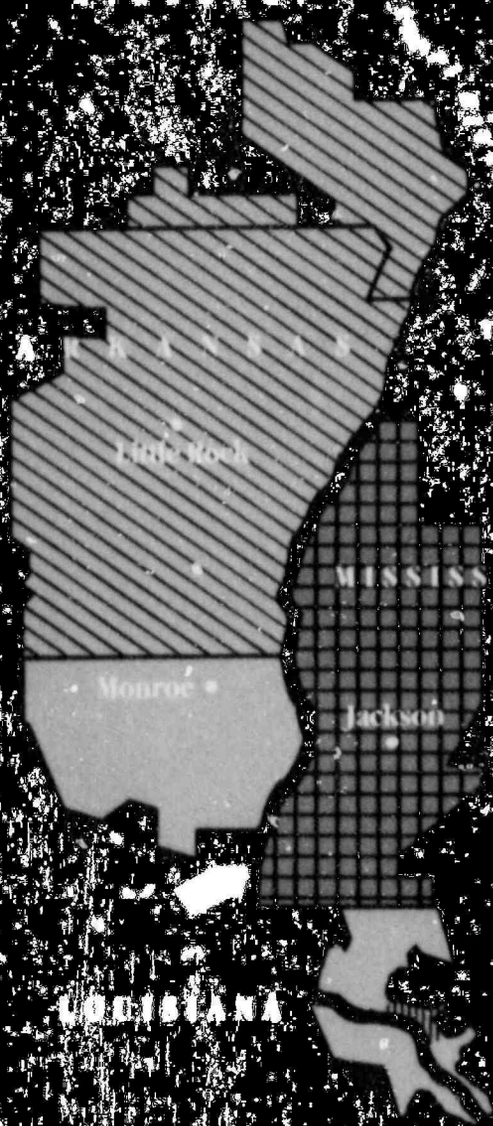
MISSISSIPPI
POWER & LIGHT
COMPANY

MIDDLE SOUTH UTILITIES SYSTEM



SERVICE AREA

Arkansas Power & Light Company

Mississippi Power & Light Company

Louisiana Power & Light Company

New Orleans Public Service Inc.

CORPORATE PROFILE

Mississippi Power & Light Company is a regulated public utility company engaged in the generation, purchase, distribution and sale of electric energy. The Company serves approximately 337,000 customers in 45 counties of western Mississippi with an estimated population of 1.3 million.

MP&L is a wholly-owned subsidiary of Middle South Utilities, Inc., one of the largest investor-owned public utility holding companies in the United States. Ranked fourth in assets among the nation's electric and gas utilities in 1987, the MSU System is the leading electric supplier to the Middle South region, which is comprised of Arkansas, Louisiana, Mississippi, and southeastern Missouri. Gas service is provided by the System in New Orleans and portions of Arkansas and Missouri.

The System utilizes a vast, interconnected transmission and distribution network and a balanced system of fossil fuel and nuclear generating plants to meet the electric needs of 1.68 million customers in its 91,000-square-mile service area, encompassing 1,300 communities with an aggregate population of five million.

At the heart of the System are four operating companies and one generating company working together. The operating companies are AP&L, LP&L, MP&L, and NOPSI. SERI is responsible for the management of the Grand Gulf Nuclear Station.

On the Cover:
Natchez meter reader Buddy Givens programs data into a hand-held computer while reading the meter at the crossing tower on the Mississippi River at Natchez. Inset: Senior Vice President Pat Goff discusses MP&L's Grand Gulf 1 rate case prior to the hearing of oral argument by the United States Supreme Court.

PERFORMANCE HIGHLIGHTS

	1987	1986	1985
Total operating revenues (thousands)	$ 620,836	$ 673,948	$ 605,129
Total operating expenses (thousands)	$ 520,416	$ 576,007	$ 528,561
Fuel expense (thousands)	$ 94,649	$ 156,505	$ 180,293
Purchased power expense (thousands)	$ 404,636	$ 424,172	$ 295,149
Rate deferrals— net of recovery (thousands)	$ (182,739)	$ (223,155)	$ (142,958)
Operating income (thousands)	$ 100,420	$ 97,941	$ 76,568
AFUDC (thousands)	$ 498	$ (22)	$ 2,217
Net income (thousands)	$ 51,767	$ 53,860	$ 50,913
Net utility plant at year-end (thousands)	$ 778,821	$ 768,523	$ 781,980
Construction expenditures (thousands)	$ 38,420	$ 22,128	$ 24,187
Retail customers at year-end	336,780	332,805	328,996
Retail energy sales to Mississippi customers (MKWH)	8,236,[illegible]29	8,096,899	7,852,766
Peak demand (megawatts)	2,0[illegible]7	2,132	1,858

ABBREVIATIONS AND TERMS:

Abbreviations and terms used in this report include:

AFUDC	Allowance for Funds Used During Construction
AP&L	Arkansas Power & Light Company
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
February 25 decision	The Mississippi Supreme Court's 1987 decision reversing and remanding MP&L's Grand Gulf 1 rate order
Grand Gulf 1	Unit No. 1 of the Grand Gulf Nuclear Station
ISES	Independence Steam Electric Station
June 13 decision	The FERC's 1985 decision allocating Grand Gulf 1 costs to the four MSU operating companies
LP&L	Louisiana Power & Light Company
Money Pool	MSU Money Pool which allows System companies to borrow from or lend to other System companies
MP&L or Company	Mississippi Power & Light Company
MPSC	Mississippi Public Service Commission
MSU	Middle South Utilities, Inc.
NOPSI	New Orleans Public Service Inc.
SEC	Securities and Exchange Commission
SERI	System Energy Resources, Inc.
SFAS	Statement of Financial Accounting Standards
SFI	System Fuels, Inc.
SSI	MSU System Services, Inc.
System	MSU and its various direct and indirect subsidiaries
United	United Gas Pipeline Company

LETTER TO STOCKHOLDERS

Dear Stockholders:

Some of the most adverse circumstances ever to face Mississippi Power & Light Company occurred in 1987, producing an array of financial uncertainties that severely hampered our progress.

But, even though 1987 was a year which posed some serious challenges, it also was a time in which our Company's most important asset — its people — demonstrated extraordinary resiliency and dedication in a unified effort to meet those challenges. Cited in this report are examples of that spirit of excellence.

In reviewing the challenges of 1987, the most serious ones stemmed from the February 25 decision by the Mississippi Supreme Court in an appeal of the Company's September 1985 rate case. If upheld, that ruling would require MP&L to cease collection of rates approved in the MPSC's September 1985 order allowing the Company to recover its Grand Gulf 1 costs. Moreover, MP&L would be required to refund such costs previously collected. These actions would have a material and adverse effect on MP&L's financial condition.

MP&L appealed the February 25 decision to the United States Supreme Court, which stayed the Mississippi court's order on June 1 pending final judicial determination of the appeal.

On October 5, the U.S. Supreme Court agreed to hear the Company's appeal. Oral argument was heard February 22, and a decision is expected by the end of June 1988.

While an unfavorable decision by the U.S. Supreme Court would have adverse effects on the Company, MP&L believes legal precedents support its position and provide a basis for optimism that the decision will be favorable. Obviously, however, there can be no assurance that the appeal will be successful. (Please see Notes 2 and 8 to the Financial Statements for a complete discussion of this matter).

The threat of a rate rollback and the continued legal challenge to MP&L's current retail rate structure affected the Company's ability to arrange for the extensive financings required by the Grand Gulf 1 rate phase-in plan and to conduct normal operations.

One effect of legal and regulatory obstacles can be seen by examining the financings arranged by the Company before and after the Mississippi Supreme Court's February 25 decision. In January, MP&L sold $35 million of preferred stock at an annual dividend rate of 9.76 percent. In December, however, the Company sold $75 million of first mortgage bonds at an interest rate of 14.40 percent.

Another Grand Gulf matter that continued to hurl obstacles in the Company's path to financial stability in 1987 was the MPSC's Docket U-4900. In connection with initiation of the docket in September 1986, MP&L's 1987 revenues were estimated to be lowered by approximately $41 million via a temporary rate reduction rider. This rider, which was offset by reduced federal income taxes and other cost savings, took effect in October 1986 when MP&L implemented the second phase-in of Grand Gulf 1 rates. The third phase-in went into effect in October 1987 whereby the Company's revenues will increase by approximately $29 million annually.

Amid adversities associated with MP&L's rate case, uncertainties resurfaced in 1987 concerning the FERC's allocation of the Company's share of costs associated with Grand Gulf 1.

An order issued in June by a three-judge panel of the U.S. Court of Appeals for the District of Columbia Circuit required the FERC to review its plan allocating Grand Gulf 1 costs to the four MSU operating companies. Although the FERC reaffirmed its plan in November and again in January 1988, this decision on the method of cost allocation is subject to further judicial review. However, the FERC's authority to allocate Grand Gulf costs has been upheld by the D.C. Court of Appeals.

Donald C. Lutken
Chairman and President

To further complicate matters, MP&L's Grand Gulf 1 rate phase-in plan has been affected by a FASB statement issued in August 1987 which requires that deferred costs under phase-in plans be recovered within 10 years from the date of a plan's amendment.

The new accounting standard contains transition provisions which permit a delay in the application of the statement if the Company has filed a rate application to amend its plan or intends to do so as soon as practicable, and if it is reasonably possible that the regulator will change the terms of the phase-in plan to meet the requirements of the statement.

MP&L is studying the transition provisions of the new FASB statement and, as soon as practicable, following the decision of the U.S. Supreme Court on the Company's appeal of the Mississippi Supreme Court's February 25 decision, intends to attempt to restructure its rate phase-in plan or take other steps to permit the continued recording of its deferred Grand Gulf 1 costs as assets.

Despite the financial and regulatory difficulties experienced by MP&L in 1987, the Company recorded numerous accomplishments.

Of particular significance was the Company's expanded marketing activities in which major emphasis was placed on improving residential and industrial sales. Through special incentive programs, which are outlined elsewhere in this report, MP&L experienced increased sales in each of these areas.

Company-wide efforts to enhance the business environment in which we operate, through improving economic development and education, were also broadened or initiated.

The Energy Plus program, begun in 1986 with the goal of creating or attracting 14,000 jobs beyond projected employment growth in western Mississippi by 1990, has influenced nearly 50 new businesses and 115 expansions of existing businesses. Since the inception of the economic development program, 7,679 new manufacturing jobs have been created.

On the educational front, MP&L has been just as successful.

Perhaps the most visible of the Company's educational efforts in 1987 was the Council for the Support of Public Higher Education which is dedicated to improving higher education in Mississippi. In its first year, the council worked to get the Legislature to restore nearly half of the funds cut from college and university budgets a year earlier.

In another area, MP&L joined MSU, our parent company, in working to solve some of Mississippi's staggering illiteracy problems. By providing computer hardware to Jackson State University, we are part of a proven program that is teaching literacy skills to more than 150 Jackson-area adults.

Additional educational programs were developed by MP&L to address the state's awesome dropout problem and to encourage academic excellence.

The Company was pleased to announce in December four additions to its Board of Directors. James B. Campbell, president and chairman of the board of Mississippi School Supply and John N. Palmer, president of Mobile Communications Corporation of America, were elected directors. Former directors Herman Hines, who previously served as chief executive officer of Deposit Guaranty National Bank, and Lawrence Adams, a Natchez attorney, were named advisory directors.

Additionally, Bill F. Cossar, who previously served as the Company's director of governmental affairs, was elected vice president of public affairs in December.

In other organizational changes, George M. Ledlow, vice president of special projects, and John D. Holland, vice president of governmental affairs, retired in September and October, respectively.

As we look to 1988, we can be certain that it will be a pivotal year for MP&L. Let me assure you that the Company is resolved to meet current challenges and move forward. We will continue to explore ways to lower operating costs while continuing to provide reliable service.

It would be unrealistic to say that MP&L will see the end of its financial uncertainties in the near future, but some important questions will be answered. Many of the obstacles likely will be lessened, and it is hoped that MP&L will be establishing itself on firmer financial ground. As I have already noted, however, there can be no assurance that the Company's appeal of the February 25 decision will be successful.

Adversity tends to bring members of an organization closer together, and the challenges experienced by MP&L in 1987 unified our people, perhaps to the greatest extent in MP&L's history in efforts to find solutions and move forward.

We are not minimizing the tasks ahead, but we face the future with optimism.

Sincerely,

Donald C. Lutken
Chairman and President
March 11, 1988

Legal challenges related to MP&L's Grand Gulf 1 rate case, which led to oral argument before the U.S. Supreme Court, required much of Senior Vice President Pat Goff's attention during 1987.

Larry Johnson, an apprentice lineman in Hernando, works to bring customers back on line following a tornado in DeSoto County.

REGULATORY AND FINANCIAL MATTERS

Demanding much of MP&L's concentration during 1987 and early 1988 was an array of regulatory and financial matters. These included the Company's Grand Gulf 1 rate case, the FERC cost allocation plan for Grand Gulf 1, MPSC Docket U-4900, SFAS No. 92, and United Gas contract litigation.

An overview of these issues follows. A more complete review of MP&L's regulatory and financial matters can be found in Management's Financial Discussion and Analysis and in the Notes to Financial Statements contained in the back section of this report.

Grand Gulf 1 Rate Case

Following a June 1985 ruling by the FERC allocating SERI's 90 percent share of Grand Gulf 1 costs to the four MSU operating companies, the MPSC issued an order in September 1985 approving a $327 million rate increase to cover MP&L's 33 percent allotment. That order was appealed the following month by the state attorney general and the Mississippi Legal Services Coalition.

On February 25, 1987, the Mississippi Supreme Court overturned the rate case and remanded it to the MPSC for a review of the prudence of the Grand Gulf project. This triggered a series of events that could have material and adverse effects on the Company.

After being denied a rehearing by the Mississippi Supreme Court in May, MP&L requested a stay from the U.S. Supreme Court to keep the rate increase in place pending an appeal. The stay was granted June 1 subject to MP&L meeting bonding requirements subsequently set by the Mississippi Supreme Court June 10.

MP&L called on the strength of the System, and the bonding arrangements were met by a combination of guarantees and undertakings by the Company, MSU and SERI. Also included in the bonding arrangements was a monthly escrow by SERI of MP&L's cash collections for Grand Gulf 1 power. To the extent that either MSU or SERI makes payments to discharge MP&L's obligations to make refunds to its customers as a result of an adverse final judicial determination of the Company's appeal, SERI and/or MSU will have an immediate right of reimbursement from MP&L.

On October 5, the U.S. Supreme Court agreed to hear MP&L's appeal of the February 25 decision. The stay granted by the court on June 1 remains in effect and the Company is continuing to collect Grand Gulf 1 rates, subject to refund, pending a decision by the court.

The U.S. Supreme Court heard oral argument in the Grand Gulf 1 rate case on February 22, 1988.

MP&L, based on the opinion of its counsel and assuming the FERC has jurisdiction to allocate Grand Gulf 1 costs, believes the Mississippi Supreme Court's decision should be reversed by the nation's highest court on the basis of constitutional grounds if that court, upon further consideration of the issue of its jurisdiction, accepts the appeal or otherwise agrees to decide the case on the merits. However, there can be no assurance that the Company's appeal will be successful nor is it possible to predict what will be the ultimate outcome of the Grand Gulf 1 rate phase-in plan and related appeals and proceedings or their effects upon MP&L. A decision is expected by the end of June 1988.

Certain decisions adverse to MP&L's interest in the ongoing proceedings relating to its Grand Gulf 1 rate order would impair the financial condition of the Company and could render it insolvent.

The MPSC's September 1985 rate order provides a detailed plan under which all costs are assured of being recovered over the life of the plant. If the U.S. Supreme Court's decision is adverse to MP&L's interest, the recoverability of these deferred costs will be destroyed immediately.

Current accounting standards then would require MP&L to recognize all monthly Grand Gulf 1 costs as expenses and charge them against current income instead of deferring and recording a portion of those costs as an asset as they are now. All previous deferrals also would be charged against current income. (A more complete discussion of the accounting treatment of rate deferrals is included under SFAS No. 92 in this section).

The effect of the possible cancellation of the Grand Gulf 1 rate rider, including the possible substantial refund obligations of MP&L with regard to previously collected amounts and the loss of the ability to defer Grand Gulf 1-related costs and to recognize those deferred costs as an asset, would cause immediate, substantial and irreparable harm to the Company.

In accordance with the provisions of the rate phase-in plan approved by the MPSC in the September 1985 order, the Company implemented its second annual increase in rates billed to customers beginning October 1, 1987. The 4 percent increase in base rates will increase MP&L's revenues by approximately $29 million during the period October 1, 1987 through September 30, 1988. In conjunction with this rate increase, Grand Gulf 1-related costs, which are charged to expense and collected through rates, increased by approximately $2 million per month.

Charlie Davis, plant operator at Gerald Andrus Steam Electric Station in Greenville, monitors equipment to ensure efficient operations at the power plant.

As part of MP&L's continuing efforts to develop more competitive rates, Barbara Tynes, rate analyst I, analyzes the Company's fuel cost projections.

FERC Cost Allocation Plan

In November 1987 and January 1988, the FERC reaffirmed and reinstated its 1985 decision allocating Grand Gulf 1 costs to the four MSU operating companies.

A three-judge panel of the U.S. Court of Appeals for the District of Columbia Circuit had ordered the FERC in June to reconsider the plan that required MP&L to pay 33 percent of the costs for Grand Gulf 1; AP&L, 36 percent; LP&L, 14 percent; and NOPSI, 17 percent.

In maintaining the previous allocation of capacity and energy among the System operating companies, the FERC also concluded that the cost allocation plan was not unduly discriminatory.

The FERC's decision on the method of cost allocation is subject to further judicial review. However, the FERC's authority to allocate the Grand Gulf costs has been upheld by the D.C. Court of Appeals.

In addition, the System has initiated a study to determine whether a more equitable method of allocating future energy costs, including those relating to Grand Gulf 1, may be possible. The study is slated for completion in the near future.

MPSC Docket No. U-4900

In September 1986, the MPSC established Docket No. U-4900, the purpose of which was to obtain a comprehensive review of all aspects of MP&L's current rate requirements and the current rate structure of its affiliate and co-certificate holder, SERI.

In February 1987, the MPSC issued a scheduling order in Phase VII of the docket ordering MP&L to file testimony supporting its current revenue requirements and any necessary adjustments. In March 1987 MP&L filed a complaint in the Hinds County Chancery Court seeking, among other things, preliminary and permanent injunctive relief enjoining the MPSC from implementing and enforcing the order as proceedings to determine rates.

After a preliminary injunction was issued against the MPSC by the Hinds County Chancery Court in May, the state Supreme Court issued an order vacating and setting aside the decree of the Chancery Court.

In its order, the Mississippi Supreme Court stated that the Chancery Court did not have jurisdiction to prevent the MPSC from conducting its rate hearings prior to the exhaustion of MP&L's legal and administrative remedies. Additionally, the state court remanded the procedural scheduling of Phase VII of Docket No. U-4900 to the MPSC for entry of a new scheduling order pursuant to Mississippi law. The matter is pending.

SFAS No. 92

In August 1987, the FASB issued SFAS No. 92, Regulated Enterprises — Accounting for Phase-in Plans, an amendment of SFAS No. 71.

SFAS No. 92 requires, among other things, the following conditions for deferral of costs of a newly completed plant: (1) the costs deferred are scheduled for recovery within 10 years of the date when deferrals begin; and (2) the percentage increase in rates for each future year is no greater than the percentage increase in rates for each immediately preceding year.

The new statement, subject to the transition rules discussed below, is effective for fiscal years beginning after December 15, 1987, and requires that amounts deferred under plans that do not meet the requirements of the statement be written off.

