merger, and other important information. Shareholders are urged to read the Joint Proxy Statement and Prospectus carefully.

Almost lost in the news about the mergers is the fact that SDG&E had another good year from a financial and operating standpoint. Revenues rose 9 percent, from $1.9 billion in 1987 to almost $2.1 billion last year. Earnings were down 3 percent, from $3.28 to $3.18 per share. SDG&E's authorized rate of return for 1988 was lowered by the California Public Utilities Commission to 12.75 percent, down from 13.9 percent in 1987, making it increasingly difficult for the company to show earnings growth. However, we were able to increase the dividend for the twelfth consecutive year. Last year, the dividend was raised 4 percent, from $2.50 to $2.60 per share.

Looking ahead, we believe the merger will take more than a year to complete. From our standpoint, we will use 1989, as we did 1988, to position the company for a swift and efficient entry into a merged system. The company currently is well-positioned to succeed in this effort:

- We have managed record growth in the 1980s while reducing our employee-to-customer ratio and controlling costs. On this score we are a leader, and expect Edison to adopt many of the approaches we have used successfully.
- SDG&E has an exceptional work force, well-trained, experienced and motivated.
- Our customer acceptance is very high and we have a number of programs in place that will improve service further.
- The employees of SDG&E have deep roots in San Diego and we are dedicated to seeing that our customers and the community are treated fairly and equitably during the merger process and into the future.

The proposed merger between San Diego Gas & Electric and Southern California Edison creates opportunities. For investors, customers, our communities, and employees, the merger will allow us to expand our horizons on the Pacific Rim and to shape a new and better future.

Thomas A. Page
Chairman, President and
Chief Executive Officer

March 3, 1989

San Diego is the fastest-growing major city in California. Over the last five years, SDG&E has proven its ability to manage rapid growth, adding new electric customers at a 5.3 percent average annual rate. SDG&E's residential customer growth rate was a healthy 4.3 percent in 1988. The company's service territory in southern Orange County and northern San Diego County is growing extremely fast, at annual rates over 9 percent and 7 percent, respectively.

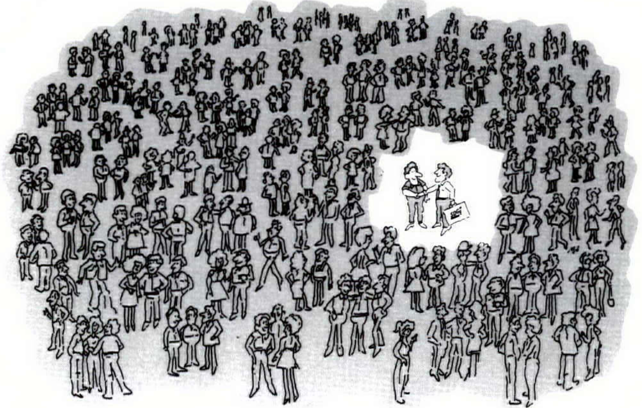
Residential customers benefited from a 7 percent electric rate decrease on January 1, 1989. As the result of the first general rate decrease request by a major California utility company in 25 years, the average customer saw a drop of $2.91 in his or her monthly electric bill. With this reduction, the company has fulfilled its pledge to bring the average monthly residential utility bill below $60.00, as the bill of a typical user of 400 kilowatt-hours of electricity and 40 therms of gas dropped to $58.86. Since 1984, SDG&E's cost-cutting strategies have lowered residential customers' average rates by 19 percent.

SDG&E's one millionth electric customer was the major milestone signifying company growth. Celebrations were held throughout SDG&E's service territory in April to commemorate the occasion and seven homes, one in each of the company's seven service areas, were designated recipients of "one millionth customer" plaques and lamps. Employees wore "Now you're one in a million" lapel buttons in honor of the event, and ads proclaiming "Now You're One in a Million. But We'll Treat You Like the Only One" were placed in local newspapers.

An independent national survey showed that SDG&E customers' bills are among the lowest in the nation. San Diego ranked in the bottom 11 percent of the cities surveyed, listed number 228 out of 256 metropolitan areas. Mild weather, small homes and aggressive energy management programs initiated by the company have made expenditures on utilities a smaller component of living costs for San Diegans than for people living almost anywhere else.

Two peak demand records were set last year. Customers required an all-time high of 2,777 megawatts of electricity from SDG&E on September 6, at the end of a long, hot Labor Day weekend that witnessed the second-highest temperature ever recorded in San Diego County. Gas customers set a record on the crisp winter morning of January 28, when they warmed up with 22.6 million cubic feet of natural gas within an hour. In both cases, the company experienced no problems in meeting these needs.

Now You're One in a Million. But We'll Treat You Like the Only One.



SDG&E is one of the fastest growing utilities in the country, last year adding 50,000 new customers. Last month, we connected our millionth electric customer. That's a big milestone and we're proud to have achieved it.

We know as some companies grow, they seem more concerned about getting bigger than with treating you right. To them, you're more important as a number than as a person.

At SDG&E we don't think that way.

As our customer you deserve our best and we work hard for you every day. To have the power on when you need it. To have services available that help you. And to be a company you can count on.

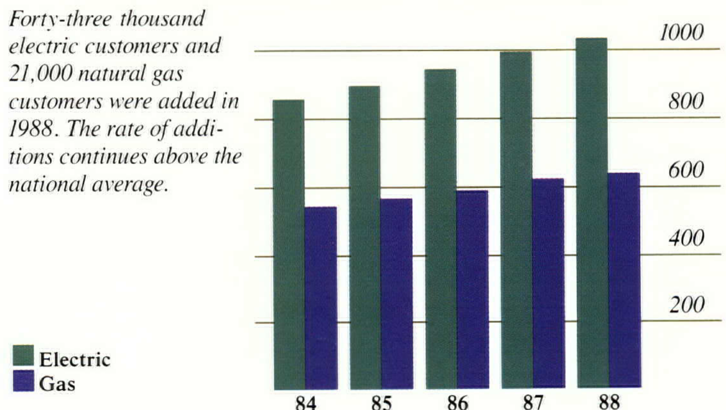
As we grow, we remain committed to two things. Continuing to lower rates and always treating you right.

*The SDG&E logo is a registered mark of San Diego Gas & Electric

Advertisements in local newspapers were part of the festivities marking the addition of SDG&E's one millionth electric customer in April.

ELECTRIC AND GAS CUSTOMERS

(In Thousands, at December 31)



Forty-three thousand electric customers and 21,000 natural gas customers were added in 1988. The rate of additions continues above the national average.

Commercial and Industrial Customers

■ A serious challenge to SDG&E has been a pricing environment in which large customers have left or threatened to leave the electric system to generate their own power. Historically, SDG&E has had rates that subsidized residential customers at the expense of commercial and industrial users.

By early 1987, SDG&E had lost nearly 8 percent of its commercial and industrial electric market share as large customers sought alternative, lower-cost energy sources, primarily through cogeneration. Fortunately, lower fuel prices occurred at the same time SDG&E was implementing strict cost controls, and at the end of 1987 the CPUC approved a rate structure based more closely on the costs of serving each class of customer. Last year was, without a doubt, a success in retaining commercial customers.

The rate reductions that took effect on January 1, 1989, were designed to support the company's continuing program to bring greater equity into the rate system and reduce the amount by which commercial customers subsidize residential customers. This rate restructuring was begun in 1987, as rates were reduced for all customers but reduced by a larger proportion for the commercial and the industrial sectors. While residential customers received a 7 percent reduction in electric rates with the new rate decreases, the rates of commercial and industrial customers were cut 10.5 percent.

A signed agreement with the U.S. Navy was a great achievement. The Navy agreed to abandon its plan to leave SDG&E's electric system and build cogeneration plants to serve its four main bases in San Diego. The 10-year agreement, with options that could extend up to 30 years, provides that the Navy will pay the same rates as other customers in its class for the energy it uses, but will receive a 5 percent savings on costs not related directly to fuel consumption. These are primarily overhead costs associated with the operation of power plants, substations and transmission lines. While the Navy's savings—about $1.25 million in the first year—will be borne by all other customers, the agreement avoids the much larger increases other users would have experienced had the Navy become independent of the company. As its largest customer, the Navy accounts for 7 percent of the power supplied by SDG&E.

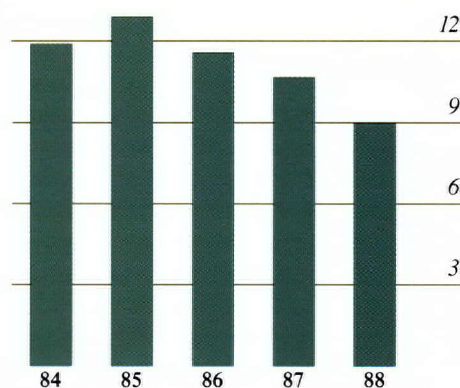
The company has worked closely with its large customers to reduce electricity costs through special rates and the installation of more energy-efficient equipment. As a result of these and many other actions, small- and medium-size commercial customers have seen their rates drop by 34 percent from 1985 to 1989. Large industrial customers have enjoyed an exceptional 45 percent rate decrease in the same period.

SDG&E will begin to offer cogeneration units to qualified customers in 1989, and will offer to purchase and service the units of some customers who left the system in the early 1980s to install their own cogeneration systems. Under an agreement signed with Tecogen, Inc., the leading manufacturer of packaged cogeneration systems, SDG&E

AVERAGE COMMERCIAL/INDUSTRIAL ELECTRIC RATE

(In Cents per Kilowatt Hour)

The California Public Utilities Commission's permission to give a higher share of rate decreases to these customers recognizes that they cost less to serve than residential customers.



will buy and install small, packaged cogeneration units each year for the next three years. The packages will be located at the facilities of large commercial and industrial customers and become a part of the SDG&E system, supplying small increments of energy for use by all customers. The customer on whose property the unit sits will receive the use of low-cost heat produced by the units for their space heating and manufacturing processes. SDG&E is believed to be the first utility in the United States to use this comprehensive and integrated approach to meeting the thermal energy needs of its biggest customers.

A new "Commercial Load Controller Program" began in 1986, offering very large customers lower rates in exchange for agreeing to reduce their energy use greatly during periods of intense peak demand on the SDG&E system. Thirteen companies signed up for this program in 1988 and initial inquiries were quite impressive. By reducing their electricity use during peak times, these customers are helping to reduce the need to build additional power generating facilities.

In 1989, the company began to purchase and operate cogeneration units for commercial customers.

Throughout its history, SDG&E has been one of the most consistent and generous contributors to the community of San Diego. Last year alone, more than $1.2 million was given by SDG&E to local organizations.

The diversity of these organizations reflects the needs of the city itself, from the United Way, the Boys and Girls Clubs, and the La Jolla Cancer Research Institute to the Old Globe Theatre, major universities and the San Diego Zoo. In all, 500 health and human care, cultural, civic and educational groups received direct monetary assistance from the company in 1988.

Southern California Edison has pledged in the merger agreement to maintain support of these activities in San Diego. Included in this pledge will be the creation of two full college scholarships for the children of San Diego-area customers. Edison's record as a good corporate citizen in the 800 communities it serves is equal to SDG&E's. Over the past six years, Edison's overall corporate support for community groups has increased an average of 14 percent each year.

SDG&E's employees participate in the community enrichment process through the Contrib Club, a voluntary organization that raised $700,000 last year from employees and donated thousands of hours to community activities. Many other thousands of hours, not related to company sponsorships, are donated by employees to the religious, sports, neighborhood and youth organizations to which they and their families belong. SDG&E encourages its employees to be involved in this work.

SDG&E contributed over $50,000 in money and services to the Logan Heights Family Health Center in 1988, helping to provide much-needed health care service to the predominantly Hispanic community.

Several new corporate community programs were begun during 1988. SDG&E cosponsored "Operation Opportunity," a one-day trade fair designed to help minority businesses better understand how to solicit and win contracts from large corporations. The event was held during National Minority Business Week.

Another new program, sponsored in cooperation with the San Diego Police Department, helped discourage fifth- and sixth-graders from taking drugs. Underwritten by SDG&E, the week-long program featured the internationally acclaimed motivational group "Up With People."

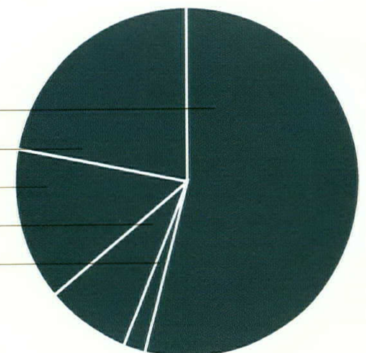
In the spring, SDG&E sponsored a free symphony concert in the predominantly minority neighborhood of Southeast San Diego. For the sixth year in a row, the company also sponsored the International History Fair, a cross-border exposition presented in San Diego and its neighboring city of Tijuana, Mexico. Both programs were part of the company's continuing effort to expand culture and the arts beyond their traditional audiences.

Public safety is one of SDG&E's main priorities. Throughout the year, the company offered demonstrations to the media on how to avoid power-related accidents and how to operate heating and electrical equipment properly. During the year, the company held briefings on gas furnace safety, the dangers of attempting to retrieve kites and metallic balloons from overhead wires, preparations for possible winter storm damage and power outages, holiday lighting safety and other subjects.

The company continues to make investments to replace overhead utility lines with underground ones. SDG&E paid approximately $13 million last year for such conversion projects. A typical $700,000 project undertaken in 1988, for example, buried lines along an ocean-front highway in south Orange County. Not only are underground lines less susceptible to damage by the elements, they help preserve the natural beauty of the Southern California coast.

1988 CONTRIBUTIONS

54%	*Health and Human Care*
22%	*Education*
14%	*Civic and Community*
8%	*Culture*
2%	*Other*



EMPLOYEES

The hard work, skills and creativity of SDG&E's 4,400 employees have built the company into one of the best-run utilities in America.

SDG&E has one of the highest customer-to-employee ratios in the industry, a tribute to the efficiency, productivity and training of its employees. This ratio was 350-to-1 in 1987 and climbed to 379-to-1 in 1988, an 8.3 percent increase that exceeded the company's most optimistic projections.

Since the initiation of the Performance Improvement Program 2½ years ago, the SDG&E work force has been reduced by 557 employees, or 11.2 percent, as the electric customer base has risen by 12.5 percent. The great majority of these reductions was accomplished through normal attrition, retirement and reassignment. Through job restructuring, the cooperation of union management, new technology, and exceptional motivation on the part of employees, the level of service to customers has remained extremely high.

