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New Orleans Public Service Inc. Annual Report

Serving...Yesterday, Today & Tomorrow

NEW ORLEANS PUBLIC SERVICE
MIDDLE SOUTH UTILITIES SYSTEM

This 1986 Annual Report is prepared for the information of stockholders, employees, and other interested persons.

The Company's 1986 Annual Report to the Securities and Exchange Commission on Form 10-K (including financial statement schedules) is available to any stockholder without charge. Stockholders can obtain a copy by writing to:

M. H. McLetchie
Senior Vice President—
Accounting & Finance, and Treasurer
New Orleans Public Service Inc.
P. O. Box 60340
New Orleans, LA 70160
Telephone: (504) 595-3100

Dear Fellow Stockholders and Employees:

The year 1986 was somewhat of a turning point for our Company and for those of you who are stockholders in New Orleans Public Service Inc. or employees of the Company. We were successful in getting a number of our major problems behind us in the past year, thus enabling us to move forward with new ideas and innovative programs to better serve the energy needs of our customers. I am happy to say that because of some improvement in our financial picture, we were able to reinstate payment of preferred dividends and to catch up on those previously missed due to our earnings problem.

One of our healthiest accomplishments in 1986 was to return our net income to a positive position. As you may recall, in 1985 the Company suffered a net loss of $18.8 million, the first operating loss in its 63-year history. This operating loss was largely due to our inability to obtain timely regulatory authorization for recovery of costs associated in the Company's 17% allocation of Grand Gulf 1. With the rate case settlement negotiated with the New Orleans City Council (Council) in March 1986 on these Grand Gulf 1-related costs, the Company was granted sufficient rate relief, together with a phase-in and deferral plan, to allow 1986 net income to reach approximately $42.0 million. Of course, 1986 net income reflects the one-time impact of deferring on our books for future recovery $15.9 million, net of related income taxes, of Grand Gulf 1 costs that previously had been expensed in 1985. This deferral was authorized by our regulators, the Council, as part of the March 1986 rate settlement.

Also similarly affected in 1986 were the Company's return on average capitalization and return on average common equity. Both showed significant increases when compared with the negative returns experienced in these two categories in 1985.

Operating revenues for 1986 totalled $428.8 million, an increase of about $8.2 million over 1985 operating revenues. At the same time, operating expenses for the year were $376.4 million, which represented a $57.2 million decrease from 1985 operating expenses or a 13% decline.

Another significant factor occurring in 1986 was the Company's agreement to absorb $51.2 million of unrecovered costs associated with Grand Gulf 1 as part of the rate settlement reached with the Council in March 1986. The $51.2 million of unrecovered Grand Gulf 1 costs were absorbed by the Company in 1985 and, therefore, were reflected in the 1985 financial results.

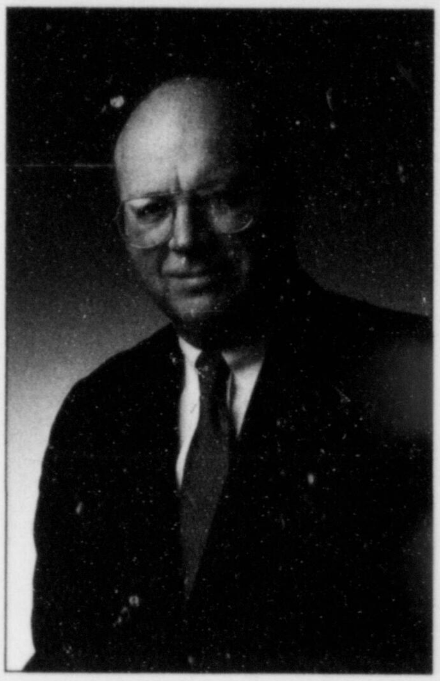
Electric operating revenues for the year were approximately $326.1 million, a 4% increase from 1985 electric operating revenues, while operating revenues from our resale gas system were about $102.7 million, down 3% from the previous year.