Transition rules for SFAS No. 92 are designed to allow any affected company to delay application of the new statement and to continue the deferral of costs under its existing phase-in plan provided: (1) the company files a rate application to have the plan amended to meet the requirements of the statement or intends to do so as soon as practicable, and (2) it is reasonably possible that the regulator will change the terms of the plan so that it will meet the requirements of the statement.

MP&L's current rate phase-in plan includes the recovery of significant amounts of deferred costs beyond the 10-year recovery period required in SFAS No. 92. As soon as practicable, following the decision of the U.S. Supreme Court on its appeal of the February 25 decision, MP&L intends to attempt to restructure its rate phase-in plan during the transition period to bring it into compliance with the requirements of the new statement or to take other appropriate action.

The Grand Gulf 1 rate recovery order contains provisions which permit MP&L to make application to the MPSC to amend the rate phase-in plan if the Company is not able to finance on reasonable terms. Additionally, the order permits MP&L to make application to the MPSC to consider the effect of a change in SFAS No. 71.

If the effort to modify its existing rate phase-in plan is not successful, and if the terms of SFAS No. 92 are applied, MP&L will be required to cease deferring Grand Gulf 1 costs and instead record those costs as current operating expenses. In addition, certain previously deferred costs (up to approximately $548 million at December 31, 1987) will be required to be written off. Such action would have an immediate and materially adverse effect on MP&L, particularly in light of its already weakened financial condition.

Bobby Ray, manager of financial accounting, and Katrina Dawson, accountant II, utilize personal computers to prepare financial statements and other reports for the Company.

Treasurer Jim Martin, in a conference call with other System officials, coordinates financing arrangements for MP&L.

REGULATORY AND FINANCIAL MATTERS

United Gas Contract Litigation

In connection with the 1985 settlement of a natural gas contract dispute with United Gas Pipeline Company and pursuant to a distribution plan approved by the MPSC in 1986, MP&L refunded approximately $196 million to former wholesale and current retail customers in two distributions in 1987.

The refunds resulted from two lawsuits in which MP&L claimed that United breached the terms of a gas sales agreement.

Pursuant to this settlement agreement, United paid the Company $165 million in September 1985 and $17.5 million in September 1987.

In January 1987, United invoiced MP&L for approximately $24 million for amounts allegedly owed under a take or pay provision in the gas sales agreement. In February, the Company filed suit against United seeking a declaration that MP&L does not have to pay the invoice.

In March 1987, United filed its answer and counterclaim for the amount of the January invoice plus expenses. That filing was amended by United in August to seek recovery of an additional $4.6 million.

United submitted a second invoice in February 1988 for approximately $100 million under the gas sales agreement. MP&L is seeking to amend its complaint in the declaratory judgment action to allege that it has no obligation to pay this invoice based on the same grounds it has asserted in respect to United's January 1987 invoice.

In the event the court holds that United did not overcharge MP&L during 1986 and 1987 and that a deficiency occurred in the amount of gas taken by the Company during those years after all credits have been applied, it would be MP&L's intention to pay United for the deficiency and take the gas paid for during the year following any such final judicial ruling. The matter is pending.

Financial Review

Primarily as a result of the Mississippi Supreme Court's February 25 decision, which overturned the MPSC's 1985 Grand Gulf 1 retail rate order, 1987 was a difficult year in the financial arena for MP&L.

The MPSC approved the $327 million rate increase in September 1985 to cover MP&L's 33 percent share of costs associated with Grand Gulf 1. During a lengthy appeals process, the Company has been able to continue collecting the rates, subject to refund.

The Company's 1987 net income totaled $51.8 million, a decrease of $2.1 million or 3.9 percent compared to 1986.

The threat of a rate rollback and the continued legal challenge to MP&L's current retail rate structure affected the Company's ability to arrange for the extensive financing requirements in connection with the Grand Gulf 1 rate phase-in plan and to conduct normal operations. In 1987, approximately $183.4 million of capital requirements resulted from the operation of the Company's rate phase-in plan.

However, the Company was successful in accomplishing such financing although at higher interest rates after the February 25 decision.

In January, the Company sold $35 million of preferred stock at a dividend rate of 9.76 percent.

In a private placement on December 17, the Company sold $75 million of 14.40 percent first mortgage bonds due Decem[illegible]2. Of the proceeds of this sale, [illegible] million was set aside to retire first mortgage bonds maturing in early 1988.

On January 15, 1988, $45 million of 11 1/4 percent first mortgage bonds were redeemed. In addition, $15 million of 4 1/8 percent first mortgage bonds will be retired at maturity on April 1, 1988.

On February 11, 1988, MP&L privately placed $75 million of bonds issued under a new secondary mortgage. Of this amount, $20 million was sold at 14.95 percent interest maturing in 1995, and $55 million was sold at 14.65 percent interest maturing in 1993. The new mortgage under which the bonds were issued constitutes a second mortgage lien on substantially all the properties and assets of the Company, subject and subordinate to the lien of MP&L's first mortgage indenture.

Additionally, on October 2, 1987, MP&L began a program of selling its customer accounts receivable. The proceeds from the initial sale of billed receivables totaled approximately $39 million. This process accelerates the receipt of cash from customer bills and lessens the need for external capital from other sources.

The proceeds from the above sales were used for the financing of a portion of the costs associated with the Company's retail rate phase-in plan related to its Grand Gulf 1 charges, for the retirement of maturing long-term debt, for the financing of MP&L's construction program, and for other corporate purposes.

Brenda Benway, a Vicksburg customer service specialist II, handles a call from a customer, while engineering associates Charlie Ervin, left, and Lonnie Breithaupt dispatch crews to repair damage caused by a series of November thunderstorms.

A customer offers Senior Lineman Larry Williamson hot coffee after he and other crew members restored power to a Jackson neighborhood during a January ice storm.

OPERATIONS

Lightning danced in the distance, illuminating the destruction caused a few hours earlier by an impartial tornado that had roared through western Mississippi.

Left in the path of the November 16 storm were downed utility poles and lines, roofless homes, windowless offices, and vigilant MP&L crews ready to restore power in the downpour that travels with such weather.

"Anytime you get a call that a tornado has hit, you know things are going to be real bad," said Jim Watkins, Rankin District construction foreman, who headed one of the crews that worked around-the-clock to bring customers back on line.

"When you get there, you just feel lost," he said. "The lights are off, so its pitch dark. All you have is a hand light as you dig through the rubble to assess the damage and figure out what you've got. The damage is unreal."

The damage caused by this tornado and thunderstorms was among the worst inflicted upon MP&L's service area in the last decade. At the height of the storm, an estimated one-third of MP&L customers were affected.

Worst hit was a corridor through Vicksburg, Clinton, Jackson and Rankin County, but the storm affected every division of the Company — from the Louisiana state line to the south to Grenada to the north.

The ensuing performance proved typical of the quality service which has been a long-standing MP&L tradition as crews and office personnel worked tirelessly to assist customers and repair damages as quickly as possible.

"You work all night hoping against hope that you've done everything you have to do to get the power back," said Watkins. "But, when the lights come on and customers come by to thank you for your efforts, it makes any inconveniences you've had to go through all worthwhile."

Energy Sales and Customers

MP&L's total energy sales to Mississippi customers in 1987 amounted to 8.2 billion kilowatt-hours, an increase of 1.5 percent when compared with 1986.

Residential sales increased to 3.4 billion kilowatt-hours while commercial sales increased to 2.4 billion kilowatt-hours.

Industrial sales increased 3.6 percent to 2.1 billion kilowatt-hours. This growth reflects the success of the industrial incentive and inducement rates started by the Company in 1986.

Offsetting a portion of these increases was a 2.5 percent decrease in governmental and municipal sales which fell to .3 billion kilowatt-hours in 1987.

MP&L's average residential customer used 11,724 kilowatt-hours in 1987 compared to 11,649 in 1986.

At year's end, the number of customers was 336,782, an increase of 3,975 over those being served at the end of 1986.

Customers by classification were:

Residential—288,577
Commercial—42,095
Industrial—3,425
Government & municipal—2,683
Other public utilities—2

Construction

Expenditures for construction during 1987 were $38.4 million compared to $22.1 million in 1986.

Two new 115 kilovolt distribution substations and the associated 115 kilovolt ties were completed at Whitfield and Star.

Work continued on the Tunica 115/230 kilovolt substation and the Freeport 500/230 kilovolt substation.

Other major 1987 construction projects included transmission capacitor bank additions at the North Greenville, Rex Brown, Greenwood, Clarksdale and Greenville substations.

Major transmission projects completed during the year included MP&L's portion of the Richie-Tunica 230 kilovolt line. Work continued on the Tunica-Freeport 230 kilovolt line and on the conversion and rebuild of the Rex Brown-Pickens 115 kilovolt line. Preliminary design, survey work and right-of-way acquisition continued on the Freeport-Batesville and the McAdams-Indianola 230 kilovolt lines.

New Office

In its efforts to better serve customers, MP&L opened a business office in northwest Jackson in March.

Located in the Jackson Mall area, the office offers several services, including receiving bill payments, applications for service and working out terms for extended payment.

Fuels Management

To better plan for fuel needs and more effectively work with suppliers, MP&L implemented in June a System reorganization plan for fuels planning and procurement.

Employing a Systemwide Teamwork approach to improving fuels management, the plan centralizes fuels planning, procurement guidelines and contract approval for the System companies. After developing plans and guidelines for oil, gas, coal and nuclear fuels requirements of the System, a System committee issues the fuels plan, approves its implementation and monitors its administration.

MP&L and the other System operating companies handle fuel contract negotiations and the contract administration.

Accumulating the most points in the Employee Earned Energy Program in 1987 was easy for Centreville Customer Service Specialist II Janet Walsh, who used knowledge gained from building her total electric home to recommend MP&L products and services to customers.

Randy Barnett, engineer II in Southaven, is part of a team which helped MP&L increase its share of total electric, new single family homes to 30.3 percent in 1987.

MARKETING

Janet Walsh, a Centreville customer service specialist, was planning to build a total electric home when a new program encouraging employees to promote MP&L products and services was announced in February.

The Employee Earned Energy program, which awards employees points toward a variety of merchandise and travel in exchange for valid sales leads, was one of several incentives introduced by MP&L's Marketing Department in 1987. All are designed to solicit assistance from others in increasing product sales, and ultimately, Company profits.

"Being an MP&L employee, I was familiar with the many advantages of a total electric home," said Ms. Walsh. "But, as we began to make decisions for our home relating to a heat pump and other items, we realized how efficient and reliable the Company's products really are.

"The 3E program made it easy to for me to recommend the products to others," she said.

By the end of 1987, Ms. Walsh had earned the most points in the non-marketing category of the program, which drew nearly 700 participants.

Of the 3,513 referrals made, 3,359 resulted in sales totaling $506,305 in present value revenue.

Residential Market Incentives

Recognizing the importance of builders/developers, real estate agents and heating/air conditioning dealers in influencing residential sales decisions, MP&L introduced several incentives aimed at these individuals in 1987.

Builder/developer incentives included a variety of motivational items for various types of builders and were designed to encourage them to specify heat pumps in their new homes. A total of 110 builders/developers participated in the program that produced more than 25 percent of the new total electric homes in MP&L's service area.

Moreover, MP&L completed the year with total electric homes constituting 30.3 percent of all new single family homes being built, up from 25.4 percent in 1986.

Real estate agents also were a target in the sales effort. A special training video was developed and used with a feedback system that channeled questions from home buyers back to MP&L's marketing personnel. This program had 230 participants with information on 81 homes submitted.

With the introduction of the dual fuel heat pump program, MP&L broke into the existing home market by offering customers with older gas heating units an opportunity to obtain more efficient electric heating systems. Heating and air conditioning dealers were included in this incentive program to ensure their support of this relatively new product.

Stronger efforts to promote electric heat pump systems also were launched to protect the Company's existing heating market. In August, information on the heat pump programs was mailed to 11,000 total electric customers and 39,000 gas heat customers. Both packages explained special financing arrangements. Additionally, rebates of $100 and $150, respectively, were offered to customers who purchased the dual fuel heat pump and to dealers installing the equipment.

Industrial Market Incentives

A key contributor in MP&L's thrust for increased industrial sales in 1987 was its Industrial Customer Incentive Pricing program. The program, initiated in 1986, enables customers on the large and alternate large general service rates to receive incentive prices on their monthly bills for load additions.

Existing industrial customers who were on the large or alternate large general service rate and who increased their energy use by 200,000 kilowatt-hours per month were eligible for the incentive rate credit. New industrial customers who were willing to contract for the large or alternate large general service rate also were eligible.

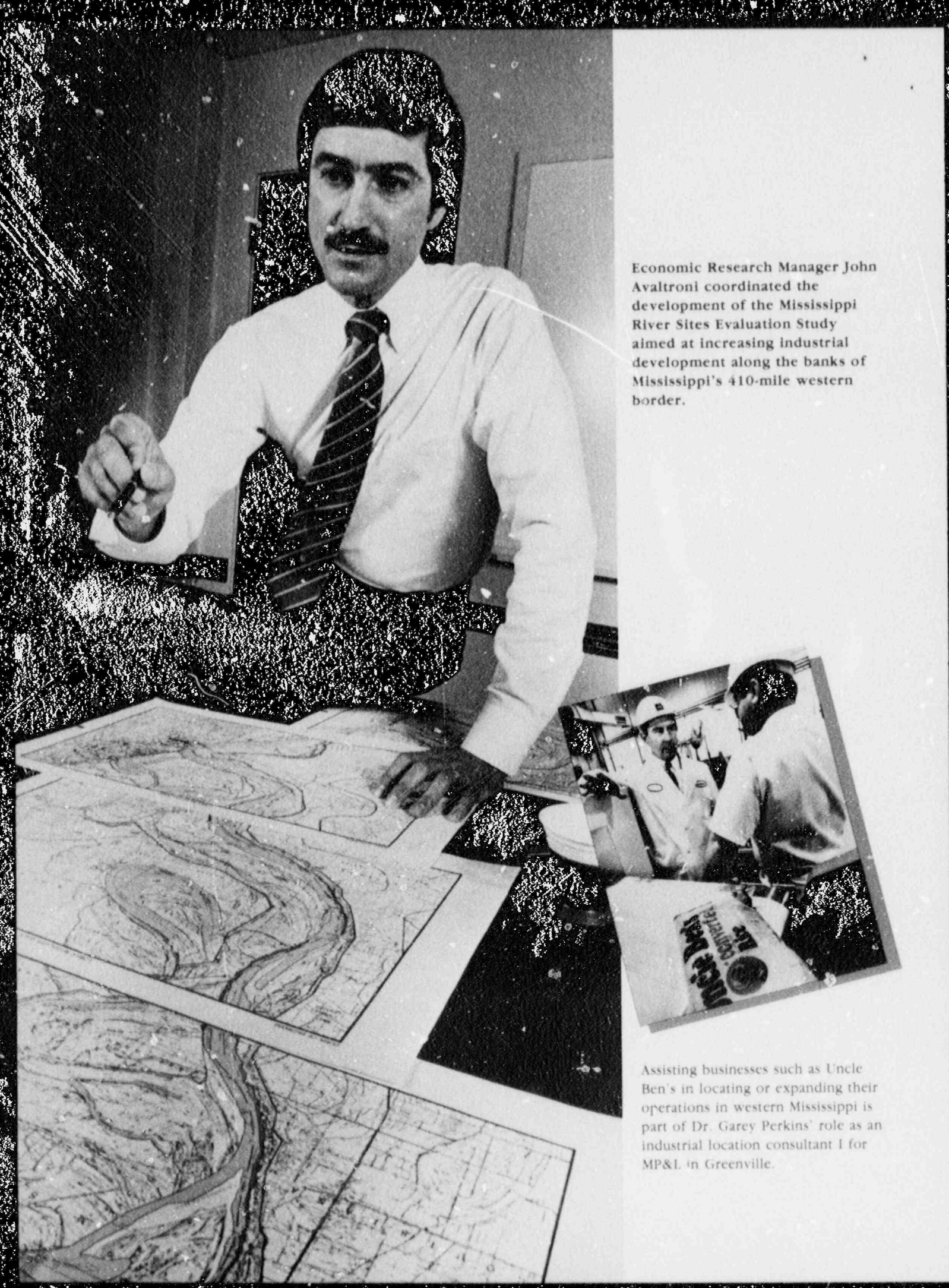
Since the program was started in May 1986, 37 existing businesses and five new businesses have applied for the special rate incentives. In 1987, a total of 78,760 megawatt-hours were discounted under the program, up significantly from the 12,670 megawatt-hours billed in 1986.

Seasonal Credit Account

MP&L's Level Pay Plan received renewed emphasis and a new name in 1987 with the introduction of the Seasonal Credit Account. Under the program, a customer's monthly bill is the adjusted average of their electric bills for the past 12 months.

Of the more than 225,000 draw-draft and total electric customers who received information through two direct mail campaigns, approximately 33,000 signed up.

At year's end, the Company had approximately 37,500 customers signed up for the Seasonal Credit Account, nearly six times the number of participants previously enrolled in the program.



Economic Research Manager John Avaltroni coordinated the development of the Mississippi River Sites Evaluation Study aimed at increasing industrial development along the banks of Mississippi's 410-mile western border.

Assisting businesses such as Uncle Ben's in locating or expanding their operations in western Mississippi is part of Dr. Garey Perkins' role as an industrial location consultant I for MP&L in Greenville.

The year began on an uneasy note for many Natchez residents. Armstrong Tire and Rubber Company, one of the town's largest employers, had announced plans for closing, and rumors were flying that a proposed buyout was faltering. Employees, many of them 20- and 30-year veterans feared that when negotiations were over, their jobs would be lost.

Up the Mississippi River in Greenville, workers at Mohasco Carpet Mill were experiencing similar feelings following the parent company's decision to shutdown its Mississippi operation.

Easing those fears fit squarely into the goals of MP&L's Energy Plus program, an aggressive economic development effort launched by the Company in 1986 with a goal of attracting or creating 14,000 new jobs over and above projected employment growth by the end of 1990.

"In both cases, the magnitude of the plant closings would have been devastating to those areas," said Will Mayo, MP&L's manager of economic development.

"We didn't perceive the utility cost to be the key item in either case," he noted, "but their profit margins were low, and we felt any savings we could pass along to them would improve their chances of success."

Working closely with state and local leaders, MP&L helped develop a special package that included incentive programs to encourage the plants to remain in operation.

Today, the former Armstrong operation is Fidelity Tire Company, and the former Mohasco operation is U.S. Axminster. Nearly 800 jobs have been saved, and more than 200 added.

Industrial Recruitment

Industrial recruitment for a state known primarily for its agriculture is an awesome challenge, but the need for more industry in Mississippi is great. Such recruitment is a key component of MP&L's area development efforts.

The scope of the Company's industrial recruitment is international. In 1987, MP&L contacted 258 U.S. and 34 foreign companies to discuss the prospects of locating facilities in Mississippi, while hosting 86 clients on 122 visits.

During the year, 30 new businesses located in MP&L's service area and 53 businesses expanded operations, providing 3,535 new manufacturing jobs. The resulting megawatt load was 47.5, a 14 percent increase over 1986's 41.6. Estimated annual revenue from the added load was $9.2 million with the total investment in plant and equipment by the new and expanding businesses totaling nearly $162 million.

Community Development

Recognizing that area development is dependent upon component communities being competitive for industrial growth, MP&L broadened its assistance to local leaders in 1987.

A total of 20 intensive workshops and seminars were conducted or co-sponsored by the Company, attracting more than 600 participants. Topics included small business development, existing industry committee training, and community development.

Six awards, totaling $17,300, were made by MP&L to assist Enterprise Zone co-op projects. An Enterprise Zone initiative provides assistance, including incentive rates and marketing support, for distressed communities.

The Company also recommended four projects to receive Urban Development Action Grants. Three of the data projects — catfish projects in Itta Bena and Belzoni and a dairy project in Kosciusko — received a total of $2.1 million in federal funds.