Employees are rewarded for their productivity increases through the Performance Improvement Program. The initial phase of this program, The 10% Solution, was started in 1986. Employees whose ideas for cost savings and efficiency enhancements are accepted by the company receive 10% of the first year's anticipated savings in the form of a bonus. Suggestions that will save customers $4 million have been approved since the program began, and individual employee awards have ranged as high as $25,000.

A second dimension to the Performance Improvement Program is Gain Sharing, which was introduced in 1988. Nearly all employees received a $1,015 Gain Sharing award for meeting three goals in 1988:

- Reducing the operating and maintenance expenses.
- Exceeding the customer service satisfaction goal.
- Meeting the capital cost budget.

Combined, The 10% Solution and Gain Sharing are achieving phenomenal reductions in costs and increases in productivity that lead directly to lower costs for customers.

A vivid demonstration of employee dedication was the company's response to a severe wind storm in January 1988. One of the worst in 20 years, the storm caused more than $1 million in damage to SDG&E's distribution system. More than 400,000 customers suffered power losses. During the storm and the immediate follow-up period, there were more than 100 crews and 700 employees in the field making repairs and restoring power, many working 24-hour shifts. Over a three-day period, the company responded to 48,000 customer calls.

A new Skills Training Center for line workers opened in May. The center has centralized and improved the education and training process for these highly-skilled specialists. Included in the $1.5 million facility is a network of underground electric lines that can be programmed to simulate an assortment of difficult problems. Electric linemen and gas line workers now have a state-of-the-art facility in which they receive some of the most rigorous and comprehensive training in the nation.

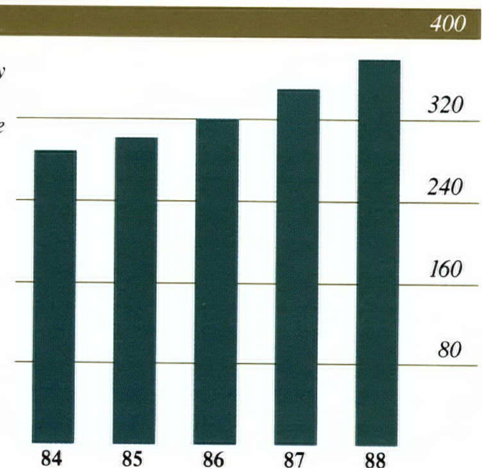
Employee safety is one of the company's most important responsibilities. In fact, the number of total accidents declined 20 percent in 1988 and continues to remain below the industry average. Safety is expected to remain one of the highest priorities once the merger is completed.

A modern Skills Training Center for gas and electric line workers was completed in 1988.

CUSTOMERS SERVED PER EMPLOYEE

(At December 31)

SDG&E has successfully reduced its work force despite an above-average growth in number of customers.



The modern $6 million South Bay Service Center, one of SDG&E's fully consolidated district office and operating centers, was completed in August.

One of SDG&E's many strengths is the ability to supply customers power from a diverse number of sources—oil, gas, nuclear power, and purchased power. This diversity protects customers from fluctuations in the cost or the performance of any one energy source, and allows the company to produce and purchase power from the most economical sources.

The San Onofre Nuclear Generating Station, jointly owned by Edison and SDG&E, remained one of the highest-performing nuclear power plants in the U.S. in 1988. The three units at San Onofre are using fuel that costs the equivalent of oil at $6 per barrel. They operated at very high rates of capacity again last year, and were able to meet 22 percent of SDG&E's total electrical requirement.

There are two measures of dependable performance at San Onofre of which the company is particularly proud:

- Overall availability was 74 percent, well ahead of the industry average of 64 percent. The "star" of the three-unit system for the second consecutive year was Unit 2, which operated at 95 percent of capacity and was third among all U.S. nuclear units in terms of electrical energy production. Unit 3's third fuel cycle was completed in July; its average capacity factor was 80.6 percent. This exceeds the 80 percent upper limit of performance standards set by the California Public Utilities Commission. As a consequence of this excellent result, SDG&E anticipates receiving an award from the CPUC of $130,000.
- The nuclear industry nationally averages 2.4 automatic reactor shutdowns per unit every year. During 1988, San Onofre did not experience any such shutdowns in any of its three units.

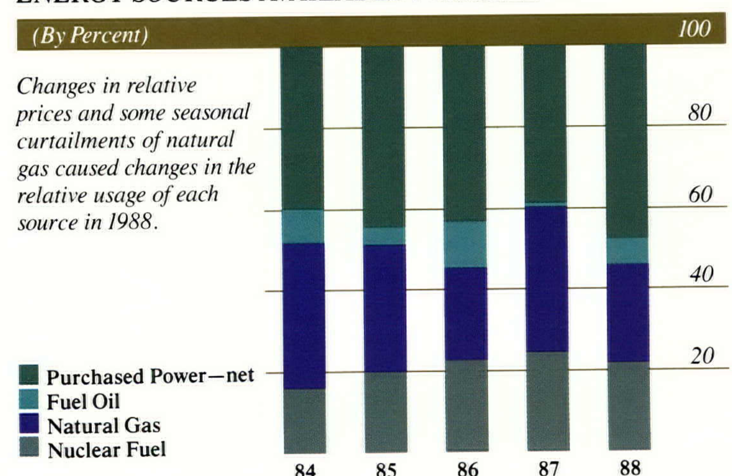
The Encina and South Bay power plants, which can burn either fuel oil or natural gas, operated at 90.3 percent availability in 1988 and together produced 26 percent of customer electrical needs. The forced outage rate at the two plants was only 1.3 percent, one-half of the previous year's rate.

The company achieved a record in selling electricity outside its system. Compared to 576,000 megawatt-hours sold in 1987, sales of electricity to other utilities climbed to 1.1 million megawatt-hours last year as record heat and drought in the West dramatically escalated demand. Outside sales provide added revenues and spread SDG&E's costs over a higher level of production.

The Southwest Powerlink is a 500,000-volt transmission line extending into Arizona. SDG&E purchased 50 percent of its energy requirements in 1988, of which three-fourths was delivered over the power line. A small amount was delivered over the Pacific Intertie from the Pacific Northwest.

The Heber geothermal plant was a research and development project funded by the U.S. Department of Energy, the Electric Power Research Institute, and other private and public organizations, including a 31 percent share held by SDG&E. While successfully providing energy to the company's system when it was operating, the plant's costs of production were too high compared to current alternatives. The plant was closed and put up for sale in 1987. The company continues to seek a buyer and will receive 31 percent of the proceeds from the sale, which customers will receive. The plant demonstrated that a specific technology could be used in the event of another oil embargo or other serious fuel supply problem.

ENERGY SOURCES AVAILABLE FOR SALE



Changes in relative prices and some seasonal curtailments of natural gas caused changes in the relative usage of each source in 1988.

Pacific Diversified Capital's strategy continues to be one of diversification into unregulated, utility-related businesses that ultimately can supplement earnings from SDG&E's regulated energy management business.

In only its second full year of existence, Pacific Diversified Capital again was profitable, showing improvement over last year. While PDC's profit improvement was modest, with gains at Wahlco and Mock Resources offset by losses in real estate, many actions were taken in 1988 to set the stage for increasing profitability in the future.

Wahlco, Inc., acquired in 1987, was PDC's earnings leader last year. The company manufactures flue gas conditioning systems that are sold to electric utilities for air pollution control, primarily for use on coal-fired generating plants. Several new orders during 1988 brought Wahlco's backlog to better than $16 million at the end of the year.

Mock Resources, Inc. markets and distributes fuel oil and natural gas in several western states. The company increased profits again in 1988. Mock increased its participation in the natural gas business during the year to help balance the down cycles in the fuel oil side of the business that occur when oil prices rise and customers shift from oil to gas. Although Mock was successful in securing both supplies and customers, the company relies on third-party pipelines to transport its gas and securing gas transmission was a frequent problem during the year. Mock continues to be run by managers who have exceptional experience in energy-supplies marketing.

Integrated Information Systems Company, a computerized-mapping firm started and built by PDC, has continued to grow as the market for its new software capabilities has expanded. IIS's revenues have grown quickly for a start-up, and the company approached the break-even point at the end of 1988. Mapping contracts with the City of San Diego and municipalities in other parts of the country and overseas contributed to a $1.5 million backlog at year-end that should make the company profitable in 1989. IIS also has signed software development contracts with IBM Corporation that will allow the company to advance its product line development rapidly.

Phase One Development, Inc., PDC's real estate development subsidiary, continued to suffer from the economic weakness of Colorado Springs, one of the company's two major investment markets. The area has been overbuilt in anticipation of potential government contracts that have yet to materialize. Leasing activity on PDC's projects picked up during 1988 in spite of the competition's often offering lease terms that are economically unacceptable to Phase One. The company has been working closely with lenders in Colorado Springs to restructure its portfolio to improve the probability of long-term success and preserve capital for investment in other areas.

Phase One's successes in 1988 were achieved in San Diego. The award-winning Chesapeake Park office complex was sold to a trust fund for $13.35 million, and the Belmont Park ocean-front mall and recreation area was completed and opened. Phase One currently is negotiating to sell the rights to manage the restored historic property. It is also in the process of selling other properties.

Phase One's results should improve in 1989 as the properties in Colorado Springs are repositioned and leasing and sales continue strong in the dynamic San Diego real estate market.

PDC's Wahlco, Inc. subsidiary is a world leader in air pollution control technology.

SIX-YEAR SUMMARY

(In Millions of Dollars Except Per Share Amounts) *For the Years Ended December 31*	1988	1987	1986	1985	1984	1983
Operating revenues	**$2,076.1**	$1,904.2	$1,634.2	$1,738.7	$1,620.7	$1,530.2
Operating income	**272.2**	261.8	282.4	287.9	251.6	174.2
Income before cumulative effect of change in accounting principle	**189.4**	179.1	167.3	202.7	183.5	187.4
Net income (before preferred dividend requirements)	**189.4**	196.8	167.3	202.7	183.5	187.4
Earnings per common share before cumulative effect of change in accounting principle	**3.18**	2.96	2.59	3.25	3.01	3.20
Earnings per common share	**3.18**	3.28	2.59	3.25	3.01	3.20
Dividends declared per common share	**2.60**	2.50	2.345	2.205	2.065	1.925
Cash provided by operations	**265.4**	412.4	410.4	417.3	376.9	358.4
Additions to utility plant (excluding allowance for funds used during construction)	**196.4**	189.4	251.2	246.4	218.8	282.8
At December 31						
Total assets	**3,532.7**	3,551.5	3,409.2	3,332.6	3,197.6	3,082.5
Long-term debt and preferred stock subject to mandatory redemption (excludes current portion)	**1,357.0**	1,388.4	1,333.2	1,354.1	1,391.0	1,338.9

The Six-Year Summary should be read in conjunction with the financial statements, notes to financial statements and statistical data contained elsewhere in this report.

QUARTERLY FINANCIAL DATA (UNAUDITED)

(In Thousands Except Per Share Amounts) *Quarter Ended*	March 31	June 30	September 30	December 31
1987				
Operating revenues	$443,010	$455,569	$475,457	$530,192
Operating expenses	388,418	391,657	403,339	459,035
Operating income	54,592*	63,912	72,118	71,157
Other income	6,160	5,413	3,534	4,954
Net interest charges	25,156	25,588	25,814	26,152
Income before cumulative effect of change in accounting principle	35,596	43,737	49,838	49,959
Cumulative effect of change in accounting principle	17,673	—	—	—
Net income (before preferred dividend requirements)	53,269	43,737	49,838	49,959
Preferred dividend requirements	3,936	3,707	3,048	3,054
Earnings applicable to common shares	$ 49,333	$ 40,030	$ 46,790	$ 46,905
Average common shares outstanding	55,848	55,848	55,848	55,854
Earnings per common share before cumulative effect of change in accounting principle	$ 0.56	$ 0.72	$ 0.84	$ 0.84
Earnings per common share	$ 0.88	$ 0.72	$ 0.84	$ 0.84
1988				
Operating revenues	$517,063	$494,409	$538,700	$525,915
Operating expenses	446,026	434,976	473,511	449,347
Operating income	71,037	59,433	65,189	76,568
Other income	6,772	6,941	8,811	(3,324)
Net interest charges	24,942	26,517	24,712	25,891
Net income (before preferred dividend requirements)	52,867	39,857	49,288	47,353
Preferred dividend requirements	3,051	2,985	2,840	2,840
Earnings applicable to common shares	$ 49,816	$ 36,872	$ 46,448	$ 44,513
Average common shares outstanding	55,873	55,873	55,873	55,882
Earnings per common share	$ 0.89	$ 0.66	$ 0.83	$ 0.80

*Includes the loss from the reversal of previously recorded revenues associated with the regulatory disallowance of San Onofre construction costs, as described in Note 7 of the notes to consolidated financial statements.

These amounts are unaudited, but in the opinion of the company reflect all adjustments necessary for a fair presentation.

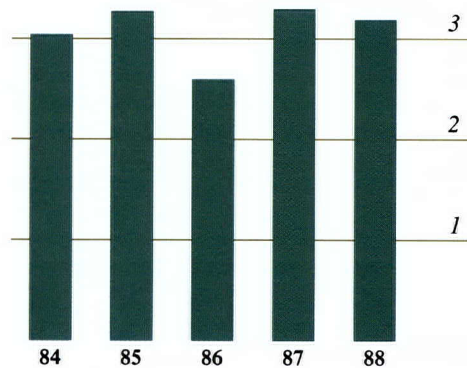
Results of Operations

Earnings Earnings of $3.18 per share in 1988 exceeded, by 22 cents, the 1987 earnings before the effect of the 1987 accounting change to record unbilled revenues. The increase is due primarily to the 1987 costs associated with the disallowance of certain San Onofre Nuclear Generating Station construction costs by the California Public Utilities Commission.

Prior to the restatement described below, 1986 earnings per share and net income were higher than 1987 amounts because in 1986 the company gained $14 million, or 25 cents per share, from the sale of its investment in Energy Factors, Inc.

