The Year In Review

- Earnings per share were $4.21 on a 7% increase in the average number of shares outstanding, compared with $4.41 in 1977.
- The quarterly dividend was increased in January, 1978, from 49¢ to 53¢ per share and increased again in January, 1979, to 59¢ per share.
- HL&P was granted a $98 million rate increase by the Texas Public Utility Commission.
- HL&P's second generating unit designed to burn coal went into service in December.
- Primary Fuels signed an agreement with Shell Oil Company to participate as a limited partner in Shell's onshore oil and gas exploration in the continental U.S.
- Utility Fuels signed a contract for a 25-year supply of coal, which will be a source of fuel for three of HL&P's generating units.

Financial & Operating Highlights

	1978	1977	% Increase (Decrease)
Houston Industries			
Revenues (000)	**$ 1,349,438**	$ 1,095,561	**23***
Net Income (000)	**$ 128,657**	$ 125,636	**2**
Per Share Data:			
Net Earnings	**$ 4.21**	$ 4.41	**(5)**
Cash Dividends	**$ 2.12**	$ 1.86	**14**
Book Value	**$ 33.04**	$ 31.14	**6**
Number of Weighted Average Shares Outstanding	**30,589,992**	28,478,757	**7**
Average Return on Shareholders' Equity	**13.27%**	14.95%	**(11)**
Total Property (000)	**$ 3,542,063**	$ 3,001,242	**18**
Construction Expenditures (000)	**$ 530,594**	$ 466,256	**14**
HL&P			
Turbine Name Plate Capacity (Kilowatts)	**11,056,000**	10,427,000	**6**
Peak Load (Kilowatts)	**9,362,000**	8,645,000	**8**
Kilowatt Hour Sales (000)	**50,275,767**	45,885,725	**10**
Number of Customers Served	**891,509**	809,820	**10**
Average Residential Use (Kwh)	**14,734**	14,266	**3**
Average Residential Cost Per Kwh	**3.36¢**	3.09¢	**9**
Fuel Cost (000)	**$ 682,261**	$ 517,870	**32**
PFI			
Net Natural Gas Production (Million Cubic Feet)	**11,049**	9,458	**17**
Net Condensate Production (Barrels)	**132,000**	81,000	**63**

***Of the $253.9 million increase in revenues, $164.4 million resulted solely from recovery of increased fuel costs.**

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To Our Shareholders:

The year 1978 reflected the dynamic growth and evolving nature of Houston Industries' subsidiary operations.

During the year:

- Houston Lighting & Power Company recorded new highs in sales and in the number of new customers served;
- HL&P was granted a $98 million rate increase;
- Primary Fuels, Inc., expanded its oil and gas operations from offshore to onshore in the continental U.S.; and
- Utility Fuels, Inc., began acquiring and transporting coal for use by HL&P.

Houston Industries' revenues were up $253.9 million, or 23 percent, to reach $1,349 million. Net earnings were $128.7 million or 2.4 percent over the previous year. However, earnings per share of $4.21 were down 20 cents on the basis of a 2.1 million increase in average shares outstanding.

Dividend Raised

In January, 1978, the quarterly dividend was increased from 49 cents to 53 cents per share. A further increase to 59 cents per share, payable March 10 to the holders of record January 26, was declared in January, 1979. Dividends per share have risen 51 percent from the third quarter of 1976.

HL&P Granted Rate Increase

New rates, reflecting a system-wide rate increase aggregating $98 million annually, took effect during December. The increase was granted HL&P by the Texas Public Utility Commission, following the filing in July of the company's first request to the commission for rate relief.

The amount of the increase the PUC granted was less than that requested, however, I believe this first experience resulted in mutual respect between HL&P and the commission. The company, with an ambitious construction program designed to utilize fuels other than natural gas and to serve the area's growing electric power needs, will require additional rate relief on a regular basis.

Some of the results of HI's subsidiary operations in 1978 were:

Houston Lighting & Power Company

HL&P accounted for nearly 94 percent of HI's earnings. An unprecedented net gain of 81,689 individually metered customers reflected the service area's continuing growth. Total kilowatt hour sales were up 9.6 percent.

In 1978, HL&P spent $453.7 million on construction. The company and HI raised more than $300 million through long-term financings, including the sale of two million shares of common stock, first mortgage and pollution control bonds.

HL&P expects to spend nearly $625 million for new generating plants and related facilities in 1979, $801 million in 1980 and $918 million in 1981. More than half of the required funds will have to be raised by outside financing.

In January, 1979, HL&P sold 300,000 shares of cumulative preferred stock carrying an annual dividend of $9.04. The following month, Houston Industries sold two million shares of common stock at $29 ⅛. The net proceeds from the sale were invested primarily in the common stock of HL&P and used to defray the cost of its construction program. It is anticipated that additional debt and equity securities will be sold before the year is out.

A number of significant events took place in 1978 with respect to HL&P's construction and fuel diversification programs:

- The company's first generating unit designed to burn coal achieved a 100 percent coal burn. A second 660,000-kilowatt coal-fired generator was placed in commercial operation on gas and switched to full coal burning in early 1979.
- HL&P announced plans to build a 750,000-kilowatt lignite unit to be completed in 1985. The company's previous plans to build two, 750,000-kilowatt lignite units in partnership with Dow Chemical Company USA were cancelled when Dow withdrew from the venture.
- The company reached a settlement with Westinghouse Electric Corporation regarding nuclear fuel for the South Texas Project. HL&P, as project manager of the jointly owned plant, sued Westinghouse in 1975 after Westinghouse said they would be unable to fulfill uranium supply agreements.
- HL&P announced that construction delays could defer initial operation of the South Texas Project for up to two years. Completion of the project's two 1,250,000-kilowatt reactors is now scheduled for 1982 and 1983.
- A construction permit for the Allens Creek nuclear plant was not issued as had been anticipated. It is now expected to be issued in late 1979 or early 1980.

Primary Fuels, Inc.

Primary Fuels increased its potential to contribute to HI's earnings when it signed an agreement with Shell Oil Company to participate as a limited partner

in Shell's onshore oil and gas exploration in most of the continental U.S.

Despite a limited market for natural gas during much of the year, PFI contributed $7.4 million or 24 cents per share to HI's earnings, compared to $6.1 million or 21 cents in 1977.

Utility Fuels, Inc.

Utility Fuels signed a contract with Spring Creek Coal Company in Montana for a 25-year supply of low-sulfur coal. In addition, it acquired coal handling facilities owned by HL&P and purchased 1,150 coal cars to supply coal to HL&P's coal-fired generating units.

National Energy Act & CSW Dispute

Two very important matters that will affect our future operations are the National Energy Act and the Central and South West case.

The National Energy Act passed in 1978 will have a far-reaching effect on HL&P's future operations. Some of its more onerous and inequitable provisions were moderated during its consideration by Congress. However, Federal regulatory agencies are attempting to go beyond the intent of the Congress by imposing unreasonably burdensome regulations on the industry which will be unnecessarily costly to electric users. The company is actively participating in efforts to mitigate the inflationary effect of such regulations.

In February, 1979, a Federal judge ruled in HL&P's favor regarding Central and South West Corporation's attempt to force interconnection of electric utilities in Texas with other regional power pools covering most of the Eastern United States.

HL&P and two other electric utilities challenged CSW's attempt since no showing had been made that their customers would benefit from such interconnections, whereas substantial costs would be incurred in making such interconnections. The judge supported HL&P's contention that HL&P and other electric utilities in Texas have the right to restrict their operations to the state if it is in the best interests of their customers.

Final resolution of this problem is subject to action in several other forums in which the matter is under consideration.

Reese, Woodson Retire

In April, J. G. Reese retired as Chairman of the Board. He will, however, continue to serve as a member of the HI board until April, 1979.

B. N. Woodson retired after 22 years of distinguished service as an HI and HL&P board member. Howard W. Horne, president of a Houston commercial real estate sales and leasing firm, was elected to the position vacated by Mr. Woodson.

The Outlook

There are a number of factors favoring Houston Industries' future performance:

- We will continue to do business in the most dynamic area in the nation.
- We have a strong management team and dedicated employees who continue to deal effectively with our many diverse problems.
- We own a physical plant with up-to-date, efficient generating units and advanced facilities to monitor our performance.

Inflation, the rising price of fuel, higher construction costs imposed by both rapid growth and the need to utilize fuels other than natural gas and more regulation will continue to pose challenges which are unprecedented in our industry. We pledge our best efforts in meeting and solving these business problems.

D. D. JORDAN
President and
Chief Executive Officer

HI's Financial Picture

Revenues Were Up; But So Were Expenses

Houston Industries' revenues in 1978 were $1,349 million, an increase of $253.9 million, or 23.2% over 1977. Nearly 97% of HI's revenues were contributed by electric sales of its subsidiary, Houston Lighting & Power Company.

Total operating expenses rose 28.9% or $233.6 million to reach $1,041 million. These expenses included a 32% jump in HL&P's fuel costs and a 24% increase in HL&P's expenditures for operation and maintenance. More than 52% of HL&P's $1,304 million revenues in 1978 went to pay for fuel.

Earnings Slightly Up

Increased costs were largely responsible for holding earnings for common stock to $128.7 million, 2.4% over 1977 earnings.

Retained earnings for the year were up 12.7% and HI's net worth per common share ("book value") increased 6% to $33.04. The market price of HI common stock at year's end was $27 3/8, compared to a closing price of $30 5/8 at the end of 1977.

Dividends Continue to Grow

Houston Industries' dividends have continued to grow over the last decade. Dividends have increased at a compound annual growth rate of approximately 8% since 1970 and 11% for the past four years.

The quarterly dividend was increased four cents to 53 cents per share in January 1978, resulting in an annual rate of $2.12 per share compared with $1.86 per share in 1977. In January, 1979, the quarterly dividend was raised to 59 cents per share.

In 1978, the first year of HI's Dividend Reinvestment Plan, Houston Industries raised $2,631,674 of new equity capital and invested these proceeds in the common stock of HL&P. By year's end, 10% of the shareowners were participating in the plan. These 3,275 shareowners purchased 87,246 shares of HI common stock. Reinvested dividends accounted for 67% of the shares and optional cash payments for the remaining 33%.

Under the plan, shareowners may automatically reinvest quarterly cash dividends in HI common stock and make optional cash payments of not less than $50 nor more than $3,000 each calendar quarter for additional shares. Stockholders may elect either or both options. Shareowners may receive additional information on the plan by writing:

Ms. Ann Cherry
Vice-President and Trust Officer
Texas Commerce Bank
P.O. Box 2558
Houston, Texas 77001

Quarterly High And Low Sales Price On The New York Stock Exchange And The Composite Tape

1978

Quarter	High	Low	Dividend
First	$ 31⅜	$ 28	$ 0.53
Second	31⅞	28	0.53
Third	33⅜	30	0.53
Fourth	33⅜	26⅞	0.53

1977

Quarter	High	Low	Dividend
First	$ 36⅛	$ 31¾	$ 0.44
Second	34⅝	30	0.44
Third	35⅝	31¾	0.49
Fourth	34	29¼	0.49

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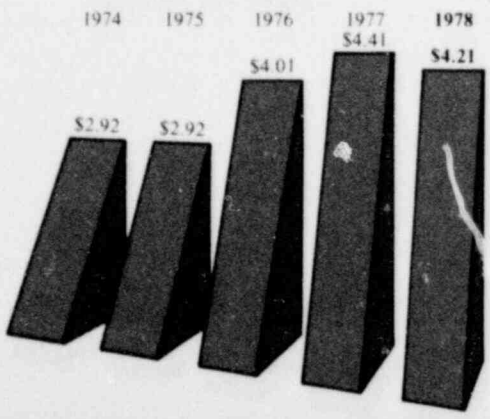
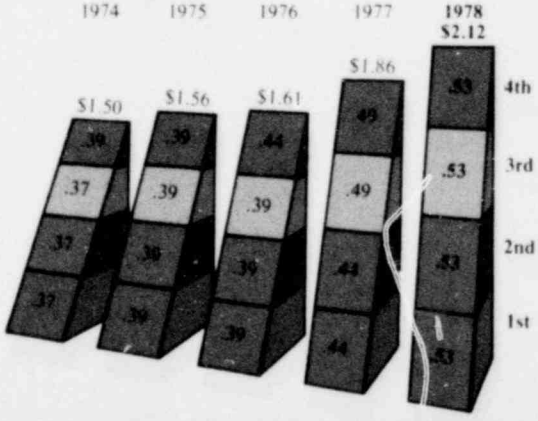
Earnings Per Share



Dividends Paid on Common Stock (By Quarter)



The Service Area's Healthy Economy

Houston Lighting & Power Company serves and is an integral part of one of the healthiest economic areas in the nation today.