Additionally, MP&L, through working with leaders from several counties, established the Delta Regional Procurement Center in Greenville and raised $47,700 for the first year of operation in an effort to increase marketing opportunities for existing industries.

Mississippi River Sites Evaluation

MP&L, in conjunction with Deposit Guaranty National Bank, unveiled in September the Mississippi River Sites Evaluation Study aimed at promoting additional industrial development along Mississippi's 410-mile western border.

The study examined the industrial potential of seven sites, including three undeveloped sites at Newport, Rosedale and Scott and the four developed Mississippi River ports at Greenville, Natchez, Rosedale and Vicksburg.

Data sheets were compiled to show how the sites can be developed or modified to meet specific industrial needs. The information was mailed to more than 1,000 target industries.

Forum Two

Approximately 400 Mississippi business, industry and government leaders participated in MP&L's second annual economic development conference — Forum Two — in May.

The event featured presentations by George Busbee, former governor of Georgia; Dr. William Freund, senior vice president and chief economist of the New York Stock Exchange for 18 years; Dr. Jesse White Jr., executive director of the Southern Growth Policies Board; and State Treasurer Bill Cole.

Louise Richards, marketing representative III in the General Office, is one of 20 MP&L representatives committed to lowering Mississippi's high school dropout rate through the "Choices" program.

MP&L's Energy Assembly Program, presented by Senior Communications Specialist Ken Cook, features an array of props to trace energy sources and highlight conservation methods for upper elementary and secondary students.

EDUCATION

A student, posing as a high school dropout, accepts a "job" and paper money to symbolize one month's salary as his classmates discuss what his monthly expenses might be. After money is taken out for items such as rent, groceries, and gasoline, the dropout soon realizes that he is surprisingly out of money.

It is no coincidence that this episode taken from MP&L's Choices program is like a chapter from real life, because real life choices are what the program is all about.

Launched in 1987 by MP&L as part of a major effort to improve education in Mississippi, Choices consists of two, one-hour presentations for ninth graders. The program is designed to encourage this group, which has a 40 percent dropout rate, to stay in school.

"Students expect teachers and parents to convey a certain message," said Jim Moore, vice president of corporate communications and coordinator of MP&L's educational efforts. "But when someone from the business community explains the effects of dropping out of school to a class, it seems to carry a lot more weight."

MP&L's close relationship with education began years ago with home economics classes and expanded into other areas.

Today, however, the Company's educational efforts are much more thorough and comprehensive.

"In many cases, there's a tendency to stay away from working for educational improvements, because the results cannot be measured immediately," said Moore. "But the important fact is that they can be measured, and that's why MP&L decided to become involved. Educational improvement is important for the long-term, best interest of Mississippi and MP&L."

Adult Literacy Program

MP&L and MSU joined forces in May with Jackson State University to establish a Continuing Education Learning Center for employees of business, government, and industry in the Jackson area.

The learning center opened in September in the Battlefield Park Industrial Complex.

Jackson State developed the literacy project utilizing concepts designed by IBM for its Principle of the Alphabet Literacy System (PALS) program. PALS is an interactive, computer-based instructional program that teaches alphabetic principles and letter sounds.

MP&L and MSU fulfilled their portion of the partnership by furnishing the computer equipment, including the interactive videos and videodisc players. The investment totaled approximately $75,000.

Support of Public Higher Education

MP&L was a leading advocate of higher education in 1987. The Council for Support of Public Higher Education, spearheaded by MP&L in 1986 and composed of 30 business representatives who recognize the role higher education plays in the growth of Mississippi, was active in promoting sufficient funding for state universities.

Led by MP&L Chairman and President Donald Lutken, the non-profit council launched an intensive public relations effort for adequate funding for universities by the 1987 Legislature. The group became highly visible with award-winning television, radio and newspaper advertising, and it distributed through direct mail hundreds of thousands of informative fliers.

The council's support for a responsible increase in state income taxes to improve higher education funding gained majority support for the legislation in the House of Representatives but fell five votes short of the required two-thirds to pass the revenue bill. However, much to the credit of the council's efforts, the Legislature voted to restore almost half of the higher education funding cut in 1986.

Energy Assembly Program

Designed to provide a vivid demonstration of energy and conservation, MP&L's Energy Assembly Program was made available to upper elementary and secondary schools in 1987.

The program, which solicits audience participation, employs seemingly unrelated props and statistics.

To illustrate how much energy is required to turn on a light, volunteers peddle a stationary two-seater bicycle with a generator connected to wheels. To demonstrate how electrostatic precipitators at coal plants remove hazardous chemicals from smoke, a Van de Graaf generator is used.

Additionally, a classroom program highlighting conservation methods is presented to science students.

Science Screen Reports

An approach taken by MP&L to encourage student interest in science is through the Science Screen Reports. This series of audiovisual presentations provides schools with a monthly program on science and technical issues for eight months. The presentations address topics such as robotics, computers and space exploration.

In addition to the video tapes, the Science Screen Report provides a teachers' guide which includes teaching strategies and the names of organizations to contact for more information.

Isiah Charleston, apprentice electric meterman and winner of MP&L's 1987 Distinguished Service Award, uses his position as director of the Tiffentown Community Choir to encourage young people to pursue their education.

Working as a volunteer through MP&L's Helping Hands program, Dennis McCallum, a marketing representative III in McComb, caulks a window at a customer's home.

COMMUNITY INVOLVEMENT

Isiah Charleston doesn't pretend to be a musician, but he's the founder and director of one of the best-known youth choirs in the Bovina community of Warren County.

The choir activities began 11 years ago when Charleston, an apprentice meterman in Jackson, was asked by a community church to assemble some children for a fund-raising program.

"I got several kids together, and their enthusiasm got me enthusiastic," said Charleston. "We wanted to sing a few more times, and so we decided to keep it up."

Tiffentown Community Choir, with its changing membership as older members become adults and younger ones join, has been singing for special occasions in area churches ever since.

The tie that brings the young people together is music, but from Charleston they also receive encouragement to get a good education.

"By no stretch of the imagination am I a musician," said Charleston. "I'm more of a disciplinarian. A lot of the kids are from single-parent homes or disadvantaged families. We have discussions at rehearsals, and I urge them to stay in school."

For his actions, Charleston was awarded a Distinguished Service Award under MP&L's Community Service Awards Program. The program was introduced in August to recognize full-time employees who perform outstanding community service.

Joining Charleston as a Distinguished Service Award recipient was Bobby Boykin of Jackson.

Community Service Award winners included Jim Schimpf, Carl Ray Smith, Rebecca Broome, John Johnson Jr. and Stan Stuart of Jackson; Barbara Ingram of McComb; Brenda Olmi of Greenville; and Ray Tomlinson of Senatobia.

Energy CONCERN Program

MP&L's Energy CONCERN program, administered by The Salvation Army, helps elderly and handicapped low-income customers pay their utility bills. The Salvation Army works with 180 social service agencies in western Mississippi to certify applicants.

In 1987, approximately 9,000 customers and 1,151 employees donated approximately $183,000 for Energy CONCERN.

In addition, MP&L, in conjunction with SERI and the Salvation Army, sponsored the third annual Energy CONCERN Run. More than 480 entrants participated in the five-mile and one-mile runs, raising $3,000.

A total of 3,590 grants totaling more than $247,000 were distributed to needy families through Energy CONCERN in 1987. In five years of operation, the program has raised nearly $760,000 for distribution to needy citizens.

Helping Hands Program

MP&L's Helping Hands program provides weatherization and conservation assistance for homes of eligible, needy customers.

In 1987, more than $82,000 was spent on weatherization projects for approximately 466 qualified homes through Helping Hands.

During the program's five years of operation, the Company has provided weatherization for 1,089 homes at a total cost of more than $175,000 in materials. All labor is contributed through community service organizations.

MP&L Women's Club

Active, retired and part-time female MP&L employees in the Jackson area demonstrated their community service interest in June by organizing the MP&L Women's Club.

Fund-raising events were conducted by the group in 1987 to benefit programs such as CONTACT, a 24-hour crisis intervention service; Community Hospital, a treatment center for chemically dependent adults; and Energy CONCERN.

Gatekeeper Program

MP&L led the way for other community service-minded groups in January by becoming the first participant in Gatekeepers, a program to assist Mississippi's elderly citizens.

Sponsored by the Mississippi Council on Aging, Gatekeepers trains persons working in the community to recognize potential problems among the elderly and instructs them to notify counselors if problems are suspected.

More than 50 referrals were made in 1987 by meter readers and customer service specialists in the Company's Central and Western divisions.

Citizenship Recognition

MP&L, in conjunction with two Jackson radio stations, launched a campaign in November aimed at recognizing outstanding community involvement.

Via "A Salute to Mississippi," and "The Good News Report," WJDX and MISS 103, respectively, spotlight individuals who have made significant contributions to their communities. The 60-second features air each weekday during the morning, mid-day and afternoon commuting times.

REPORT OF MANAGEMENT

The management of Mississippi Power & Light Company is responsible for the preparation, integrity and objectivity of the financial statements as well as all other information contained in this annual report. The financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and necessarily reflect amounts based on management's best estimates and judgments with appropriate consideration given to materiality. The financial information included elsewhere in this annual report is consistent with that in the financial statements.

To meet its responsibilities with respect to financial information, management maintains and enforces a system of internal accounting controls designed to provide reasonable assurance that transactions are executed in accordance with management authorization according to established policies and procedures, that the financial statements are prepared in accordance with generally accepted accounting principles and the Uniform System of Accounts prescribed by the FERC and that the assets of the Company are properly safeguarded against loss. The concept of reasonable assurance is based on the recognition that the cost of maintaining a system of internal accounting controls should not exceed the benefits expected to be derived from the system. Mississippi Power & Light Company believes that its system of internal accounting controls, augmented by a comprehensive internal audit function, appropriately balances the cost/benefit relationship. The system of internal accounting controls also includes the selection and training of qualified personnel, an organizational structure that provides for appropriate delegation of authority and segregation of responsibilities and the establishment and communication of written accounting and business policies and procedures throughout the organization.

The Company's independent public accountants, Deloitte Haskins & Sells, are engaged to provide an independent, professional assessment of the degree to which management meets its responsibility for fairness of financial reporting and to render an opinion as to whether such financial statements, considered in their entirety, present fairly the Company's financial position, operating results and changes in its cash flows, in conformity with generally accepted accounting principles. Their examination is conducted in accordance with generally accepted auditing standards and includes such procedures believed by them to be sufficient to provide reasonable assurance that the financial statements are not materially misleading and do not contain material errors. No material internal control weaknesses were reported to management by the independent public accountants during 1987. The report of independent public accountants does not limit management's responsibility for information contained in the financial statements and elsewhere in this annual report.

The Board of Directors pursues its oversight responsibility for reported financial information through its Audit Committee. This committee, which is composed entirely of outside directors, meets periodically with financial management, the internal auditors and the independent public accountants to make inquiry as to the manner in which the responsibilities of each are being discharged. The independent public accountants and the internal audit staff have access to the Audit Committee without management's presence to freely discuss internal accounting control, auditing and financial reporting matters.

The management of Mississippi Power & Light Company recognizes its responsibility for conducting the Company's affairs according to the highest standards of personal and corporate conduct. Management believes that its policies and procedures, including its system of internal accounting controls, provide reasonable assurance that the Company's operations are carried out in conformity with high standards of business conduct.

G. A. Goff
Senior Vice President &
Chief Financial Officer

OPINION OF INDEPENDENT PUBLIC ACCOUNTANTS

Deloitte Haskins & Sells

39th Floor
One Shell Square
New Orleans, Louisiana 70139-3997

To the Shareholders and the Board of Directors of Mississippi Power & Light Company:

We have examined the balance sheets of Mississippi Power & Light Company as of December 31, 1987 and 1986 and the related statements of income, retained earnings, and of cash flows for each of the three years in the period ended December 31, 1987. 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.

As discussed in Notes 2 and 8 of the Notes to Financial Statements, on February 25, 1987, the Mississippi Supreme Court reversed and remanded the September 1985 order of the MPSC granting permanent rate relief to the Company with respect to its recovery of Grand Gulf 1 costs pursuant to a multi-year phase-in plan. The Mississippi Supreme Court found reversible error in the MPSC's rate order based, in part, on the assertion that the MPSC approved retail rates to recover Grand Gulf 1 expenses without first determining that the expenses were prudently incurred. In connection with this rate phase-in plan, the Company has collected $280 million as of December 31, 1987, and has recorded a rate deferral of $548 million for future recovery. The Company continues to collect the rates approved by the MPSC in its September 1985 order, which rates are subject to refund and such related rate deferral may not be collectible to the extent that a final judicial determination may result in a schedule of rates less than what the MPSC allowed. The Company is unable to predict the ultimate outcome of this matter and no provision for any losses that may result from its resolution has been made in the financial statements.

In our opinion, subject to the effects on the financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty referred to in the preceding paragraph been known, the above-mentioned financial statements present fairly the financial position of the Company at December 31, 1987 and 1986 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1987, in conformity with generally accepted accounting principles applied on a consistent basis.

Deloitte Haskins & Sells

February 19, 1988

MANAGEMENT'S FINANCIAL DISCUSSION AND ANALYSIS

I. Financial Condition

On February 25, 1987, the MPSC's September 1985 Final Order on Rehearing which granted annual retail rate relief of $327 million to the Company with respect to its FERC-ordered allocation of Grand Gulf 1-related costs was reversed by the Mississippi Supreme Court and remanded to the MPSC for further proceedings. On May 21, 1987, the Company asked the United States Supreme Court to stay the mandate of the February 25 decision pending final disposition of the appeal to the U. S. Supreme Court. On June 1, such stay was granted, subject to the Company meeting the bonding requirements subsequently set by the Mississippi Supreme Court on June 10. On September 14, pursuant to the Mississippi Supreme Court's order setting bond, the Company filed with that court the Company's corporate undertaking in the amount of approximately $206 million for the refund of collections from September 20, 1985 through June 30, 1987 ("Past Collections"), the corporate guarantee of SERI for Past Collections, the corporate guarantee of MSU for Past Collections, SERI's corporate undertaking for the possible refund of collections after May 31, 1987, a trust agreement between SERI and Trustmark National Bank, under which SERI will make deposits equivalent to the Company's cash collections for Grand Gulf 1-related costs beginning June 1, 1987, and the corporate undertaking of the Company for the refund of all collections after June 30, 1987. MSU or SERI has an immediate right of reimbursement from the Company to the extent either of those companies makes payments to discharge the Company's obligation to make refunds to its customers as a result of the final judicial determination of the Final Order on Rehearing. SERI has agreed at the request of its creditor banks to demand immediate reimbursement from the Company on account of all amounts paid by SERI (whether directly or from monies placed in trust) on behalf of the Company and to promptly take all reasonable actions necessary to collect such amounts from the Company. On September 17, the Mississippi Supreme Court entered an order approving the bonding arrangements. Through December 31, 1987, SERI has paid approximately $99.4 million under the above-mentioned trust arrangement and such payments are estimated to average approximately $14 million per month through June 1988, by which time it is expected that a decision shall have been rendered by the U. S. Supreme Court.

On October 5, the U. S. Supreme Court decided to hear full argument of the Company's appeal of the February 25 decision but postponed further consideration of the U. S. Supreme Court's jurisdiction to the hearing of the case on the merits. Oral argument was held on February 22, 1988 and a decision is expected by the end of June 1988. The Company, based on the opinion of its counsel and assuming the FERC has jurisdiction to allocate Grand Gulf 1 costs, is of the belief that the February 25 decision should be reversed by the U. S. Supreme Court on the basis of constitutional grounds, if that court, upon further consideration of the issue of its jurisdiction, accepts the appeal or otherwise agrees to decide the case on its merits. While the Company has been successful in obtaining two stays from the U. S. Supreme Court and the court has heard full argument of the case, no assurances can be given that the Company's appeal before the U. S. Supreme Court will be successful. The stay will remain in effect until a final decision is rendered by the U. S. Supreme Court.

The Company is continuing to collect the rates approved by the MPSC in the Final Order on Rehearing, subject to refund. As of December 31, 1987, the Company had billed approximately $280 million to its customers and recorded expense deferrals of approximately $548 million pursuant to the rate phase-in plan.

At this time, it is not possible to predict what will be the ultimate outcome of the Company's Grand Gulf 1 rate phase-in plan and related appeals and proceedings or their effects upon the Company. If the ultimate judicial resolution is adverse to the Company's interest, the Company's Grand Gulf 1 rate order could be cancelled. If the Company's Grand Gulf 1 rates are cancelled, in addition to the substantial refund obligations of the Company in respect of previously collected amounts (up to approximately $280 million as of December 31, 1987) as well as the Company's ceasing to collect, and to defer for future collection, its Grand Gulf-1 related costs, the Company would, under generally accepted accounting principles, be required to write off (record as a loss) certain previously deferred costs (up to approximately $548 million at December 31, 1987). A cancellation of its Grand Gulf 1 rates, without a commensurate reduction in costs, could render the Company insolvent in a short period of time. (See Note 8F of Notes to Financial Statements - "Potential Debt Acceleration, Bankruptcy and System Viability").

In September 1986, the MPSC issued an initial order establishing Docket No. U-4900 directing the opening of a multi-phased proceeding designed to obtain a comprehensive review of all aspects of the Company's current rate requirements and the current rate structure of its affiliate and co-certificate holder, SERI. See Note 2C of Notes to Financial Statements -

"MPSC Docket No. U-4900", for additional information concerning this matter.

For information with respect to the possible material and adverse effect on the Company as a result of changes in accounting standards related to the accounting for rate phase-in plans, see Note 8D of Notes to Financial Statements - "Commitments and Contingencies - New Accounting Standard - SFAS No. 92."

For a discussion of the status of Grand Gulf 2 and the possible material and adverse effect on the Company if a portion of Grand Gulf 2 costs were allocated to the Company and it was unable to recover such costs from its customers, see Note 8E of Notes to Financial Statements - "Commitments and Contingencies - Uncertainties Related to Grand Gulf 2."

For information concerning the possible effect on the Company as a result of changes in accounting standards related to income taxes (SFAS No. 96, Accounting for Income Taxes), see Note 3 of Notes to Financial Statements - "Income Taxes."

II. Liquidity And Capital Resources

The Company's principal capital requirements continue to be associated with the deferred recovery of Grand Gulf 1-related costs pursuant to the Grand Gulf 1 rate phase-in plan ordered by the MPSC in September 1985. In the future, additional capital funds will be needed for construction expenditures, the refinancing of maturing long-term debt, and the satisfaction of preferred stock sinking fund requirements.

During the legal and regulatory proceedings referred to above, the Company's ability to obtain necessary long-term financing has been and may continue to be limited or may not be effected on a timely basis, which may result in liquidity problems. In the event the Company's current 33 percent allocation of Grand Gulf 1 costs remains unchanged and the U. S. Supreme Court's determination of the appeal of the order approving the rate phase-in plan results in a schedule of rates less than what the MPSC allowed in September 1985, the Company's liquidity and financial condition will be materially adversely and immediately affected.

The Company's current monthly obligation to SERI for Grand Gulf 1-related costs is approximately $26 million. Approximately $183 million, $223 million and $143 million of Grand Gulf 1 costs were deferred in 1987, 1986 and 1985, respectively, under the terms of the Grand Gulf 1 rate phase-in plan. By deferring these costs to the future when they will be collected through increased rates billed to customers, the impact of the rate phase-in plan on the statement of income has been removed. Since the actual collection of revenues will not occur until the future, the rate phase-in plan results in additional current capital requirements.