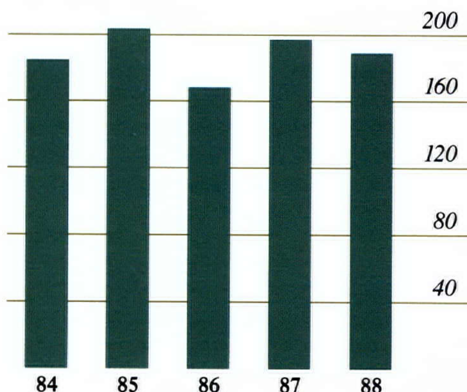
EARNINGS PER SHARE

(In Dollars) 4



NET INCOME

(In Millions of Dollars) 240



San Onofre Nuclear Generating Station In 1986, the California Public Utilities Commission voted to disallow $69 million of the company's $1.1 billion share of the San Onofre construction costs. The company, together with Southern California Edison, petitioned for a rehearing. In 1987, the commission reheard the case and reduced the disallowance to $53 million. The disallowance reduced 1986 net income by $5 million, or eight cents per share, and 1987 income by $22 million, or 39 cents per share. The disallowance also required the company to write-off the disallowed plant costs in 1988 by restating 1986 earnings. A follow-up decision in December 1988 resolved certain implementation issues and increased the construction cost writeoff. However, since the majority of the decision adopted matters that the parties had stipulated to previously or that the company had otherwise anticipated, the decision did not have a significant effect on 1988 earnings. The complex accounting effects of the disallowance are explained further in Note 7 of the notes to consolidated financial statements.

Unbilled Revenues Before January 1, 1987, the company recorded revenues from the sale of gas and electricity when it read customers' meters and billed customers for service. In 1987, the company began recording revenue based on the date the gas and electricity are delivered to customers. This change increased net income $18 million, or 32 cents per share, in the first quarter of 1987 but has had no significant effect on the seven subsequent quarters. It is discussed in Note 2 of the notes to consolidated financial statements.

Southwest Powerlink As discussed in Note 7 of the notes to consolidated financial statements, the CPUC has completed its evaluation of the cost of power transported over the Southwest Powerlink transmission line. Its decision is expected in the first quarter of 1989. An unfavorable commission decision will adversely affect earnings and cash provided by utility operations.

Revenues The CPUC controls the company's prices, and thereby its revenues, generally by two mechanisms: base prices and balancing accounts.

Base prices compensate the company for operating and maintenance costs, taxes and depreciation, and provide a return on capital. Base prices are set in a General Rate Case every three years. Between rate cases, the commission makes annual adjustments for inflation, system growth and rate of return. The latest three-year cycle started January 1, 1989.

The company has used balancing accounts for fuel costs, both electric and gas, and for San Onofre ownership costs, consisting primarily of depreciation and a return on capital. The commission sets balancing account rates based on estimated costs. Differences between actual and estimated costs are accumulated in the balancing accounts. Periodically, the company adjusts rates to amortize the balances. The company also uses balancing accounts to compensate for the differences between actual and estimated sales volumes. However, the account for gas sales to certain large customers was eliminated, effective May 1988. In the first two years, a transition arrangement limits the change's potential impact on the company's earnings.

On January 1, 1989, base prices replaced the balancing account for San Onofre construction costs. The remaining balance in the balancing account will be amortized over three years by a small adjustment to general rates.

Electric revenue for 1988 was up three percent, primarily due to increased volume, partially offset by lower costs. Gas revenue for 1988 was down three percent from 1987, primarily due to lower fuel costs, partially offset by increased volume.

Gas and electric operating revenues for 1987 were down five percent from 1986. About one-third of the decrease is due to lower fuel costs. The remainder largely is due to the San Onofre write-off discussed above and in Note 7 of the notes to consolidated financial statements.

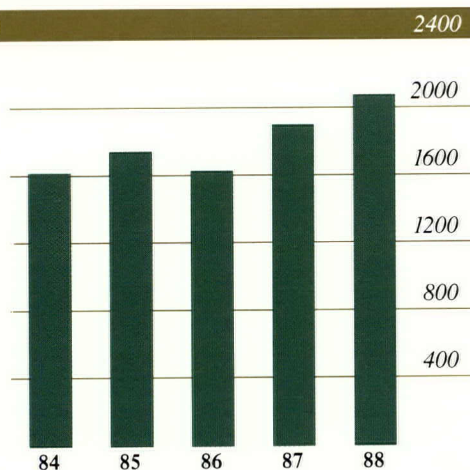
Revenues also decreased due to a lower authorized margin. The margin is lower because authorized return on equity decreased from 15 percent in 1986 to 13.9 percent in 1987 and to 12.75 percent in 1988. Also, margin is lower because less revenue is required to cover the lower tax expense since the Tax Reform Act of 1986 lowered tax rates from 46 percent in 1986 to 40 percent in 1987 and to 34 percent in 1988. Increases in the authorized equity to debt ratio partly offset the lower authorized return on equity. The net effect of these changes was a reduction of net income by about $5 million, or 10 cents per share in 1988 and 1987.

Gas and electric sales volumes in 1988 were up six percent and seven percent, respectively, over 1987, primarily due to customer growth. Electric sales volume increased six percent in 1987, reflecting customer growth. Gas sales volume increased 17 percent in 1987, primarily due to cold weather.

Revenues from diversified operations arise from subsidiaries of Pacific Diversified Capital Company, a company subsidiary. Most of these revenues and the gas and oil for resale to other customers arise from Mock Resources, Inc., one of these subsidiaries, which was acquired during the fourth quarter of 1986. Mock purchases the gas and oil and sells them at a small margin. Mock's revenues increased in 1988 due to increased sales volumes.

OPERATING REVENUES

(In Millions of Dollars)



Costs The total cost of electric fuel and purchased power increased in 1988 because of increased volume, due to customer growth, and higher costs for natural gas. The cost had decreased in 1987 because lower prices more than offset the increase in sales volume. The lower prices primarily resulted from the decline in world oil and gas prices and the company's aggressive program of spot-market gas purchases.

The cost of gas purchased for resale decreased in 1988 and 1987 because of lower prices, partially offset by the volume increases described above.

Taxes on operating income decreased in 1988 and 1987 because the Tax Reform Act of 1986 lowered corporate tax rates. Lower operating income in 1987 was an additional cause of the lower taxes in 1987 compared to 1986.

The company earns an allowance for funds used during construction on the construction funds held by a trustee as well as on construction in progress. The total allowance for construction funds, both debt and equity, changed only slightly in 1987 and 1988. The allowance is not a current source of cash but will result in increased future cash flows as its amortization is included in rates.

Other income in 1986 includes the $21 million pretax gain from the sale of the company's investment in Energy Factors, Inc.

Interest charges are net of interest income on construction funds temporarily invested by the trustee. In 1987, construction funds increased while debt reductions and the use of low-interest, tax-exempt financings increased. This resulted in a decrease in interest charges. 1988 interest charges were down slightly from 1987. The company's embedded cost of debt decreased from 9.6 percent in 1986 to 9.4 percent in 1987 and to 9.2 percent in 1988.

Liquidity and Capital Resources

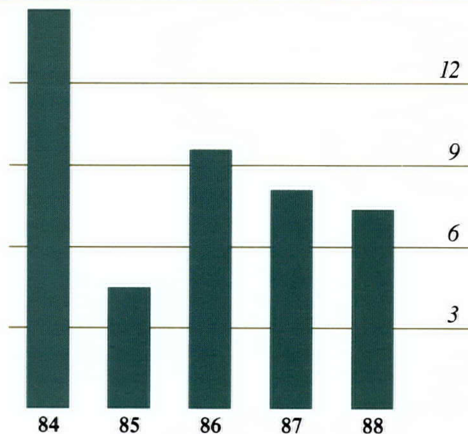
Utility operations are a major source of liquidity for the company. Since 1984, tax-exempt industrial development bonds and pollution control bonds have been the major external sources of liquidity. Funds from operations and tax-exempt bonds have been more than adequate to cover construction of utility plant, payment of dividends and maturing long-term debt.

A good measure of liquidity provided by operations is the percentage of earnings that arises from the allowance for funds used during construction. Since this type of earnings does not provide cash in the short-term, utilities prefer it to be a small percentage of earnings. The company's success in this area is shown in the following chart.

QUALITY OF EARNINGS

(By Percent) *15*

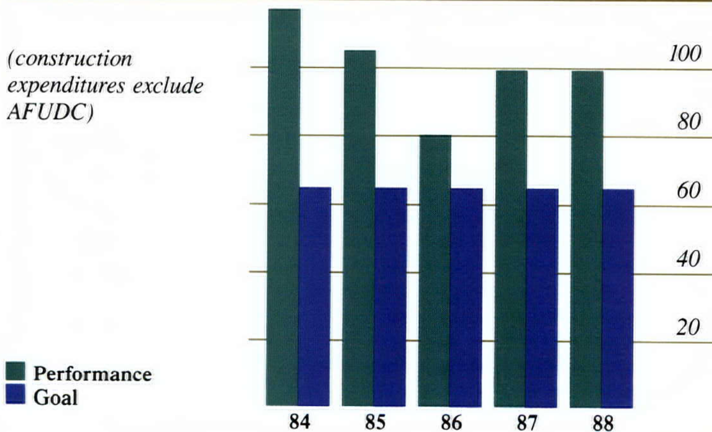
(percent of earnings attributable to AFUDC)



The percentage of funds for construction that the company can generate internally is another good measure of liquidity provided by operations. The company's goal is to exceed 65 percent. The following chart shows the company's success in achieving that goal.

MAINTAIN INTERNAL GENERATION OF CONSTRUCTION EXPENDITURES (AT 65 PERCENT OR MORE)

(By Percent) *120*



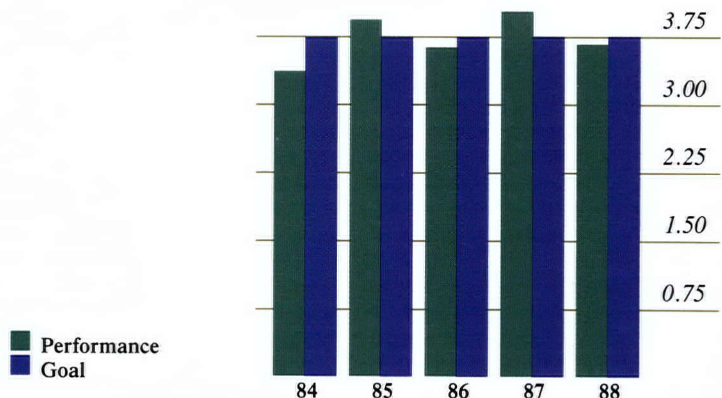
The company's capital structure is one factor that has enabled it to obtain long-term financing at attractive rates. The following table shows the percentages of capital represented by common equity, preferred stock and long-term debt.

	1984	1985	1986	1987	1988	Goal
Common equity	40%	43%	42%	44%	**46%**	45-48%
Preferred stock	9	8	7	6	**6**	5-7
Debt and leases	51	49	51	50	**48**	46-49
Total	100%	100%	100%	100%	**100%**	100%

Another measure of the company's ability to obtain financing is pretax interest coverage. The company's goal is to exceed 3.75. The chart shows the company's results. The goal would have been met in 1988 if the CPUC had not lowered the company's authorized rate of return.

MAINTAIN 3.75X PRETAX INTEREST COVERAGE

(Including Capital Lease Interest) *4.50*



Net additions to utility plant, excluding nuclear fuel and the allowance for funds used during construction, are expected to total $225 million in 1989. 1989 construction is expected to be funded from the use of the construction trust funds related to previous issuances of industrial development bonds, internal generation and short-term debt. And, in spite of the uncertainty associated with the Southwest Powerlink, management believes ample external sources of long-term and short-term financing will continue to be available. Nevertheless, regulatory disallowances associated with the Southwest Powerlink may reduce cash flow from operations.

The Future

Several trends and factors are expected to affect future operating results and liquidity.

- The company may merge with Southern California Edison Company, an adjacent electric utility.
- Fluctuations in interest and inflation rates are affecting the authorized rates of return.
- San Diego's population is growing at a rapid rate, resulting in increasing sales.
- The Tax Reform Act of 1986 has lowered tax rates, eliminated investment tax credits and reduced the benefit of depreciation deductions.
- Competition and partial deregulation are growing.

A short description of each of these follows.

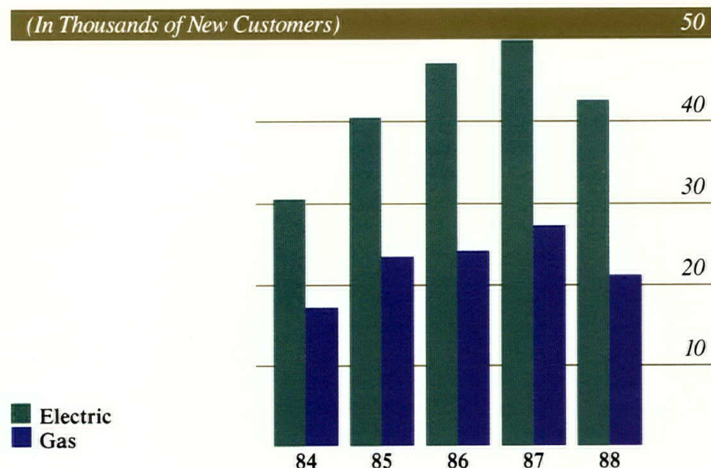
Possible Merger On November 30, 1988, the company signed a merger agreement with SCEcorp and its utility subsidiary, Southern California Edison Company, under which the company will be merged into Edison, if various conditions are met. These conditions include favorable votes of the common, preferred and preference shareholders of the companies and approval of regulatory authorities. This process is expected to take more than a year. (This is explained in more detail in "Item No. 2—Proposed Merger" in the March 1989 Proxy Statement.)

SDG&E understands that certain governmental units are giving consideration to opposing the proposed merger with Edison and/or condemning utility property and taking over SDG&E's operations. No condemnation proceedings have been initiated as of the date hereof. (This is explained in more detail in "Item No. 2—Proposed Merger—Regulatory Filings and Approvals" in the March 1989 Proxy Statement.)

Rate of Return Fluctuations in inflation and interest rates have led to changes in authorized rates of return on equity. The CPUC lowered the authorized rate of return on equity from 16 percent in 1985 to 15 percent in 1986, 13.9 percent in 1987 and 12.75 percent in 1988. Although the rate was increased to 13 percent for 1989, the equity portion of the capital structure was artificially set at 48 percent, which is below the actual percentage. This effectively results in an overall authorized return to common shareholders for 1989 that is approximately 0.3 percent below that authorized for 1988.

Other than being a factor in determining the authorized rate of return, inflation does not generally affect income. Increases in operating costs due to inflation are normally recovered through base prices. Changes in fuel and purchased power prices do not affect income because these costs are recovered in the balancing accounts.

CUSTOMER GROWTH



Population Growth The company's rate of new customer additions is slowing slightly, but continues to be well above the national average. For 1987 and 1988, the rate was four to five percent for electric and about four percent for gas. The company expects the future rate of growth to be about three percent over the next five years. Over the last five years, electric and gas customer growth has averaged approximately four percent. The spread of cogeneration, which had partially offset the effects of population growth, is slowing, due largely to reductions in the company's electric rates, especially those for the largest customers.