Dominated by Houston, the nation's fifth largest and fastest growing city, the metropolitan area is expected to continue to have the highest growth rates in the nation in several categories — including after-tax personal income and total retail sales, according to "Sales & Marketing Management," a source of annual market data widely used by financial analysts.

Since 1970, population of the Houston-Galveston Standard Consolidated Statistical Area, which roughly approximates HL&P's service area, has grown by more than one-third and now exceeds 2.9 million. By 1985, it's expected to reach 3.6 million.

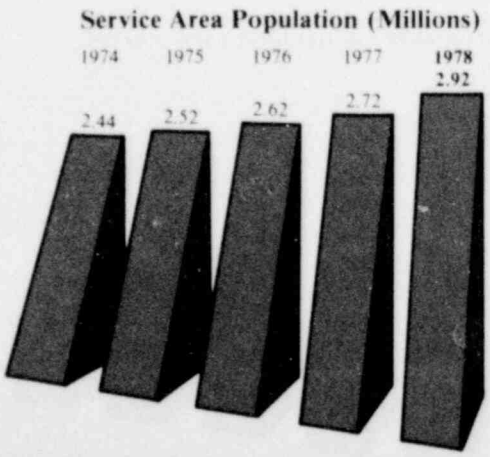
Houston is the energy center of the country and leads the nation in the number of energy-related firms occupying 1,000 square feet or more of office space with 539. Forty percent of the nation's basic petrochemical manufacturing capacity is concentrated in the Houston-Gulf Coast region.

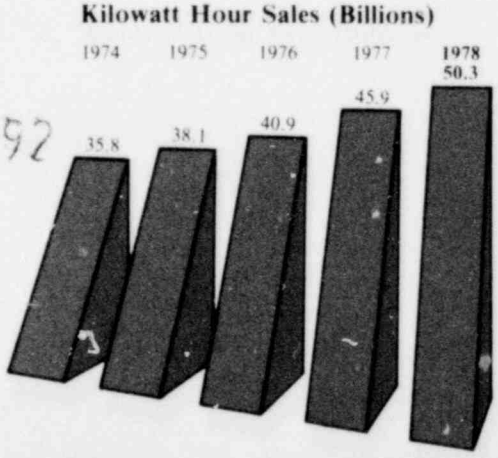
The area is the fourth largest manufacturing center in the nation and tops the U.S. in manufacturing capital expenditures. The city's man-made port is the third largest seaport in the U.S. in total tonnage.

The Houston area was No. 1 in the U.S. in 1978 in nonresidential construction. Houston leads the country in downtown and suburban office construction and leasing. In a decade of mixed economics in most parts of the country, Houston has more than doubled its office space.

For the fourth year in a row, the metropolitan area led the nation in residential construction. Indicative of the city's eminence in this category was the move to Houston in March, 1979, of the headquarters of U.S. Home Corporation — one of the largest builders of single family homes and townhomes in the country.

The metropolitan area has one of the lowest unemployment rates in the nation. The number of new jobs has been increasing about twice the national average and is expected to grow at an annual rate exceeding 5% between 1978 and 1982.





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Opposite: The U.S. Home Building, 18 stories of mirrored glass and polished aluminum, was completed in Houston in 1978. U.S. Home Corporation moved its headquarters from Clearwater, Fla., into the building in March, 1979.

Sales, Business Activity Vigorous

The booming economy of the Houston-Gulf Coast area was reflected in HL&P's energy sales in 1978. Customers of HL&P consumed almost 50.28 billion kilowatt hours of electricity — a 9.6% increase over 1977. The increase was down from the 12.3% jump in sales recorded in 1977. HL&P also established a record peak demand of 9,362,000 kilowatts — an 8.3% increase over the 1977 peak.

The increase in HL&P's total kilowatt hour sales was due primarily to the unprecedented surge in the number of new customers. A net gain of 81,689 individually metered customers was established in 1978—almost 30,000 more than the previous record set in 1977.

The residential classification led all others in 1978 with a 12.3% increase in consumption. Usage per residential customer was up only 3.3%, compared to a 9% increase in 1977. The 1977 increase was the result of an extremely hot summer while the summer of 1978 was near normal.

Average annual usage per residential customer was 14,734, 65% above the national average. Average cost per residential kilowatt hour rose from 3.09¢ in 1977 to 3.36¢ in 1978, primarily as a result of increased fuel costs.

Industrial customers increased kilowatt hour usage by 9.6% followed by the commercial class with an increase of 6.9%.

Residential Construction

The Houston-Gulf Coast area continued to boom in 1978 and once again led the nation in residential construction. More than 64,100 homes, apartments and condominiums were completed in 1978. Apartment construction was up 30% over the year before.

Nearly 17,000 homes and 21,690 apartment units were under construction at year's end.

Commercial Building

The service area's robust business activity was bolstered by a banner year in retail and office construction. In 1978, retail construction was more than double the previous year's with 7.3 million square feet completed.

More than 7.5 million square feet of office space was completed in 1978.

Thirty-one major office buildings representing 12.5 million square feet were under construction at year's end.

The most notable start in 1978 was the El Paso Tower, a 2-million-square-foot, 75-story skyscraper which will be the tallest office building in the country, outside New York and Chicago.

Industrial Expansion

The company's service area has historically been dominated by heavy industry. In 1978, this sector accounted for 55% of HL&P's kilowatt hour sales.

The lifeblood of this base is the manufacture of chemicals and petrochemicals. This group accounts for nearly 59% of HL&P's industrial energy sales. Some of the bigger expansions in this area were made by Diamond Shamrock, Oxirane Chemical and Phillips Petroleum. The largest industrial load addition was made by U.S. Steel.

At year's end, 42 industrial projects were under construction. Some of the larger projects are Air Products & Chemicals' air separation plant, an addition to Big Three Industries' Bayport plant, an ethylene production plant by Exxon Company USA and an ethylene production plant by Monsanto-Conoco.

Future Outlook

Though faced with near record high interest rates and a tightening of the money supply, the area's construction activity should continue to be among the strongest in the nation in 1979.

Housing starts are expected to be down but should still lead the country.

Although commercial and industrial expansion should continue strong through 1979 due to those projects already under construction, recent studies done in conjunction with area industrial firms indicate that the rate of growth may slow in the immediate future.

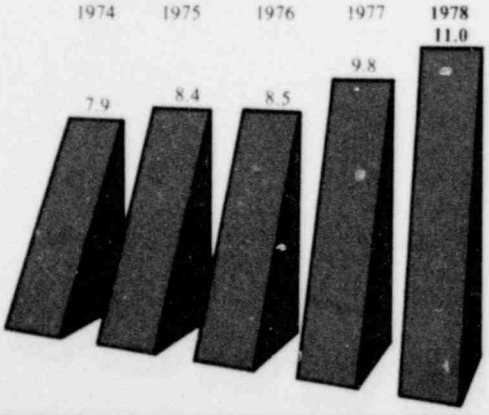
HL&P has consequently lowered its estimates of annual peak load growth to the 4 to 5% range. For the past 5 years, peak demand within the HL&P system has grown at a compound rate of 6.9% per annum.

However, HL&P is continously monitoring the projected growth in peak demands and will take necessary steps to respond to changing conditions.

Building For The Future

HL&P spent $453.7 million on construction in 1978. Seventy percent of that was for new generating facilities, an all-time record. The company expects to spend $624.6

Residential Kilowatt Hour Sales (Billions)



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Opposite: The immensity of the South Texas Project is graphically shown by the relationship between the size of the Unit 2 reactor containment building and workers placing reinforcing steel on its massive facade.

million for construction in 1979 and more than $2.3 billion for the 1979-1981 period. Both projected expenditures are well above the industry average.

In 1978, the company increased its generating capacity to 11,056,000 kilowatts with the start of commercial operation in December of W. A. Parish Unit 6—a 660,000-kilowatt coal-fired generator.

W. A. Parish Coal Units

Work is progressing on HL&P's third unit designed to burn coal. Unit 7, a 600,000-kilowatt generator, is scheduled to begin operation in 1980. Work will begin that same year on Unit 8, also a 600,000-kilowatt generator, with completion scheduled for 1983.

Because of the planned use of relatively clean burning Western coal by HL&P, W. A. Parish Units 5, 6, and 7 will operate without expensive flue gas desulfurization equipment ("scrubbers"). However, as a result of amendments to the Clean Air Act, scrubbers will be required for Unit 8 and for any future coal-fired plants, regardless of the amount of contaminants in the coal.

Lignite in HL&P's Future

The company's plans to build a lignite plant were delayed in 1978 after Dow Chemical Company USA withdrew in May from what was designated as the Freestone Project. Plans announced in February had called for Dow to provide lignite for two, 750,000-kilowatt generating units to be built and operated in Freestone County, Texas by HL&P. HL&P was to have a 50% or 750,000-kilowatt share of those units.

HL&P has now decided to proceed with one, wholly-owned, 750,000-kilowatt unit to be completed in 1985 at a site outside the service area that is yet to be determined. A supply of lignite for the unit is now being negotiated. The estimated in-service date is based on the assumption that such fuel contracts and all construction permits and licenses will be obtained by September, 1981.

South Texas Project

HL&P announced in November that construction delays could defer initial operation of the South Texas Project (STP) up to two years. Completion of the project's two units is now scheduled for 1982 and 1983.

STP, a nuclear plant with two, 1,250,000-kilowatt reactors, is jointly-owned by HL&P, Central Power and Light Company and the cities of Austin and San Antonio. HL&P is project manager and owns 30.8% of the plant, which is located 80 miles southwest of Houston.

HL&P's announcement of the completion delay was made after results of an analysis by an independent consulting firm also indicated the extended schedule could push the plant's cost to about $2 billion.

STP's revised cost of $800 per kilowatt is still comparable to similar facilities under construction elsewhere in the country.

Allens Creek

The Allens Creek Nuclear Generating Station was the subject of regulatory delay and opposition from interveners in 1978. Allens Creek, planned as a wholly-owned, 1,200,000-kilowatt plant, is to be located about 50 miles west of Houston.

The company had planned to begin construction on Allens Creek in late 1978. However, the Atomic Safety and Licensing Board postponed by two months a pre-hearing which had been scheduled for September 15. The delay dashed the company's hopes to begin work on the plant in 1978.

In February, 1979, additional delays became almost certain when an environmental group and others were given permission to intervene in opposition to the granting of a construction permit.

As a result of the delays and the involvement of interveners, it's now expected that a construction permit for Allens Creek cannot be obtained before late 1979 and that the plant cannot be completed until 1986. Previously, a 1985 start-up date was planned. Should the licensing process be delayed further, the planned completion date of 1986 may not be met.

Reserve Margins And Demand

Delays in the scheduled completion of planned generating facilities may require the company to supplement its generating capability during the 1982-1985 period to maintain a reserve margin at or above 15%.

HL&P projects it will be between 150,000 and 400,000 kilowatts short of a 15% reserve margin during the period of 1982 to 1985. The company is now evaluating alternatives to meet these shortfalls, including purchased power.