A new all-time record demand for electricity was established on the Company's electric system in the summer of 1986 with a peak load of 1,185,000 kilowatts. This topped the previous peak of 1,115,000 kilowatts set in 1985.

The Company's typical residential electric customer used an average of 10,748 kilowatt-hours (kwh) of electricity in 1986, up 495 kwh from the average usage in 1985. The average unit cost per residential kwh to our customers in 1986 was 6.2 cents, as compared to an average unit cost per residential kwh of 5.89 cents in 1985. Of the total average residential cost of electricity in 1986, 2.2 cents per kwh or 35% was the result of the cost of fuel used to generate electricity or for purchased power.

Largely due to the fuel savings associated with the use of nuclear-generated electricity, the July 1986 fuel adjustment in customer electric bills was the lowest since January 1980.

The typical residential gas customer served by the Company used an average of 611.8 ccf (hundred cubic feet) in 1986, an increase of less than 1% from 1985 use. The average unit cost per residential ccf of gas to our customers was 57.7 cents in 1986 as compared with 55.7 cents per residential ccf in 1985. Increases in the supply cost of gas to the Company from its suppliers accounted for all of the increased cost to customers in the past year. Of the unit cost of a residential ccf of gas in 1986, 38.78 cents or 67% was attributable to the cost of gas purchased for the system.



James M. Cain
President of the Company

At year-end, the Company was serving a total of 196,822 electric customers and 165,059 gas customers in Orleans Parish. A complete look at the 1986 financial picture of the Company follows on pages 15 through 31 of the annual report.

In other matters of interest, a settlement in the long-standing litigation between the Company and United Gas Pipe Line Company (United) was announced in February 1987. If approved by the parties to the suit and the courts, the settlement would result in the refund of approximately $70 million to electric customers served by the Company during the period 1973-1975.

The settlement arises out of a lawsuit filed by the Company in 1974 against United for breach of contract stemming from United's failure to deliver obligated quantities of natural gas for power plant use. Among other things, the suit sought damages in behalf of the Company's electric customers for the increased cost of power plant gas and alternate fuels that the Company was required to purchase to generate electricity because of United's breach. In 1984, the Civil District Court for the Parish of Orleans ruled against United, awarding damages totaling $44.4 million plus interest thereon. United subsequently appealed this decision to the Louisiana Fourth Circuit Court of Appeals, where it was pending at the time of the settlement.

As investors, you will recall that after having been forced to defer payment of preferred dividends for two quarters, Public Service was able to declare in April 1986 dividends on all series of preferred stock previously missed due to the Company's financial problems. These payments were made on June 2, 1986, which means that the Company is now current on all preferred dividends. However, Public Service still has not yet been successful in restoring common dividends to its parent, Middle South Utilities, Inc.

While the improvement in our financial situation permitted us to lift some of our most severe austerity measures, the Company continued to operate in 1986 under tight budget constraints and with all expenditures scrutinized carefully. Our construction expenditures for the year totalled $13,655,000, which represented necessary improvements to our electric and gas systems.

The improved financial condition of the Company in 1986 permitted Public Service to resume its active involvement in the community and to meet its responsibility as a good corporate citizen. The Company embarked on several new programs during the year, all aimed at furthering such involvement and demonstrating our concern for our customers and the community. One such effort was Operation Mainstream.

Sponsored by the YMCA, Operation Mainstream is a program that is attempting to overcome adult illiteracy in New Orleans by sponsoring programs in which individuals are taught to read and, thereby, help themselves in the job market. Public Service entered into the program with the YMCA and provided advertising support to inform the public about the program as well as soliciting volunteer tutors. The results have been overwhelming and a source of great satisfaction to all of us.

Not only were we successful in bringing in numerous new students into Operation Mainstream, but the program also recruited over 1,300 volunteer tutors, many of whom were Company employees. Our involvement in Operation Mainstream also was a source of personal pride to me because I recognize how important education is to the economic development of our community.