Capital Requirements and Funds Generation

	1987	1986	1985	Total
		(In Millions)		
Capital Requirements Associated with Rate Deferrals	**$183.4**	$217.6	$146.6	$547.6
Construction Expenditures	**38.4**	22.1	24.2	84.7
Maturing Long-term Debt	**10.1**	10.1	10.1	30.3
Redemption of Preferred Stock	**——**	30.0	——	30.0
Total Capital Requirements	**$231.9**	$279.8	$180.9	$692.6
Internally Generated Funds	**$ 72.9**	$164.8	$130.9	$368.6
Externally Generated Funds:				
Sale of Common Stock	**——**	——	10.0	10.0
Sale of Preferred Stock	**35.0**	35.0	——	70.0
Sale of First Mortgage Bonds	**75.0**	70.0	30.0	175.0
Remarketing of Other Long-term Debt	**10.0**	10.0	10.0	30.0
Sale of Billed Customer Accounts Receivable	**39.0**	——	——	39.0
Total Externally Generated Funds	**$159.0**	$115.0	$ 50.0	$324.0
Total Funds Generation	**$231.9**	$279.8	$180.9	$692.6

The following 1988-1990 estimates of the Company's capital requirements with respect to deferred Grand Gulf 1 costs and internal and external financing projections assume: (1) the continuation of the Company's current 33 percent allocation of Grand Gulf 1 capacity and energy, (2) the allocation of other energy costs under the system agreement in accordance with the June 13 decision (See Note 28 of Notes to Financial Statements - "FERC June 13 decision"), (3) that the Company's appeal of the February 25 decision is successful and (4) no changes to the Company's rate phase-in plan for the recovery of Grand Gulf 1-related costs as a result of the new accounting standards set forth in SFAS No. 92.

These estimates are also based on certain other assumptions and judgments with respect to, among other things, earnings, dividend policy, the outcome of regulatory and judicial proceedings and access to capital markets. Alteration of rate and regulatory orders could significantly affect the Company's financing plans and capabilities.

Estimates of Capital Requirements and Funds Generation

	1988	1989	1990	Total
		(In Millions)		
Capital Requirements Associated with Rate Deferrals	$127.3	$ 66.2	$14.1	$207.6
Construction Expenditures	44.4	43.1	45.0	132.5
Maturing Long-term Debt	70.2	0.2	30.2	100.6
Preferred Sinking Fund Requirements	0.5	1.3	1.3	3.1
Total Capital Requirements	$242.4	$110.8	$90.6	$443.8
Internally Generated Funds	$ 92.2	$ 77.6	$97.5	$267.3
Utilization of Previous Year Cash Balance	10.2	33.2	(6.9)	36.5
Externally Generated Funds	140.0	—	—	140.0
Total Funds Generation	$242.4	$110.8	$90.6	$443.8

Included in the above construction expenditure estimates is AFUDC of $1.5 million, $1.6 million and $1.6 million for the years 1988, 1989 and 1990, respectively.

The Company's present plan is to obtain the necessary externally generated funds through the sale of general and refunding (G&R) bonds (See Note 6 of Notes to Financial Statements - "Long-term Debt"), and through sales of common stock. In addition, the Company may utilize short-term borrowings, sales of its unbilled customer accounts receivable and such other securities and such other methods of obtaining necessary funds as may be determined to be available and appropriate. The Company may enter into arrangements for the sale and leaseback of property in which the proceeds from such transactions could be used to retire debt at par.

As a result of uncertainties surrounding recovery of its Grand Gulf 1-related costs, the Company may experience delays in obtaining regulatory approvals for particular financings or may have difficulties accessing the capital market on reasonable terms in order to effect financing. Moreover, the Company's ability to obtain additional capital through the sale of common stock to MSU is limited at this time because of the need for MSU to conserve available cash resources. If timely external financing cannot be arranged, the Company's liquidity could be severely jeopardized.

In January 1987, the Company sold $35 million of $100 par value preferred stock at an annual dividend rate of 9.76 percent. In December 1987, the Company privately placed $75 million of 14.40 percent first mortgage bonds. A portion of the proceeds were applied to meet 1987 capital requirements while $60 million was deposited with the first mortgage bond trustee to be applied to the early retirement prior to maturity of $45 million of 11 1/4 percent first mortgage bonds on January 15, 1988, and the retirement at maturity of $15 million of 4 1/8 percent first mortgage bonds due on April 1, 1988.

On October 2, 1987, the Company entered into an agreement for the sale of its billed and unbilled customer accounts receivable. Proceeds from the initial sale of billed accounts receivable totaled approximately $39 million. The terms of this agreement allow for the sale and assignment by the Company, on a daily basis, of its outstanding customer accounts receivable, including all collections relating thereto, without recourse to the Company and is subject to cancellation by either party upon 30 days written notice.

The Company's ability to issue additional first mortgage bonds was significantly limited by the amount of its available property additions. Because of these constraints, the Company has established a new mortgage indenture to provide for future issuances of G&R bonds. See Note 6 of Notes to Financial Statements for information concerning this new mortgage and its issuance test requirements, including an earnings coverage test of twice the annual pro-forma amount of bond interest charges for issuance of additional G&R bonds.

In February 1988, $75 million of the two initial series of G&R bonds were issued ($55 million at an interest rate of 14.65 percent and $20 million at an interest rate of 14.95 percent). After taking into consideration these transactions and the retirement in January and April 1988 of first mortgage bonds as discussed above, the Company's December 31, 1987 interest coverage ratio under the new mortgage indenture of 2.52 would have permitted the issuance of an additional $116 million of G&R bonds assuming an annual interest rate of 13 percent.

The charter coverage ratio, which must be a minimum of 1.5 times annual interest charges and preferred dividend requirements to allow the issuance of additional preferred stock, was 1.32 as of December 31, 1987, after taking into consideration the same transactions as discussed above in determining the bond interest coverage ratio. This would have precluded the Company from issuing additional preferred stock.

The Company has authority from the SEC to borrow in an amount up to a maximum of 10 percent of capitalization on a short-term basis (approximately $100.5 million at December 31, 1987). The Company's new mortgage also limits short-term borrowings to an aggregate amount not exceeding in general, the greater of 10 percent of capitalization or 50 percent of rate deferrals available to support the issuance of G&R bonds (See Note 6 of Notes to Financial Statements - "Long-term Debt"). Utilization of short-term borrowings is subject to the availability of short-term credit resources. The Company has lines of credit with Mississippi banks totaling $30 million, none of which was outstanding at December 31, 1987. As of February 29, 1988, the full amount of the Company's local bank lines is available. In the event of certain future adverse developments, the availability of these bank lines could be the subject of further negotiation. The balance of authorized borrowings can be obtained through the Money Pool, subject to the availability of funds, which at any particular point in time may be limited. The Company made use of short-term borrowings from the Money Pool in 1987 during the months of January through October with a maximum amount of $70.8 million utilized. There were no Money Pool borrowings outstanding at December 31, 1987. The proceeds from these Money Pool and bank borrowings are utilized to finance the Company's capital requirements on an interim basis, pending permanent financing.

Temporary investments at December 31, 1987, totaled approximately $22.2 million, including $4.2 million received in September 1987 as proceeds of litigation with United which was refunded to customers commencing November 12, 1987.

As a result of uncertainties facing the Company and the System, dividends on common stock were not declared from mid-1985 through June 1987. Beginning in July 1987, common stock dividends were declared/paid as follows:

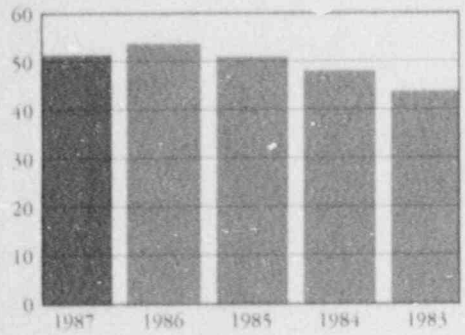
	(In Millions)
July/August 1987	**$3.8**
October/November 1987	**4.0**
January/February 1988	4.0

All of the Company's preferred stock dividend requirements have been met without interruption.

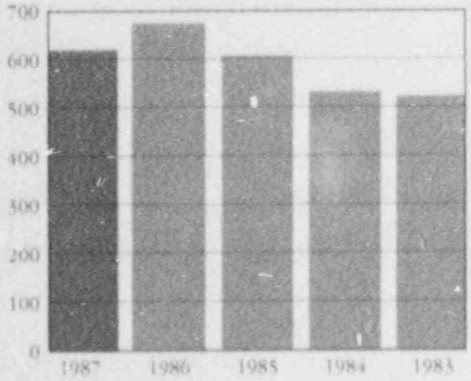
III. Results of Operation
1987 Compared to 1986

Description	1987	1986	Increase or (Decrease)	Percent Change
		(In Thousands)		
Net Income	$ 51,767	$ 53,860	$ (2,093)	(3.9)
Operating Revenue	620,836	673,948	(53,112)	(7.9)
Fuel Expense	94,649	156,509	(61,860)	(39.5)
Purchased Power Expense	404,636	424,172	(19,536)	(4.6)
Maintenance Expense	28,407	32,639	(4,232)	(13.0)
Rate Deferral—Net of Recoveries	(182,739)	(223,155)	40,416	18.1
Income Taxes—Operations	41,626	48,728	(7,102)	(14.6)
Interest Expense	49,892	45,369	4,523	10.0
Energy Sales to Mississippi Customers (MKWH)	8,216,929	8,096,899	120,030	1.5

Net Income
(Millions of Dollars)



Operating Revenue
(Millions of Dollars)



The decline in the Company's 1987 net income was due to a number of factors as discussed below.

Revenue associated with sales to Mississippi customers decreased approximately $12.2 million compared to 1986 levels despite a small increase of 1.5 percent in energy sales.

Of this revenue decrease, $10.2 million was due to the rate reduction rider placed in effect in January 1987, recognizing the decrease in the federal corporate income tax rate from 46 percent to 40 percent, effective January 1, 1987.

Sales for resale declined $42.1 million or 46.6 percent in 1987 due primarily to changes in the generation requirements among the companies within the System.

In accordance with the provisions of the rate phase-in plan approved by the MPSC in the September 1985 Final Order on Rehearing, the Company implemented its second annual increase in rates billed to customers effective October 1, 1987. It is estimated that this 4 percent increase in base rates will increase the Company's operating revenues by approximately $29.1 million during the period October 1, 1987, through September 30, 1988.

In conjunction with this increase, Grand Gulf 1 costs which are charged to expense and collected through rates, increased by approximately $2 million per month.

In the third quarter of 1986, the Company placed a temporary rate reduction rider into effect which reduced the Company's non-Grand Gulf 1-related base rates previously approved by the MPSC in June 1985. In 1987, this temporary rate reduction rider reduced the Company's operating revenue by approximately $30.7 million, compared to what operating revenue would have been had the rider not been in effect.

Due to the reduction in the federal corporate income tax rate from 40 percent to 34 percent effective January 1, 1988, the Company implemented a credit adjustment of 3.7 percent in its rates which is expected to result in a revenue decrease of approximately $10.8 million in 1988 as compared to 1987.

The reduction in 1987 fuel expense was due to a lower volume of gas purchased because of a decrease in generation requirements and lower average unit prices.

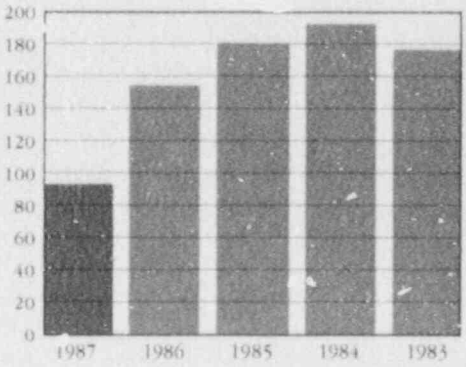
The decrease in purchased power expense was primarily due to a significant reduction in purchases of energy from non-associated utilities in 1987.

Maintenance expense decreased in 1987 due to delays in the level of maintenance performed at the Company's steam electric stations.

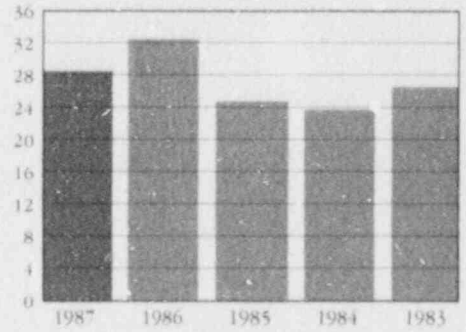
The decrease in the amount of Grand Gulf 1-related costs deferred in 1987 (Rate Deferral-Net of Recoveries) reflects the fact that the Company, pursuant to its rate phase-in plan under the Final Order on Rehearing, collected a greater amount of Grand Gulf 1-related costs from its customers than was recovered in 1986.

The 1987 decrease in income taxes was due primarily to the reduction in the federal corporate income tax rate from 46 percent to 40 percent effective January 1, 1987. The increase in 1987 interest expense reflects the current expense related to the financing of the inventory and phase-in portions of Grand Gulf 1-related costs and the higher interest rates recently incurred by the Company in connection with those financings, primarily due to the uncertainty created by the February 25 decision and related appeals.

Fuel Expense
(Millions of Dollars)



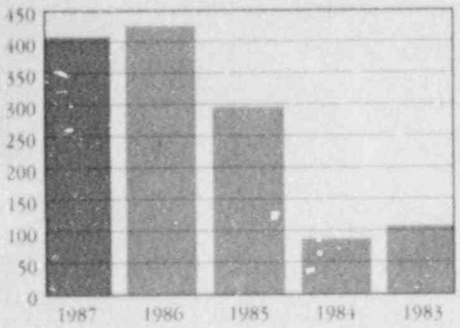
Maintenance Expense
(Millions of Dollars)



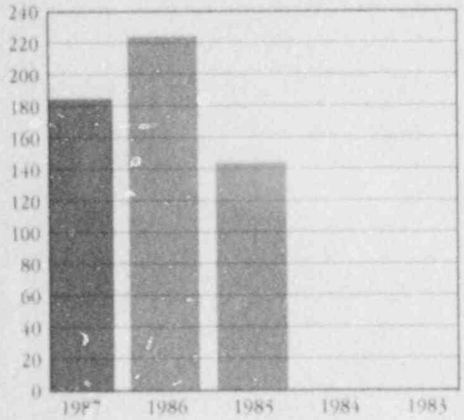
1986 Compared to 1985

Description	1986	1985	Increase or (Decrease)	Percent Change
		(In Thousands)		
Net Income	$ 53,860	$ 50,913	$ 2,947	5.8
Operating Revenue	673,948	605,129	68,819	11.4
Fuel Expense	156,509	180,293	(23,784)	(13.2)
Purchased Power Expense	424,172	295,149	129,023	43.7
Maintenance Expense	32,639	24,808	7,831	31.6
Rate Deferral—Net of Recoveries	(223,155)	(142,958)	(80,197)	(56.1)
Income Taxes—Operations	48,728	37,750	10,978	29.1
Interest Expense	45,369	38,862	6,507	16.7
Energy Sales to Mississippi Customers (MKWH)	8,096,899	7,852,766	244,133	3.1

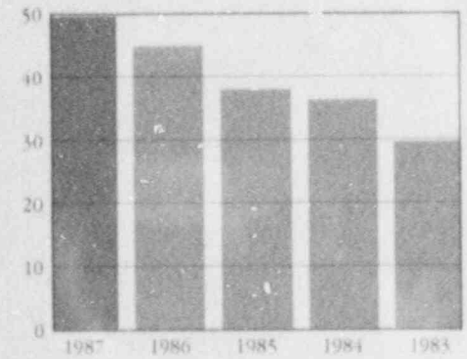
Purchased Power Expense
(Millions of Dollars)



Rate Deferral — Net of Recoveries
(Millions of Dollars)



Interest Expense
(Millions of Dollars)



The increase in the Company's 1986 net income was also due to several factors as discussed below.

Revenue associated with sales to Mississippi customers increased approximately $80.2 million compared to 1985 levels in conjunction with an increase of 3.1 percent in energy sales. The increase in revenue was mainly the result of increases in rates permitted by the MPSC while the increase in energy sales reflected economic improvement and growth in the Company's service area.

In 1986, the temporary rate reduction rider placed in effect in the third quarter of 1986 reduced the Company's operating revenue by approximately $10.1 million compared to what operating revenue would have been had the rider not been in effect.

The decrease in 1986 fuel expense was due to lower gas volumes burned and lower average unit prices.

In 1986, purchased power expense included Grand Gulf 1 charges for a full year whereas 1985 did not since the unit was placed in service on July 1, 1985.

The increase in 1986 maintenance expense was due primarily to work performed at the Company's steam electric stations which had been postponed in earlier years.

Rate deferral — net of recoveries reflected a full year of Grand Gulf 1-related deferrals as compared to the 1985 amount which covered only the period subsequent to July 1.

The 1986 increase in income taxes was due to a combination of several of the above factors causing a higher level of taxable income.

The increase in 1986 interest expense was due to the financing of the inventory and phase-in portions of Grand Gulf 1-related costs as required under the terms of the Final Order on Rehearing.

IV. Summary

The Company's future financial condition is dependent upon (1) obtaining a reversal of the February 25 decision of the Mississippi Supreme Court, (2) the effect of changes related to the accounting for rate phase-in plans pursuant to SFAS No. 92, (3) the resolution of a multi-phased proceeding initiated by the MPSC to examine the Company's rate requirements and structure, including prudence issues, (4) the ability to secure the necessary external financing in order to continue the Grand Gulf 1 rate phase-in plan and meet other capital requirements and (5) the ultimate resolution of the status of Grand Gulf 2 and the possible allocation to the Company of costs associated with that unit. (See Notes 2 and 8 to the Financial Statements for additional discussion of the possible material and adverse consequences to the Company in connection with these matters.)

STATEMENTS OF INCOME & STATEMENTS OF RETAINED EARNINGS

FOR THE YEARS ENDED DECEMBER 31, 1987, 1986 and 1985

	1987	1986	1985
		(In Thousands)	
OPERATING REVENUES (Notes 2 and 8)	$620,836	$673,948	$605,129
OPERATING EXPENSES:			
Operation:			
Fuel	94,649	156,509	180,293
Purchased power	404,636	424,172	295,149
Other	69,822	75,307	75,183
Maintenance	28,407	32,639	24,808
Depreciation	35,151	34,672	34,392
Taxes other than income taxes	28,864	27,135	23,944
Income taxes (Note 3)	(36,952)	(59,948)	(31,871)
Rate deferral:			
Rate deferral—net of recovery (Notes 1, 2 and 8)	(182,759)	(223,155)	(142,958)
Income taxes (Note 3)	78,578	108,676	69,621
Total	520,416	576,007	528,561
OPERATING INCOME	100,420	97,941	76,568
OTHER INCOME AND DEDUCTIONS:			
Allowance for equity funds used during construction	11	192	857
Gain on sale of gas pipeline system	—	—	7,975
Other—net	2,339	3,003	13,676
Income taxes (Note 3)	(1,111)	(1,907)	(9,301)
Total	1,239	1,288	13,207
INTEREST CHARGES:			
Interest on long-term debt	47,073	43,245	38,447
Other interest—net	3,306	1,910	1,775
Allowance for borrowed funds used during construction	(487)	214	(1,360)
Total	49,892	45,369	38,862
NET INCOME	$ 51,767	$ 53,860	$ 50,913
RETAINED EARNINGS, JANUARY 1	$147,099	$106,837	$ 85,788
ADD: Net income	51,767	53,860	50,913
Total	198,866	160,697	136,701
DEDUCT:			
Dividends—cash:			
Preferred stock	12,679	11,300	10,884
Common stock (Note 7)	7,749	—	18,980
Premium paid on capital stock redemption	—	2,298	—
Total	20,428	13,598	29,864
RETAINED EARNINGS, DECEMBER 31 (Note 7)	$178,438	$147,099	$106,837

See Notes to Financial Statements.