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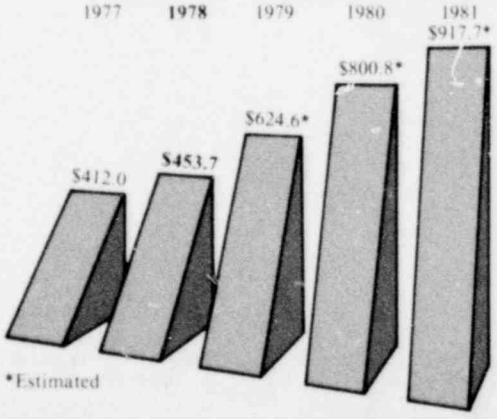
Generating Plant Construction Program

	Estimated Unit Capacity (MW)	Fuel	Scheduled In-Service Date	Estimated Expenditures in 1979-1981
W. A. Parish No. 7	600	Coal	1980	$129,864,000
South Texas No. 1	385	Nuclear	1982	32[illegible],745,000
South Texas No. 2	385	Nuclear	1983	
W. A. Parish No. 8	600	Coal	1983	36[illegible],330,000
To be determined	750	Lignite	1985	289,744,000
Allens Creek	1,200	Nuclear	1986	618,252,000

Construction Expenditures (Millions)



Opposite: The unfinished stack and superstructure of W. A. Parish Unit 7 is silhouetted against the evening sun. The 600,000-kilowatt coal-fired unit is scheduled for completion in 1980.

While the company expects it will be able to maintain a 15% reserve with its present construction program through 1981, it has signed an agreement with the City of Austin to purchase reserve energy in 1980 and 1981.

The City of Austin will sell HL&P 500,000 kilowatts per year on an as needed basis. This agreement serves the same purpose as if the capacity were installed on the HL&P system and will be an economical method to satisfy temporary needs.

Financing The System's Expansion

Permanent financing by HL&P and its parent during 1978 consisted of four issues:

- Houston Industries sold two million shares of common stock in February, 1978, at $29.30 per share. The net proceeds of the sale were invested primarily in the common stock of HL&P.
- In June, HL&P sold $19.2 million of 4.78% pollution control bonds.
- In August, HL&P sold $125 million of first mortgage bonds at a cost of 8.915%.
- In December, HL&P sold $100 million of first mortgage bonds at a cost of 9.344%.

In addition, HL&P's parent issued a total of 87,246 shares of common stock through the Dividend Reinvestment Plan at an average price of $30.16 per share. Another 171,902 common shares were issued through the Employee Stock Ownership plans at an average price of $32.76. The proceeds of both were invested in HL&P common stock.

To support its $625 million construction budget, sales of securities in 1979 began in January when HL&P sold $30 million of $9.04 cumulative preferred stock at a cost of 9.14%. HI sold two million shares of common stock in February at $29 1/8 per share. Proceeds of $54.8 million from the latter were invested in the common stock of HL&P to be used in support of its 1979 construction.

HL&P's Fast Changing Fuel Mix

The company passed a major milestone August 31 in its program to reduce its reliance on natural gas for boiler fuel when W. A. Parish Unit 5 achieved a 100% coal burn. Although this 660,000-kilowatt unit was designed to burn coal, it had been fired on natural gas from the time it was placed in commercial operation in December, 1977.

Unit 6, a twin to Unit 5, was placed on full coal burning status January 17, 1979. They represent 11.5% of the company's generating capability.

Natural gas provided 98% of HL&P's boiler fuel requirements in 1978. However, by 1990 gas is expected to account for only 11% of the company's generating requirements. Coal will account for 43% of HL&P's fuel mix in 1990 with oil and nuclear representing 31% and 15% of the fuel mix that year respectively.

Oil will be the transitional or "swing" fuel for the company. Nearly 5,500,000 kilowatts of gas-fired capacity, one-half of HL&P's total capacity, has been converted to burn oil as well as gas on a continuous basis.

In addition, 6.7 million barrels of oil storage and a pipeline connecting these plants are in place.

This mix could be affected if the Texas Railroad Commission modifies or eliminates a 1975 Natural Gas Order. Under this ruling, HL&P cannot enter into any additional natural gas contracts or extend its existing gas contracts. The commission announced in January, 1979, it will reconsider this order because no other state or the Federal government was following Texas' lead.

The National Energy Act has established a date of 1990 for the complete cutoff of natural gas as boiler fuel for base load plants. HL&P projects gas will account for 11% of its fuel mix that year. However, the Department of Energy has authority to grant exemptions under the act.

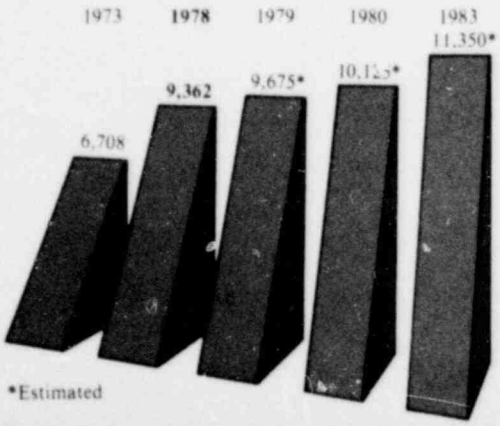
Fuel For Electric Generation

The company's fuel supply position was strengthened in 1978 by the signing of a long-term coal supply contract with Utility Fuels, Inc. (UFI), and a settlement with Westinghouse Electric Corporation concerning nuclear fuel for the South Texas Project.

In June, HL&P signed a contract with UFI for 165 million tons of low-sulfur coal over a 25-year period. Deliveries began in July. The coal will fuel W. A. Parish Units 5, 6 and 7.

In October, HL&P reached an agreement in its dispute with Westinghouse regarding nuclear fuel for the South Texas Project. The company, acting as an agent of the participating utilities of STP, sued in 1975 following an announcement that Westinghouse would be unable to fulfill uranium supply agreements.

Peak Demand Growth (Megawatts)



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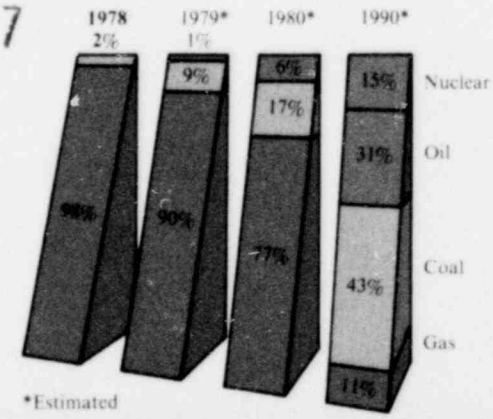
Energy Sources for Electric Generation



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The settlement assures a nuclear fuel supply for STP at terms very favorable to the STP participants. If the terms of the settlement develop to their fullest potential, the South Texas Project participants could receive full recovery of the value of the claim.

Also in 1978, HL&P began receiving uranium concentrate under terms of a contract with Atlas Corporation for the initial core of Allens Creek.

The company terminated financial support of a joint uranium project with Continental Oil Company in New Mexico for economic reasons. The project had been regarded as a source of additional uranium for Allens Creek. HL&P will request rate relief sufficient to amortize over a reasonable period of time the $8.9 million it had invested in the project. If the request is denied, the costs will be charged to income in the period such a determination is made.

HL&P is now seeking additional uranium concentrate for Allens Creek to replace in part that which the Conoco project was to provide.

The company has sufficient fuel supplies to meet its generating requirements through the early 1980's. Additional fuel contracts are now being negotiated. Natural gas will remain the backbone of HL&P's generating system through 1983. It is provided by two long-term contracts which expire in 1996 and 1984 respectively.

Low-sulfur coal for W. A. Parish Units 5 and 6 is being provided by Utility Fuels, which has a contract with Kerr-McGee Coal Corporation that expires in 1981. The coal comes from Kerr-McGee's Jacobs Ranch Mine in Wyoming, some 1,600 railroad miles from the W. A. Parish plant.

The cost to transport this coal increased significantly, from $15.60 to $17.11 per ton, in 1978. HL&P has appealed to the courts the Interstate Commerce Commission's approval of the original $15.60 tariff. The matter is still in litigation.

The company's fuel costs rose $164.4 million, or 32% over 1977. The average unit cost of fuel per million British Thermal Units (BTUs) was 126.2¢, compared to 105.5¢ the year before—a 20% increase. Fuel costs are expected to continue to climb in 1979.

Rates And The Regulatory Climate

The company entered into a new regulatory environment in 1978 when for the first time HL&P filed a request for a rate increase with the Texas Public Utility Commission (PUC).

The PUC, led by a three-man board appointed by the governor, assumed jurisdiction in 1976 over electric rates in unincorporated areas. Customers in these areas account for about 46% of HL&P's revenues.

Municipalities retained regulation over rates within their respective corporate limits with HL&P having the option to appeal their decisions to the PUC. If they desire, these cities can relinquish their rate-making authority to the commission, subject to recall. To date, only one municipality where HL&P furnishes service has transferred its rate jurisdiction to the PUC.

HL&P filed a request July 14 with the PUC and the incorporated cities it serves for rates designed to increase operating revenues by approximately $175 million, plus an additional $54 million for revenues which would have otherwise been collected under the company's then existing Cost of Service clause. On November 20, the PUC issued an order granting HL&P a rate increase, which on a system-wide basis, would increase operating revenues by approximately $98 million.

HL&P placed the new rates in effect throughout the system in December. The PUC is allowing the company to apply the new rates on an interim basis pending the outcome of appeals to the rate ordinances passed by some cities, including Houston, which granted increases lower than the PUC's rate order.

The specifics of the rate increase approved by the PUC were:

- It provided for a 13.8% return on common equity.
- It allowed 40% of Construction Work in Progress (CWIP) and nuclear fuel to be included in the rate base.
- It eliminated the company's Cost of Service adjustment which allowed HL&P to pass on monthly changes in labor costs, depreciation, interest and preferred dividend requirements on a 12-month moving average basis.

While the PUC granted an increase considerably less than what HL&P had asked for, the commission did handle the application in a timely manner. The PUC issued a final order on HL&P's request about four months after it was filed.

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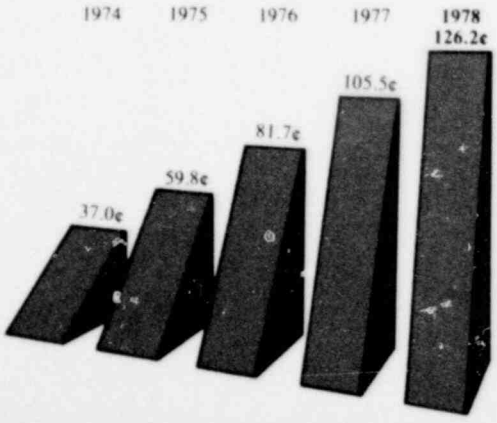
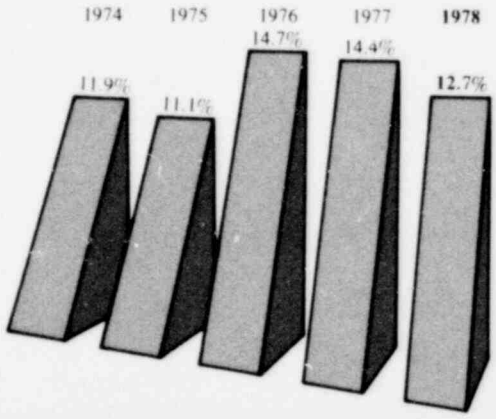
Average Cost of Fuel (Cents Per Million BTU)



HL&P Return on Average Common Equity



Based on the amount of increase the PUC approved and HL&P's financial needs, the company may be required to seek rate relief on a regular basis.

Research And Development

HL&P's R&D efforts are designed to develop new sources of energy and find better ways to use and conserve the ones already available.

In 1978, HL&P joined other utilities , the University of Texas and the Department of Energy in the drilling of a geopressured-geothermal well 30 miles south of Houston. The purpose of the project is to determine if hot and highly pressurized water laden with methane gas can be tapped to help meet the nation's energy requirements.

Drilling began in June. However, in December the well had to be abandoned at 15,700 feet after losing a piece of drilling equipment downhole. A new well was begun in January, 1979, near the site of the first.