Tax Reform Act of 1986 The act did not significantly affect the company's net income because electric and gas prices are adjusted for the tax changes. However, it has reduced cash provided by operations because investment credits have been eliminated and the benefits of depreciation deductions have been reduced. Otherwise, the lower tax rates reduce tax expense and revenue by equal amounts, but do not affect cash flow. The effects of the act on cash flow will not be significantly greater in 1989 than they were in 1988.

Competition and Partial Deregulation The electric and natural gas utility industry is facing competition and partial deregulation. Deregulation could result in increased volatility in electricity prices. In the future, customers may be able to purchase power from other sources and transmit it over the company's transmission lines. This could result in higher rates to remaining customers and increased cost recovery risk to the company.

As of January 1, 1989, the company's electricity prices averaged 8.7 cents per kilowatt-hour. While still higher than many other utilities, the company's average electricity prices have decreased one-third since 1985 and are now lower than those of the other major, investor-owned California utilities. The company continues to pursue goals to lower prices and restructure the way customers pay for electric service to better reflect the company's costs. Because of this, the company expects its prices to be more competitive with the alternative sources of electricity available to its customers.

In the past, price increases were placed disproportionately on large electricity users in an effort to minimize price increases to residential customers. This resulted in commercial and industrial customers' paying a price higher than the actual cost to serve them. This differential has been reduced greatly as a larger portion of price decreases has been passed on to commercial and industrial customers. These price structure policies have not allowed residential prices to decrease as quickly or as much as those for commercial and industrial customers. These changes are expected to reduce the amount of bypass of the company's electric system.

Almost one-tenth of the company's electric sales are to the federal government, principally to the U.S. Navy. As part of a national program, the Navy studied its utility costs and considered leaving the company's electrical system. The changes described above have reduced the prices charged to the Navy. The company and the Navy recently signed a long-term contract, which is awaiting approval from the CPUC.

The company is continuing to take advantage of the deregulation of the natural gas industry. In 1985, the Federal Energy Regulatory Commission provided for open access to interstate gas transmission pipelines. For the last two years the company has bought a substantial portion of its natural gas from suppliers in Texas and Oklahoma at relatively low spot-market prices. Southern California Gas Company transports that gas for a fee. This arrangement has lowered the total cost of natural gas purchases greatly. Previously, all gas came from Southern California Gas. SDG&E retail customers that meet certain criteria may purchase gas and pay SDG&E a transmission fee. The CPUC also has restructured the price-setting mechanisms for natural gas sales to certain large customers.

Responsibility Report for the Financial Statements

The company is responsible for the financial statements and other data in this annual report. To meet its responsibility for the reliability of the financial statements, the company has developed a system of internal accounting controls and engages a firm of independent auditors. The board of directors of the company carries out its responsibility for the financial statements through its audit committee, composed of directors who are not officers or employees of the company.

Management maintains the system of internal accounting controls, which it believes is adequate to provide reasonable, but not absolute, assurance that its assets are safeguarded, transactions are executed in accordance with its objectives, and the financial records and reports are reliable for preparing the financial statements in accordance with generally accepted accounting principles.

The concept of reasonable assurance recognizes that the cost of a system of internal accounting controls should not exceed the benefits derived and that management makes estimates and judgments of these cost/benefit factors. The system of internal accounting controls is supported by an extensive program of internal audits, selection and training of qualified personnel, and written policies and procedures.

The company's independent auditors, Deloitte Haskins & Sells, are engaged to audit the company's financial statements in accordance with generally accepted auditing standards for the purpose of expressing their opinion as to whether the company's financial statements are presented fairly, in all material respects, in accordance with generally accepted accounting principles.

The audit committee discusses with the company's internal auditors and the independent auditors the overall scope and specific plans for their respective audits. The committee also discusses the company's consolidated financial statements and the adequacy of the company's internal controls. The committee met twice during the fiscal year with the internal auditors and the independent auditors without management present, to discuss the results of their examinations, their evaluations of the company's internal controls, and the overall quality of the company's financial reporting. The internal auditors and the independent auditors have full and free access to the committee throughout the year.

Company management has prepared the financial statements and other data in this annual report. In the opinion of the company, the financial statements, which include amounts based on estimates and judgments of management, have been prepared in conformity with generally accepted accounting principles.

Frank H. Ault
Controller

Independent Auditors' Report

To the Shareholders and Board of Directors of San Diego Gas & Electric Company:

We have audited the consolidated financial statements of San Diego Gas & Electric Company and its subsidiaries (pages 17 to 29) for the years ended December 31, 1988, 1987 and 1986. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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 the company and its subsidiaries as of December 31, 1988 and 1987, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1988, in conformity with generally accepted accounting principles.

As discussed in Note 7 of the notes to consolidated financial statements, the California Public Utilities Commission is considering matters relating to the cost of energy received over the company's Southwest Powerlink. The outcome of these matters is uncertain at this time and could result in the reversal of revenues previously recorded.

As discussed in Notes 2 and 7 of the notes to consolidated financial statements, the company changed its method of accounting for unbilled revenues in 1987 and its method of accounting for disallowed plant costs in 1988.

Deloitte Haskins & Sells

DELOITTE HASKINS & SELLS

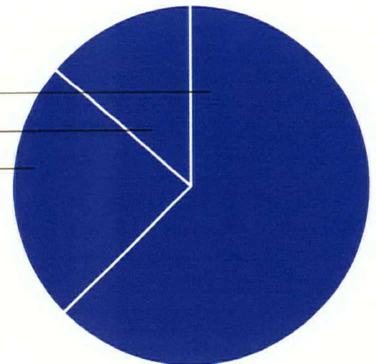
San Diego, California
January 23, 1989, except for
Note 1, as to which the date is
March 6, 1989

1988 REVENUE DOLLAR

Increased sales by Mock Resources, Inc. again accounted for the significant change in the source and disposition of the revenue dollar compared with the prior year.

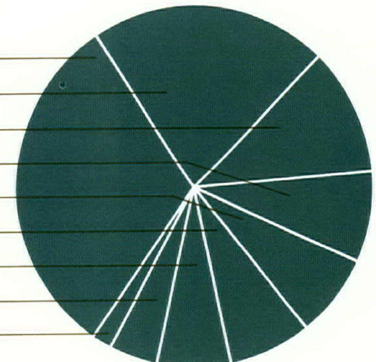
Source

62.6¢	*Utility Electric Sales*
13.8¢	*Utility Gas Sales*
23.6¢	*Diversified Operations*



Disposition

31.1¢	*Fuel and Purchased Energy*
21.5¢	*Gas and Oil for Resale to Other Customers*
11.1¢	*Other Operating Expenses*
7.6¢	*Total Taxes*
8.3¢	*Depreciation*
7.5¢	*Dividends to Shareholders*
7.0¢	*Salaries and Benefits*
4.3¢	*Cost of Money—net of AFUDC*
1.6¢	*Reinvested in Business*



Statements of Consolidated Income

(In Thousands Except Per Share Amounts)

For the Years Ended December 31		1988	1987	1986
Operating Revenues				
Electric		**$1,299,995**	$1,261,312	$1,333,479
Gas		**285,430**	293,859	299,202
Diversified operations	a	**490,662**	349,057	1,530
Total operating revenues		**2,076,087**	1,904,228	1,634,211
Operating Expenses				
Electric fuel and purchased power		**482,333**	437,842	456,402
Gas for resale to utility customers		**164,120**	170,303	175,286
Gas and oil for resale to other customers	a	**445,934**	336,632	—
Maintenance		**66,509**	66,041	73,502
Depreciation and amortization		**172,841**	151,655	140,732
Property and other taxes		**41,776**	40,479	37,714
Other		**311,950**	288,476	282,378
Income taxes (Note 6)	b	**118,397**	151,021	185,847
Total operating expenses		**1,803,860**	1,642,449	1,351,861
Operating Income		**272,227**	261,779	282,350
Other Income and (Deductions)				
San Onofre cost disallowance (Note 7)	c	**—**	—	(49,702)
Allowance for equity funds used during construction		**12,398**	14,816	13,035
Taxes on nonoperating income (Note 6)		**3,324**	7,161	(775)
Other—net	d	**3,478**	(1,916)	34,296
Total other income		**19,200**	20,061	(3,146)
Income Before Interest Charges and Cumulative Effect of Change in Accounting Principle		**291,427**	281,840	279,204
Interest Charges				
Long-term debt		**89,166**	90,529	95,364
Short-term debt and other		**13,704**	12,109	17,468
Allowance for borrowed funds used during construction		**(808)**	72	(881)
Net interest charges		**102,062**	102,710	111,951
Income Before Cumulative Effect of Change in Accounting Principle	e	**189,365**	179,130	167,253
Cumulative effect of change in accounting principle (Note 2)	f	**—**	17,673	—
Net Income (before preferred dividend requirements)		**189,365**	196,803	167,253
Preferred Dividend Requirements		**11,716**	13,745	22,425
Earnings Applicable to Common Shares		**$ 177,649**	$ 183,058	$ 144,828
Average Common Shares Outstanding		**55,875**	55,849	55,830
Earnings Per Common Share				
Before cumulative effect of change in accounting principle		**$ 3.18**	$ 2.96	$ 2.59
Cumulative effect of change in accounting principle		**—**	.32	—
Net earnings		**$ 3.18**	$ 3.28	$ 2.59
Dividends Declared Per Common Share		**$ 2.60**	$ 2.50	$ 2.345

See notes to consolidated financial statements.

Excerpts from the Financial Review

a. This relates primarily to Mock Resources, Inc., a nonutility subsidiary acquired at the end of 1986 by Pacific Diversified Capital.

b. Taxes on operating income decreased in 1988 and 1987 because the Tax Reform Act of 1986 lowered corporate tax rates.

c. The disallowance of certain San Onofre Nuclear Generating Station construction costs required the company to write off the disallowed plant costs in 1988 by restating 1986 earnings.

d. Other income in 1986 includes the $21 million pretax gain from the sale of the company's investment in Energy Factors, Inc.

e. The increase in 1988 is due primarily to the 1987 costs associated with the disallowance of certain San Onofre Nuclear Generating Station construction costs.

f. In connection with the Tax Reform Act of 1986, the company changed the timing of when it records revenue. This resulted in a one-time boost to earnings.

CONSOLIDATED BALANCE SHEETS

(In Thousands of Dollars)

Balance at December 31		1988	1987
Assets			
Utility plant—at original cost	a	**$4,159,240**	$3,996,169
Accumulated depreciation		**(1,220,993)**	(1,128,964)
Utility plant—net (Note 3)		**2,938,247**	2,867,205
Investments and other property		**102,791**	81,436
Construction funds held by trustee (Note 8)	b	**36,267**	130,946
Current assets			
Cash and temporary investments		**38,086**	84,178
Receivables		**186,996**	189,020
Inventories		**77,206**	48,862
Other		**17,658**	14,351
Total current assets		**319,946**	336,411
Goodwill		**38,851**	38,722
Deferred charges and other assets		**96,590**	96,818
Total		**$3,532,692**	$3,551,538
Capitalization and Liabilities			
Capitalization (see Statements of Consolidated Capital Stock and Long-Term Debt)			
Common equity		**$1,229,937**	$1,197,400
Preferred stock		**149,993**	156,307
Long-term debt (Note 3)	c	**1,179,483**	1,204,587
Total capitalization	d	**2,559,413**	2,558,294
Current Liabilities			
Long-term debt redeemable within one year (Note 3)		**115,000**	115,000
Current portion of long-term debt (Note 3)		**26,006**	39,695
Accounts payable		**176,077**	179,961
Dividends payable		**39,160**	37,971
Taxes accrued		**7,979**	18,849
Interest accrued		**25,600**	26,628
Regulatory balancing accounts overcollected—net	e	**71,284**	58,883
Other		**49,004**	56,704
Total current liabilities		**510,110**	533,691
Customer advances for construction		**73,708**	65,692
Accumulated deferred income taxes—net (Note 6)		**182,319**	183,176
Accumulated deferred investment tax credits (Note 6)		**151,497**	159,897
Deferred credits and other liabilities		**55,645**	50,788
Contingencies and commitments (Notes 7 and 8)		**—**	—
Total		**$3,532,692**	$3,551,538

See notes to consolidated financial statements.

Excerpts from the Financial Review

a. The disallowance of certain San Onofre Nuclear Generating Station construction costs required the company to write off the disallowed plant costs in 1988 by restating 1986.

b. 1989 construction is expected to be funded from the use of the construction trust funds related to previous issuances of industrial development bonds, internal generation of funds and issuances of short-term debt.

c. The company's embedded cost of debt decreased from 9.6 percent in 1986 to 9.4 percent in 1987 to 9.2 percent in 1988.

d. The California Public Utilities Commission set the company's equity portion of its 1989 capital structure below the actual percentage.

e. The company uses balancing accounts for fuel costs, San Onofre ownership costs, and the difference between actual and estimated sales volumes.

STATEMENTS OF CONSOLIDATED CASH FLOWS

(In Thousands of Dollars)

For the Years Ended December 31		1988	1987	1986
Cash Provided by Operations				
Cash received from customers	a	**$2,069,497**	$1,973,210	$1,616,105
Cash paid for fuel, gas and power	b	**(1,154,306)**	(886,209)	(636,348)
Cash paid to other suppliers and employees		**(367,837)**	(336,553)	(335,228)
Taxes paid		**(174,907)**	(232,185)	(119,822)
Interest paid	c	**(107,033)**	(105,896)	(114,317)
Cash provided by operations		**265,414**	412,367	410,390
Cash Invested				
Additions to utility plant	d	**(196,368)**	(189,378)	(251,157)
Payment for purchase of Wahlco Inc., net of cash acquired		**—**	(19,387)	—
Payment for purchase of other subsidiaries, net of cash acquired		**—**	—	(7,692)
Other—net		**(21,891)**	5,658	33,819
Net cash invested		**(218,259)**	(203,107)	(225,030)
Cash Provided (Used) by Financing Activities				
Dividends paid		**(155,761)**	(152,720)	(152,760)
Sale of preferred stock		**—**	44,481	—
Sale of common stock		**129**	124	125
Issuance of long-term debt	e	**9,071**	60,460	140,417
Retirement of long-term financing		**(45,963)**	(126,064)	(166,750)
Issuance of short-term debt		**4,635**	—	—
Payment of short-term debt		**(37)**	(27,978)	—
Net cash used by financing activities		**(187,926)**	(201,697)	(178,968)
Net increase (decrease) in cash, construction funds and temporary investments		**(140,771)**	7,563	6,392
Balance at beginning of year		**215,124**	207,561	201,169
Balance at end of year		**$ 74,353**	$ 215,124	$ 207,561
Reconciliation of Net Income to Cash Provided by Operations				
Net income		**$ 189,365**	$ 196,803	$ 167,253
San Onofre cost disallowance		**—**	—	45,943
Depreciation and amortization		**172,841**	151,655	140,732
Change in receivables, payables and balancing accounts		**824**	130,112	(42,728)
Other—net		**(97,616)**	(66,203)	99,190
Cash provided by operations		**$ 265,414**	$ 412,367	$ 410,390
Supplemental Schedule of Noncash Investing Activities				
Acquisition of subsidiaries				
Working capital other than cash acquired		$ —	$ (8,940)	$ 17,963
Long-term assets acquired		—	(46,309)	(51,365)
Long-term liabilities assumed		—	15,862	20,714
Notes payable issued		—	20,000	—
Net assets attributable to minority interests		—	—	4,996
Net cash outflow		$ —	$ (19,387)	$ (7,692)

See notes to consolidated financial statements.