BALANCE SHEETS

DECEMBER 31, 1987 and 1986

	1987	1986
	(In Thousands)	
Assets		
UTILITY PLANT:		
Electric (Note 1)	$1,163,081	$1,133,199
Construction work in progress	16,852	3,947
Electric plant acquisition adjustments	953	1,135
Total	1,180,886	1,138,281
Less accumulated depreciation	402,065	369,758
Utility plant—net	778,821	768,523
OTHER PROPERTY AND INVESTMENTS:		
Investment in subsidiary company, at equity (Note 8)	19,444	19,444
Other	702	702
Total	20,146	20,146
CURRENT ASSETS:		
Cash and special deposits	3,014	471
Temporary investments—at cost which approximates market:		
Associated companies	—	10,800
Other	18,000	—
Gas contract settlement (Note 11)	4,274	180,497
Total cash and cash equivalents	25,288	191,768
Funds held by first mortgage bond trustee (Note 6)	60,000	—
Notes receivable	109	—
Accounts receivable:		
Customer and other - less allowance for doubtful accounts (Note 4)	4,022	28,418
Associated companies	233	2,074
Materials and supplies—at average cost:		
Fuel oil	3,070	3,063
Other	8,004	8,399
Rate deferral (Notes 1, 2 and 8)	11,765	24,397
Gas contract settlement (Note 11)	—	17,500
Income taxes receivable	—	38,133
Other	8,606	8,676
Total	121,097	322,430
DEFERRED DEBITS:		
Rate deferral - net of recoveries (Notes 1, 2 and 8)	535,851	339,837
Other	3,489	2,236
Total	539,340	342,073
TOTAL	$1,439,404	$1,453,172

See Notes to Financial Statements.

Liabilities	1987	1986
	(In Thousands)	
CAPITALIZATION:		
Common stock, no par value (stated value $23 per share) authorized 15,000,000 shares; issued and outstanding 6,275,000 shares (Note 5)	$ 144,325	$ 144,325
Retained earnings (Note 7)	178,438	147,099
Total common shareholder's equity	322,763	291,424
Preferred stock (Note 5):		
Without sinking fund	38,077	38,077
With sinking fund	90,689	56,193
Long-term debt (Note 6)	483,010	468,156
Total	934,539	853,850
OTHER NONCURRENT LIABILITIES (Note 1):		
Obligations under capital leases	6,635	—
Accumulated provision for property insurance	597	3,509
Accumulated provision for injuries and damages	—	242
Total	7,232	3,751
CURRENT LIABILITIES:		
Currently maturing long-term debt (Note 6)	70,150	10,100
Accounts payable:		
Associated companies	46,190	35,857
Other	12,252	20,093
Gas contract settlement (Note 11)	4,362	197,997
Customer deposits	17,027	15,989
Taxes accrued	20,317	20,459
Interest accrued	16,563	15,149
Preferred dividends declared	3,344	2,290
Accumulated deferred income taxes (Note 3)	7,27[illegible]	11,882
Obligations under capital leases (Note 1)	1,688	—
Other	9,165	4,509
Total	208,130	334,325
DEFERRED CREDITS:		
Accumulated deferred income taxes—net (Note 3)	260,496	208,695
Accumulated deferred investment tax credits (Note 3)	41,102	45,960
Other	7,905	6,591
Total	309,503	261,246
COMMITMENTS AND CONTINGENCIES (Notes 2 and 8):		
TOTAL	$1,459,40[illegible]	$1,453,172

See Notes to Financial Statements.

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 1987, 1986 and 1985

	1987	1986	1985
		(In Thousands)	
OPERATING ACTIVITIES:			
Net Income	$ 51,767	$ 53,860	$ 50,913
Noncash items included in net income:			
Rate deferral—net of recovery (Notes 1, 2 and 8)	(182,739)	(225,155)	(142,958)
Depreciation	35,151	34,672	34,392
Deferred income taxes	43,741	152,407	(13,697)
Investment tax credits—net	(4,858)	(5,033)	1,425
Allowance for funds used during construction	(498)	22	(2,217)
Changes in:			
Accounts and notes receivable (Note 4)	26,128	550	(8,091)
Materials and supplies	388	(324)	(83)
Accumulated provisions for losses	(3,154)	(3,655)	(2,714)
Accounts payable	2,492	(8,054)	39,690
Customer deposits	1,038	1,183	1,[illegible]9
Taxes accrued	(142)	(53,517)	54,8[illegible]
Income taxes receivable	38,133	(38,133)	—
Interest accrued	1,414	4,349	(3,715)
Proceeds from gas contract settlement (Note 11)	20,138	11,846	168,651
Refunds to customers—gas contract settlement (Note 11)	(196,273)	—	—
Power purchase advance repayments	—	25,833	25,320
Other	8,390	(5,836)	3,972
Net cash flow (used by) provided by operating activities	(158,884)	(52,785)	206,815
INVESTING ACTIVITIES:			
Construction expenditures	(38,420)	(22,128)	(24,187)
Allowance for funds used during construction	498	(22)	2,217
Net cash flow used by investing activities	(37,922)	(22,150)	(21,970)
FINANCING ACTIVITIES:			
Proceeds from issuance of:			
Common stock	—	—	10,005
Preferred stock	35,000	35,000	—
First mortgage bonds	75,000	70,000	30,000
Other long-term debt	10,000	10,000	14,493
Redemption of preferred stock	—	(30,000)	—
Retirement of other long-term debt	(10,100)	(10,700)	(12,624)
Funds held by first mortgage bond trustee (Note 6)	(60,000)	—	—
Preferred dividends paid	(11,825)	(11,732)	(10,885)
Common dividends paid	(7,749)	—	(28,356)
Net cash flow from financing activities	30,326	63,168	2,635
Net (decrease) increase in cash and cash equivalents	(166,480)	(11,767)	187,480
Cash and cash equivalents at beginning of year	191,768	203,535	16,055
Cash and cash equivalents at end of year	$ 25,288	$191,768	$203,535
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest	$ 38,519	$ 40,492	$ 41,786
Income taxes	(3[illegible])	(8,922)	5,426
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:			
Capital lease obligations recorded (Note 1)	8,323	—	—

See Notes to Financial Statements

NOTES TO FINANCIAL STATEMENTS

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Regulation

The Company is subject to regulation by the MPSC and the FERC and maintains its accounts in accordance with the Uniform System of Accounts prescribed by those agencies.

B. Revenues

The Company records revenues as billed to its customers on a cycle-billing basis. Revenue is not accrued for unbilled energy delivered at the end of the fiscal period. The rates of the Company include fuel adjustment clauses under which fuel costs above or below the base levels allowed in the various rate schedules are permitted to be billed or required to be credited to customers.

C. Utility Plant and Depreciation

Utility plant is stated at original cost. The costs of additions to utility plant include contracted services, direct labor, materials, allocated overheads and allowances for borrowed and equity funds used during construction. The costs of units of property retired are removed from utility plant, and such costs plus removal costs, less salvage, are charged to accumulated depreciation. Maintenance and repairs of property and replacement and renewal of items determined to be less than units of property are charged to operating expenses. Substantially all of the utility plant is subject to the lien of the Company's first mortgage bond indenture and the second lien of the Company's new mortgage bond indenture.

Depreciation is computed using the straight-line method at rates based on the estimated service lives of the various classes of property. Depreciation provisions on average depreciable property approximated 3.3 percent in 1987, 1986 and 1985.

D. Rate Deferrals

In September 1985, the MPSC issued its Final Order on Rehearing which granted the Company full recovery of its Grand Gulf 1 costs. However, in order to mitigate the immediate effect upon ratepayers of the inclusion of Grand Gulf 1 costs in retail rates, the Final Order on Rehearing provides for a rate phase-in plan under which portions of the Company's Grand Gulf 1-related costs are to be inventoried or deferred in the early years of commercial operation of the unit and collected in later years. By deferring costs to the future when they will be collected through increased rates billed to customers, the impact of the rate phase-in plan on the statement of income has been removed. Because the actual collection of revenue to recover the deferred costs will not occur until the future, the Company records a deferred asset ("Rate deferral-net of recoveries"), reduces operating expenses by the amount of the deferral and incurs additional current capital requirements in order to finance the deferral. The carrying charges associated with the financing of the deferral are being recovered currently from customers (See Notes 2 and 8).

E. Postretirement Benefits

The companies of the System have various postretirement benefit plans covering substantially all of their employees. The pension plan is non-contributory and provides pension benefits that are based on employees' credited service and average compensation, generally during the last five years before retirement. Pension costs have been funded in accordance with contribution guidelines established by the Employment Retirement Income Security Act of 1974.

F. Income Taxes

The Company joins its parent in filing a consolidated federal income tax return. Income taxes are allocated to the Company in proportion to its contribution to the consolidated taxable income. Deferred income taxes are provided for differences between book and taxable income to the extent permitted by the regulatory bodies for ratemaking purposes. Investment tax credits allocated to the Company have been deferred and are amortized based upon the average useful life of the related property.

G. Allowance for Funds Used During Construction

In accordance with the Uniform System of Accounts, the Company capitalizes AFUDC as an appropriate cost of utility plant. Under this utility industry practice, construction work in progress on the balance sheet is charged and the statement of income is credited for the approximate composite interest cost of borrowed funds and for a reasonable return on the equity funds used during construction. This procedure is intended to remove the effect of the cost of financing the construction program from the statement of income and results in treating the AFUDC charges in the same manner as construction labor and material costs in that each is capitalized rather than expensed. As non-cash items, these credits to the statement of income have no effect on current cash earnings. After the property is placed in service, the AFUDC charged to construction costs is recoverable from customers through depreciation provisions included in rates charged for utility service. The effective composite AFUDC rates were 7.09 percent, 7.25 percent and 11.34 percent for the years 1987, 1986 and 1985, respectively.

H. Statement of Cash Flows

The Company has adopted SFAS No. 95, Statement of Cash Flows and accordingly has presented the Statement of Cash Flows for the years 1985, 1986 and 1987. For purposes of the Statement of Cash Flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

I. Other Noncurrent Liabilities

During 1987, the Company continued the suspension of current provisions and the amortization of the accumulated provisions for uninsured property risks and claims for injuries and damages as ordered by the MPSC in 1985.

With respect to the accumulated provision for property insurance, the amortization of the accumulated provision will continue through June 1988 or until such time as the accumulated provision is exhausted by current charges, whichever is earlier.

J. Capital Leases

Effective January 1, 1987, the Company began complying with the provisions of SFAS No. 13 and SFAS No. 71 with respect to the accounting for lease obligations.

As of December 31, 1987, the Company had assets and obligations under capitalized leases of approximately $8.3 million.

The recording of these capital leases in 1987 did not affect the amounts reported as either expenses or net income.

2 RATE AND REGULATORY MATTERS

A. Grand Gulf 1 Rate Order

On July 1, 1985, Grand Gulf 1 was placed into commercial operation. Pursuant to the unit power sales agreement among SERI and the System operating companies, as modified and approved by the FERC in the June 13 decision (See part B of this Note), 33 percent of SERI's share of the capacity and energy and costs of Grand Gulf 1 was allocated by the FERC to the Company. The Company, thereupon, became obligated to make substantial payments, approximately $26 million per month currently, to SERI for wholesale power from Grand Gulf 1.

Following extensive proceedings before the MPSC with respect to the Company's recovery through retail rates of the FERC-allocated wholesale power costs associated with Grand Gulf 1, the MPSC in September 1985, issued its Final Order on Rehearing which granted the Company a total annual retail rate increase of approximately $327 million, thereby providing the Company with full recovery of its Grand Gulf 1-related costs. In order, however, to mitigate the immediate effect upon retail customers of this rate increase, the Final Order on Rehearing provides for a rate phase-in plan which is structured as follows. The Company is required to (1) inventory one-third of its 33 percent allocation of Grand Gulf 1 costs for a ten year period (Ten Year Inventory Period), (2) inventory the remaining portion of Grand Gulf 1 costs that exceed a 14.5 percent allocation (7.5 percent) for a three year period (Three Year Inventory Period), and (3) phase-in over a three year period a portion of the 14.5 percent allocation. Beginning in the fifth year, the Company will be allowed to recover through rates the deferred costs accumulated in the Three Year

Inventory Period and the phase-in period in equal amounts over years five through ten. Beginning in year eleven and continuing over the remaining depreciable life of Grand Gulf 1 or such shorter period of time as the MPSC may subsequently determine to be appropriate, the Company will be permitted to include the balance of the accumulated costs included in the Ten Year Inventory Period in its rate base used for determining its revenue requirements and to recover through rates such accumulated costs in equal annual amounts.

The Final Order on Rehearing also provides for the Company to recover through rates during the first three years of the deferral plan, all Grand Gulf 1 costs incurred by the Company during the period July 1, 1985 through September 19, 1985. Through December 31, 1987, $54.6 million of these costs have been recovered leaving $17.2 million to be recovered through September 1988. The Company also is permitted to recover on a current basis the costs of financing the inventoried and deferred portions of the Grand Gulf 1 costs. (See Note 8D for a discussion of provisions contained in the Final Order on Rehearing for possibly amending the rate phase-in plan if the Company is unable to reasonably finance the rate deferral or for changes made in accounting standards related to phase-in plans).

In October 1985, the Mississippi attorney general filed a notice of appeal with the Mississippi Supreme Court, and the Mississippi Legal Services Coalition filed a notice of appeal with the MPSC, each giving notice of its appeal of, among other things, the Final Order on Rehearing. On February 25, 1987, the Mississippi Supreme Court issued a decision reversing and remanding the rate case to the MPSC for further proceedings not inconsistent with the court's opinion. The Mississippi Supreme Court found reversible error in the Final Order on Rehearing on the grounds, among others, that the MPSC adopted retail rates to pay Grand Gulf 1 expenses without first determining that the expenses were prudently incurred.

On May 20, the Mississippi Supreme Court denied the Company's petition for rehearing and also overruled the Company's motion for stay of the mandate.

On the same day, the Company filed its notice of appeal of the February 25 decision with the U. S. Supreme Court. Furthermore, on May 21, the Company filed with the U. S. Supreme Court an application asking the U. S. Supreme Court to stay the mandate of the Mississippi Supreme Court's decision pending final disposition of the appeal to the U. S. Supreme Court. The Mississippi Supreme Court's mandate was issued on May 22, reinvesting the MPSC with jurisdiction in the matter.

On May 26, the MPSC entered an order suspending the rate rider schedules approved in the Final Order on Rehearing, effective immediately. In its order, the MPSC directed the Company to prepare and file with the MPSC, within 30 days, "an appropriate refunding plan to be completed within 90 days of the date of this Order." As of December 31, 1987, the Company had billed approximately $279.8 million under the affected rate schedules.

On June 1, 1987, the U. S. Supreme Court granted the Company's application for stay pending the timely filing and disposition of the appeal by the U. S. Supreme Court, thereby effectively staying the MPSC's May 26 suspension and refund order. The court order granting the stay was "conditioned upon the posting of a good and sufficient bond, in manner and amount to be determined by the Supreme Court of Mississippi."

After review of filings made by the Company, the MPSC, the Mississippi attorney general and the Mississippi Legal Services Coalition, the Mississippi Supreme Court issued an order setting bond on June 10, which provided that the Company file an undertaking to refund past collections from September 20, 1985, to June 30, 1987, such undertaking to be co-guaranteed by SERI and MSU. This order further provided that the Company's potential refund obligation related to future Grand Gulf 1 collections would be guaranteed and secured by SERI placing the amount of those collections in escrow on a monthly basis.

On June 17, the MPSC filed in the Chancery Court of the First Judicial District of Hinds County, Mississippi, a complaint seeking, among other things, a temporary restraining order and preliminary injunction requiring the Company to comply with the MPSC's May 26 order suspending the rate rider schedules approved in the Final Order on Rehearing. On June 17, the Chancery Court held a hearing on the MPSC's request for mandatory temporary restraining order, and, at the conclusion of the hearing, denied such request.

On June 18, the MPSC petitioned the Mississippi Supreme Court to vacate and set aside the Chancery Court's ruling. On June 19, the Mississippi Supreme Court granted that petition. The Mississippi Supreme Court also granted the MPSC's request for a mandatory temporary restraining order

requiring the Company to comply with the terms of the MPSC's May 26 order until the Company provided to the Mississippi Supreme Court a bond for approval as contemplated by the terms of the Mississippi Supreme Court's June 10 bonding order. On June 22, the Company applied to the U. S. Supreme Court for a stay of the Mississippi Supreme Court's June 19 order. On June 23, the U. S. Supreme Court granted the Company's application for stay pending further order of that court.

On September 10, the SEC approved the participation by MSU and SERI in the bonding requirements of the Mississippi Supreme Court. On September 14, the Company filed with the Mississippi Supreme Court its corporate undertaking in the amount of approximately $206 million for the refund of collections from September 20, 1985 through June 30, 1987 ("Past Collections"), the corporate guarantee of SERI for Past Collections, SERI's corporate undertaking for refund of collections after May 31, 1987, the corporate guarantee of MSU for Past Collections, a trust agreement between SERI and Trustmark National Bank, under which SERI will make deposits equivalent to the Company's cash collections beginning June 1, 1987, and the corporate undertaking of the Company for the refund of all collections after June 30, 1987. On September 17, the Mississippi Supreme Court entered an order approving these bonding arrangements.

The Company's billings to its retail customers with respect to Grand Gulf 1-related costs for the period September 20, 1985, through December 31, 1987, totaled approximately $279.8 million. To the extent that either SERI or MSU makes payments to discharge the Company's obligation to make refunds to its customers as a result of a final judicial determination of the Final Order on Rehearing, SERI and/or MSU, as the case may be, will have an immediate right of reimbursement from the Company. Through December 31, 1987, SERI had paid approximately $99.4 million under the above-mentioned trust arrangement and such payments are estimated to average approximately $14 million per month through June 1988 by which time it is expected that a decision shall have been rendered by the U. S. Supreme Court. SERI has agreed at the request of its creditor banks to demand immediate reimbursement from the Company on account of all amounts paid by SERI (whether directly or from monies placed in trust) on behalf of the Company and to promptly take all reasonable actions necessary to collect such amounts from the Company.

On October 5, 1987, the U. S. Supreme Court decided to hear full argument of the Company's appeal of the February 25 decision but postponed further consideration of the U. S. Supreme Court's jurisdiction to the hearing of the case on the merits. The stay of the February 25 decision and of the Mississippi Supreme Court's June 19 order noted above remain in effect. Accordingly, the Company is continuing to collect Grand Gulf 1-related rates, subject to refund, pursuant to the Final Order on Rehearing, pending the U. S. Supreme Court's decision. Oral argument was held on February 22, 1988, and a decision is expected by the end of June 1988. The Company, based on the opinion of its counsel and assuming the FERC has jurisdiction to allocate Grand Gulf 1 costs, is of the belief that the February 25 decision should be reversed by the U. S. Supreme Court on the basis of constitutional grounds if that court, upon further consideration of the issue of its jurisdiction, accepts the appeal or otherwise agrees to decide the case on the merits. While the Company has been successful in obtaining two stays from the U. S. Supreme Court and that court has heard full argument of the case, no assurances can be given that the Company's appeal before the U. S. Supreme Court will be successful.

See Note 8 for a discussion of the possible material and adverse consequences of a failure by the Company to maintain in effect retail rates adequate to recover its Grand Gulf 1-related costs, including a possible bankruptcy filing by the Company.

As noted above, the terms of the Final Order on Rehearing have remained in full force and effect during the pendency of the related litigation. In accordance with the provisions of the Final Order on Rehearing, the Company implemented its second annual increase in rates billed to customers effective October 1, 1987. It is estimated that this 4 percent increase in base rates will increase the Company's revenues by approximately $29 million during the period October 1, 1987 through September 30, 1988. In conjunction with this increase, Grand Gulf 1 costs expensed currently rather than deferred increased by approximately $2 million per month.