HL&P is also continuing to help fund research in fusion at the University of Texas through the Texas Atomic Energy Research Foundation, which sponsors the UT Fusion Research Center. In 1978, construction began on the Texas Experimental Tokamak (TEXT) at UT, a new atomic fusion machine. It is expected to begin operation in 1980.

HL&P is also involved in a number of research projects involving energy conservation:

- The company is monitoring the amount of energy consumed by 20 test homes heavily equipped with energy-saving components. Electric service costs for the test homes will be compared to those of 10 "control" homes similar in size and design. When cost/benefit figures are available, they will be provided to builders and home buyers desiring to employ effective energy-saving measures in home construction.
- The company is providing direction and guidance to Rice University for a study of how changes in comfort levels affect attitudes toward energy conservation. It is expected the results will be used to demonstrate to the business community that certain conservation measures can be implemented without adversely affecting operations.
- The company is also studying the economics of using waste heat from air conditioners for water heating.

In addition to R&D activities of particular interest to HL&P, the company continued financial support of the Electric Power Research Institute (EPRI), which consolidates major research efforts of both public and investor-owned utilities.

Improving Energy Conservation

In promoting the wise and efficient use of electrical energy, HL&P accomplishes two objectives. First, it holds down the growth in peak demand for electricity, thus reducing the need for additional generating facilities which in turn minimizes capital, operational and maintenance costs.

Secondly, the company positions itself as one which is responsive to customers' concerns over the rising cost of energy by offering assistance and advice on how to avoid wasting energy and thus hold down electric bills.

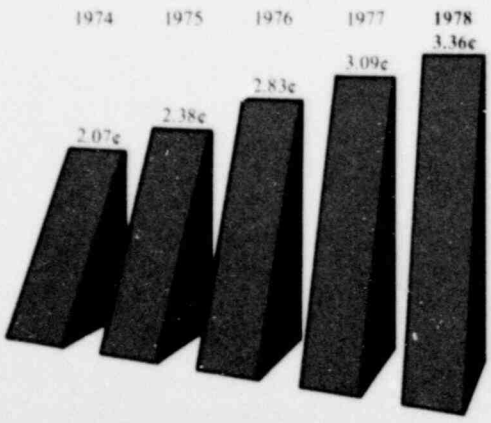
In 1978, HL&P made progress in achieving both these goals. The company estimates its promotion of conservation in all customer categories saved HL&P more than $25 million in future power plant construction costs.

A new Conservation Activities Division was formed in 1978 to plan and conduct the company's residential and commercial energy conservation programs. Its major accomplishments were:

- Saw that 49% of all homes started in the service area joined the company's "Energy Checked" program. The "Energy Checked" home is designed to meet energy efficiency standards which result in lower peak demands.
- For existing homes, provided information and assistance to more than 30,000 customers through presentations, personal consultation, and literature mailouts. Advice concentrated on weatherizing homes and modifying usage habits to conserve energy.
- In the business area, utilized personal calls and energy audits, seminars, and handout literature to educate business customers on energy conservation opportunities and how to implement them.

In addition to Conservation Activities' efforts, approximately 80% of HL&P's advertising in 1978 dealt with energy conservation. Such advertising generated more than 150,000 requests for literature on the subject.

Average Residential Cost Per Kwh (Cents)



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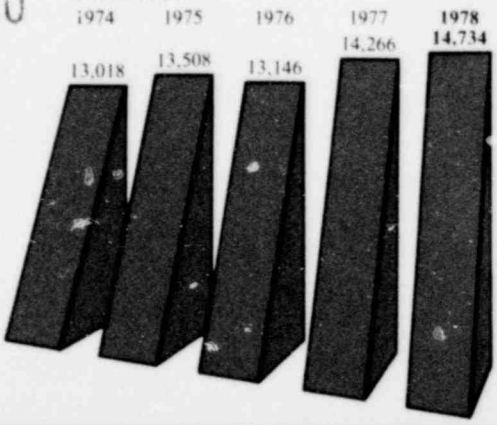
Average KWH Use Per Residential Customer

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Opposite: Drilling pipe is lined up for use in a geopressured-geothermal well in the background. HL&P, the University of Texas, other utilities and the Department of Energy are financing the drilling project.

HL&P's load management and conservation efforts will be intensified in 1979. Provisions within the Federal Energy Conservation Policy Act will require the company to make on-site audits of homes and assist homeowners in arranging installation of energy saving devices. The act will also require HL&P to arrange financing for the purchase of these devices and to provide detailed cost/benefit information. HL&P is now working to comply with the guidelines.

Protecting The Environment

The company's expenditures for environmental protection facilities have risen dramatically as a result of the start of coal burning.

In 1978, HL&P spent $32 million for environmental protection equipment. The company expects to spend $54 million for such facilities in the next two years. Expenditures for this equipment for the five years ending 1978 totaled $79.6 million.

Improving Service

The company has long been proud of its customer service record. Results of a survey conducted in late 1977 showed that 92% of those customers queried felt their electric service was reliable and dependable.

However, it became evident to the company in 1978 that the phenomenal growth in the number of customers and the resultant rise in workload volumes was challenging HL&P's ability to respond quickly to requests for service.

Consequently, a task force was created to evaluate HL&P's ability to respond to customer needs and make recommendations to improve customer response. As a result of its proposals, dis[illegible] managers were designated in geographic areas throughout the system and given responsibility to coordinate service activities in their respective areas.

This decentralization of responsibility has resulted in better and faster response to customer needs. Don Sykora, Commercial Vice President, assumed direction of this effort and the new title of Vice President of Customer Relations.

Building New Work Centers

In 1978, the company completed a 27,000-square-foot Chemical Laboratory building at its Energy Development Complex. The facility houses labs for health physics, materials testing, metallurgy, fuel oil and coal analysis, instrument testing and air quality and environmental studies.

At the complex, work continued on a 100,000-square-foot maintenance shop. Scheduled for completion in the first quarter of 1979, the facility will enable the company to make more in-house repairs of turbine generators and large pieces of equipment associated with power production.

In the northern sector of the city, where a good portion of Houston's building boom is taking place, progress was made on construction of the Gears Road Service Center. The 87,000-square-foot center will be finished in 1979.

Human Resources And Efficiency

Labor relations throughout the HL&P system remained good in 1978. A new two-year agreement between the company and the International Brotherhood of Electrical Workers, which represents approximately 3,350 bargaining unit employees, became effective May 26.

While HL&P's operating efficiency has been consistently good, the company has instituted a number of measures to hold down operating costs and increase the efficiency of its employees and operations.

An analysis of the company's operations begun by HL&P in 1975 is still ongoing. The study is being made under the direction of a management consulting firm, with the cooperation and assistance of special company audit teams and an HL&P coordinator.

The firm has presented staffing, organizational and procedural recommendations in the areas of materials management, data processing and clerical/administrative areas.

To date, approximately $3 million in savings has been documented by changes made as a result of the audit.

HL&P's top management team was strengthened in 1978 when following the annual shareholders' meeting, two new officers were elected and two others appointed to new positions in the company.

The new officers are Allen R. Beavers, Vice President-Purchasing & Services, and Edward A. Turner, Vice President-Power Plant Construction & Technical Services.

Beavers, who has 30 years of service with HL&P, was given added responsibility over Architecture, Building Services and Special Services. He was formerly General

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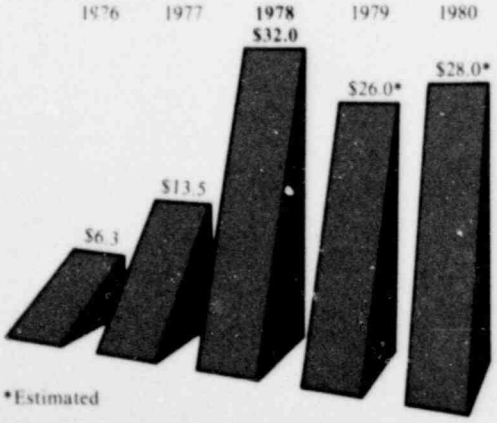
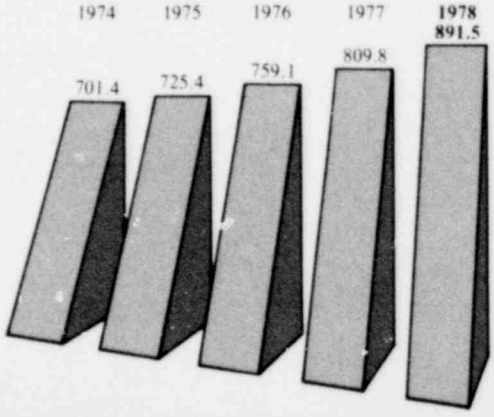
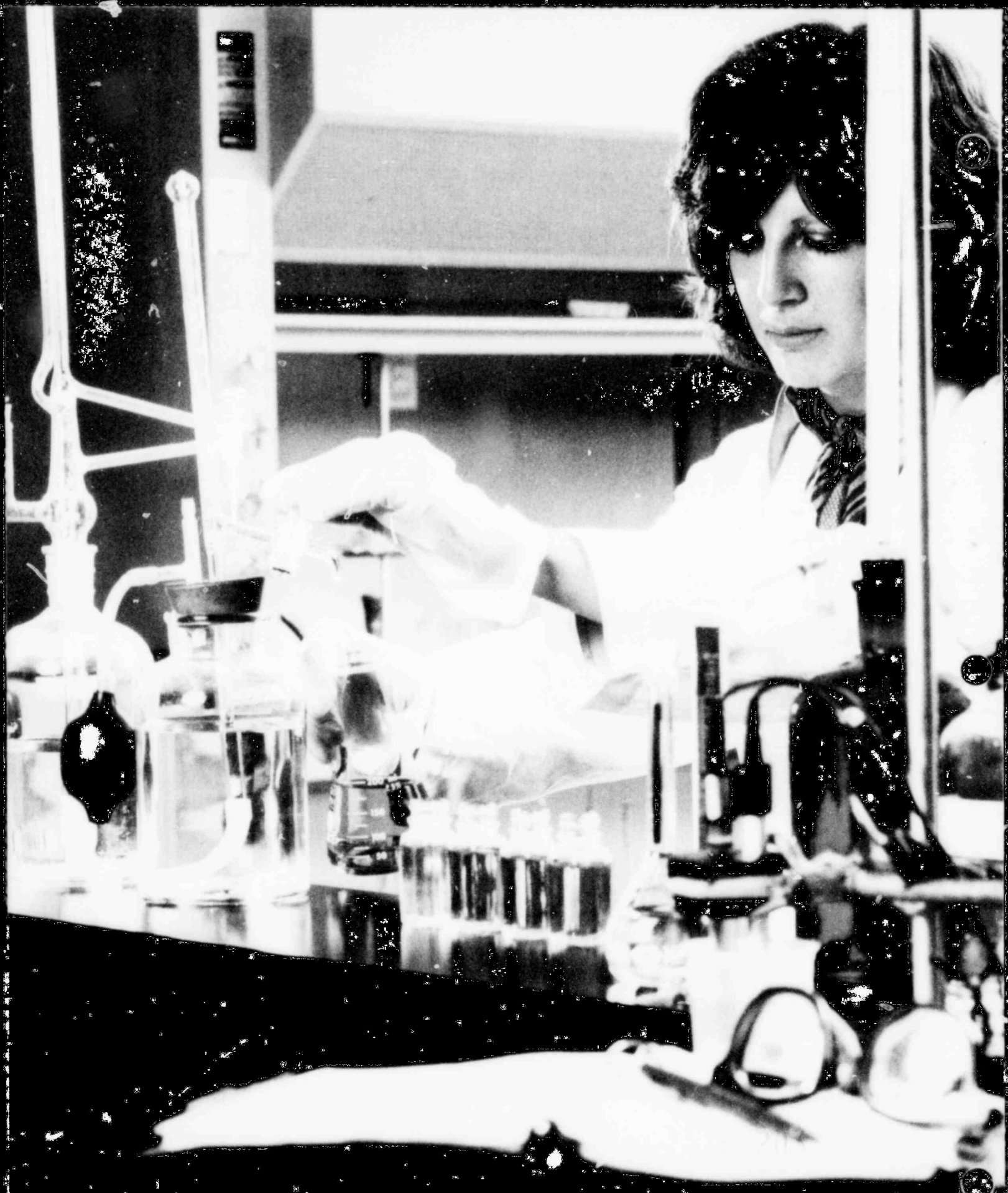
Expenditures for Environmental Protection Facilities (Millions)



*Estimated

Number of Customers (Thousands)





Opposite: Katie Dubey, an HL&P lab technician, conducts an analysis in the company's Chemical Building, which was completed in 1978.