Along with Operation Mainstream, we also participated in another community education program called "G.E.D. on TV." This program was aimed at helping prepare individuals lacking a high school diploma to achieve equivalency certification as high school graduates.

We also were involved in many other community activities in 1986 in which we made a sincere and dedicated effort to become even more out-reaching in our attempts to communicate, listen, and respond to our customers' needs. Pages 6 through 13 of this year's annual report will give you more of an insight into these programs and what they are all about.

Another highlight of 1986 was the selection of Public Service to receive a special Presidential Citation for Private Sector Initiatives in recognition of the Company's community service activities. NOPSI was one of 70 businesses and associations across the nation honored with such an award in June 1986 at the U.S. Chamber of Commerce Building in Washington, D.C. Needless to say, we were very proud to accept this award on behalf of the Company, its shareholders, and its employees.

An employee-volunteer organization, "Family of Community and Utility Supporters" (FOCUS), also came into being in 1986 and accomplished a number of outstanding achievements during the year. Most noteworthy of the projects undertaken by FOCUS was the collection of a record number of food items which were turned over to the Greater New Orleans Food Bank for needy citizens. In addition, FOCUS members participated in various fund raising activities for worthy projects in the community, sang Christmas carols at local nursing homes during the holiday season, and took part in other community activities. All of us at Public Service are extremely proud of the accomplishments of FOCUS in its first year of existence.

Toward the end of 1986, the Company announced plans for participation in yet another community project in early 1987 — DINAMATION, an exhibit of life-sized, animated dinosaurs being co-sponsored with the Louisiana Science and Nature Center in New Orleans. The exhibit opened January 17, 1987 and will run until the end of May. Thousands of students and adults from the Greater New Orleans area are expected to visit the exhibit during its stay in New Orleans.

While the majority of our news was good in 1986, the year ended with some air of uncertainty still lingering over the outcome of the prudence review undertaken by the Council regarding the Company's decision to participate in the Grand Gulf project. This prudence review was initiated by the Council as part of its consideration of the rate increase request filed by the Company in 1985 to recover its Grand Gulf 1-related costs. Although a settlement was eventually reached between the Company and the Council on a rate increase in March 1986, the Council retained the right to conduct a prudence review.