B. FERC June 13 decision

On June 13, 1985, the FERC issued its June 13 decision in the proceeding relating to the unit power sales agreement, under which SERI would sell its 90 percent share of the capacity and energy from Grand Gulf 1, and in the proceeding relating to the system agreement, which provides for the coordinated planning, construction and operation of generation and transmission facilities by, and establishes the terms and conditions for the sale and exchange of energy and capacity among, the System operating companies.

In the June 13 decision, the FERC affirmed the initial decision of an administrative law judge in the unit power sales agreement proceeding allocating capacity and energy from Grand Gulf 1 and the cost thereof as follows: the Company, 53 percent; AP&L, 36 percent; LP&L, 14 percent; and NOPSI, 17 percent. The June 13 decision also affirmed the administrative law judge's decision on all other issues, with minor modifications. Further, the June 13 decision generally approved the system agreement as filed, with certain minor modifications.

Various parties to these proceedings requested rehearings and, after the FERC denied all requests for rehearing, various parties, including the Company, filed appeals of these orders with the U. S. Court of Appeals for the District of Columbia Circuit (Court of Appeals).

On January 6, 1987, a three judge panel of the Court of Appeals affirmed the June 13 decision, including that part relating to allocation. In the January 6 decision, the panel of the Court of Appeals held, among other things, that the FERC has authority to review and modify the allocation of power from Grand Gulf 1 and to establish an allocation of such power which the FERC found to be just and reasonable under the Federal Power Act. Various parties filed requests for rehearing with the Court of Appeals and petitions for certiorari to the U. S. Supreme Court.

On June 24, the Court of Appeals reversed, in part, the June 13 decision and remanded the June 13 decision to the FERC (June 24 remand) for reconsideration of its decision to equalize the capacity costs of all System nuclear plants and for an explanation of the criteria used to determine what constitutes "undue discrimination" under the Federal Power Act and why the June 13 decision is not unduly discriminatory. In reversing, in part, the June 13 decision, the Court of Appeals did not change that part of its January 6 decision upholding the FERC's authority to review and modify the allocation of power from Grand Gulf 1.

As noted above, various parties filed petitions for certiorari with the U. S. Supreme Court seeking review of the principle underlying that portion of the Court of Appeals' decision that affirmed the FERC's jurisdiction to allocate Grand Gulf 1 costs. Certain of these parties requested that the U. S. Supreme Court consider their challenges to FERC jurisdiction at the same time that court considers the Company's appeal of the February 25 decision. On December 14, the U. S. Supreme Court denied, without comment, these petitions for certiorari, thereby leaving in place that part of the January 6 decision upholding the FERC's jurisdiction to allocate Grand Gulf 1 costs.

On July 17, SERI filed a brief with the FERC in which SERI urged the FERC to find that the allocation of costs established in the June 13 decision is just, reasonable and not unduly discriminatory. Various other parties also filed briefs with the FERC in some of which, positions were taken which were different from SERI's.

On November 30, the FERC issued an order in response to the June 24 remand whereby the June 13 decision was affirmed and reinstated, thus maintaining the previous allocation of Grand Gulf 1 capacity and energy among the System operating companies. In issuing the November 30 order, the FERC found that the allocation in the June 13 decision was not unduly discriminatory. Various parties filed requests for rehearing of the FERC's November 30 order. By order dated January 29, 1988, the FERC denied these requests. Petitions for review of the FERC's November 30, and January 29, 1988 orders have been filed with the D.C. Circuit Court of Appeals by various parties.

It is not possible at this time to predict the ultimate outcome of these matters, including possible reallocation, if any, or the effect thereof upon the Company, SERI and the other System operating companies, including possible refunds, if any. Any material modification of the allocation established by the June 13 decision could give rise to additional litigation, disputes and challenges in the affected jurisdictions.

In addition, the System has initiated a study, currently scheduled to be completed in the near future, to determine whether a more equitable method of allocating future energy costs, including those relating to Grand Gulf 1, would be appropriate.

C. MPSC Docket No. U-4900

In September 1986, the MPSC issued an initial order establishing Docket No. U-4900 for the stated purposes, among other things, of examining the prudence of actions of the Company and/or SERI relating to the construction and operation of the Grand Gulf Nuclear Station and the appropriate regulatory treatment of the associated costs; obtaining FERC review of SERI's rate of return on common equity; obtaining FERC revision and/or modification of various aspects of the Company's Grand Gulf 1 expenses established by the FERC, including the allocation of Grand Gulf 1 costs; inquiring generally into the appropriateness of the Company's general rate structure; and performing a detailed audit of the books and records of SERI. On January 28, 1987, the MPSC overruled separate motions to dismiss filed by SERI and the Company.

In connection with the initiation of the docket in September 1986, the Company's annual revenues were estimated to be lowered by approximately $41 million via a temporary rate reduction rider. This rider, which was offset by reduced federal income taxes and other cost savings, took effect in October 1986 when the Company implemented the second phase-in of Grand Gulf 1 rates.

On February 12, the MPSC issued a scheduling order in Phase VII of this docket ordering the Company to file testimony supporting the Company's "current revenue requirements and any adjustments thereto considered by the Company to be necessary and proper." The order further established a schedule for filing testimony by the Company, the MPSC and intervenors and for public hearings in May 1987.

On May 20, the Mississippi Supreme Court issued an order overturning a preliminary injunction obtained by the Company in April with respect to this proceeding. The Mississippi Supreme Court remanded the procedural scheduling of Phase VII of Docket No. U-4900 to the MPSC for entry of a new scheduling order pursuant to Mississippi law. This matter is pending.

On February 3, 1987, the MPSC issued an order in Phase II of this docket directing SERI and the Company to show cause why their Certificate of Public Convenience and Necessity (Grand Gulf Certificate) relating to construction and operation of the Grand Gulf Nuclear Station should not be cancelled for the failure of SERI and the Company to allow the MPSC to audit the books and records of SERI. SERI had objected to the MPSC auditing its books and records on jurisdictional and other grounds.

On April 29, SERI filed a complaint against the MPSC in the U. S. District Court for the Southern District of Mississippi, seeking declaratory relief and preliminary and permanent injunctive relief against the MPSC in connection with the initial order establishing Docket No. U-4900 as it related to SERI and the order entered ordering SERI and the Company to show cause why the Grand Gulf Certificate should not be cancelled for failure of SERI to allow the MPSC to conduct a detailed audit of the books and records of SERI. South Mississippi Electric Power Association, the owner of 10 percent of Grand Gulf 1, and various other parties intervened in the federal court action.

On May 16, the District Court denied SERI's motion for a preliminary injunction. In its opinion, the District Court recognized that the FERC has exclusive jurisdiction over rates to be charged by SERI to interstate wholesale customers. However, the District Court found that this authority "does not bar the statutory authority of the Mississippi Public Service Commission to have access to and the right to inspect and examine all accounts, records, memoranda and property of SERI...for whatever other proper purposes the Mississippi Public Service Commission may have." Furthermore, the District Court opined that such an audit of SERI's books and records "is clearly a proper exercise of state regulatory authority so long as it makes no attempt to interfere with the rate amounts mandated by FERC" and that "(I)nsofar as the audit is conducted to ascertain and clarify matters pertaining to the intrastate rates imposed by MP&L (the Company), it is reasonable and within the regulatory limits left to the states by congress." The District Court further stated that SERI could avoid the suspension of the Grand Gulf Certificate by agreeing to allow its books to be audited by the MPSC. On May 18, based on its May 16 opinion, the District Court entered an order denying SERI's motion for temporary restraining order and preliminary injunction.

On May 19, the Company and SERI filed with the MPSC separate but similar supplemental responses to show cause order and reservations of rights. In its supplemental response, SERI, in light of the District Court's May 16 decision and in order to avoid the irreparable harm that could result from the threatened cancellation of the Grand Gulf Certificate in a show cause hearing

before the MPSC, agreed to cooperate with the MPSC staff in an audit of the books and records of SERI relating to Grand Gulf 1 wholesale rates approved by the FERC. This agreement was made with full reservation of all of SERI's rights under state and federal law and under the condition that such agreement satisfies the requirements of the show cause order. SERI also stated in its supplemental response that it intends to pursue its request for declaratory and permanent injunctive relief in the federal court action. Both the Company and SERI requested that the show cause order entered February 3, 1987, be dismissed in light of SERI's compliance with the order of the MPSC that SERI cooperate in an audit of its books and records. In light of the supplemental response filed by SERI agreeing to cooperate with the MPSC in an audit, the MPSC, on May 19, continued the show cause hearing until further order of the MPSC. The federal District Court action seeking an injunction and declaratory relief is pending.

3 INCOME TAXES

Income tax expense (credit) consists of the following:

	1987	1986	1985
		(In Thousands)	
Current:			
Federal	$ 3,725	$ (96,617)	$53,043
State	129	(122)	6,280
Total	3,854	(96,739)	59,323
Deferred—net:			
Rate deferral—net of recoveries (Notes 1, 2 and 8)	78,578	108,676	69,621
Federal reclassification due to tax loss carryforward	(24,852)	(35,767)	—
State reclassification due to tax loss carryforward	(3,864)	(15,387)	—
Alternative minimum tax	(2,171)	—	—
Gas contract settlement (Note 11)	1,037	81,096	(82,133)
Unbilled revenue	(5,051)	750	(2,909)
Liberalized depreciation	6,221	8,612	5,129
Engineering and design costs—delayed generating stations and proposed FERC audit adjustments	(6,473)	5,361	(5,544)
Other	316	(934)	2,139
Total	43,741	152,407	(13,697)
Investment tax credit adjustments—net	(4,858)	(5,033)	1,425
Income tax expense	$42,737	$ 50,635	$47,051
Charged to operating expenses	$41,626	$ 48,728	$37,750
Charged to other income and deductions	1,111	1,907	9,301
Total income taxes	$42,737	$ 50,635	$47,051

Total income taxes differ from the amounts computed by applying the statutory federal income tax rate to income before taxes. The reasons for the differences are as follows:

	1987		1986		1985	
	(In Thousands)					
	Amount	% of Pre-Tax Income	Amount	% of Pre-Tax Income	Amount	% of Pre-Tax Income
Computed at statutory rate	$37,802	40.0	$48,067	46.0	$45,064	46.0
Increases (reductions) in tax resulting from:						
Depreciation	1,563	1.7	2,678	2.6	(597)	(0.6)
State income taxes—net	2,969	3.1	2,761	2.6	2,687	2.7
Investment tax credit amortization	(1,979)	(2.1)	(1,732)	(1.7)	(1,680)	(1.7)
Gas contract settlement	975	1.0	—	—	—	—
Other—net	1,407	1.5	(1,139)	(1.1)	1,577	1.6
Total income taxes	$42,737	45.2	$50,635	48.4	$47,051	48.0

The tax effects of the portion of 1986 and 1987 federal net operating tax losses that are carried forward have been recorded as reductions of deferred income taxes. These tax losses totaling $161.6 million are available to offset taxable income in future years and, if not utilized, will expire in the years 2001 and 2002.

The alternative minimum tax (AMT) credit at December 31, 1987, is $2.2 million. This AMT credit can be carried forward indefinitely and will reduce regular income tax in the future.

Unused investment tax credits at December 31, 1987, amounted to $5.8 million after the 35 percent reduction required by the Tax Reform Act of 1986. These credits may be applied against federal income tax liabilities in future years. If not used, they will expire in years 1992 through 2002.

Cumulative income tax timing differences for which deferred income taxes have not been provided are $80.4 million, $69.9 million and $72.8 million in 1987, 1986 and 1985, respectively.

In December 1987, the FASB issued SFAS No. 96, Accounting for Income Taxes, which is effective for years beginning after December 15, 1988. Under the liability method adopted by SFAS No. 96, deferred tax balances will be based on enacted tax laws at tax rates that are expected to be in effect when the temporary differences reverse. SFAS No. 96 expands the requirement to record deferred income taxes for all temporary differences that are reported in one year for financial reporting purposes and a different year for tax purposes. This will require the recognition of deferred tax balances for certain items not previously reflected in the financial statements, such as a deferred tax liability relating to AFUDC.

It is expected that reductions in deferred taxes resulting from the lower corporate federal tax rates will be reflected as liabilities to customers since the Company's regulators may require any such savings to be passed on to ratepayers. The impact of SFAS No. 96 on the financial position or results of operations of the Company has not yet been determined.

4 SHORT-TERM BORROWINGS, LINES OF CREDIT, AND SALE OF ACCOUNTS RECEIVABLE

The Company has authority from the SEC under the Public Utility Holding Company Act of 1935 to borrow in an amount up to a maximum of 10 percent of capitalization on a short-term basis (approximately $100.5 million at December 31, 1987). The Company's new mortgage also limits short-term borrowings to an aggregate amount not exceeding in general, the greater of 10 percent of capitalization or 50 percent of rate deferrals available to support the issuance of general and refunding bonds (See Note 5). Utilization of short-term borrowings is subject to the availability of short-term credit resources. At December 31, 1987, the Company had $30 million in lines of credit with Mississippi banks, none of which was outstanding at that date. As of February 29, 1988, the full amount of the Company's local bank lines is available. In the event of certain future adverse developments, the availability of these bank lines could be the subject of further negotiation.

The Company also participates with certain other companies of the System in a Money Pool arrangement whereby those companies with available funds can lend those funds to other participating companies in the System having short-term borrowing needs. The availability of Money Pool funds at any particular point in time may be limited. The Company may borrow from these sources subject to its maximum authorized level of short-term borrowings.

On October 2, 1987, the Company entered into an agreement for the sale of its billed and unbilled customer accounts receivable. Proceeds from the initial sale of billed accounts receivable totaled approximately $39 million. The terms of this agreement allow for the sale and assignment by the Company, on a daily basis, of its outstanding customer accounts receivable, including all collections relating thereto, without recourse to the Company and is subject to cancellation by either party upon 30 days written notice.

In light of the February 25 decision and pending final disposition of the appeal of that decision, the Company's ability to obtain externally generated funds may be limited. (See Note 2A.)

The short-term borrowings and applicable interest rates (determined by dividing interest expense by the average amount borrowed) for the Company were as follows:

	1987	1986	1985
		(In Thousands)	
Maximum borrowing:			
Bank loans	$10,000	—	—
Associated companies	$70,800	$50,700	$22,000
Average borrowing:			
Bank loans	$ 4,535	—	—
Associated companies	$17,050	$ 4,629	$ 2,692
Average interest rate during the period:			
Bank loans	8.11%	—	—
Associated companies	6.87%	6.84%	8.48%

5 PREFERRED AND COMMON STOCK

Preferred stock at December 31, 1987 and 1986 consisted of the following:

	Shares Authorized at 12/31/87	Shares Outstanding 1987	Shares Outstanding 1986	(In Thousands) Amount Outstanding 1987	(In Thousands) Amount Outstanding 1986	Call Price Per Share at 12/31/87
Without sinking fund ($100 per share):						
4.36% Series	60,000	**59,920**	59,920	**$ 5,992**	$ 5,992	$103.86
4.56% Series	44,476	**43,888**	43,888	**4,389**	4,389	107.00
4.92% Series	100,000	**100,000**	100,000	**10,000**	10,000	102.88
7.44% Series	100,000	**100,000**	100,000	**10,000**	10,000	104.67
9.16% Series	75,000	**75,000**	75,000	**7,500**	7,500	104.06
Premium				**196**	196	
Total	379,476	**378,808**	378,808	**$38,077**	$38,077	
With sinking fund ($100 per share):*						
9.00% Series	350,000	**350,000**	350,000	**$35,000**	$35,000	109.00
9.76% Series	350,000	**350,000**	—	**35,000**	—	109.76
12.00% Series	100,000	**100,000**	100,000	**10,000**	10,000	112.00
16.16% Series	150,000	**150,000**	150,000	**15,000**	15,000	116.16
Discount				**(4,311)**	(3,807)	
Total	950,000	**950,000**	600,000	**$90,689**	$56,193	
Unissued	375,000					
Total	1,704,476					

*These series are to be retired in full through the operation of sinking funds in accordance with the schedule shown below.

Series	Redemption Date	Number of Shares per Year
9.00%	July 1, 1991 and each July 1 thereafter through 1995	70,000
9.76%	January 1, 1993 and each January 1 thereafter through 1997	70,000
12.00%	March 1, 1988 and each March 1 thereafter through 2007	5,000
16.16%	November 1, 1989 and each November 1 thereafter through 2008	7,500

In addition, for the 12.00% and the 16.16% series, the Company has the non-cumulative option to redeem an additional like amount of said shares each year commencing in the first year of redemption for each series.

	Number of Shares Sold 1987	1986	1985
Common stock	—	—	435,000
Preferred stock	**350,000**	350,000	—

6 LONG-TERM DEBT

Long-term debt at December 31, 1987 and 1986 consisted of the following:

	1987	1986
	(In Thousands)	
First Mortgage Bonds:		
4 1/8% Series due 1988	$ 15,000	$ 15,000
11 1/4% Series due 1988	4 000	45,000
15 1/8% Series due 1990	30,000	30,000
12 1/4% Series due 1992	30,000	30,000
14.40% Series due 1992	75,000	—
4 5/8% Series due 1995	20,000	20,000
5 1/8% Series due 1996	25,000	25,000
6 3/8% Series due 1996	10,000	10,000
9 5/8% Series due 1999	20,000	20,000
9 1/4% Series due 2000	17,500	17,500
7 3/4% Series due 2002	15,000	15,000
7 3/4% Series due 2003	30,000	30,000
8 1/4% Series due 2003	20,000	20,000
9 7/8% Series due 2004	25,000	25,000
10 7/8% Series due 2005	25,000	25,000
14 1/2% Series due 2014	35,000	35,000
9 5/8% Series due 2016	70,000	70,000
Total First Mortgage Bonds	507,500	432,500
Pollution Control Revenue Bonds:		
7 1/4% to 8 1/2% due 1989 to 1995	1,400	1,500
7 1/2% due 2004	9,400	9,400
8 1/2% due 2004	8,575	8,575
7 7/10% due 2012*	10,000	10,000
9% due 2013	10,000	10,000
9 1/2% due 2014	10,000	10,000
Total Pollution Control Revenue Bonds	49,375	49,475
Unamortized Premium on Debt	664	725
Unamortized Discount on Debt	(4,379)	(4,444)
Total Long-term Debt	553,160	478,256
Less—Amount Due Within One Year*	70,150	10,100
Long-term Debt Excluding Amount Due Within One Year	$483,010	$468,156

At December 31, 1987, the sinking fund requirements and maturities for long-term debt for years 1988 through 1992 were as follows:

Year	Sinking Fund**	Maturities
	(In Thousands)	
1988	$ 1,987	$ 70,150*
1989	2,037	150
1990	2,037	30,150
1991	2,037	—
1992	2,037	105,000

*This series of pollution control revenue bonds reaches its next fixed interest rate date on July 1, 1988 and the Company has therefore included this series as a current maturity. The Company intends to request authority from the SEC to waive its optional redemption rights on July 1, 1988 with respect to these bonds in order to fix a long-term interest rate on and to economically price the bonds. The holders of the bonds will have the right to have their bonds repurchased by the Company on the above fixed rate date. The intent of the Company will be to remarket these bonds on July 1, 1988.

**Sinking fund requirements may be satisfied by certification of property additions at the rate of 167 percent of such requirements.

In December 1987, the Company issued $75 million of 14.40 percent first mortgage bonds of which $60 million was deposited with the first mortgage bond trustee to be applied to the early retirement prior to maturity of $45 million of 11 1/4 percent first mortgage bonds on January 15, 1988, and the retirement at maturity of $15 million of 4 1/8 percent first mortgage bonds on April 1, 1988.