Excerpts from the Financial Review

a. Revenues are increasing due to growth in the number of customers and increased sales volume by Mock Resources, Inc., a subsidiary that buys and sells gas and oil.

b. Costs are going up due to higher volume and some unit cost increases.

c. The reduction in the authorized rate of return by the California Public Utilities Commission prevented the company from attaining its interest coverage goal of 3.75 times.

d. The company again exceeded its goal of 65 percent internal generation of construction funds by providing 99 percent for the second straight year.

e. Since 1984, tax-exempt industrial development bonds and pollution control bonds have been the major external sources of liquidity.

STATEMENTS OF CONSOLIDATED CHANGES IN CAPITAL STOCK AND RETAINED EARNINGS

(In Thousands of Dollars)

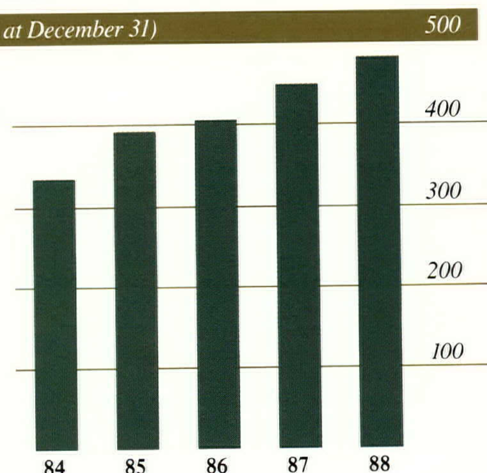
For the Years Ended December 31, 1986, 1987 and 1988	Preferred Stock: Not Subject to Mandatory Redemption	Preferred Stock: Subject to Mandatory Redemption	Common Stock	Premium on Capital Stock	Retained Earnings
Balance, December 31, 1985	$161,000	$57,500	$279,114	$481,238	$392,632
Net income					167,253
Common stock sold (25,060 shares)			125		
Preferred stock retired (1,300,350 shares)	(32,507)			(7,380)	
Current sinking fund requirement		(6,250)			
Dividends declared					
Preferred stock					(22,172)
Common stock					(130,934)
Balance, December 31, 1986	128,493	51,250	279,239	473,858	406,779
Net Income					196,803
Common stock sold (24,780 shares)			124		
Preferred stock sold (450,000 shares)		45,000		(527)	
Preferred stock retired (1,384,360 shares)	(41,000)	(22,436)		(5,713)	
Current sinking fund requirement		(5,000)			
Dividends declared					
Preferred stock					(13,528)
Common stock					(139,635)
Balance, December 31, 1987	87,493	68,814	279,363	467,618	450,419
Net Income					189,365
Common stock sold (25,740 shares)			129		
Preferred stock retired (25,640 shares)		(1,314)		(8)	
Current sinking fund requirement		(5,000)			
Dividends declared					
Preferred stock					(11,681)
Common stock					(145,268)
Balance, December 31, 1988	$ 87,493	$62,500	$279,492	$467,610	$482,835

See notes to consolidated financial statements.

RETAINED EARNINGS

(In Millions of Dollars, at December 31)

Balances at the end of 1986 and 1987 have been restated downward, due to the write-off of disallowed construction costs at the San Onofre Nuclear Generating Station.



Statements of Consolidated Capital Stock

(In Thousands of Dollars Except Voluntary Redemption Price)

Balance at December 31	Voluntary Redemption Price	1988	1987
Common Equity			
Common stock, without par value, authorized 170,000,000 shares, outstanding: 1988, 55,898,342 shares, 1987, 55,872,602 shares		**$ 279,492**	$ 279,363
Premium on capital stock		**467,610**	467,618
Retained earnings		**482,835**	450,419
Total common equity		**$1,229,937**	$1,197,400
Preferred Stock			
Not subject to mandatory redemption			
$20 par value, authorized 1,375,000 shares			
5% Series, 375,000 shares outstanding	$24.00	**$ 7,500**	$ 7,500
4½% Series, 300,000 shares outstanding	21.20	**6,000**	6,000
4.40% Series, 325,000 shares outstanding	21.00	**6,500**	6,500
4.60% Series, 374,650 shares outstanding	20.25	**7,493**	7,493
Without par value*			
$7.80 Series, 200,000 shares outstanding	101.00	**20,000**	20,000
$7.20 Series, 150,000 shares outstanding	101.00	**15,000**	15,000
$2.475 Series, 1,000,000 shares outstanding	28.35	**25,000**	25,000
Total not subject to mandatory redemption		**$87,493**	$87,493
Subject to mandatory redemption			
Without par value*			
$8.25 Series, 1988, 85,000 shares; 1987, 95,000 shares outstanding	104.4	**$ 8,500**	$ 9,500
$9.125 Series, 1988, 120,000 shares; 1987, 160,000 shares outstanding	104.565	**12,000**	16,000
$15.44 Series, 1987, 25,640 shares outstanding	—	**—**	2,564
$7.05 Series, 450,000 shares outstanding	107.05	**45,000**	45,000
Current sinking fund requirement		**(3,000)**	(4,250)
Total subject to mandatory redemption		**$62,500**	$68,814

*Authorized 10,000,000 shares total (both subject to and not subject to mandatory redemption).

See notes to consolidated financial statements.

STATEMENTS OF CONSOLIDATED LONG-TERM DEBT

(In Thousands of Dollars)

Balance at December 31	1988	1987
First mortgage bonds (Note 3)		
4⅝% Series H, due October 1, 1990	**$ 30,000**	$ 30,000
5½% Series I, due March 1, 1997	**25,000**	25,000
7% Series J, due December 1, 1998	**35,000**	35,000
8¾% Series K, due February 1, 2000	**40,000**	40,000
8% Series L, due September 1, 2001	**45,000**	45,000
8⅜% Series M, due January 15, 2004	**75,000**	75,000
8¾% Series Q, due March 15, 2007	**50,000**	50,000
9¾% Series R, due May 1, 2008	**50,000**	50,000
5½% Series U-2, due September 1, 1994	**10,468**	10,868
16.70% Series W, due November 3, 1988	**—**	20,000
12⅞% Series Z, due July 15, 2013	**—**	8,069
10% Series AA, due June 1, 2018	**150,000**	150,000
10% Series BB, due September 1, 2018	**150,000**	150,000
6.30% Series CC, due May 1, 2008	**53,000**	53,000
6.30% Series DD, due December 1, 2008	**27,000**	27,000
9¼% Series EE, due September 1, 2020	**100,000**	100,000
5⅞% Series FF, due December 1, 2007	**35,000**	35,000
7⅝% Series GG, due July 1, 2021	**44,250**	44,250
7⅜% Series HH, due December 1, 2021	**81,350**	81,350
8¾% Series II, due March 1, 2023	**25,000**	25,000
Total	**1,026,068**	1,054,537
Capitalized leases		
Nuclear fuel	**76,618**	92,811
Generating facility	**97,738**	101,534
Other	**25,182**	20,775
Total	**199,538**	215,120
Other long-term debt	**110,715**	106,172
Unamortized discount on long-term debt	**(15,832)**	(16,547)
Long-term debt redeemable within one year (Note 3)	**(115,000)**	(115,000)
Current portion of long-term debt (Note 3)	**(26,006)**	(39,695)
Total	**$1,179,483**	$1,204,587

See notes to consolidated financial statements.

SCHEDULES OF CONSOLIDATED FINANCIAL INFORMATION BY SEGMENTS OF BUSINESS

(In Thousands of Dollars)

At December 31 or for the Years Then Ended	1988	1987	1986
Operating Revenues*	**$2,076,087**	$1,904,228	$1,634,211
Operating Income			
Electric operations	**$ 242,656**	$ 241,777	$ 258,581
Gas operations	**25,794**	21,734	24,940
Diversified operations	**3,777**	(1,732)	(1,171)
Total	**$ 272,227**	$ 261,779	$ 282,350
Depreciation and Amortization			
Electric operations	**$ 147,029**	$ 129,470	$ 123,078
Gas operations	**21,164**	19,288	17,345
Diversified operations	**4,648**	2,897	309
Total	**$ 172,841**	$ 151,655	$ 140,732
Utility Plant Additions**			
Electric operations	**$ 161,206**	$ 153,632	$ 197,053
Gas operations	**35,162**	35,746	54,104
Total	**$ 196,368**	$ 189,378	$ 251,157
Identifiable Assets			
Utility plant—net			
Electric operations	**$2,662,318**	$2,610,706	$2,566,690
Gas operations	**275,929**	256,499	247,969
Total	**2,938,247**	2,867,205	2,814,659
Inventories			
Electric operations	**60,368**	46,735	60,988
Gas operations	**16,838**	2,127	5,058
Total	**77,206**	48,862	66,046
Other identifiable assets			
Electric operations	**189,060**	276,285	252,773
Gas operations	**52,863**	74,842	96,236
Diversified operations	**169,810**	143,719	59,666
Total	**411,733**	494,846	408,675
Other Assets	**105,506**	140,625	119,850
Total Assets	**$3,532,692**	$3,551,538	$3,409,230

*The detail to operating revenues is provided in the Statements of Consolidated Income on page 17. The gas operating revenues shown therein include $8 million in 1988, $18 million in 1987 and $27 million in 1986, representing the gross margin on sales to the electric segment. These margins arise from interdepartmental transfers of $129 million in 1988, $137 million in 1987 and $100 million in 1986, based on transfer pricing allowed by the California Public Utilities Commission in tariff rates.

**Excluding allowance for funds used during construction.

See notes to consolidated financial statements.

The company is an operating public utility engaged principally in the generation, purchase, distribution and sale of electrical energy and the purchase, distribution and sale of natural gas. Income taxes and corporate expenses are allocated to departments in accordance with regulatory accounting requirements.

1 *Merger Agreement with Southern California Edison Company*

On November 30, 1988, the company signed a merger agreement with SCEcorp and its utility subsidiary, Southern California Edison Company, under which the company will be merged into Edison, if various conditions are met. These conditions include favorable votes of the common, preferred and preference shareholders of the companies and approval of regulatory authorities. This process is expected to take more than a year. (This is explained in more detail in "Item No. 2—Proposed Merger" in the March 1989 Proxy Statement.)

SDG&E understands that certain governmental units are giving consideration to opposing the proposed merger with Edison and/or condemning utility property and taking over SDG&E's operations. No condemnation proceedings have been initiated as of the date hereof. (This is explained in more detail in "Item No. 2—Proposed Merger—Regulatory Filings and Approvals" in the March 1989 Proxy Statement.)

The March 1989 Proxy Statement contains, among other things, pro forma combined financial information of the two companies as of December 31, 1988, and for the year then ended.

2 *Summary of Accounting Policies*

Utility plant and depreciation Utility plant represents the buildings, equipment and other facilities used to provide electric and gas service. The cost of utility plant includes labor, material, contract services and other related items and an allowance for funds used during construction. The cost of depreciable retired utility plant, plus removal expenses minus salvage value, is charged to accumulated depreciation.

Depreciation expense reflects the straight-line remaining useful life method. The provisions for depreciation approximated 4.07 percent of average depreciable utility plant in 1988 and 4.12 percent in 1987 and 1986.

Inventories Inventories include $43 million of materials and supplies ($36 million in 1987) and $34 million of fuel oil and natural gas ($13 million in 1987). Materials and supplies are valued at average cost and fuel oil and natural gas are valued by the last-in first-out, or LIFO, method.

Allowance for funds used during construction The allowance represents the cost of funds used to finance the construction of utility plant and is added to the cost of utility plant. AFUDC also increases income, partly as an offset to financing costs shown in the Statements of Consolidated Income, although it is not a current source of cash.

Revenues and regulatory balancing accounts Revenues from utility customers consist of deliveries to customers and the changes in regulatory balancing accounts. Prior to 1987, these revenues were based on meters read on a cycle basis throughout each month. The cumulative effect of this change increased first quarter 1987 revenue by $32 million and net income by $18 million, or $0.32 per share.

Earnings fluctuations from changes in the costs of fuel oil, purchased energy and gas, and consumption levels for electricity and the majority of gas are eliminated by balancing accounts authorized by the California Public Utilities Commission. The balances of these accounts represent amounts that will be recovered from, or repaid to, customers by adjustments to future prices. The CPUC reviews the reasonableness of the amounts in these accounts.

The CPUC also ordered the use of a balancing account to record the ownership costs, such as depreciation and an investment return, for San Onofre nuclear units 2 and 3 pending resolution of the issue discussed in Note 7. That balancing account has now been eliminated and these units are being treated as part of base rates.

Goodwill Goodwill arose from the acquisition of certain businesses by Pacific Diversified Capital Company, an SDG&E subsidiary. It is being amortized on a straight-line basis over 20 to 40 years.

Other In 1988, the company adopted Statement No. 95 of the Financial Accounting Standards Board, replacing the Statements of Consolidated Sources of Funds for Construction with the Statements of Consolidated Cash Flows.

Certain prior year amounts have been reclassified for comparability.

See Note 5 regarding employee benefit plans, Note 6 regarding accounting for income taxes and Note 8 regarding accounting for leases.

3 *Long-Term Debt*

Due dates of long-term obligations are shown on the Statements of Consolidated Long-Term Debt on page 22. Excluding capital leases, which are described in Note 8, combined aggregate maturities and sinking fund requirements of long-term debt are $16 million for 1989, $58 million for 1990, $8 million for 1991, $8 million for 1992, and $1 million for 1993.