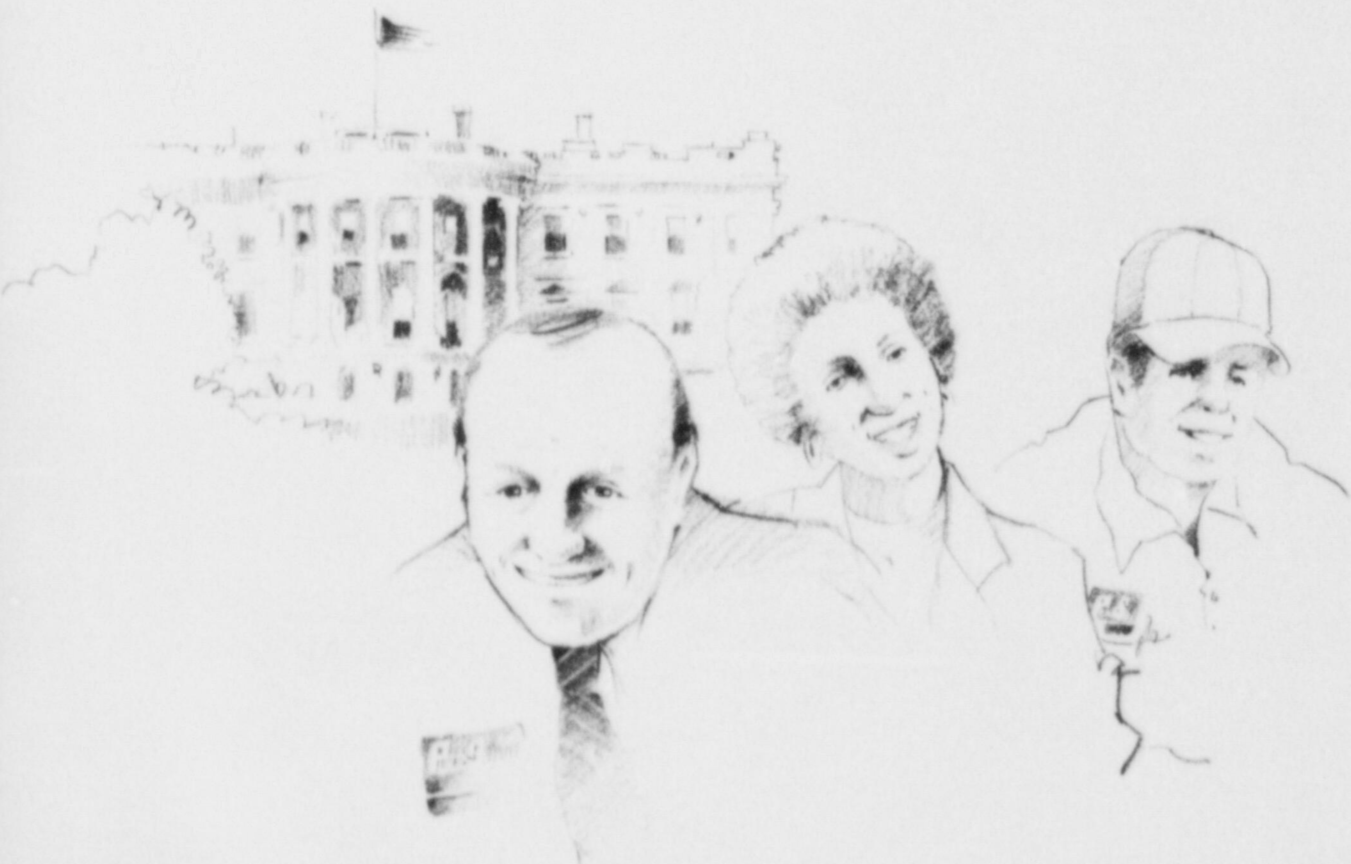
Numerous public hearings were held over the course of the year and volumes of testimony were presented by all participants in the prudence matter. A special hearing examiner appointed by the Council presided over the hearings and created an official record which, eventually, will be turned over to the Council for a decision.

Hearings in connection with this prudence review were being conducted as late as February 1987. A final decision by the Council is expected by mid-year. In the event the Council finds imprudence with regard to the Company's arrangements for Grand Gulf 1, it may attempt to take action to force the Company to absorb costs associated with Grand Gulf 1 in excess of the unrecovered \$51.2 million resulting from the March 1986 settlement, and unless such action were stayed by the courts, the Company's earnings, liquidity, financial condition, and ability to meet its continuing obligations (including its ability to effect further financing necessary to meet those obligations) could be adversely affected. The Company would vigorously oppose through the courts any materially adverse decision of the Council that may result from the prudence inquiry.

The Company made several new officer appointments in 1986 and added two new members to the Board of Directors. Among the officer changes made were the election of Shelton G. Cunningham, Jr. as Senior Vice President-Marketing & Rates; Robert J. Dunn as Vice President-Administrative Services; Richard C. Guthrie as Vice President-Public Affairs; and W. J. Lannes, III as Vice President-System Engineering. In addition, the title of G. F. Delery, III was changed to Vice President-Marketing and Lee W. Randall was promoted to Vice President-Accounting & Finance, and Assistant Treasurer. Nolin J. Briley, Assistant Secretary for Louisiana Power & Light Company, was given the additional responsibility in 1986 of Assistant Secretary of Public Service.

On May 12, 1986, the Company's Board of Directors elected Gerald D. McLendon to the Board. Until his retirement in April 1987, Mr. McLendon will serve in the interlocking position of Executive Vice President for both Public Service and LP&L.

We also were pleased to have Dr. Henry E. Braden, III elected to the Company's Board of Directors on October 27, 1986. Dr. Braden is a prominent New Orleans physician who has been active in professional and civic affairs throughout his career.