As of February 1, 1988, the Company established a new general and refunding (G&R) mortgage to provide for the issuance of G&R bonds. On February 11, 1988, the Company issued $75 million in aggregate principal amount of two initial series of G&R bonds in accordance with the provisions of the new mortgage. The stated fixed annual interest rates are 14.65 percent for the first series ($55 million) and 14.95 percent for the second series ($20 million). The first series bonds mature on February 1, 1993 and the second series bonds mature on February 1, 1995. After giving effect to the issuance of the G&R bonds and the redemption and retirement of first mortgage bonds in early 1988 as described above, the maximum amount of G&R bonds issuable at December 31, 1987 under the terms of the new mortgage described below would have been $116 million.

The Company is precluded from issuing any additional first mortgage bonds under the first mortgage indenture, except for such bonds as may be issued to provide additional security for G&R bonds. Consequently, any future mortgage bond financing will be affected pursuant to the new mortgage. The new mortgage constitutes a second lien on substantially all the properties and assets of the Company, subject and subordinate to the lien of the Company's first mortgage indenture.

The issuance of G&R bonds is subject to a test permitting the Company to issue G&R bonds in an aggregate principal amount not to exceed 70 percent of property additions since December 31, 1987, plus the lesser of 50 percent of the cumulative balance of deferred Grand Gulf 1 costs recorded as an asset on the books of the Company or up to an aggregate principal amount on this basis of $400 million. In addition, the new mortgage contains an earnings coverage test requiring minimum earnings coverage of twice the pro-forma annual bond interest charges for the issuance of additional G&R bonds.

7 RETAINED EARNINGS

The Company's bond indentures relating to long-term debt provide for restrictions on the payment of cash dividends on common stock. As of December 31, 1987, $35.9 million of retained earnings were free from such restrictions.

As a result of uncertainties facing the Company and the System, dividends on common stock were not declared from mid-1985 through June 1987. Beginning in July 1987, common stock dividends were declared/paid as follows:

	(In Millions)
July/August 1987	**$3.8**
October/November 1987	**4.0**
January/February 1988	4.0

All of the Company's preferred stock dividend requirements have been met without interruption.

8 COMMITMENTS AND CONTINGENCIES

A. Overview

A number of significant contingencies threaten the Company. The most significant relates to obtaining a reversal from the U. S. Supreme Court of the February 25 decision rendered by the Mississippi Supreme Court, which overturned the Company's 1985 retail rate order. This issue, if not favorably resolved for the Company, could render the Company insolvent in a short period of time (See Notes 2A and 8F). Other significant issues facing the Company include (1) the possible effect on the Company of recent changes in accounting standards related to the accounting for rate phase-in plans (See Note 8D), (2) the resolution of a multi-phased proceeding initiated by the MPSC to examine the Company's current rate requirements and structure, including prudence issues (See Note 2C), (3) the need to access the capital markets for external financing (See Note 8B), and (4) the ultimate resolution of the status of Grand Gulf 2 and the possible allocation to the Company of costs associated with that unit (See Note 8E).

In addition, various matters, including retail rate matters of certain other System companies, continue to threaten the viability of the System (See Note 8F).

B. Capital Requirements and Financing

The Company's obligation for payments to SERI for Grand Gulf-1 related charges is approximately $26 million per month. Deferred purchased power costs in connection with the Company's rate phase-in plan were approximately $182.7 million, $223.2 million and $143.0 million in 1987, 1986 and 1985, respectively. The Company estimates that it will incur total capital requirements of approximately $127.3 million in 1988, $66.2 million in 1989 and $14.1 million in 1990 in connection with the deferral or phase-in of Grand Gulf 1-related costs pursuant to the Final Order on Rehearing, as discussed in Note 2A.

The Company's construction program (including AFUDC) is currently forecast to total approximately $44.4 million, $43.1 million and $45.0 million in 1988, 1989 and 1990, respectively.

The Company will have maturing long-term debt of $70.2 million in 1988, $.2 million in 1989 and $30.2 million in 1990.

Preferred stock sinking fund requirements will total $3.1 million during the period 1988-1990. During the legal and regulatory proceedings referred to above, the Company's ability to obtain necessary long-term financing has been and may continue to be limited or may not be effected in a timely basis, which may result in liquidity problems.

It is presently estimated that approximately $140.0 million of the above capital requirements will be externally financed during the years 1988-1990. The above external financing estimate assumes (1) the continuation of the Company's current 33 percent allocation of Grand Gulf 1 capacity and energy, (2) the allocation of other energy costs under the system agreement in accordance with the June 13 decision, (3) that the Company's appeal of the February 25 decision is successful and (4) no changes to the Company's rate phase-in plan for the recovery of Grand Gulf 1-related costs as a result of the new accounting standards set forth in SFAS No. 92. These estimates are also based on certain other assumptions and

judgments with respect to, among other things, earnings, dividend policy, the outcome of regulatory and judicial proceedings and access to capital markets. Alteration of rate and regulatory orders could significantly affect the Company's financing plans and capabilities.

The Company may enter into arrangements for the sale and leaseback of property in which the proceeds from such transactions could be used to retire debt at par.

C. Grand Gulf 1 Rate Order

See Note 2A for information regarding this matter.

D. New Accounting Standard—SFAS No. 92

The accounting standards relating specifically to phase-in of rates associated with the costs of newly completed generating plants are set forth in SFAS Nos. 71 and 92 promulgated by the FASB. The Final Order on Rehearing includes a phase-in plan for recovery of costs related to Grand Gulf 1 which meets the requirements of SFAS No. 71, before subsequent amendment by SFAS No. 92.

In August 1987, the FASB issued SFAS No. 92, Regulated Enterprises—Accounting for Phase-in Plans, an amendment of SFAS No. 71. SFAS No. 92 requires, among other things, the following conditions for deferral of costs of a newly completed plant: (1) the costs deferred are scheduled for recovery within 10 years of the date when deferrals begin and (2) the percentage increase in rates for each future year is no greater than the percentage increase in rates for each immediately preceding year. Subject to the transition provisions discussed below, the new statement is effective for fiscal years beginning after December 15, 1987 and requires that amounts deferred under plans that do not meet the requirements of the statement be written off. SFAS No. 92 has transition rules designed to allow any affected company to delay application of the new statement and to continue deferral of costs under its existing phase-in plan provided that both of the following conditions are met: (1) the company has filed a rate application to have the plan amended to meet the requirements of the statement or it intends to do so as soon as practicable and (2) it is reasonably possible that the regulator will change the terms of the phase-in plan so that it will meet the requirements of the statement.

The terms of the Final Order on Rehearing provide for the recovery of a significant amount of deferred costs beyond the 10 year recovery period required in SFAS No. 92. The Company is studying the transition provisions of the new statement and, as soon as practicable, following the decision of the U. S. Supreme Court on the Company's appeal of the February 25 decision, intends to attempt to restructure its rate phase-in plan during the transition period to bring it into compliance with SFAS No. 92 or take other appropriate action. The Final Order on Rehearing does contain provisions which permit the Company to make application to the MPSC to amend its rate phase-in plan if the Company establishes the existence of an inability to finance on reasonable terms and also permits the Company to make application to the MPSC to consider the effect of a change in SFAS No. 71. During the pendency of the Company's appeal of the February 25 decision to the U. S. Supreme Court, the Company intends to continue to record its deferred Grand Gulf 1 costs as assets on its books in accordance with the transition provisions of SFAS No. 92. If the effort to modify its rate phase-in plan is not successful and if the terms of SFAS No. 92 are applied, the Company will be required to cease deferring Grand Gulf 1 costs on its books and instead to record these costs as current operating expenses. In addition, certain previously deferred costs (up to approximately $547.6 million at December 31, 1987) will be required to be written off, which will have an immediate and materially adverse effect on the Company, particularly in light of its already weakened financial condition.

E. Uncertainties Related to Grand Gulf 2

As of December 31, 1987, SERI had invested approximately $890 million in Grand Gulf 2 (including approximately $392 million of AFUDC), which was approximately 34 percent complete based on the estimated man-hours needed to complete the unit. From late 1979 until September 1985, only a limited amount of construction was performed on Grand Gulf 2.

In September 1983, the MPSC, in Docket No. U-4387, issued a citation to show cause to the Company and SERI to show why they should not be ordered to adhere to representations allegedly relied upon by the MPSC in determining the need and economic justification for additional generating capacity in the form of the Grand Gulf Station. In January 1984, the MPSC (1) limited the proceeding to relate solely to Grand Gulf 2 and (2) ordered SERI and the Company to show cause for the continued construction and need for Grand Gulf 2. In September 1985, the MPSC issued an order directing suspension of construction of Grand Gulf 2, which directed SERI and

the Company to suspend construction of Grand Gulf 2 as of the date of the order and to formally report to the MPSC before the end of the year regarding future plans for the unit. As an addendum to the order, the MPSC advised the Company and SERI that it was the MPSC's position at that time that any potential plan for recovery by the Company of "sunk costs" in Grand Gulf 2 through retail rates was unjustifiable.

In September 1985, following the suspension order of the MPSC in Docket No. U-4387, SERI suspended construction activities on Grand Gulf 2. Since that time, SERI has limited expenditures to only those activities which are absolutely necessary for suspension and demobilization of the unit.

In late 1986, a special group of System officials and outside consultants completed a comprehensive evaluation and review of various possibilities as to the future of Grand Gulf 2 and made recommendations to the Board of Directors of SERI. In December 1986, SERI's Board of Directors (with the MSU Board of Directors concurring) adopted that group's recommendation that suspension of construction activities be continued and that a further decision be made by 1990 on the future status of Grand Gulf 2 in light of alternatives available at that time. During the period of continuation of suspension, the energy needs of the region served by the System as well as some of the uncertainties concerning the cost of constructing nuclear power plants should be further clarified.

During the period of continuation of suspension, SERI's expenditures on Grand Gulf 2 will be limited, and it will continue not to accrue AFUDC on its investment in the unit. Consequently, during the suspension period, the increase in SERI's investment in Grand Gulf 2 will be limited and SERI will forego any return on this investment.

SERI will continue during the suspension period to evaluate various alternatives for the future of Grand Gulf 2 and will also continue to assess whether certain equipment or facilities should continue to be carried at their full cost. Any determination that the value of SERI's investment should be reduced and the amount of any such reduction written off could adversely effect various companies in the System. SERI believes, however, that it is justified in carrying Grand Gulf 2 at its full value because the property currently comprising Grand Gulf 2 is of the same design as that of Grand Gulf 1, is being properly maintained and is therefore suitable for its intended purpose.

As a result of the decision of SERI's Board of Directors with respect to continuation of suspension of construction, SERI does not intend to make an application to the FERC during the period of suspension with respect to the recovery through rates of SERI's investment in Grand Gulf 2.

While SERI believes that all of its investment to date in Grand Gulf 2 has been prudent, in connection with any subsequent decision as to the value of Grand Gulf 2 or the ultimate decision with respect to the future of Grand Gulf 2, SERI will, at an appropriate time, make a determination as to the appropriate recovery of its investment. In making such determination, SERI will consider, among other things, the regulatory environment, generally, and legal standards then applicable. Any action to seek recovery of Grand Gulf 2 costs would likely involve a filing by SERI with the FERC requesting such recovery, over a period of years, through charges to the System operating companies, and related filings by the System operating companies before state or local regulatory authorities to recognize the FERC-allowed charges in retail rates. In view of the controversies over the Grand Gulf Station, including the adverse reaction of various rate regulatory bodies to allocation of costs, and regulatory uncertainties, including ratemaking, attendant to a delay in the decision as to the future of Grand Gulf 2, there can be no assurance that the full cost of Grand Gulf 2 will be recovered or as to the timing of any recovery. As was the case with Grand Gulf 1, proceedings before the FERC and, with respect to recognition in retail rates of FERC-approved rates, before state or local regulatory authorities could be protracted and strongly contested on various grounds, including imprudence. If costs associated with Grand Gulf 2 were allocated to the System operating companies and they were unable to recover these costs from their customers, the System operating companies' financial condition could be materially and adversely affected.

During the period to 1990, certain issues could cause a decrease in the valuation of the investment in Grand Gulf 2. Failure to obtain rate relief for all or a substantial portion of the cost of Grand Gulf 2 could have a material and adverse effect upon the financial condition of SERI, MSU and possibly the System operating companies, depending upon, among other things, the timing of the realization of any such loss.

In January 1988, the FERC issued an order which modified its policy regarding recovery of cancelled or abandoned plant costs by utilities subject to its jurisdiction. The revised policy provides for a "50/50 sharing of prudently incurred costs of a cancelled plant between the owner and the ratepayers, whereby 50 percent of the prudently incurred costs of the cancelled plant would be amortized and recovered from ratepayers over the expected life of the plant as if it had been completed. The currently unamortized portion of such amount also would be included in rate base thereby allowing for a return thereon. The remaining 50 percent of prudently incurred costs would be written off.

F. Potential Debt Acceleration, Bankruptcy and System Viability

The February 25 decision has been appealed to the U. S. Supreme Court, where the matter is pending. Further, certain other System operating companies' retail rate structures relating to their recovery of Grand Gulf 1 costs are being challenged or may be challenged in the future. Adverse regulatory or judicial decisions as to these matters could produce varying consequences.

An adverse determination by the U. S. Supreme Court on the Company's appeal of the February 25 decision could render the Company insolvent in a short period of time (See Note 2A). Furthermore, the Council of the City of New Orleans, on February 4, 1988, after a lengthy prudence investigation, adopted a resolution requiring NOPSI to absorb, and not recover from its retail electric customers, $135 million of its Grand Gulf 1 costs in addition to the $51.2 million of such costs that NOPSI had previously agreed to absorb. Should NOPSI fail to maintain in effect retail rates to recover its Grand Gulf 1-related costs, NOPSI would not have adequate resources to meet its contractual obligations to SERI in respect to Grand Gulf 1 and could, in a short period of time, be rendered insolvent.

Failure of the Company or any other System operating company to maintain its current rate structure or to meet its contractual obligations to SERI in respect of the Grand Gulf Nuclear Station, could, under certain agreements relating to SERI's indebtedness (but, in most cases, only upon further action by the requisite percentage of SERI's creditors), lead to acceleration of such indebtedness unless (1) waivers were obtained, (2) the debt were restructured or (3) other arrangements could be negotiated. In addition, in the absence of such waivers, debt restructuring or other negotiated arrangements, acceleration of such indebtedness could occur if the Company or any other System operating company were rendered insolvent as a result of a substantial reduction in rates. Given the substantial amount of SERI's debt, it would not be able to meet its obligations, if accelerated. Under SERI's financing agreements, neither the Company nor the other System operating companies would be responsible to pay SERI's accelerated obligations if SERI could not meet them. (See Note 8H for a discussion of the obligations of the System operating companies, including the Company, to make payments or advances to SERI under the Availability Agreement.) Moreover, MSU, with its financial resources currently limited, would not at this time be in a position to satisfy SERI's obligations, if accelerated.

Certain of SFI's financing agreements and leases may require payments by the System operating companies (including the Company), MSU, or SERI in the event SFI's obligations under such agreements are accelerated as a result of the insolvency of a System operating company and SFI is unable to meet these obligations or otherwise to satisfy these obligations through the sale of the collateral securing such obligations. (See Note 8I for information regarding certain financial undertakings by the Company and the other System operating companies on behalf of SFI.) In addition, insolvency of the Company or any other System operating company would affect terms of financing, including an increase in cost of financing, or could preclude financing for other System companies.

In the event of any of the foregoing adverse developments, the continuing viability of the System would be placed in jeopardy, and it could be difficult to avoid a bankruptcy filing by the Company or other affected System companies. In this connection, the Company and certain other System companies have each retained independent special counsel experienced in bankruptcy matters and have been studying the relief and protection that might be available to them under Chapter 11 of the U. S. Bankruptcy Code.

While no decisions with regard to bankruptcy filings have yet been made, it must be recognized, in light of the risks discussed herein, that future events either singly or in combination, may result in such adverse changes in business circumstances or such a decrease in liquidity as to make it prudent for the Company or one or more other System companies to file a petition for reorganization under Chapter 11. Many of these future events are beyond the control of the System.

The effects of a bankruptcy proceeding involving the Company or any other System company or companies and the extent of the jurisdiction of the SEC under the Holding Company Act and of other federal and state regulatory bodies over the bankrupt entity or entities and over any other System companies not in bankruptcy cannot be predicted. In any event, security holders and creditors of the company or companies involved in bankruptcy proceedings could be significantly affected by such proceedings. The proceedings could last for years, and there are many uncertainties as to how provisions of the law would be applied. Rights and remedies of security holders and creditors may be altered, denied or limited under such laws. The obligations of MSU and the System operating companies under the availability agreement and the assignments thereof, could also be litigated and possibly reduced or eliminated. There can be no assurance that any creditors would be able to recover the full amount of their claims and securities and stock with inferior rights could be substituted for those with priorities. Further, holders of equity securities may not be able to recover any substantial amount on their investment. Moreover, it is uncertain whether the bankrupt entity or entities could be successfully reorganized in their present form, whether the current relationships between and among various System companies would be significantly altered or whether the System would continue to exist in its present form after bankruptcy of one or more System companies.

G. Unit Power Sales Agreement and System Agreement

See Note 2B for information regarding these agreements.

H. Availability and Reallocation Agreements

The System operating companies are severally obligated to SERI under the availability agreement in accordance with stated percentages (the Company 31.3 percent, AP&L 17.1 percent, LP&L 26.9 percent, NOPSI 24.7 percent) to make payments or subordinated advances adequate to cover all of the operating expenses, including depreciation, of SERI. The System operating companies, including the Company, in November 1981, entered into a reallocation agreement which would have allocated the capacity and energy available to SERI (and the related costs) from the Grand Gulf Nuclear Station to the Company, LP&L and NOPSI. These companies thus had agreed to assume all the responsibilities and obligations of AP&L with respect to the Grand Gulf Nuclear Station under the availability agreement and the power purchase advance payment agreement, with AP&L relinquishing its rights to capacity and energy from the Grand Gulf Nuclear Station. Each of the System operating companies, including AP&L, however, would have remained primarily liable to SERI and its assignees for payments of advances under these agreements. AP&L would have been obligated to make its share of the payments or advances only if the other System operating companies had been unable to meet their contractual obligations. However, the June 13 decision allocating a portion of Grand Gulf 1 capacity and energy to AP&L supersedes the reallocation agreement insofar as it relates to Grand Gulf 1.

I. System Fuels, Inc.

The Company has a 19 percent interest in SFI, a jointly-owned subsidiary of the four operating companies (the Company, AP&L, LP&L, and NOPSI) of MSU. SFI operates on a non-profit basis for the purpose of planning and implementing programs for the procurement of fuel supplies for all of the System operating companies and SERI. SFI's costs are primarily recovered through charges for fuel delivered.

The parent companies of SFI had agreed to make loans to SFI to finance its fuel supply business under a loan agreement dated January 1, 1984, as amended January 1, 1987, which provided for SFI to borrow up to $51 million from its parent companies through December 31, 1987. This loan agreement was not amended in 1988

and consequently, the Company may not be required to make further loans to SFI at this time. As of December 31, 1987, the Company had loaned SFI approximately $19.4 million under this agreement and other previous loan agreements. Notes mature in 1992, 2002 and 2008 under provisions of these loan agreements.

In connection with certain of SFI's outside borrowing arrangements, SFI's parent companies, including the Company, have covenanted and agreed severally in accordance with their respective shares of ownership of SFI's common stock, that they will take any and all action necessary to keep SFI in a sound financial condition and to place SFI in a position to discharge, and to cause SFI to discharge its obligations under these arrangements. At January 1, 1988, the total loan commitment under these arrangements amounted to approximately $105 million of which approximately $97 million was outstanding at that date. Also, SFI's parent companies, including the Company, have made similar covenants and agreements in connection with long-term leases by SFI of oil storage and handling facilities and coal hopper cars. At December 31, 1987, the aggregate discounted value of these arrangements was approximately $73.5 million.