First mortgage bonds are secured by a lien on substantially all utility plant. Additional first mortgage bonds may be issued upon compliance with the provisions of the bond indenture.

Certain first mortgage bonds have variable interest rate provisions. Bondholders may elect to redeem their bonds at the interest adjustment dates. The 1989 interest rate adjustment dates will be August 1 for Series FF and September 1 for Series CC and DD.

4 *Facilities Under Joint Ownership*

The Southwest Powerlink transmission line and the San Onofre nuclear power plant are jointly owned with other utilities. The company's interests at December 31, 1988, were:

(In Millions of Dollars)

Project	Southwest Powerlink	San Onofre
Ownership interest (%)	89	20
Utility plant in service	$209	$1,141
Accumulated depreciation	$ 30	$ 206
Construction work in progress	$ 0	$ 12

Each participant in the projects must provide its own financing.

The company's share of operating expenses is included in its Statements of Consolidated Income.

The company's share of future dismantling and decontamination costs for the San Onofre units is estimated to be $170 million. These costs are considered in setting rates and are expected to be fully recovered in rates over the estimated lives of the plants. In December 1987, the company began placing in an externally managed trust fund the amounts collected in rates.

5 *Employee Benefit Plans*

The company-funded pension plan covers substantially all employees. Benefits are related to the employees' compensation. Plan assets consist primarily of common stocks, annuity contracts, U.S. government securities and bonds.

In 1987, the company adopted Statement of Financial Accounting Standards No. 87. This had no effect on pension expense. The company continues to fund the plan based on the aggregate cost actuarial method, subject to full-funding limitations. The cost for 1988 was less than it otherwise would have been due to new limitations imposed by changes in federal tax laws.

Net pension cost consists of the following:

(In Thousands of Dollars)	1988	1987
Cost related to current service	**$ 13,695**	$ 14,413
Interest on projected benefit obligation	**21,231**	20,878
Return on plan assets	**(48,936)**	(9,854)
Other	**19,405**	(14,650)
Total cost	**$ 5,395**	$ 10,787

The plan's status at December 31 is as follows:

(In Thousands of Dollars)	1988	1987
Accumulated benefit obligation:		
Vested	**$202,823**	$178,296
Nonvested	**4,446**	16,682
Total	**$207,269**	$194,978
Plan assets at fair value	**$344,159**	$297,438
Projected benefit obligation	**295,246**	285,818
Excess of plan assets over projected benefit obligation	**48,913**	11,620
Unrecognized effect of accounting change	**(2,980)**	(3,209)
Unrecognized actuarial gains and losses	**(45,933)**	(8,411)
Amount recognized as an asset	**$ —**	$ —

The projected benefit obligation assumes an eight percent actuarial discount rate and a six percent average annual salary increase. The expected long-term rate of return on plan assets is 8.5 percent.

Eligible employees may make a contribution of 1 to 11 percent of their base pay to the company's Savings Plan for investment in mutual funds or in common stock of the company. The company contributes up to three percent of a participant's base compensation for investment in the company's common stock.

The company contributed approximately $8 million in 1988, $14 million in 1987, and $16 million in 1986 to these plans.

The company partially provides health and life insurance benefits to retired employees. The benefits paid and expensed amounted to $2 million in 1988, $3 million in 1987 and $2 million in 1986.

The company has a long-term incentive stock compensation plan that provides for aggregate awards of up to 1,350,000 shares of common stock over a 10-year period ending in 1996. The company issued approximately 25,000 shares of stock to officers for $5 per share in each of 1986, 1987 and 1988. These shares were issued subject to buy-back if certain corporate goals are not met.

6 *Income Taxes*

Deferred income taxes arise from including income or deductions in the company's income tax returns in a year different from the year they are reported in the financial statements. However, deferred taxes are not provided for those timing differences that are reflected in customer rates. At December 31, 1988, the cumulative net amounts of timing differences for which deferred taxes have not been provided were approximately $390 million for federal purposes and $640 million for state purposes. In addition, current tax reductions arising from investment tax credits are deferred and recognized over the useful lives of the related property.

In December 1987, the Financial Accounting Standards Board issued a new rule that made a major change in the way tax expense will be computed in future years. Deferred taxes shown in the income statement are essentially taxes on current year income that will be paid in future years. Under prior rules, deferred taxes are computed using current tax rates even if these taxes are expected to be higher or lower when they are paid in future years. The new rule will change that. Also, when tax rates change, as they did under the Tax Reform Act of 1986, the new rule requires an adjustment of deferred taxes. Prior rules do not permit it.

This new rule is not expected to affect the company's profits or net worth significantly because most tax increases or reductions are borne by customers. However, deferred taxes on the balance sheet will increase by a substantial, but not yet quantified, amount and a new regulatory asset will be reported for the estimated amount collectible from customers. Implementation of the new rule is required by the first quarter of 1990.

Components of Income Tax Expense

(In Thousands of Dollars)	1988	1987	1986
Current federal income tax	**$102,797**	$145,679	$ 87,231
Current state franchise tax	**26,498**	39,300	28,060
Total current taxes	**129,295**	184,979	115,291
Deferred—federal and state taxes			
Construction projects	**(31,205)**	(22,106)	2,703
Tax over book depreciation	**26,703**	38,985	41,564
State franchise tax	**8,901**	(876)	828
Regulatory balancing accounts	**(7,136)**	(43,767)	15,935
Unbilled revenue	**(6,284)**	7,050	—
Nuclear fuel financing	**541**	(2,009)	(2,693)
Call premium on refunded debt	**(519)**	(821)	5,862
Other—net	**3,177**	(4,825)	2,117
Total deferred taxes	**(5,822)**	(28,369)	66,316
Deferred investment tax credits—net	**(8,400)**	2,161	5,015
Total income tax expense	**$115,073**	$158,771	$186,622

Total Tax Expense as Reported in the Statements of Consolidated Income

(In Thousands of Dollars)	1988	1987	1986
Operating expenses	**$118,397**	$151,021	$185,847
Taxes on nonoperating income	**(3,324)**	(7,161)	775
Cumulative effect of change in accounting principle	—	14,911	—
Total	**$115,073**	$158,771	$186,622

Reconciliation of Statutory Federal Income Tax Rate to Effective Rate

(In Thousands of Dollars)	1988	1987	1986
Income before federal income taxes	**$279,734**	$326,595	$320,101
Statutory federal income tax rate	**34.0%**	40.0%	46.0%
Depreciation	**4.4**	4.4	3.1
Construction costs capitalized	**(1.0)**	(1.0)	(2.0)
Allowance for funds used during construction	**(1.6)**	(1.7)	(1.5)
Other—net	**(3.3)**	(2.6)	2.2
Effective federal income tax rate	**32.5%**	39.1%	47.8%

7 *Contingencies Concerning San Onofre and the Southwest Powerlink*

San Onofre Nuclear Generating Station Units 2 and 3
In 1987, the California Public Utilities Commission completed its evaluation of the construction costs for San Onofre units 2 and 3. They disallowed $53 million of the company's share of the costs. The disallowance results in lower revenues and net income over the 30-year life of the plant. It reduced net income by $5 million in 1986 and $22 million in 1987. The annual reduction of net income will decline from $7 million in 1988 to zero over the remaining 26-year life of the units. The 1987 reduction was so much larger than future annual amounts will be because it included reductions related to 1983 through 1986 revenues.

As required by Statement No. 90 of the Financial Accounting Standards Board, SDG&E has made an adjustment to its 1986 income to write down its investment in San Onofre Nuclear Generating Station units 2 and 3 because of the disallowance. The after-tax effect of this adjustment was to reduce 1986 earnings and retained earnings at December 31, 1986 by $46 million, or $0.82 per share.

On December 9, 1988, the Commission issued its decision on implementation of the 1987 decision and on the cost of capital additions subsequent to the day the units went into operation. The majority of this decision adopted matters that the parties had stipulated to previously or that SDG&E had otherwise anticipated. Accordingly, the decision did not have a significant effect on 1988 earnings.

Southwest Powerlink The company's 1986 General Rate Case decision by the California Public Utilities Commission ordered SDG&E to establish a five-year balancing account for the difference between the cost of energy received over the company's Southwest Powerlink transmission line and avoided cost.

In June 1986, the commission granted the company's request for a rehearing of this portion of the decision. During the hearings, the CPUC's Division of Ratepayer Advocates proposed disallowances aggregating $285 million in connection with power purchases over the transmission line. The Division of Ratepayer Advocates also recommended a balancing account, which would not earn interest, for allowed costs in excess of avoided costs.

In October 1988 an administrative law judge issued a draft decision that recommended a disallowance of $29 million and no balancing account. A CPUC decision is expected in the first quarter of 1989.

Management cannot predict the outcome of this matter.

8 *Other Contingencies and Commitments*

Nuclear insurance Public liability claims that could arise from a nuclear incident are limited by the Price-Anderson Amendments Act of 1988 to a maximum amount of $7.6 billion for each licensed nuclear facility. The company and the co-owners of the San Onofre units have purchased primary insurance of $160 million for this exposure, the maximum amount available in 1988. The remaining $7.4 billion is provided by secondary financial protection required by the Nuclear Regulatory Commission. This secondary coverage provides for loss sharing among utilities owning nuclear reactors if a costly accident occurs. The company could be assessed retrospective premium adjustments of up to $40 million in the event of a nuclear incident involving any of the licensed, commercial reactors in the United States, if the amount of the loss exceeds $160 million.

In addition to public liability insurance, coverage is provided for property damage and replacement power costs at San Onofre. Primary property damage coverage is provided for losses of up to $500 million. Additional decontamination liability and excess property damage insurance coverage of $1.1 billion at December 31, 1988, is provided. Replacement power insurance provides weekly indemnity payments for up to two years, commencing after a waiting period of 21 weeks. These three insurance coverages are provided primarily through mutual insurance companies owned by utilities with nuclear facilities. If losses at any of the nuclear facilities covered by the risk-sharing arrangements were to exceed the accumulated funds available for these insurance programs, the company could be assessed retrospective premium adjustments of up to $13 million per year.

Construction Approximately $225 million, excluding nuclear fuel and AFUDC, is planned to be spent for utility plant construction in 1989. Construction funds held by a trustee (see the Consolidated Balance Sheets) represent unspent proceeds from certain first mortgage bonds.

Leases Nuclear fuel, an office building and a generating facility are financed by long-term capital leases. Utility plant includes $289 million at December 31, 1988, and $319 million at December 31, 1987, related to these leases.

The minimum rental commitments payable in future years under all noncancellable leases are:

(In Millions of Dollars)	Operating Leases	Capitalized Leases
1989	$14	$ 40
1990	11	39
1991	10	39
1992	9	16
1993	7	12
Thereafter	12	132
Total future rental commitments	$63	278
Imputed interest (6 to 8 percent)		(78)
Net commitment		$200

Rental payments totaled $59 million in 1988, $54 million in 1987, and $45 million in 1986.

Purchased power contracts The company buys electric power under several long-term contracts. The contracts expire on various dates between 1989 and 2013. At December 31, 1988, the future minimum payments under the contracts were:

(In Millions of Dollars)	
1989	$ 150
1990	113
1991	116
1992	121
1993	125
Thereafter	1,232
Total minimum payments	$1,857

These payments are fixed charges. The company is required to pay additional amounts for actual deliveries of energy under the contracts.

Total payments, including energy payments, under the contracts were $253 million in 1988, $229 million in 1987, and $231 million in 1986.

Termination agreement Under the Termination and Settlement Agreement that terminated the pending merger with Tucson Electric Power Company, the company would be obligated, among other things, to pay Tucson $25 million if the SCEcorp merger is consummated.

San Diego Gas & Electric

San Diego Gas & Electric is an investor-owned energy management company founded in 1881. Three-fourths of the company's revenues are generated from its utility businesses.

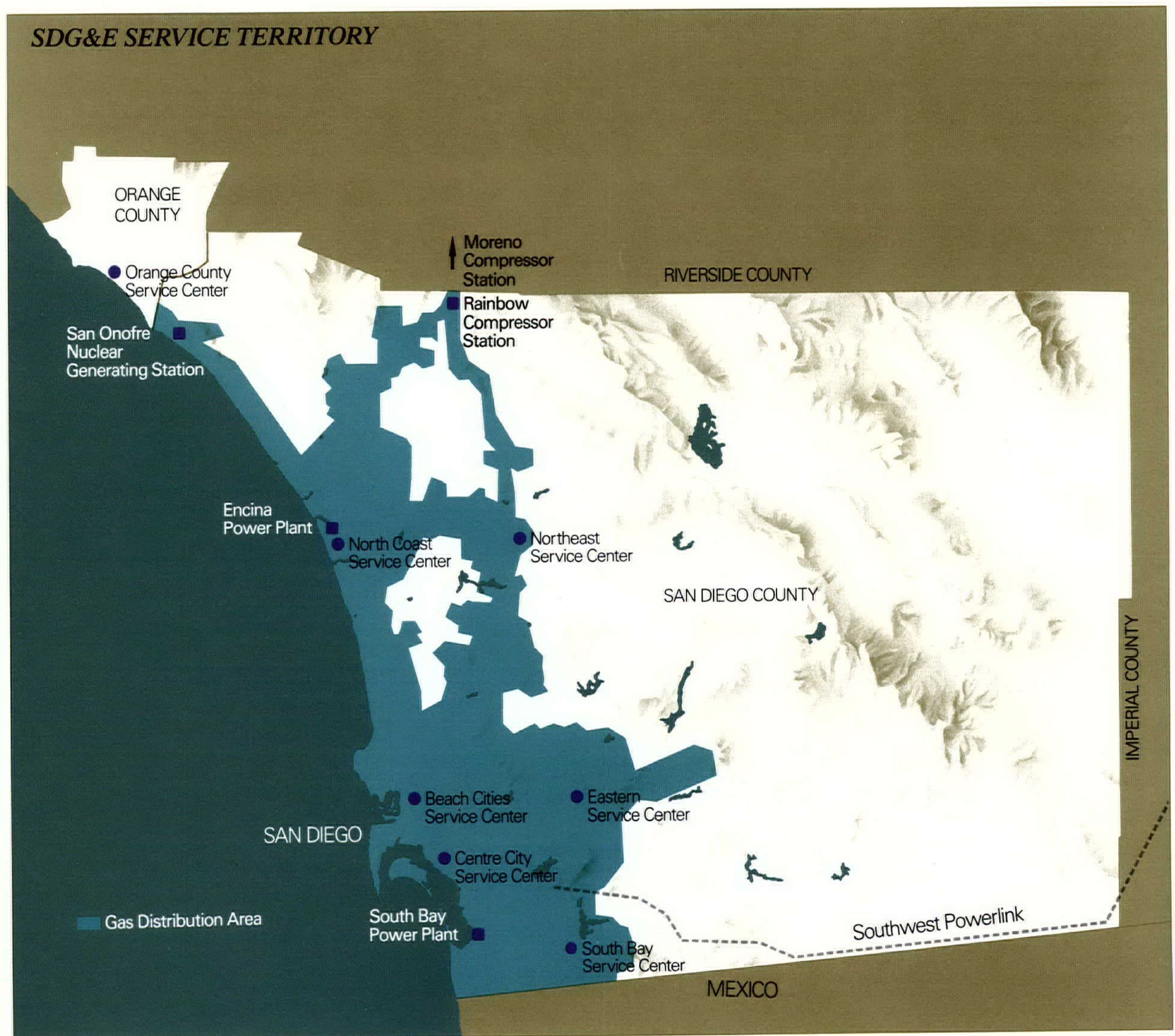
The electric operations division purchases, generates and distributes energy to 1,030,000 customers in San Diego County and the southwest corner of Orange County. The electric service area has a population of approximately 2.5 million.