Manager of Purchasing & Stores.

Turner was given responsibility for Power Plant Construction and Technical Services. Formerly General Manager of Transmission & Distribution, Turner has been with the company since 1954.

J. D. Cowart was appointed to the new position of Group Vice President-Administrative and R. Steve Letbetter to Comptroller.

Cowart continues to have responsibility for the company's administrative activities, including Personnel Relations, Corporate Services, Land & Right of Way, as well as Operational Research and Security functions. Cowart has been with HL&P since 1943.

Letbetter, previously Assistant Comptroller, continues in his new job to manage the company's Accounting Department. He joined HL&P in 1974.

Obtaining Public Understanding

HL&P broadened its efforts in 1978 to more effectively communicate an understanding of the issues in which the company is involved.

Through print, radio and television, the company emphasized the need to conserve energy, including how home weatherization measures and appliance selection and use affect electric bills.

During the year, volunteer employee members of the company's Speakers Bureau spoke to audiences totaling more than 17,000 on subjects including energy conservation, future energy sources, nuclear power and coal.

To help junior and senior high school students better understand the production, transmission and use of electricity, the company added a full-time science demonstrator in 1978 who gave programs to more than 10,000 students.

Opposite: A production platform about eight miles out in the Gulf of Mexico at the No. 6 well in State Tract 520 is the largest of several such platforms used in marketing Primary Fuels' offshore production.

Primary Fuels, Inc.

Primary Fuels (PFI) expanded its activities during a year in which production was limited by soft market conditions.

Average daily production in 1978 was approximately 30 million cubic feet of gas per day and 362 barrels of condensate. PFI had the capability to market 60 million cubic feet of gas per day in 1978.

PFI's contribution to HI's net income was $7.4 million or 24 cents per share, as compared to $6.1 million or 21 cents per share on approximately 2.1 million fewer shares in 1977.

Shell Contract

In 1978, PFI expanded its activities when it signed an agreement in August with Shell Oil Company to participate as a limited partner in Shell's onshore oil and gas exploration and production in most of the continental United States.

Under terms of the agreement, Shell and PFI will engage in drilling exploration and development wells and producing oil and gas onshore in the lower 48 states, excluding Michigan and part of the Gulf Coast. Term of the partnership is three and one-half years with Primary Fuels having the option of terminating the agreement at the beginning of each calendar year.

At year's end, PFI was participating with Shell in 19 exploratory wells in nine states. Of the 13 wells completed, two are oil producers and four others show promise of being productive.

Offshore Activity

Primary Fuels has a 50% interest in a joint oil and gas exploration venture being conducted along the lower Texas Gulf Coast.

Primary Fuels' share of offshore production in 1978 totaled approximately 11 billion cubic feet of gas and 132,000 barrels of condensate. At year's end, 26 of the 51 wells drilled were commercial producers, including the venture's first oil well.

Gas and condensate was sold to unaffiliated purchasers at an average price of approximately $1.91 per million BTU for the gas, after all transportation charges and other adjustments, and $12.86 per barrel for condensate.

At the end of 1978, Miller and Lents, Ltd., independent petroleum engineers, estimated Primary Fuels' net proved developed producing and nonproducing reserves at 88.7 billion cubic feet of gas and 1 million barrels of condensate.

	Estimated Net Recoverable Reserves of Primary Fuels as of January 1, 1979	
Classification	Gas Million Cubic Feet	Condensate Barrels
Proved Developed Producing	**77,266**	**604,725**
Proved Developed Nonproducing	**11,400**	**430,369**
Total	**88,666**	**1,035,094**

An oversupply of intrastate gas in 1978 prevented PFI from approaching its maximum production capability.

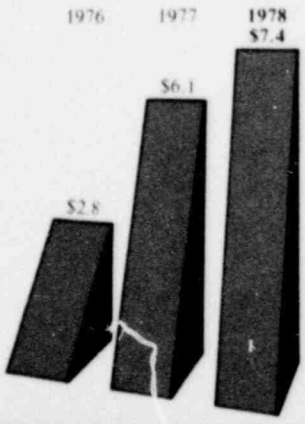
At year's end PFI had approximately 43,000 acres of offshore leases obtained from the state. In February, 1979, 14 tracts totaling 14,500 acres were acquired.

Of the 1978 total acreage, about 41% was held by commercial production or the presence of wells capable of commercial production. Remaining leases expire between 1981 and 1983, unless they are successfully drilled or the state allows them to be pooled with other leases that are producing.

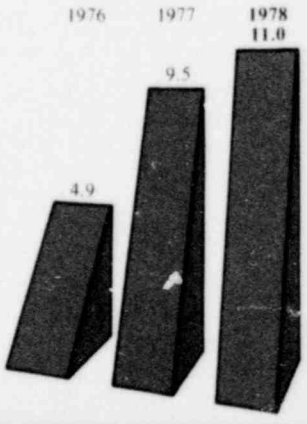
The El Gordo Field continued to be the most productive of the five fields discovered since the start of drilling in 1974. Located close to Matagorda Island, El Gordo accounted for approximately 66% of Primary Fuels' production in 1978. All natural gas from El Gordo is being purchased by Houston Pipe Line Company under a contract which expires in 1996.

Five wells completed in 1978 have yet to be connected to the pipe line.

Primary Fuels Net Income (Millions)



PFI Gas Production (Billions of Cubic Feet)



Opposite: A Utility Fuels unit train heads into the "dumper house" at the W. A. Parish plant for unloading. Coal-fired units (from left) 5, 6 and 7 are in the background.

Utility Fuels, Inc.

Utility Fuels (UFI) operated primarily as a supplier and transporter of coal in 1978. UFI was organized in 1973 to handle the acquisition and delivery of fuels to HL&P's generating plants.

UFI's major accomplishments for the year were:

- the signing of a contract for a 25-year supply of coal;
- the acquisition from HL&P of coal handling facilities at the W. A. Parish plant;
- the purchase of 1,150 railroad cars to haul coal from Wyoming to the W. A. Parish plant; and
- the completion of the first milling campaign at a uranium mine it owns in Wyoming.

In May, UFI purchased from HL&P coal handling facilities. The same month, HL&P transferred its short-term coal contract with Kerr-McGee Coal Corporation to UFI. UFI also purchased a fleet of 1,150 coal cars.

Coal Contract

In June, UFI signed a contract with Spring Creek Coal Company, a subsidiary of Northern Energy Resources Company whose parent is Pacific Power & Light Company, for 181.1 million tons of low-sulfur coal to be provided to Utility Fuels over a 25-year period beginning in 1980.

The coal will come from a proposed mine near Decker, Montana, some 1,600 railroad miles from Houston, and will help meet UFI's contract commitments to HL&P for coal.

The arrangement of UFI undertaking the fuel supply function benefits HL&P in two ways: 1) It frees HL&P capital to finance projects more closely related to providing electric service. 2) It enables UFI to take advantage of financing opportunities which cannot be utilized by HL&P because of its financial requirements as a utility. These two advantages combine to save money for shareholders and customers.

Uranium Mine

In addition to its coal-related activities, UFI continued to make progress at a uranium mine located on an 80-acre site near Casper, Wyoming. In June, UFI completed its first milling campaign, processing of uranium ore into yellowcake, with 113,165 pounds of yellowcake made available to UFI.

Based on estimates of the lease's recoverable reserves, the project could yield enough uranium concentrate for a maximum of three years of fuel reloads for Allens Creek. However, at the present there are no commitments to sell this uranium concentrate to HL&P or anyone else.

UFI will aggressively pursue further fuel contracts in 1979. It expects to purchase two unit trains of 110 coal cars each in April and May. UFI expects to own approximately 2,500 cars by the time W. A. Parish Unit 8 goes on line in 1983.

UFI sold $65 million of 9% secured notes in 1978 to finance the purchase of coal handling equipment and coal cars.

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Summary of Consolidated Operations

(Thousands of Dollars)

	1978	1977	1976	1975	1974
Operating Revenues:					
Electric	**$ 1,303,604**	$ 1,069,786	$ 841,616	$ 634,153	$ 486,837
Fuel Sales	**20,823**	6,305			
Oil and Gas	**25,011**	19,470	9,558	2,372	
Total Operating Revenues	**1,349,438**	1,095,561	851,174	636,525	486,837
Operating Expenses:					
Electric:					
Operation and Maintenance	**196,942**	159,093	129,569	120,010	104,300
Fuel	**682,261**	517,870	353,651	239,947	139,323
Other Taxes	**60,172**	51,435	47,364	42,622	36,777
Cost of Fuel Sold	**15,489**	6,319			
Oil and Gas Operating Expenses	**5,449**	3,960	1,515	304	
Depreciation, Depletion and Amortization	**81,010**	69,073	58,953	51,428	45,148
Total Operating Expenses	**1,041,323**	807,750	591,052	454,311	325,548
Net Operating Income	**308,115**	287,811	260,122	182,214	161,289
Other Income—Net	**19,718**	14,699	17,171	9,014	8,643
Fixed Charges	**100,397**	79,171	81,204	74,861	54,111
Federal Income Taxes	**98,779**	97,703	90,775	51,949	52,245
Net Income	**$ 128,657**	$ 125,636	$ 105,314	$ 64,418	$ 63,576
Earnings Per Common Share	**$ 4.21**	$ 4.41	$ 4.01	$ 2.92	$ 2.92
Dividends Per Common Share	**$ 2.12**	$ 1.86	$ 1.61	$ 1.56	$ 1.50
Shares Outstanding—End of Year (000)	**31,089**	28,828	26,752	23,752	21,752
Shares Outstanding—Average (000)	**30,590**	28,479	26,252	22,097	21,752
Electric Plant Investment (thousands of $):					
Gross Additions	**482,403**	436,294	310,500	321,023	266,247
Total Plant Investment	**3,381,245**	2,943,997	2,494,712	2,191,706	1,872,217
Accumulated Depreciation	**512,604**	450,946	396,417	348,185	310,469
% of Total Plant Investment	**15.2**	15.3	15.9	16.0	16.6
Generating Statistics:					
Steam Electric Stations Economy— Btu Per Net KWH Generated	**10,223**	10,154	10,042	10,009	9,929
Turbine Name Plate Capacity (MW)	**11,056**	10,427	9,791	9,429	9,080
Maximum System Load (MW)	**9,362**	8,645	8,219	7,465	7,150
Electric Plant in Service Per KW of Maximum System Load ($)	**288**	272	235	239	229
General Statistics:					
Kilowatt Hour Sales (000)	**50,275,767**	45,885,725	40,858,700	38,146,548	35,807,282
Number of Customers	**891,509**	809,820	759,085	725,387	701,352
Average Residential Use (KWH)	**14,734**	14,266	13,146	12,508	13,018
Average Residential Cost Per KWH	**3.36¢**	3.09¢	2.83¢	2.38¢	2.07¢
Book Value Per Common Share	**$ 33.04**	$ 31.14	$ 28.27	$ 26.42	$ 25.61
Average Cost of Fuel (Million BTU)	**126.2¢**	105.5¢	81.7¢	59.8¢	37.0¢

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Management's Discussion and Analysis of Summary of Consolidated Operations

Operating Revenues

Electric. Operating revenues increased $233,818,000 or 22% in 1978 as compared with $228,170,000 or 27% in 1977. Such increases have been attributable to recoveries of increased fuel costs, rate increases, and increased kilowatt hour (KWH) sales in the following relative proportions:

Comparative Periods	Recovery of Increased Fuel Costs	Rate Increases	Increased KWH Sales
1978 v. 1977	73%	5%	22%
1977 v. 1976	74%	3%	23%

Increases in recoveries of fuel costs (see "Operating Expenses — Electric — Fuel Costs," below) have risen as a result of increased generation and sharp increases in the cost of fuel. Houston Lighting & Power Company (HL&P), as a result of a settlement in April 1976 with the City of Houston, was authorized to make monthly rate adjustments for certain changes in labor costs, depreciation, interest, and dividend requirements on preferred stock. This Cost of Service adjustment accounted for electric operating revenues of $5,498,000 and $16,499,000 in 1977 and 1978, respectively. In November 1978, the Texas Public Utility Commission issued an order granting HL&P a rate increase and eliminating the Cost of Service adjustment. The new electric rates were placed into effect during December of 1978.