Retiring from the Company's Board of Directors in 1986 was A. L. Jung, Jr. who reached the mandatory retirement age for a director. Mr. Jung had been a member of the Board since 1951. His retirement was effective May 12, 1986.

In conjunction with the April 1, 1987 retirement of Gerald D. McLendon, Executive Vice President, two new Executive Vice Presidents were elected by the Company's Board of Directors in early 1987. Elected as Executive Vice Presidents were Donald Hunter, formerly Vice President-Projects at Yankee Atomic Electric Company, and R. Drake Keith. Mr. Keith had been Senior Vice President, System Executive-Financial Officer at Middle South Utilities, Inc., our parent company. Mr. Hunter will have responsibility for the areas of Energy Supply-Fossil, Energy Delivery, and Administration and Planning. Mr. Keith will be responsible for Accounting & Finance and Treasury, External Affairs, and Marketing and Rates.

Although the sluggish state economy carried over into New Orleans, the success of several major new developments along the Mississippi Riverfront provided some ray of optimism that 1986 may have marked the beginning of an economic recovery for the City. The Rouse Riverwalk Development got off to an exciting start in mid-year with its more than 200 restaurants, shops and cafes opening for business. This facility is located on a portion of the site formerly occupied by the Louisiana World Exposition. Located adjacent to the Riverwalk Complex is the New Orleans Convention Center, which enjoyed another successful year in 1986. More than 30 trade shows and conventions are already booked for 1987 in the Convention Center, with another 20 tentatively scheduled. In addition, the Jackson Brewery Extension was completed in 1986, adding even more shopping and eating space to this popular tourist and local attraction in the French Quarter.

The Louisiana Land and Exploration Tower, the City's newest highrise office building, was nearing completion at year-end, while the Eastover Development in eastern New Orleans, a community complex featuring an 18-hole championship golf course and over 200 homesites, is expected to be completed in the fall of 1987. Also underway in late 1986 was the Poydras Square Development located between the Superdome and the Hyatt Hotel. This new commercial development is scheduled for completion by the end of 1988.

A major New Orleans development approved by voters in 1986 was the Aquarium Project to be built along the Riverfront near Canal Street. Plans are for this world-class aquarium to be managed by the Audubon Park Commission. An opening date of early 1990 is being planned for this new facility. Also in January 1987, it was announced that New Orleans had been selected as the site for the 1988 National Republican Convention, an event that should bring the City a tremendous amount of nationwide public attention as a major convention center.

Thus, the economic picture in New Orleans is looking brighter and we are all optimistic that 1987 will see even further improvement. Because we recognize that economic development and new jobs are as important to our Company as they are to the community as a whole, Public Service will be working hand-in-hand with city officials and other community leaders to assure the continued economic recovery of our area.