The gas operations division purchases and distributes natural gas to more than 640,000 customers in San Diego County. Gas service is not available in all locations, but the company's gas service area is being expanded gradually.

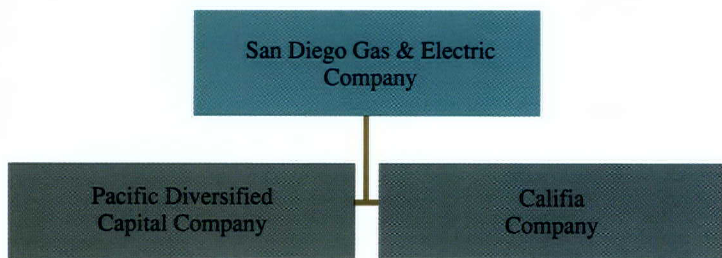
Among SDG&E's major assets are the Encina and South Bay power plants, which can burn either fuel oil or natural gas; a 20 percent interest in three nuclear units at the San Onofre Nuclear Generating Station in northwest San Diego County; the Southwest Powerlink, a 500,000-volt transmission line which connects San Diego and Phoenix; and a natural gas pipeline system within the company's gas service area. Seven service centers are operated regionally within the service territory.

As of December 31, 1988, there were 4,400 people employed in the company's utility operations.

SDG&E owns two subsidiaries—Pacific Diversified Capital, an independently operated holding company that owns companies serving utility and real estate markets; and Califia Company, a subsidiary used for general corporate purposes such as holding real estate.



SDG&E's electric service area covers all of San Diego County and the southwestern section of Orange County. The gas service area is shown in color. The Moreno gas compressor station is located in Riverside County, 35 miles north of the San Diego County line.



Officers

Thomas A. Page, 55
Chairman, President and Chief Executive Officer

Thomas Page was elected chairman in 1983. He has been president and chief executive officer since 1981. He joined SDG&E in 1978 as a senior officer.

Jack E. Thomas, 56
Executive Vice President and Chief Operating Officer

Jack Thomas was elected executive vice president in 1985 and chief operating officer in 1986, after serving as a group vice president since 1980 and a vice president since 1972. He joined SDG&E as an engineer in 1957.

Stephen L. Baum, 48
Senior Vice President and General Counsel

Stephen Baum was elected senior vice president in 1987 after serving as a vice president since 1985, when he joined SDG&E as a vice president and general counsel. He formerly was senior vice president and general counsel for the Power Authority of the State of New York.

Gary D. Cotton, 48
Senior Vice President—Engineering and Operations

Gary Cotton was elected senior vice president in 1985 after serving as a vice president since 1979. He was appointed to his current position in November 1986. Cotton joined SDG&E in 1975.

Alton T. Davis, 51
Senior Vice President—Customer Services

Alton Davis was elected senior vice president in 1985 after serving as a group vice president since 1981 and a vice president since 1976. He was appointed to his current position in November 1986. Davis joined SDG&E in 1968.

Donald E. Felsinger, 41
Vice President—Marketing and Resource Development

Donald Felsinger was elected a vice president in 1983 and was appointed vice president of marketing in November 1986. Resource development was added to the division in December 1988. Felsinger joined SDG&E in 1972.

Ronald K. Fuller, 51
Vice President—Governmental and Regulatory Services

Ronald Fuller was elected vice president of regulatory services in 1983. Governmental services was added to the division in 1984. He joined the company in 1974.

John E. Hamrick, 62
Vice President—Administrative Services

John Hamrick was elected a vice president in 1973 and was named to his current position in November 1986. He joined the company in 1971. He began his retirement December 30, 1988.

R. Lee Haney, 49
Vice President—Finance, Chief Financial Officer and Treasurer

Lee Haney was elected a vice president in 1983 after serving as treasurer for two years. He was appointed vice president—finance in April 1986 and became chief financial officer in July 1988. The position of treasurer was added to his responsibilities in December. He joined SDG&E in 1972.

James C. Holcombe, 43
Vice President—Resource Development

James Holcombe was elected a vice president in 1983 and was named to his current position in April 1985. He joined the company in 1967. On March 1, 1989, he accepted the position of executive vice president of Nevada Power Co.

Margot A. Kyd, 35
Vice President—Administrative Services

Margot Kyd was elected vice president—administrative services in December 1988 after serving as treasurer since 1986. She served as manager—financial services and assistant treasurer the previous year. Kyd joined the company in 1980.

Richard L. Manning, 57
Vice President—Public Relations

Richard Manning has been vice president—public relations since he joined SDG&E in 1981 from the Western Oil & Gas Association, where he was manager of public affairs.

George A. F. Weida, 52
Vice President—Human Resources

George Weida joined SDG&E in 1983 as a vice president and was named head of the human resources division in 1984. Previously, he was head of human resources for other major U.S. corporations.

Frank H. Ault, 44
Controller

Frank Ault was elected controller in May 1986 after serving as director—internal auditing. Ault joined SDG&E in 1969.

Delroy M. Richardson, 50
Corporate Secretary

Delroy Richardson was elected secretary in December 1986 after serving as assistant secretary since 1983. He joined SDG&E as an attorney in 1971.

Pacific Diversified Capital

In 1986, Pacific Diversified Capital was created as an independent SDG&E subsidiary whose mission was to increase return on shareholder equity by diversifying into new, unregulated business areas.

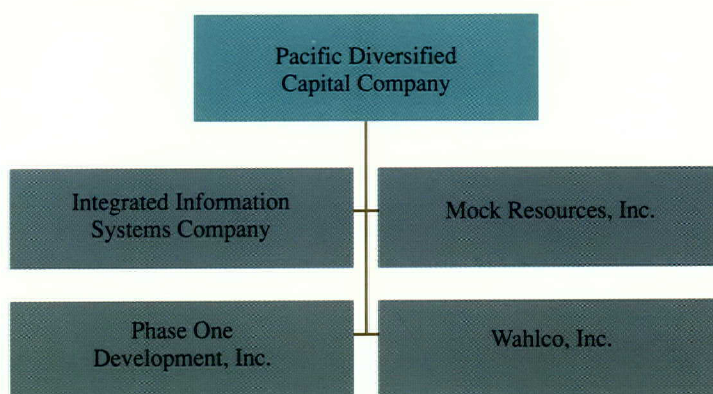
PDC's strategy calls for the company to operate as a holding company, investing in companies that serve the utility industry and its marketplace, or companies engaging in real estate development in San Diego and other select locations.

PDC intentionally has proceeded slowly and carefully in its acquisition effort, limiting risk to shareholders while taking time to learn to manage the businesses it has acquired.

In 1986 and 1987, PDC acquired four companies:

- Computing Solutions, Inc., of Port Chester, New York, which was merged into Integrated Information Systems of San Diego, an existing PDC subsidiary. Integrated Information Systems provides mapping services to the utility industry and to municipalities in the United States and in several foreign countries.
- Phase One Development, Inc., a San Diego-based commercial real estate development company with projects in San Diego and Colorado Springs.
- Mock Resources, Inc., of Irvine, California, which markets and distributes fuel oil, natural gas and other petroleum products in several western states.
- Wahlco, Inc., of Santa Ana, California, the world's leading manufacturer of flue gas conditioning systems for air pollution control. Wahlco's primary customers are electric utilities with coal-fired generating plants.

Pacific Diversified Capital and its subsidiaries had 319 employees on December 31, 1988.



Pacific Diversified Capital Company

Richard Korpan, 47
President and Chief Executive Officer

Henry N. Huta, 41
Executive Vice President and Chief Operating Officer

Integrated Information Systems Company

C. Christopher Fecher, 42
President and Chief Executive Officer

Thomas E. Anderson, 39
Vice President and General Manager

Charles Kogan, 51
Vice President

Jeffrey R. Sauter, 33
Vice President—Marketing and Business Development

Phase One Development, Inc.

Gary Hollenbeck, 39
President and Chief Executive Officer

Jerry A. Berdine, 43
Executive Vice President—Operations and Administration

Michael J. Lowell, 30
Vice President—Chief Financial Officer

Mock Resources, Inc.

Brian Mock, 42
President and Chief Executive Officer

Christopher P. Kunzi, 38
Executive Vice President

L. Keith McNair, 40
Vice President—Natural Gas and Business Development

L. Craig Smith, 34
Chief Financial Officer

Wahlco, Inc.

W. Clay Matthews, 60
President and Chief Executive Officer

John H. McDonald, 56
Executive Vice President—Operations and Secretary

Howard E. Sandler, 47
Executive Vice President—Administration, Assistant Secretary and General Counsel

BOARD OF DIRECTORS

The seven-person board of directors consists of six outside directors and the chief executive officer of SDG&E, who serves as its chairman. The directors provide a broad perspective because of their diverse business, professional and civic backgrounds.

Thomas A. Page*
Thomas Page, 55, a director since 1979, has been chairman of the board since 1983. He is president and chief executive officer of SDG&E. He also is the chairman of the board of Pacific Diversified Capital, an SDG&E subsidiary. Page is a certified public accountant and a licensed professional engineer with an extensive management background. He is past chairman of the Pacific Coast Gas Association and a member of the board and former chairman of the San Diego Economic Development Corporation.

Clair W. Burgener
Clair Burgener, 67, a director since 1983, is president of Burgener Properties, Inc., a real estate and property development firm. Earlier, he served 24 years in elected public office. Burgener serves on the boards of several community service organizations and is a director of San Diego Trust and Savings Bank, of TCS Enterprises and of Blue Shield of California.

Malin Burnham*
Malin Burnham, 61, a director since 1967, is chairman of John Burnham & Co., a mortgage loan, real estate and insurance firm. He is chairman of the board of First National Bank in San Diego and is a director of Businessmen's Assurance Co., of Cubic Corporation, of Gen-Probe, Inc., and of Pacific Diversified Capital. He also is chairman and a director of Burnham American Properties, Inc., and Burnham Pacific Properties, Inc. He serves as president of Sail America, which organized the USA's 1988 defense of the America's Cup.

Daniel W. Derbes*
Daniel Derbes, 58, a director since 1983, was president of Allied-Signal International Inc., and executive vice president of Allied-Signal Inc., from 1985, when the company was formed, until December 31, 1988. From 1983 to 1985, he was president of the Signal Advanced Technology Group and executive vice president of the Signal Companies, Inc. Derbes is a director of WD-40 and of Pacific Diversified Capital. He also is involved with many community organizations.

Ralph R. Ocampo
Dr. Ralph Ocampo, 57, a director since 1983, is a physician and surgeon. He has been active throughout his career in many professional associations and in community activities. He is a director of the Mercy Hospital and Medical Center, of the San Diego chapter of the American Cancer Society and of the San Diego Community Foundation. He served as president of the Hispanic American University Foundation in 1986.

Fred C. Stalder
Fred Stalder, 68, a member of the board since 1969, was chief executive officer of Central Federal Savings and Loan in San Diego from 1948 until his retirement in 1985. He is a private investor. Stalder has been involved with and has provided leadership to many San Diego area civic and cultural organizations for over 40 years.

Catherine Fitzgerald Wiggs
Catherine Fitzgerald Wiggs, 55, a director since 1979, is a management consultant in the fields of human resources and organizational effectiveness. In the nine years prior to establishing her own consulting business in 1986, she was executive vice president of human resources and a member of the executive committee for The Broadway Stores, Inc., a division of Carter Hawley Hale Stores, Inc.

COMMITTEES OF THE BOARD

Audit This committee selects an independent auditor and reviews the overall plan of the audit, financial statements, audit results, scope of internal audit procedures and the auditors' evaluation of internal controls.

Executive This committee is empowered to act in place of the full board, except in certain transactions for various board responsibilities that are reserved for the board.

Executive Compensation
This committee reviews the salaries and other forms of compensation of company officers and makes compensation recommendations to the board.

Finance This committee plans and counsels with management concerning the company's capital requirements, proposed financing programs and capital risk exposure analyses and reviews the general investment policy performance for the Pension Plan and the Savings Plan.

Nominating This committee considers and recommends nominees to the board, criteria for board and committee composition and membership, and directors' compensation.

*Member of the executive committee

Stock Listing and Trading Information

Common stock: Listed on the New York and Pacific stock exchanges under the ticker symbol SDO. Shareholders can find the previous day's closing price in the New York Stock Exchange listing table of daily newspapers under the symbol SDieGs.

Preferred and preference stocks: Listed on the American and Pacific stock exchanges under the ticker symbol SDO. Previous day closing prices are listed in the American Stock Exchange listing table under the symbol SDgo. The 4.60% preferred series and the $7.05, $8.25 and $9.125 preference series are not listed.

Where to buy and sell stock: The listed common, preferred and preference stocks may be purchased through any brokerage firm. There are firms that specialize in making a market in the unlisted series. These firms can be located through your broker.

Common Stock Investment Plan: Please call or write for a prospectus on how SDG&E common stock shareholders can purchase additional shares by investing all or a portion of their quarterly dividends in additional shares. The plan also allows optional cash investments of as little as $25 per investment up to a maximum of $5,000 per calendar quarter. Shares purchased under this plan are free of any brokerage fees.

Dividend Deposit Service: If you wish to have your dividend check mailed directly to your bank for deposit, send signed instructions containing your bank account number and the complete mailing address of the bank to SDG&E. If the checks are being deposited to a joint account, all owners of the account and all shareholders should sign the letter.