Sales in 1976 were adversely affected by unseasonably mild weather, particularly with respect to residential users.

Fuel Sales. The increases in fuel sales reflect the delivery and sale of coal by Utility Fuels, Inc. (UFI) to HL&P which began in July of 1978. (See "Operating Expenses — Cost of Fuel Sold," below.)

Oil and Gas. Sales of oil and gas to others by Primary Fuels, Inc., (PFI) a wholly-owned subsidiary of Houston Industries (HI) increased to $25,011,000 in 1978 as compared with $19,470,000 in 1977. Increases in sales of oil and gas are due primarily to increased production. Daily production at the end of 1978 was approximately 30 million cubic feet of gas and 262 barrels of condensate. Net production totaled approximately 11,049 million cubic feet of gas and 132,000 barrels of condensate during 1978 as compared with 9,458 million cubic feet of gas and 81,000 barrels of condensate in 1977. Current gas and condensate production is limited by market demand. The gas is being sold under long-term contracts to unaffiliated purchasers for use within the state of Texas at an average price, after all transportation charges and other adjustments, of approximately $2.11 per thousand cubic feet. The contract prices are subject to future escalation. Condensate, which is subject to federal price controls, is being sold at $12.86 per barrel.

Operating Expenses

Electric. *Operation and Maintenance.* These expense items increased because of general inflationary pressures, increases in the number of customers and the amount of electricity generated, and the performance of scheduled maintenance. During 1976, these same factors had an impact on operation expenses; however, maintenance expenses were lower than normal primarily due to less scheduled maintenance and a three-month strike. The net effect of these items resulted in an increase in operation and maintenance expense of 24% in 1978 and 23% in 1977.

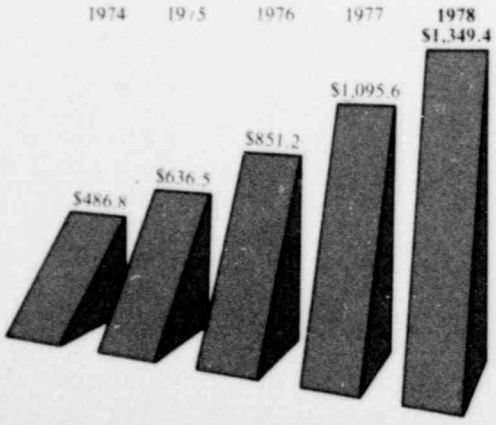
Fuel. The cost of fuel to HL&P has increased substantially over the past four years. Of the $164,391,000 and $164,219,000 increases for 1978 and 1977, approximately $111,891,000 and $117,290,000, respectively, were attributable to higher prices with the remainder of the increase resulting from increased generation. Since December, 1975, increased fuel costs have been recovered on a current basis through application of fuel adjustment clauses in its rate schedules.

HL&P's fuel requirements during 1978 were met primarily with natural gas. In August, the W. A. Parish Unit No. 5 generating station achieved a 100% coal burn. In January, 1979, Unit No. 6 was placed on full coal burning status. It is expected that coal will account for 9% of HL&P's fuel requirement in 1979.

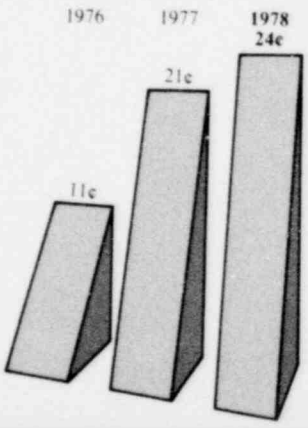
Other Taxes. These taxes increased 17% during 1978 and 9% during 1977 as a result of increased valuations, additions to property and increased revenues.

Cost of Fuel Sold. Increases in the cost of fuel sold reflect the delivery and sale of coal by UFI to HL&P which was initiated in July of 1978. The fuel delivered was used in HL&P's first coal-fired unit which switched from natural gas to coal.

Revenues (Millions)



PFI Contribution to HI Earnings (Cents Per Share)



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Oil and Gas Operating Expense. Increases in oil and gas expenses were a result of greater production from existing reserves. PFI follows the full-cost method of accounting for costs incurred in the exploration and development of oil and gas reserves. The full-cost method requires capitalization of such costs with amortization as estimated reserves are produced. (See Note 1 to the Notes to Consolidated Financial Statements.)

Depreciation, Depletion and Amortization. Depreciation expense was approximately 3.3% of average depreciable plant in service for 1976 through 1978. The increases in depreciation expense are attributable to additions to depreciable plant.

Other Income—Net. Increases in this item relate primarily to increases in amounts for the Allowance for Funds Used During Construction (AFUDC) which corresponds to changes in the average balance of qualified projects included in Construction Work in Progress. Since January 1, 1977, the debt portion of the AFUDC has been reclassified as a reduction of fixed charges. The decrease in other income in 1977 is attributable to this reclassification.

Fixed Charges. Significant increases in annual construction expenditures have required substantial external financing through the issuance of debt and equity securities during a period of high capital costs. Such financings have resulted in a significant increase in both interest expense and preferred dividend requirements. See Statements of Subsidiaries' Preferred Stock and Long-Term Debt and Statements of Changes in Consolidated Financial Position. Other interest charges decreased in 1976 and 1977 as a result of smaller average balances of short-term debt outstanding during those periods. However, in 1978 interest charges increased as a result of a higher average balance of short-term debt outstanding and increases in short-term interest rates. Since January 1, 1977, the debt portion of AFUDC has been reclassified as a reduction of fixed charges. The decrease in fixed charges in 1977 is attributable primarily to this reclassification.

Federal Income Taxes. Changes in federal income taxes are generally related to changes in income excluding taxes and AFUDC. The company did not provide for deferred income taxes on interest which is deducted currently for tax purposes but capitalized for accounting purposes, and on additions to the property insurance reserve which are expensed currently for accounting purposes but not allowed as a deduction for tax purposes until a loss is incurred. As a result, the effective tax rate for 1976, 1977, and 1978 was 43.6%, 41.3% and 40.4%, respectively.

Earnings. Net income for 1978 increased $3,021,000 resulting in earnings per share of $4.21 as compared with $4.41 a share in 1977 and $4.01 a share in 1976. Escalating operating costs in 1978 limited the increase in earnings. Increased earnings in 1978 have been attributable to rate increases and increased KWH sales. New electric rates, which were placed into effect during December of 1978, were based upon the higher cost levels being experienced in 1977 and 1978. The effect of these new rates will not be fully realized until the current year.

Construction Budget and Financing. During February, 2,000,000 shares of common stock were sold by HI at a public offering price of $29.30 per share. During June $19,200,000 of 4.78% water pollution control revenue bonds were sold by HL&P, during August $125,000,000 of 30-year First Mortgage Bonds were sold by HL&P at an effective interest cost of 8.915%, and during December $100,000,000 of 30-year First Mortgage Bonds were sold by HL&P at an effective interest cost of 9.344%. In addition, UFI, sold $65,000,000 of 9% secured notes during 1978. Internally generated funds enabled the company to finance the remainder of the 1978 construction program.

In January, 1979, 300,000 shares of $9.04 series cumulative preferred stock were sold by HL&P at a cost of 9.14% and in February, 1979, an additional 2,000,000 shares of common stock were sold by HI at a public sale offering price of $29.125 per share. Capitalization at December 31, 1978, adjusted to give effect to the February, 1979 sales of common and preferred stocks, reflected long-term debt of 51.6%, preferred stock of 8.9% and common equity of 39.5%.

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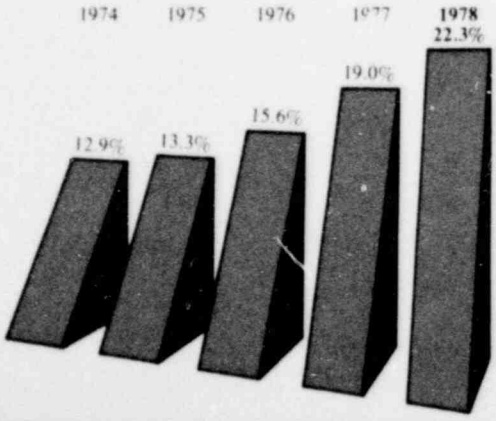
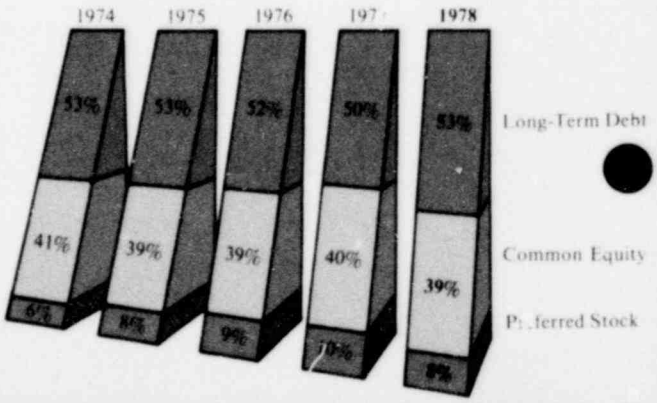
AFUDC as a Percentage of Net Income



Capital Structure



Statements of Consolidated Income and Retained Earnings

(Thousands of Dollars)

	Year Ended December 31, 1978	1977
Revenues:		
Electric	**$ 1,303,604**	$ 1,069,786
Fuel Sales	**20,823**	6,305
Oil and Gas	**25,011**	19,470
Total	**1,349,438**	1,095,561
Expenses:		
Electric:		
Operation and Maintenance (includes research and development costs: 1978, $8,775; 1977, $9,752)	**196,942**	159,093
Fuel	**682,261**	517,870
Other Taxes	**60,172**	51,435
Cost of Fuel Sold	**15,489**	6,319
Oil and Gas Operating Expense	**5,449**	3,960
Depreciation, Depletion and Amortization	**81,010**	69,073
Total	**1,041,323**	807,750
Net Operating Income	**308,115**	287,811
Other Income:		
Allowance for Other Funds Used During Construction	**17,029**	14,088
Other—Net	**2,689**	611
Total	**19,718**	14,699
Fixed Charges:		
Interest on Long-Term Debt	**87,140**	71,888
Other Interest	**7,566**	3,393
Allowance for Borrowed Funds Used During Construction	**(11,639)**	(9,821)
Preferred Dividends of Subsidiary	**17,330**	13,711
Total	**100,397**	79,171
Income Before Federal Income Taxes	**227,436**	223,339
Federal Income Taxes:		
Current	**(3,074)**	13,211
Deferred:		
Liberalized Depreciation	**34,511**	27,367
Investment Tax Credit	**53,989**	47,635
Amortization of Investment Tax Credit	**(3,156)**	(2,310)
Other—Net	**16,509**	11,800
Total	**98,779**	97,703
Net Income	**128,657**	125,636
Retained Earnings, Beginning of Year	**505,165**	432,165
Total	**633,822**	557,801
Less Common Stock Dividends: $2.12 a share in 1978 and $1.86 a share in 1977	**64,458**	52,636
Retained Earnings, End of Year	**$ 569,364**	$ 505,165
Earnings Per Common Share (based on weighted average shares outstanding: 30,589,992 in 1978 and 28,478,757 in 1977)	**$ 4.21**	$ 4.41

See notes to consolidated financial statements.