SFI contracted with a joint venture for a supply of coal from the North Antelope Coal Mine in Wyoming. This contract has been assigned to AP&L with SFI having no further obligations or involvement under the contract effective December 31, 1987. Under the contract with the joint venture, investment in the mine for leases, plant and equipment is the responsibility of the joint venture. In order to limit the joint venture's investment rights and hence, the amount to be paid to it as a component of the price of coal, the contract provided that SFI invest any funds for plant and equipment in excess of a specified amount. The Company, AP&L, Arkansas Electric Cooperative Corporation and the City of Jonesboro, Arkansas, as co-owners in part of ISES, agreed to make the investments rather than SFI and accordingly, reimbursed SFI for investments previously made. See Note 9 for additional discussion of the coal mine.

J. Shareholder Litigation

MSU, certain other System companies, including the Company, and individuals were defendants in a purported class action suit. The initial complaint was filed in August 1985 by an MSU shareholder (purporting to represent a class that purchased MSU common stock) followed by four similar complaints filed by MSU shareholders in August and September 1985. The five actions were consolidated in the U. S. District Court for the Eastern District of Louisiana. The consolidated, amended and supplemental complaint alleged violations of the disclosure requirements of the Securities Exchange Act of 1934 and the Securities Act of 1933, common law fraud and common law negligent misrepresentation in connection with the financial condition of MSU and prayed for compensatory and punitive damages, legal costs and fees and other proper relief against MSU various other System companies, including the Company, and certain officers (and former officers) and directors of MSU, the Company's outside auditors and certain underwriters of MSU common stock. MSU and the other defendants have asserted all available defenses thereto and believe that MSU's disclosure of its financial condition was in compliance with applicable SEC requirements. In April 1986, MSU and the other defendants, including the Company, filed a motion to dismiss or in the alternative, a motion for summary judgment. On January 12, 1987, the District Court entered a judgment granting defendants' motions for summary judgment and dismissed the suit. On February 6, the plaintiffs in the consolidated action filed a notice of appeal in the U. S. Court of Appeals for the Fifth Circuit. Oral argument was held on November 5. The defendants intend to vigorously oppose the appeal of the District Court's decision. In the event the dismissal is reversed on appeal, the eventual outcome and impact on the System's financial condition cannot be predicted.

9 TRANSACTIONS WITH AFFILIATES

A. Jointly Owned Facilities

The Company owns 25 percent of ISES, a two-unit, coal-fired generating station located near Newark, Arkansas. AP&L owns 31.5 percent of the station and operates the facility. The Company records its investment in and expenses associated with this station to the extent of its ownership and participation. The Company's investment in ISES at December 31, 1987, was $226.1 million, less accumulated depreciation of $31.2 million.

The Company and AP&L have entered into a unit power purchase agreement for the Company's purchase of AP&L's capacity and energy from ISES Unit 2 for a five-year term which began in December 1984.

The Company owns certain coal mining equipment and facilities at the North Antelope Coal Mine which is located near Wright, Wyoming. The low-sulphur coal produced at this mine is dedicated exclusively to ISES and the mine's estimated reserves are presently expected to provide for at least 30 years of the projected requirements of ISES. The Company records its investment in the equipment and facilities of the mine to the extent of its ownership interest. The Company's investment in the coal mine equipment and facilities at December 31, 1987, was $15.7 million, less accumulated depreciation of $3.1 million.

B. Other Affiliated Transactions

The Company buys from and/or sells electricity to the other operating subsidiaries of MSU (including SERI) under rate schedules filed with the FERC. In addition, the Company purchases boiler fuel from SFI and receives technical and advisory services from SSI.

	1987	1986	1985
		(In Thousands)	
REVENUES:			
Power sold to the System	$ 42,821	$ 80,925	$ 97,584
PURCHASED POWER EXPENSES:			
Power purchased from the System (excluding GGNS 1)	82,546	86,233	73,995
Power purchased from SERI (GGNS 1)	317,519	316,713	181,933
Power purchased from SERI (GGNS 1) (Deferred)	(182,739)	(223,155)	(142,958)
FUEL EXPENSE:			
Fuel purchased from SFI	21,973	33,610	32,748
OTHER:			
Technical & advisory services purchased from SSI	13,532	12,003	10,939

10 POST-RETIREMENT BENEFITS

The companies of the System have various postretirement benefit plans covering substantially all of their employees. The pension plans are noncontributory and provide pension benefits that are based on the employees' credited service and average compensation, generally during the last five years before retirement. The policy of the Company is to fund pension costs in accordance with contribution guidelines established by the Employment Retirement Income Security Act of 1974.

Pension plans are administered by a trustee who is responsible for pension payments to retirees. Various investment managers have responsibility for management of the plans' assets. In addition, an independent actuary performs the necessary actuarial valuations for the individual company plans.

The Company's total pension cost (income) for the last three years was as follows:

	(In Thousands)
1987	**$ (893)***
1986	4,895**
1985	6,375**

*Includes $(250) pertaining to the amortization of the special early retirement program offered in 1985 and other miscellaneous adjustments.

The Company adopted SFAS No. 87, Employers' Accounting for Pensions, effective January 1, 1987. Adoption of SFAS No. 87 reduced 1987 pension cost by approximately $6.5 million. This decrease was partially offset by various immaterial increases in pension costs.

The Company's total 1987 pension cost (income) included the following components:

	(In Thousands)
Service cost-benefits earned during the period	**$2,253**
Interest cost on projected benefit obligation	**5,521**
Actual return on plan assets	**(4,718)**
Net amortization and deferral	**(3,699)**
Net pension cost	**$ (643)**

The assets of the plan consist primarily of common and preferred stocks and fixed income securities.

The funded status of the Company's pension plan at December 31, 1987, was as follows:

	(In Thousands)
Actuarial present value of accumulated pension plan benefits:	
Vested	$51,924
Nonvested	3,400
Accumulated benefit obligation	$55,324
Projected benefit obligation	$66,947
Plan assets at fair value	87,124
Plan assets in excess of projected benefit obligation	20,177
Unrecognized transition asset	(17,504)
Unrecognized net gain	(5,492)
Accrued pension liability	$ (2,819)

The weighted average discount rate and rate of increase in future compensation used in determining the actuarial present value of the above projected benefit obligation were 9.0 percent and 5.6 percent, respectively. The expected long-term rate of return on plan assets was 8.5 percent. Transition assets are being amortized over 15 years.

The actuarial present value of accumulated plan benefits at January 1, 1986 was $48,008 (of which $3,323 was nonvested), compared with net assets available for pension benefits of $89,143. The assumed rate of return used in determining the actuarial present value of accumulated plan benefits at that date was 9 percent.

The Company provides certain health care and life insurance benefits for retired employees. Substantially all employees may become eligible for these benefits if they reach retirement age while still employed by the Company. These and other similar benefits for active employees are provided through payments of premiums and fees to insurance companies. The cost of providing these benefits for retirees is not separable from the cost of providing benefits for active employees. The total cost of providing these benefits and the average number of active employees and retirees for the last three years were as follows:

	1987	1986	1985
Total cost of health care and life insurance (in thousands)	$2,212	$2,572**	$2,423**
Number of active employees	1,512	2,431**	2,275**
Number of retirees	391	375	320

**Figures for 1986 and 1985 include employees assigned to and costs allocated to SERI. Effective January 1, 1987, approximately 950 employees of the Company transferred to SERI. The related pension liabilities and estimated assets as of that date of $4.4 million and $15.7 million, respectively, were transferred, subject to a final true-up of estimated assets, to a post retirement benefit plan administered by MSU.

11 LITIGATION AGAINST GAS SUPPLIER

A. 1985 Settlement Agreement With Gas Supplier

Two lawsuits between the Company and United arising from the Company's claim that United breached the terms of a gas sales agreement were settled by the execution of a settlement agreement between the parties in September 1985. United paid the Company $165 million in September 1985 and $17.5 million in September 1987. Upon receipt, the funds and subsequently, the interest earned on those funds were invested in United States Government Repurchase Agreements.

In August 1986, the Company filed with the MPSC a proposed plan for distributing these funds. The MPSC entered an order in October 1986 which established a distribution plan whereby the settlement proceeds were allocated between the Company's wholesale and retail customers.

In January 1987, the Company refunded approximately $18.1 million to 12 former wholesale customers. In March, the first distribution was completed with the refund of approximately $160.4 million to the Company's current retail customers. In November, the second distribution was made with $1.7 million and $16.1 million refunded to the Company's former wholesale customers and current retail customers, respectively.

B. Additional Litigation Against Gas Supplier

Two additional lawsuits filed by the Company against United in October 1986 and February 1987 are pending.

In October 1986, the Company filed a lawsuit against United in connection with United's pricing calculations. In the suit filed in U. S. District Court, the Company contended that United should include the purchase prices and volumes purchased by United's subsidiaries and marketing affiliates in the mathematical formula it uses to determine the Company's cost. This would result in fuel cost savings for the Company which would be passed on to its customers.

In January 1987, United submitted an invoice to the Company for approximately $24 million for amounts allegedly owed United under a take-or-pay provision in the gas sales contract. In February, the Company filed a declaratory judgment suit against United which seeks, among other things, a declaratory judgment that the Company does not have to pay the January 1987 invoice.

In March 1987, United filed its answer and counterclaim for the amount of the January invoice plus expenses, and in August, amended its filing to seek recovery of an additional $4.6 million.

In February 1988, United submitted a second invoice under the gas sales agreement for approximately $100 million. The Company is seeking to amend its complaint in the declaratory judgment action to allege that it has no obligation to pay this invoice based on the same grounds it has asserted in respect to United's January 1987 invoice.

In the event the court holds that United did not overcharge the Company during 1986 and 1987 and that a deficiency occurred in the amount of gas taken by the Company during those years after all credits have been applied, it would be the Company's intention to pay United for the deficiency and take the gas paid for during the year following any such judicial ruling.

This matter is pending.

12 QUARTERLY RESULTS (UNAUDITED)

Unaudited operating results by quarters were as follows:

	Quarter Ended			
	March	June	September	December
	(In Thousands)			
1987				
Operating revenues	**$134,011**	**$148,048**	**$184,105**	**$154,672**
Operating income	**20,578**	**21,315**	**36,354**	**22,173**
Net income	**8,664**	**8,824**	**24,058**	**10,221**
1986				
Operating revenues	$146,167	$149,163	$218,587	$159,931*
Operating income	22,459	20,788	34,254	20,440*
Net income	12,434	10,110	22,841	8,475*

*Fourth quarter 1986 operating revenues reflect an increase of approximately $5.0 million in connection with the reversal of provisions made in 1985 for adjustments resulting from issues raised during the FERC's normal periodic review of Company operations. This increase in revenues increased operating and net income by approximately $3.2 million. Operating and net income were reduced by approximately $3.6 million due to the recognition of engineering and design costs associated with indefinitely delayed future fossil-fueled generating facilities.

The business of the Company is subject to seasonal fluctuations with peak periods occurring during the summer months. Accordingly, earnings information for any three-month period should not be considered as a basis for estimating the results of operations for a full year.

RECORD OF PROGRESS 1983-1987

SELECTED FINANCIAL DATA (000's OMITTED)

ELECTRIC OPERATING REVENUES:	Residential
	Commercial
	Industrial
	Governmental & municipal
	Cooperatives & municipalities
	Total from energy sales (Mississippi area)
	Sales to other public utilities
	Total from energy sales
	Miscellaneous revenues
	Deferred fuel adjustment revenues[1]
	Total electric operating revenue
	NET INCOME
TOTAL ELECTRIC UTILITY PLANT:	Production
	Transmission
	Distribution
	General & other
	Total utility plant completed
	Plant held for future use
	Construction work in progress
	Electric plant acquisition adjustments
	Total utility plant
	TOTAL ASSETS
	RATE DEFERRAL—NET OF RECOVERY
	LONG-TERM DEBT
	PREFERRED STOCK, WITH SINKING FUND

[1] See Note 1 (B)—Summary of significant accounting policies.

1987	1986	1985	1984	1983
$ 240,867	$ 246,150	$ 207,738	$ 186,296	$ 185,917
175,418	178,240	152,007	134,276	129,863
121,999	125,133	113,044	106,924	108,365
22,001	22,947	19,480	17,694	19,593
—	—	—	4,189	7,996
560,285	572,470	492,269	449,379	451,734
48,310	90,411	104,384	73,218	51,171
608,595	662,881	596,653	522,597	502,905
12,129	10,302	6,100	10,422	9,788
112	765	2,376	(1,092)	7,410
$ 620,836	$ 673,948	$ 605,129	$ 531,927	$ 520,103
$ 51,767	$ 53,860	$ 50,913	$ 48,333	$ 43,495
$ 573,379	$ 572,828	$ 572,646	$ 572,938	$ 482,177
255,010	248,675	247,476	218,383	215,575
296,305	281,036	267,162	256,146	242,433
34,449	26,721	25,383	40,233	36,592
1,159,143	1,129,260	1,112,667	1,087,700	976,777
3,938	3,939	3,939	3,939	3,939
16,852	3,947	2,365	16,643	83,590
953	1,135	1,317	1,498	1,680
$1,180,886	$1,138,281	$1,120,288	$ 1,109,780	$ 1,065,986
$1,459,404	$1,453,172	$1,332,482	$ 938,220	$ 862,249
$ 547,616	$ 364,234	$ 146,608	—	—
$ 483,010	$ 468,155	$ 401,065	$ 369,200	$ 340,506
$ 90,689	$ 56,193	$ 54,802	$ 55,000	$ 40,000

OTHER DATA:

ELECTRIC ENERGY SALES (MKWH):

Residential _____
Commercial _____
Industrial _____
Governmental & municipal _____
Cooperatives & municipalities _____

Total energy sales (Mississippi area) _____
Sales to other public utilities _____

Total electric energy sales _____

ELECTRIC CUSTOMERS (END OF PERIOD):

Residential _____
Commerical _____
Industrial _____
Governmental & municipal _____
Cooperatives & municipalities _____

Total customers (Mississippi area) _____
Other public utilities _____

Total electric customers _____

ENERGY SOURCE AND DISPOSITION:

Total generation _____
Purchased and net interchange _____

Total _____
Less: Company use, losses and unaccounted for _____

Total energy sold _____

NET INPUT (MISSISSIPPI AREA)—MKWH _____
PEAK LOAD (MISSISSIPPI AREA)—KW _____
LOAD FACTOR (MISSISSIPPI AREA)—PERCENT _____
NET PLANT CAPABILITY—KW _____
CIRCUIT MILES OF ELECTRIC LINES _____

1987	1986	1985	1984	1983
3,365,404	3,336,542	3,191,980	3,051,947	2,935,883
2,440,477	2,412,868	2,318,724	2,172,115	2,026,136
2,081,977	2,009,932	2,018,793	2,085,639	2,043,737
329,071	337,557	323,269	315,885	343,789
—	—	—	94,295	178,081
8,216,929	8,096,899	7,852,766	7,719,881	7,527,626
966,351	2,389,355	2,272,493	1,605,347	980,031
9,183,280	10,486,254	10,125,259	9,325,228	8,507,657
288,377	285,400	282,043	276,586	272,281
42,095	41,308	41,016	40,290	39,403
3,425	3,461	3,411	3,387	3,246
2,683	2,636	2,525	2,448	2,363
—	—	—	—	5
336,780	332,805	328,996	322,711	317,298
2	2	2	2	2
336,782	332,807	328,998	322,713	317,300
4,583,486	6,826,689	6,471,405	6,724,724	5,445,661
5,376,143	4,372,089	4,435,969	3,294,151	3,914,796
9,959,629	11,198,778	10,907,374	10,018,875	9,360,457
776,349	712,524	782,115	693,647	852,800
9,183,280	10,486,254	10,125,259	9,325,228	8,507,657
8,993,278	8,809,423	8,634,881	8,413,528	8,380,426
2,037,000	2,132,000	1,858,000	1,758,000	1,894,000
50	47	53	54	50
3,136,000	3,136,000	3,136,000	3,183,000	2,972,000
20,284	20,016	19,871	19,578	19,387

BOARD OF DIRECTORS AND OFFICERS

Board of Directors

David C. Bramlette III
Attorney-at-Law: Adams, Forman, Truly, Ward, Smith & Bramlette
Natchez

James B. Campbell
Chairman of the Board & President
Mississippi School Supply
Jackson

Frank R. Day
Chairman of the Board and CEO
Trustmark National Bank
Jackson

Norman B. Gillis Jr.
Attorney-at-Law
Gillis & Gillis
McComb

Dr. J. Harvey Johnston Jr.
Physician
Surgical Clinic Associates, P.A.
Jackson

Robert E. Kennington II
Chairman of the Board & CEO
Sunburst Bank
Grenada

Edwin Lupberger
Chairman of the Board & President
Middle South Utilities, Inc.
New Orleans

Donald C. Lutken
Chairman of the Board & President
Mississippi Power & Light Company
Jackson

Richard D. McRae Sr.
Chairman of the Board & CEO
McRae's, Inc. (Department Stores)
Jackson

John N. Palmer
President: Mobile
Communications Corp. of America
Jackson

LeRoy F. Percy
President
Greenville Compress Company
Greenville

E. B. Robinson Jr.
Chairman of the Board & CEO
Deposit Guaranty National Bank
Jackson

Dr. Walter Washington
President
Alcorn State University
Lorman

Robert M. Williams Jr.
Partner
Reeves-Williams Builders
Southaven

Advisory Directors

Lawrence Adams
Attorney-at-Law: Adams, Forman, Truly, Ward, Smith & Bramlette
Natchez

Herman Hines
Chairman Emeritus
Deposit Guaranty National Bank
Jackson

Division Managers

John R. Craft
North Central, Greenville

Bob L. Marsh
Central, Jackson

James S. Pilgrim
Western, Vicksburg

Graham H. Tempel
Southern, Brookhaven

T. Ray Tomlinson
Northern, Senatobia

Officers

Donald C. Lutken
Chairman of the Board and President

Thomas A. Dallas
Senior Vice President
Administrative Services

George A. "Pat" Goff
Senior Vice President, Chief Financial Officer, and Corp. Secretary

Bill F. Cossar
Vice President
Public Affairs

Frank F. Gallaher
Vice President
and Chief Engineer

James L. Moore
Vice President
Corporate Communications

C. Hiram Walters
Vice President
Customer Services

James R. Martin
Treasurer and
Assistant Secretary

Allan H. Mapp
Assistant Treasurer
and Assistant Secretary

Plant Managers

Malcolm A. Alfred
Baxter Wilson, Vicksburg

L. Otis Dewease
Natchez, Natchez

A. T. Johnson
Rex Brown, Jackson

Alan J. Sebren
Gerald Andrus, Greenville

Rex M. Shannon
Delta, Cleveland

SHAREHOLDER INFORMATION

SEC Form 10-K Available

A copy of Mississippi Power & Light Company's 1987 annual report to the Securities and Exchange Commission on Form 10-K (including financial statements and financial statement schedules) is available without charge to stockholders upon written request to:

Mississippi Power & Light Company
G.A. Goff, Senior Vice President,
Chief Financial Officer,
and Corporate Secretary
Post Office Box 1640
Jackson, Mississippi 39215-1640
Telephone 601-969-2331

Tax Status Of Preferred Dividend Payments

The Company's 1987 distributions on all outstanding series of its preferred stock were entirely a return of capital and, therefore, were not taxable to stockholders as dividend income for federal income tax purposes. The tax basis of such outstanding shares should be reduced by the amount of the 1987 distributions.

The Company presently believes that it is likely that 1988 distributions on all outstanding shares of its preferred stock will constitute a return of capital and not be taxable to shareholders as dividend income for federal income tax purposes.

Registrar (for preferred stock):
Deposit Guaranty National Bank
Post Office Box 1200
Jackson, Mississippi 39215-1200

Transfer Agent (for preferred stock):
Trustmark National Bank
Post Office Box 291
Jackson, Mississippi 39215-0291

Mississippi Power & Light Company
Post Office Box 1640
Jackson, Mississippi 39215-1640

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