Transfer Agents and Registrars

The company's transfer agents and *not* the company have primary responsibility for stock transfers and the cancellation and issuance of stock certificates. The agents should be contacted directly about these subjects.

Transfer agents:

California First Bank
8155 Mercury Court
Post Office Box 2529
San Diego, California 92112
(619) 230-4487

California First Bank is the registrar of common stock in San Diego.

California First Bank is also transfer agent and registrar for the preferred and preference stocks.

First Interstate Bank of California
c/o First Interstate Trust Company of New York
2 Broadway, 29th Floor
New York, New York 10004

First Interstate Bank is the registrar of common stock in New York.

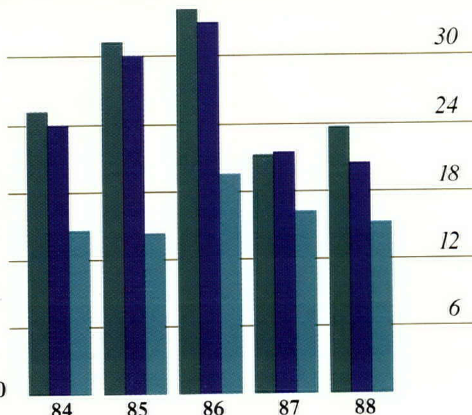
First Interstate Bank is also the transfer agent and registrar for the preference stocks, except the $8.25 and the $9.125 series.

How to transfer stock: A transfer of stock is required whenever there is a change in the name or names in which the stock certificate is registered. This can happen when you sell the stock, make a gift of stock, or add or delete owners of the certificate. The transfer can be made by filling in the stock assignment form on the back of the stock certificate and signing it exactly as the name or names appear on the front of the certificate. The signatures of the individuals transferring the stock must be guaranteed by either a commercial bank or a brokerage firm that is a member of a major stock exchange. The certificate can then be sent to the transfer agent for transfer. It is recommended that certificates be sent registered or certified mail.

TOTAL ANNUAL RETURN TO SHAREHOLDERS

(By Percent) 36

The company returned to the top 25 percent, meeting its goal, as a result of the proposed merger with Southern California Edison Company. Stock price appreciation and dividends are the components of average total return, measured over five years.

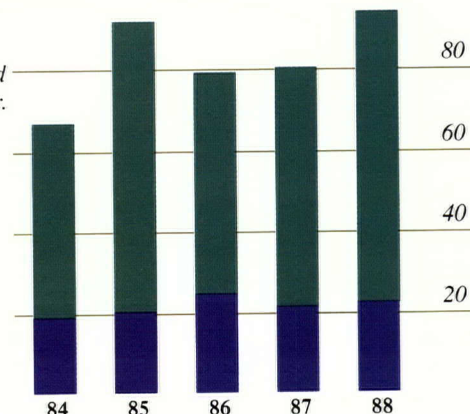


SDG&E
Top 25% of industry
Standard & Poor's 500

INVESTOR PROFILE

(By Percent, at December 31) 100

Institutional holdings continued to decline in early 1988, but increased during the fourth quarter.



Individuals
Institutions

Annual Meeting

The annual meeting of shareholders will be held on Tuesday, April 18, at 11 a.m. at the Sheraton Harbor Island East Hotel in the Champagne Room. The hotel is located at 1380 Harbor Island Drive, San Diego, California.

Record date: The record date for shareholders eligible to vote at the annual meeting is March 3, 1989.

Shareholder Profile

As of December 31, 1988, there were 69,873 common stock shareholders of record and 5,408 preferred and preference stock shareholders. There are thousands of other stock holders whose shares are held in street name by securities brokers and nominees.

Common Stock Shareholders

By account registration:	
Joint accounts	23,123
Women	20,914
Men	14,873
Fiduciaries	9,976
Securities brokers, nominees, others	987
By geographic area:	
United States, except California	35,555
California, except SDG&E service area	20,900
SDG&E service area, including employees	13,224
Foreign countries	194
By shares owned:	
1-99	13,994
100-300	38,354
301-500	8,508
501-1000	5,973
1001 or more	3,044

Publications Available to Shareholders

Annual Report: Inquiries about this annual report should be directed to Elizabeth Pecsi, Investor Communications, Post Office Box 1831, San Diego, California, 92112.

Investors' Report: Reports of current activities, recent results and features of interest to shareholders are issued periodically during the year.

Corporate Profile and Statistical Report: Contains the last 11 years of financial data on the company (1978-1988) and information on California regulation of the utility industry.

Form 10-K: The annual report to the Securities and Exchange Commission.

Shareholder Information Handbook: Answers many common questions asked by shareholders.

TOWARD 2000/Our Strategies: Explains the company's strategies to improve service, control costs, compete aggressively, serve shareholder interests and diversify.

Where to Call for Information

Inquiries about stock holdings:

Within California	(800) 826-5942
Outside California	(800) 243-5454

To hear a tape recorded corporate news report and stock update:

Within California	(800) 443-SDGE
Outside California	(800) 521-NEWS

Inquiries from the financial community should be directed to:

Jennifer Lewis, Manager, Investor Relations and Corporate Strategy (619) 696-4487

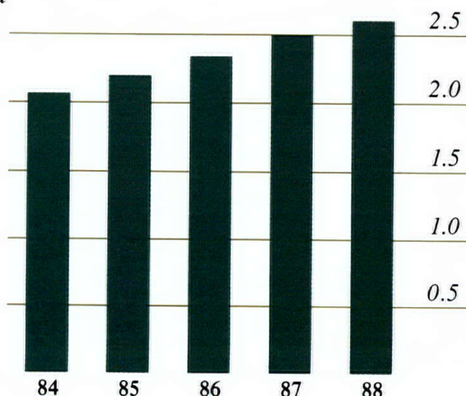
Executive Offices

San Diego Gas & Electric
101 Ash Street
Post Office Box 1831
San Diego, California 92112
(619) 696-2000

DIVIDENDS PER SHARE

(Declared, in Dollars)

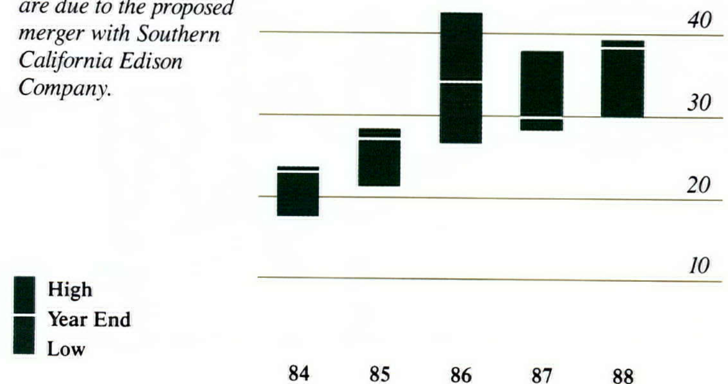
Dividends were increased in 1988 for the twelfth consecutive year.



COMMON STOCK PRICE TREND

(In Dollars)

The 1988 price increases are due to the proposed merger with Southern California Edison Company.



SELECTED FINANCIAL DATA

At December 31	1988	1987	1986	1985	1984	1983
Current assets*	**$ 319.9**	$ 336.4	$ 299.7	$ 366.2	$ 393.8	$ 267.3
Current liabilities*	**$ 510.1**	$ 533.7	$ 450.2	$ 404.8	$ 352.2	$ 429.7
Working capital*	**$ (190.2)**	$ (197.3)	$ (150.5)	$ (38.6)	$ 41.6	$ (162.4)
Working capital ratio	**.6**	.6	.7	.9	1.1	.6
Long-term debt*	**$ 1,179.5**	$ 1,204.6	$ 1,193.9	$ 1,208.6	$ 1,277.5	$ 1,275.4
Common shareholders' equity*	**$ 1,229.9**	$ 1,197.4	$ 1,159.9	$ 1,153.0	$ 1,052.9	$ 957.6
Number of customers**	**1,032.6**	990.4	940.7	893.9	853.6	823.2
Number of utility employees	**4,420**	4,612	4,815	4,860	4,841	4,917
Common shares outstanding	**55,898,342**	55,872,602	55,847,822	55,822,762	54,063,592	51,693,662
Book value per common share	**$ 22.00**	$ 21.43	$ 20.77	$ 20.65	$ 19.48	$ 18.52
Price/Earnings ratio	**12.0**	9.1	9.9	8.3	7.6	6.1

For Year Ended December 31	1988	1987	1986	1985	1984	1983
Operating Revenues*						
Electric	**$ 1,300.0**	$ 1,261.3	$ 1,333.5	$ 1,395.7	$ 1,292.8	$ 1,207.1
Gas	**$ 285.4**	$ 293.8	$ 299.2	$ 343.0	$ 327.9	$ 323.1
Diversified operations	**$ 490.7**	$ 349.1	$ 1.5	$ —	$ —	$ —
Capital expenditures*/†	**$ 196.4**	$ 189.4	$ 251.2	$ 246.4	$ 218.8	$ 282.8
Pretax income/revenue	**14.7%**	18.7%	21.6%	22.7%	19.8%	18.7%
Return on equity	**14.6%**	15.6%	12.3%	16.2%	15.8%	18.2%
Effective federal tax rate	**32.5%**	39.1%	47.8%	44.5%	38.7%	31.2%
Earnings per common share	**$ 3.18**	$ 3.28††	$ 2.59	$ 3.25	$ 3.01	$ 3.20
Dividends declared per common share	**$ 2.60**	$ 2.50	$ 2.345	$ 2.205	$ 2.065	$ 1.925
Dividend payout ratio (declared)	**81.8%**	76.3%	90.4%	68.1%	68.8%	60.7%
Price range of common shares	**$ 39½-$30**	$37⅞-$28¼	$42½-$26¾	$28⅜-$21½	$23¾-$17⅝	$ 22-$17

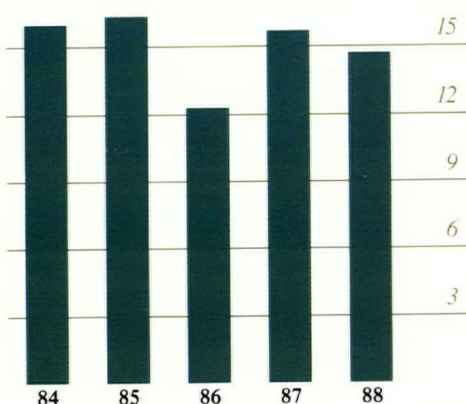
Certain data have been restated from last year's presentation to reflect the write-off of certain San Onofre Nuclear Generating Station construction costs due to their disallowance by the California Public Utilities Commission or the change from a statement of sources of funds for construction to a statement of cash flows.

FINANCIAL RETURN ON EQUITY

(By Percent)

(weighted average)

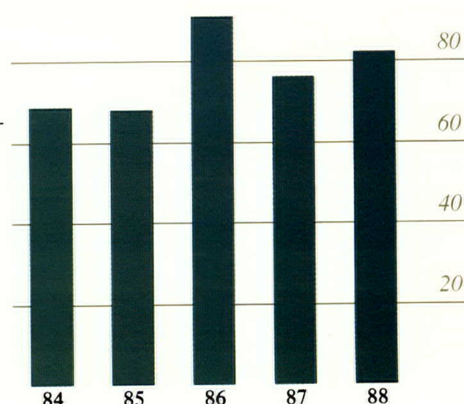
The California Public Utilities Commission's lowering of the authorized rate of return was the primary cause of the decrease in 1988. Financial return on equity is measured by earnings applicable to common shares divided by average common equity.



DIVIDEND PAYOUT RATIO

(By Percent)

The payout ratio continues to increase. 1986 has been restated for the write-off of disallowed San Onofre Nuclear Generating Station construction costs.



Compound Annual Growth Rate 5 Years (%)	1982	1981	1980	1979	1978	Compound Annual Growth Rate 10 Years (%)
3.7	$ 303.9	$ 302.4	$ 308.8	$ 218.9	$ 180.2	**5.9**
3.5	$ 443.6	$ 453.4	$ 382.3	$ 307.0	$ 216.0	**9.0**
—	$ (139.7)	$ (151.0)	$ (73.5)	$ (88.1)	$ (35.8)	—
—	.7	.7	.8	.7	.8	—
(1.6)	$ 1,007.2	$ 925.0	$ 918.5	$ 813.8	$ 610.5	**6.8**
5.1	$ 817.4	$ 672.4	$ 585.8	$ 541.2	$ 480.4	**9.9**
4.6	804.5	792.4	772.9	750.9	716.9	**3.7**
(2.1)	5,084	4,909	4,776	4,740	4,384	**0.1**
1.6	48,266,144	41,499,034	36,469,483	31,188,237	27,592,809	**7.3**
3.5	$ 16.94	$ 16.20	$ 16.06	$ 17.35	$ 17.41	**2.4**
—	5.9	5.3	11.6	7.3	7.3	—
1.5	$ 1,137.9	$ 948.6	$ 770.9	$ 593.5	$ 469.4	**10.7**
(2.5)	$ 293.0	$ 211.0	$ 189.5	$ 151.7	$ 144.2	**7.1**
—	$ —	$ —	$ —	$ —	$ —	—
(7.0)	$ 244.9	$ 206.1	$ 188.4	$ 191.5	$ 203.3	**(0.3)**
—	15.3%	10.2%	4.5%	10.0%	11.6%	—
—	17.5%	14.5%	6.0%	10.4%	11.4%	—
—	24.0%	4.7%	(13.1)%	4.3%	3.9%	—
(0.1)	$ 2.90	$ 2.34	$ 1.01	$ 1.80	$ 2.02	**4.6**
6.2	$ 1.785	$ 1.64	$ 1.56	$ 1.48	$ 1.40	**6.4**
—	62.4%	71.1%	156.8%	83.1%	71.5%	—
—	$ 17⅞-$11¾	$ 14-$11	$ 15¼-$10	$ 15⅞-$12¾	$ 16⅜-$14¼	—

*In millions of dollars.

**In thousands.

†Excluding allowance for funds used during construction.

††Including $0.32 for cumulative effect of change in accounting principle.

QUARTERLY COMMON STOCK DATA

	1988				1987			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Market price								
High	34	33⅞	36	39½	37⅞	35¼	35	33¾
Low	30	30⅝	32¾	34⅜	34	30⅝	31½	28¼
Dividends declared	65¢	65¢	65¢	65¢	62.5¢	62.5¢	62.5¢	62.5¢

The estimated cost of the 1988 annual report to shareholders is 90 cents per copy.

San Diego Gas & Electric
Post Office Box 1831
San Diego, California 92112