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Consolidated Balance Sheets (Thousands of Dollars)

Assets	December 31, 1978	1977
Property, Plant and Equipment—At Cost:		
Plant (Note 3):		
Production	**$ 1,551,962**	$ 1,296,211
Transmission	**290,951**	273,381
Distribution	**683,425**	616,936
General	**165,789**	160,127
Construction Work in Progress	**621,175**	538,109
Nuclear Fuel In Process	**65,777**	56,067
Coal Handling Equipment	**71,[illegible]**	
Electric Plant Acquisition Adjustments	**3,166**	3,166
Oil, Gas and Mining Property	**89,348**	57,245
Total	**3,542,063**	3,001,242
Less Accumulated Depreciation, Depletion and Amortization	**528,083**	458,483
Property, Plant and Equipment—Net	**3,013,980**	2,542,759
Current Assets:		
Cash in Banks	**10,606**	12,263
Temporary Cash Investments, at Cost	**69,064**	
Working Funds and Special Deposits	**4,650**	3,953
Accounts Receivable:		
Customers (less accumulated provision for uncollectible accounts)	**58,239**	41,564
Others	**31,721**	25,353
Fuel Stock:		
Oil, at Average Cost	**49,367**	51,405
Coal, at Lifo Cost	**25,304**	
Materials and Supplies, at Average Cost	**24,023**	20,072
Prepayments	**2,444**	2,727
Total	**275,418**	157,337
Deferred Debits	**25,363**	19,769
TOTAL	**$ 3,314,761**	$ 2,719,865

See notes to consolidated financial statements.

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Liabilities

	December 31, 1978	1977
Common Stock Equity:		
Common stock, no par; authorized, 50,000,000 shares; outstanding, 31,089,102 shares at December 31, 1978 and 28,828, 236 shares at December 31, 1977 (1,024,976 shares reserved for conversion of 5½% convertible debentures due 1985) (Note 8)	**$ 457,515**	$ 392,425
Retained earnings	**569,364**	505,165
Total	**1,026,879**	**897,590**
Preference Stock—No par; authorized, 10,000,000 shares, none outstanding.		
Cumulative Preferred Stock of Subsidiary (Statement on following page)	**213,945**	214,000
5½% Convertible Debentures—Due 1985 (convertible into common stock of the company at a rate of $38.96 a share) (Note 8)	**39,933**	40,000
Long-Term Debt of Subsidiaries (Statement on following page)	**1,377,646**	1,074,980
Total Capitalization	**2,658,403**	2,226,570
Current Liabilities:		
Notes Payable (Note 4)	**56,497**	31,929
Accounts Payable	**115,628**	79,970
Taxes Accrued	**21,099**	23,552
Interest Accrued	**28,491**	23,375
Accrued Liabilities to Municipalities	**27,972**	23,695
Dividends Declared	**4,332**	3,759
Current Portion of Long-Term Debt	**3,930**	
Other	**12,711**	11,637
Total	**270,660**	197,917
Deferred Credits:		
Accumulated Deferred Federal Income Taxes	**192,855**	142,254
Unamortized Investment Tax Credit	**153,161**	107,765
Other	**31,182**	37,359
Total	**377,198**	287,378
Property Insurance Reserve	**8,500**	8,000
Commitments and Contingencies (Note 5)		
TOTAL	**$ 3,314,761**	$ 2,719,865

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Statements of Subsidiaries' Preferred Stock and Long-Term Debt

(Thousands of Dollars)

	December 31, 1978	1977
Cumulative Preferred Stock of Houston Lighting & Power Company (Note 2)—Without par value; authorized 10,000,000 shares; outstanding (entitled upon involuntary liquidation to $100 a share):		
$4 series, 97,397 shares	**$ 9,740**	$ 9,740
$6.72 series, 250,000 shares	**25,115**	25,115
$7.52 series, 500,000 shares	**50,225**	50,225
$9.52 series, 400,000 shares	**39,372**	39,372
$9.08 series, 400,000 shares	**39,395**	39,395
$8.12 series, 500,000 shares	**50,098**	50,153
TOTAL	**$ 213,945**	$ 214,000
Long-Term Debt (Note 3):		
Houston Lighting & Power Company:		
First mortgage bonds:		
Series 3¼%, due 1981	**$ 20,000**	$ 20,000
Series 2¾%, due 1985	**30,000**	30,000
Series 3¼%, due 1986	**30,000**	30,000
Series 4¾%, due 1987	**40,000**	40,000
Series 3%, due 1989	**30,000**	30,000
Series 4⅞%, due 1989	**25,000**	25,000
Series 4½%, due 1992	**25,000**	25,000
Series 5¼%, due 1996	**40,000**	40,000
Series 5¼%, due 1997	**40,000**	40,000
Series 6¾%, due 1997	**35,000**	35,000
Series 6¾%, due 1998	**35,000**	35,000
Series 7½%, due 1999	**30,000**	30,000
Series 7¼%, due 2001	**50,000**	50,000
Series 7½%, due 2001	**50,000**	50,000
Series 8⅛%, due 2004	**100,000**	100,000
Series 10⅛%, due 2004	**100,000**	100,000
Series 8¾%, due 2005	**125,000**	125,000
Series 8⅜%, due 2006	**125,000**	125,000
Series 8⅜%, due 2007	**125,000**	125,000
Series 8⅞%, due 2008	**125,000**	
Series 9¼%, due 2008	**100,000**	
Total	**1,280,000**	1,055,000
7⅜% Water Pollution Control Revenue Bonds, due 2004	**18,000**	18,000
4.78% Water Pollution Control Revenue Bonds, due 1998 (net of $2,274 of proceeds held by trustee)	**16,926**	
Utility Fuels, Inc.:		
9% secured notes, maturing $7,200 annually through 1988	**61,400**	
Other	**1,320**	1,980
TOTAL	**$ 1,377,646**	$ 1,074,980

See notes to consolidated financial statements.

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Statements of Changes in Consolidated Financial Position

(Thousands of Dollars)

	Year Ended December 31, 1978	1977
Source of Funds:		
Operations:		
Net Income	$ 128,657	$ 125,636
Items Not Requiring Current Outlay of Working Capital:		
Depreciation, Depletion and Amortization	82,303	70,120
Deferred Federal Income Taxes—Net	50,929	38,148
Investment Tax Credit Deferred—Net	44,380	39,190
Allowance for Funds Used During Construction	(28,668)	(23,909)
Total	277,601	249,185
Financing and Other:		
Sale of First Mortgage Bonds	225,000	125,000
Sale of Secured Notes	65,000	
Sale of Water Pollution Control Revenue Bonds (net of proceeds held by trustee)	16,926	
Sale of 500,000 Shares of $8.12 Series Preferred Stock		50,153
Sale of 2,260,866 Shares of Common Stock	65,090	
Sale of 2,076,109 Shares of Common Stock		68,331
Other—Net	(5,299)	4,218
Total	644,318	496,887
Application of Funds:		
Construction and Nuclear Fuel Expenditures (net of allowance for funds used during construction)	530,594	466,256
Common Stock Dividends	64,458	52,636
Reclassification to Current Maturity of Long-Term Debt	3,930	
Total	598,982	518,892
Increase (Decrease) in Working Capital	$ 45,336	$ (22,005)
Changes in Components of Working Capital:		
Increase (Decrease) in Current Assets:		
Cash in Banks	$ (1,657)	$ 2,001
Temporary Cash Investments	69,064	
Customer Accounts Receivable	16,675	6,404
Fuel Stock	23,266	(2,369)
Materials and Supplies	3,951	(5,408)
Other	6,782	4,781
Total	118,081	5,409
Increase (Decrease) in Current Liabilities:		
Notes Payable	24,568	25,625
Accounts Payable	35,660	10,085
Taxes Accrued	(2,453)	(19,487)
Interest Accrued	5,116	2,761
Current Portion of Long-Term Debt	3,930	
Other	5,924	8,430
Total	72,745	27,414
Increase (Decrease) in Working Capital	$ 45,336	$ (22,005)

See notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

For the Years Ended December 31, 1978 and 1977

1. Accounting Policies. The following summarizes the more significant accounting policies of the company and its subsidiaries. The accounting records of Houston Lighting & Power Company (HL&P) are maintained in accordance with the Uniform System of Accounts prescribed by the Texas Public Utility Commission.

Principles of Consolidation

The consolidated financial statements include the accounts of the company and its wholly owned subsidiaries, HL&P (the principal subsidiary), Primary Fuels, Inc. and Utility Fuels, Inc. (UFI). All significant intercompany transactions and balances are eliminated in consolidation, except purchases of coal by HL&P from UFI that are not eliminated because of the distinction, for regulatory purposes, between utility and non-utility operations.

Plant

The cost, reduced by contributions in aid of construction, of additions to electric plant, betterments to existing property, and replacements of units of property retired is capitalized. Cost includes the original cost of contracted services, direct labor and material, indirect charges for engineering supervision and similar overhead items, and an Allowance for Funds Used During Construction (AFUDC). AFUDC, 6.5% on projects estimated to cost $50,000 or more and estimated to require 90 days or more to construct, represents the cost of borrowed funds used for construction, and a reasonable rate on other funds so used.

Maintenance of property and replacements and renewals of items determined to be less than units of property are charged to expenses—operation and maintenance. The actual or average book cost of units of property replaced or renewed, plus removal cost, less salvage, is charged to accumulated depreciation.

The company computes depreciation using the straight-line method. The provisions for 1978 and 1977 were about 3.3% of the depreciable cost of plant.

Oil and Gas Property

The full cost method of accounting is used for oil and gas operations. Accordingly, all costs of acquisition, exploration and development of properties are capitalized. Depreciation, depletion and amortization of these costs are determined on the unit-of-production method based on the estimated proved reserves of producing oil and gas properties.

Revenues — Electric

Revenues are recognized from the sale of electricity as bills are rendered to customers. Rate schedules include fuel adjustment clauses which permit recovery of fuel expenses in the month incurred.

Federal Income Taxes

The company follows the policy of comprehensive interperiod income tax allocation, except that deferred income taxes are not provided on interest which is deducted currently for federal income tax purposes but capitalized for accounting purposes, and additions to the property insurance reserve which are expensed currently for accounting purposes but not allowed as a deduction for tax purposes until a loss is incurred.

The investment tax credit applied as a reduction of federal income taxes has been deferred and is being amortized over the estimated service lives of the related property.

Property Insurance Reserve

The costs of replacing major uninsured plant losses, less related tax effects, are charged to the reserve when incurred.

Retirement Plan

The company has a noncontributory retirement plan covering eligible employees. The cost of the plan was about $4,773,000 in 1978 and $3,925,000 in 1977. Unfunded prior service costs of $20,863,000 are being amortized over a 40-year period. The policy of the company is to fund pension costs accrued. The actuarially computed value of vested benefits does not exceed the fund's assets.

Earnings Per Common Share

Earnings per common share are computed by dividing net income by the weighted average number of common shares outstanding during the respective periods. Common stock equivalents outstanding during the periods did not have a material dilutive effect on earnings per share.

2. Preferred Stock. Any part or all of HL&P's preferred stock may be redeemed at the option of the company at the following per share prices, plus any unpaid accrued dividends to date of redemption:

$4 Series, $105.00. $6.72 Series: through July 31, 1983, $103.51; thereafter, $102.51. $7.52 Series: through October 31, 1982, $105.35; thereafter, $103.35 to

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$102.35. $9.52 Series: through September 30, 1985, $109.52; thereafter, $105.00 to $101.00. $9.08 Series: through March 31, 1981, $109.08; thereafter $105.00 to $101.00. $8.12 Series: through November 30, 1982, $109.37; thereafter, $106.25 to $102.25.

3. First Mortgage Bonds. At December 31, 1978, sinking or improvement fund requirements of HL&P's first mortgage bonds outstanding will be $22,100,000 for the year 1979, $23,350,000 for the year 1980, $25,600,000 for the year 1981 and $25,200,000 for the years 1982 and 1983. Of such requirements, $12,800,000 for each of the years 1979 through 1981 and $12,600,000 in 1982 and 1983 may be satisfied by certification of property additions at 100% of the requirements and the remainder by certification of such property additions at 166-2/3% of the requirements. Sinking or improvement fund requirements for 1978 and prior years have been satisfied by certification of property additions.

The issuable amount of HL&P first mortgage bonds is unlimited as to authorization, but limited by property, earnings and other provisions of the mortgage and deed of trust and the supplemental indentures thereto. All of the company's plant is subject to liens securing its long-term debt.

4. Short-Term Financing. The interim financing requirements of the company's operating subsidiaries are met through short-term bank loans and the issuance of commercial paper. The company has bank lines of credit aggregating $270,000,000 (as compared with $241,000,000 during 1977) which limit its total short-term borrowings and provide for interest at the prime rate. No compensating balances are required by the lines of credit.

Additional information with respect to short-term borrowings is as follows:

	1978	1977
At December 31:		
Borrowings outstanding:		
Bank Loans	**$30,300,000**	$31,100,000
Commercial Paper	**25,000,000**	
	$55,300,000	$31,100,000
Weighted average interest rate on aggregate borrowings outstanding	**11.20%**	7.75%
For the year ended December 31:		
Weighted average aggregate borrowings outstanding	**$ 78,125,000**	$ 37,021,000
Weighted average interest rate on aggregate borrowings outstanding	**8.67%**	6.69%
Maximum aggregate borrowings outstanding at any month end	**$133,900,000**	$119,500,000

5. Commitments and Contingencies. Significant commitments have been incurred in connection with HL&P's construction program and for nuclear fuel purchases. The construction program is presently estimated to cost about $624,647,000 in 1979, $800,810,000 in 1980, and $917,687,000 in 1981. These amounts do not include approximately $73,236,000 expected to be spent during such period for uranium concentrate and nuclear fuel processing services for HL&P's South Texas and Allens Creek nuclear plants and in addition, approximately $54,165,000 by UFI for coal handling equipment and railroad cars which will serve HL&P's W. A. Parish plant. Commitments in connection with HL&P's construction program, principally for generating plants and related facilities, are generally revocable by HL&P subject to reimbursement of manufacturers' or expenditures incurred or other cancellation penalties.

The company has no material lease commitments.

HL&P is presently negotiating certain vendor claims resulting from the cancellation in 1976 of one of two units at its Allens Creek nuclear project. Recovery over a five-year period of claims settled through March 31, 1978 has been authorized by the regulatory authority. As remaining claims are settled and rate applications are pending, requests will be made for recovery. If the requests are denied, the costs will be charged to income in the period such denial is made. Such charge, if any, is not expected to have a significant effect on future operating results.

In October 1978, HL&P terminated its financial support of a uranium exploration project in which it had invested $8,958,000 as of December 31, 1978. HL&P will request rate relief sufficient to amortize such costs over a reasonable period. If the request is denied, the costs will be charged to income in the period such denial is made.

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6. Unaudited Quarterly Results of Operations. The following unaudited quarterly financial information for 1978 and 1977 includes, in the company's opinion, all adjustments (which comprise only normal recurring accruals) necessary for a fair presentation:

	Operating Revenues	Operating Income	Net Income	Earnings per Common Share
	Thousands of Dollars			
Quarter ended:				
March 31, 1978	$265,336	$ 54,616	$20,908	$ .71
June 30, 1978	327,099	69,316	27,849	.90
Sept. 30, 1978	426,373	112,702	49,848	1.61
Dec. 31, 1978	330,630	71,481	30,052	.99
March 31, 1977	212,947	52,074	20,400	.74
June 30, 1977	263,917	65,432	27,593	.96
Sept. 30, 1977	345,775	101,127	46,875	1.63
Dec. 31, 1977	272,922	69,178	30,768	1.98

7. Unaudited Replacement Cost Information. The impact of inflation experienced in recent years has resulted in replacement costs of productive capacity that are significantly greater than the historical costs of such assets reported in the company's consolidated financial statements. The company has computed the replacement cost data in accordance with Securities and Exchange Commission requirements and has included such data in its Form 10-K report filed with the commission.

8. Subsequent Event. On January 30, 1979, HL&P sold 300,000 shares of $9.04 cumulative preferred stock at a price of $100 per share. The net proceeds from the sale will be used to defray the cost of HL&P's construction program.

On February 7, 1979, the company sold 2,000,000 additional shares of its common stock at $29.125 per share. The net proceeds of the sale will be invested primarily in the common stock of HL&P and will be used by HL&P to defray the cost of its construction program. As a result of the sale, the conversion price for the outstanding 5½% convertible debentures was changed from $38.96 to $38.34 per share, and the number of shares of common stock reserved for conversion for such debentures was increased from 1,024,976 to 1,041,549.

9. Reclassifications. Certain amounts previously reported in the 1977 financial statements and notes thereto have been reclassified to conform with the 1978 presentation. These reclassifications had no effect on consolidated net income.

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Auditor's Opinion

Houston Industries Incorporated:

We have examined the consolidated balance sheets and the statements of subsidiaries' preferred stock and long-term debt of Houston Industries Incorporated and subsidiaries as of December 31, 1978 and 1977 and the related statements of consolidated income and retained earnings and changes in consolidated financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the above-mentioned consolidated financial statements present fairly the financial position of the company and its subsidiaries at December 31, 1978 and 1977 and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

DELOITTE HASKINS & SELLS

Houston, Texas
February 12, 1979

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Houston Industries Incorporated

Directors

Thomas H. Abell, (A,C)
Lawyer and Rancher
Wharton, Texas

Searcy Bracewell, (C,D)
Member of Law firm of
Bracewell & Patterson
Houston, Texas

Wm. R. Brown, (A,C)
Member of Law firm of
Baker & Botts and General
Counsel of the Company
Houston, Texas

H. R. Dean, (B)
Vice President and Treasurer
of the Company
Houston, Texas

John C. Echols, (B,D)
Chairman of the Board
and Chief Executive Officer
Citizens Bank & Trust Co.
Baytown, Texas

Howard W. Horne, (B)
President of The Horne
Company
Houston, Texas

D. D. Jordan, (A,B)
President and Chief Executive
Officer of the Company
Houston, Texas

Wendel D. Ley, (A,C)
Timber Lands and
Investments
Houston, Texas

G. W. Oprea, Jr., (B)
Vice President of the
Company
Houston, Texas

J. G. Reese, (A,B)
Retired Chairman
of the Board of the Company
Houston, Texas

Willard E. Walbridge, (A,D)
Senior Vice President
Corporate Affairs of Capital
Cities Communications, Inc.
Houston, Texas

(A) Member of Executive Committee
(B) Member of Finance Committee
(C) Member of Executive Salary Committee
(D) Member of Audit Committee

Officers

D. D. Jordan
President and Chief Executive
Officer

G. W. Oprea, Jr.
Vice President

H. R. Dean
Vice President and Treasurer

J. M. Dugdale
Secretary and Assistant
Treasurer

J. R. Johnston
Assistant Secretary

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Houston Lighting & Power Company
Officers

D. D. Jordan
President and Chief Executive Officer

G. W. Oprea, Jr.
Executive Vice President

T. A. Standish
Senior Vice President

J. D. Cowart
Group Vice President
Administrative

H. R. Dean
Group Vice President
Accounting & Finance

K. R. Hinckley
Group Vice President
External Relations

A. R. Beavers
Vice President
Purchasing & Services

R. L. Evans, Jr.
Vice President
Operations

R. M. McCuistion
Vice President
Engineering

C. L. McNeese
Vice President
Federal Relations

J. M. McReynolds
Vice President
Engineering Consultant

D. E. Simmons
Vice President
Corporate Planning

D. D. Sykora
Vice President
Customer Relations

E. A. Turner
Vice President
Power Plant Construction & Technical Services

R. S. Letbetter
Comptroller

J. M. Dugdale
Secretary and Treasurer

J. R. Johnston
Assistant Secretary and
Assistant Treasurer

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Annual Meeting

The annual meeting of shareholders will be held April 25, 1979, at 10 a.m. in the Electric Tower, 611 Walker, Houston, Texas. A formal notice of the meeting accompanied by a proxy statement and proxy form will be mailed to shareholders on or about March 19, 1979.

Executive Offices

Electric Tower, Houston, Texas
Mail Address: 611 Walker, P.O. Box 1700,
Houston, Texas 77001
Telephone: (713) 228-2474

Stock Listing

Houston Industries common stock is traded under the symbol **HOU** on the New York and Midwest Stock exchanges.

Transfer Agent for the Common Stock

Texas Commerce Bank National Association, Houston, Texas

Registrar for the Common Stock

First City National Bank of Houston, Houston, Texas

Trustee Under Indenture for Convertible Debentures

Bankers Trust Company, New York, New York

Auditors

Deloitte Haskins & Sells, Houston, Texas

Counsel

Baker & Botts, Houston, Texas

Dividend Disbursing Agent for the Common Stock

Texas Commerce Bank National Association, Houston, Texas

Dividend Reinvestment for the Common Stock

For the convenience of shareholders, dividends may be automatically reinvested in Houston Industries common stock. For information, contact Ms. Ann Cherry, Texas Commerce Bank, P.O. Box 2558, Houston, Texas 77001. (713) 236-4636

SEC Form 10-K

A copy of the annual report to the Securities and Exchange Commission on Form 10-K may be obtained without charge upon written request to: The Secretary, at the Houston Industries executive offices.

Central Power and Light Company
Annual Report
1978

Chairman's Letter

For Central Power and Light Company 1978 was a year of continued growth. Kilowatt-hour sales increased 7.1%, and revenues, aided by a rate increase to wholesale customers and by slightly higher fuel prices, were up 10.5%.

Several factors contributed to the growth. Among them were industrial expansions, population growth, a healthy economy, favorable weather conditions, relatively stable fuel prices, and greater customer acceptance of the higher costs of electricity. But since it was the second consecutive year for most of these factors to prevail, sales and revenue gains were modest when compared to the large increases reported in 1977.

Special efforts to control costs were continued during 1978 and contributed to an improvement of 18% in net income.

Some of the basic conditions which affect the Company's operations have improved considerably since 1974 and 1975. In those years the prices CPL paid for boiler fuel were escalating very rapidly. Fuel prices have now leveled significantly, and during the past two years the Company's unit fuel costs have risen at a lesser rate than that of inflation. The certainty of having adequate fuel supplies in the future has also improved in recent years because the Company has expanded its ability to burn fuel oil as an alternative to natural gas and because coal and nuclear capacity will be added in the near future. The downward turn of sales brought on by rising fuel prices in those recession years has been reversed, and sales have returned to growth trends that are close to historical patterns.

There is good reason to believe that the years ahead will bring a continuation of growth and progress to South Texas and to the Company. Agriculture, long the mainstay of the region's economy, is healthy and growing. Industry is expanding and record numbers of new industrial prospects have recently shown interest in the area. Tourists and winter residents are seeking the South Texas sun in ever-growing numbers and are adding hundreds of millions of dollars to the economy.

But the future will not be without challenges. Chief among these will be the need to raise capital in unprecedented amounts. For the three-year period 1979–1981 budgeted capital expenditures are $649.2 million, an amount that is greater than the Company's total investment in gross plant just three years ago. Maintaining the earnings levels and debt coverage ratios necessary to attract such funds at reasonable rates will have to continue as a high management priority. It will also require the continued cooperation of all employees in maintaining a highly efficient operation.

Difficult times such as the Company has experienced in recent years serve to prove again that a company's most important asset is its people. An active recruiting program designed to keep the Company staffed with well-qualified employees produced good results in 1978, and a training program, continually refined to meet changing needs, helped employees develop additional skills. The Company made substantial progress in carrying out its Affirmative Action plan and continued to work actively with organizations which seek greater opportunity for minorities and females.

It is a pleasure to acknowledge the support of the Company's employees. Their dedication and initiative have played a key role in solving problems of the past just as they will undoubtedly contribute immeasurably to successfully meeting the challenges of the future.

[redacted]

R. W. Hardy
Chairman and Chief Executive Officer
March 1, 1979