Sincerely,

James M. Cain

JAMES M. CAIN
President of the Company

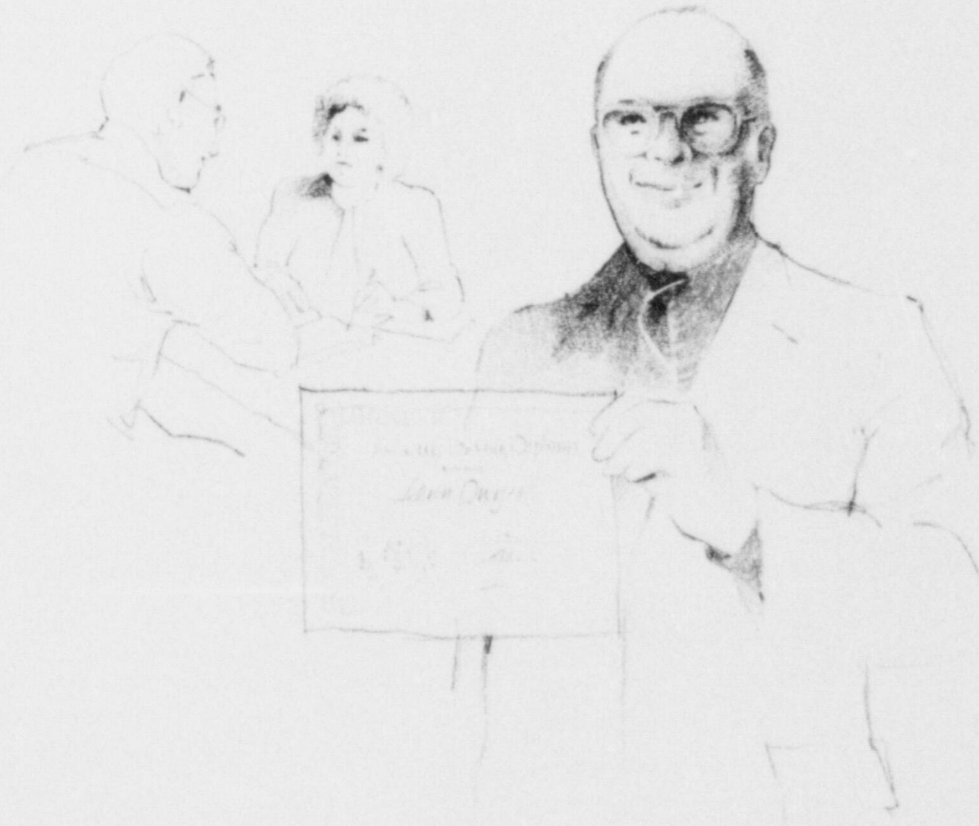
For the Board
March 5, 1987

Working Together To Build A Better Community

As the corporate entity charged with the responsibility of providing electric and gas service in the City of New Orleans, New Orleans Public Service Inc. is vitally interested in the economic well being and future of the community. That's because a healthy community means more jobs, better wages, improved lifestyles, and a brighter tomorrow for all of its citizens.

During 1986, Public Service renewed its commitment to community involvement and pledged to increase its activities as a socially responsible corporate citizen. The Company first made this commitment almost 65 years ago when New Orleans Public Service Inc. was organized to bring together the electric, gas, and transit operations in New Orleans and to provide the community with adequate, dependable, and economical utility services to meet their needs. And throughout the years, Public Service has stood by this pledge.

In an effort to further its community involvement in 1986, Public Service extended itself into many new areas of the community where the Company felt that its support was needed. The Company became a leading proponent and cheerleader for Operation Mainstream, a program to reduce adult illiteracy in New Orleans. It sponsored free energy fairs in low-income areas of the city and aggressively promoted a new program to increase business opportunities for minority and women vendors. Public Service expanded its customer service activities to make the Company more accessible to its customers and developed new ways to work with those individuals experiencing hardship situations or unusual circumstances in paying their energy bills.



In 1986, the Company and its parent organization, — Middle South Utilities, Inc., — reached out and joined hands with the community in an effort to improve the local economy and make the future brighter for New Orleans. Designated as "New Opportunities," this program is a joint effort of Middle South and its operating companies to aid in the economic development of Louisiana, Mississippi, and Arkansas. The "New Opportunities" program recognizes the link between the quality of education and the area's potential for economic development, striving to bring the two together in concert through Company support. In New Orleans, this effort has been directed by Public Service at overcoming adult illiteracy, encouraging those lacking high school diplomas to achieve General Equivalency Degrees (G.E.D.'s), and supporting educational programs, particularly in the science fields. One such project, DINAMATION, was announced in late 1986 in conjunction with the Louisiana Nature and Science Center and features life-sized, fully animated dinosaurs in a Riverfront exhibit which will remain open until May 30, 1987. Thousands of New Orleanians are expected to visit the exhibit while it is open.

These are some of the ways that New Orleans Public Service fulfilled its commitment to become even more involved in the community in 1986 and to reach out to its customers. It also was a way of recognizing that the Company and its investors have a stake in the economic welfare in the community; therefore, they want to see New Orleans grow and prosper.

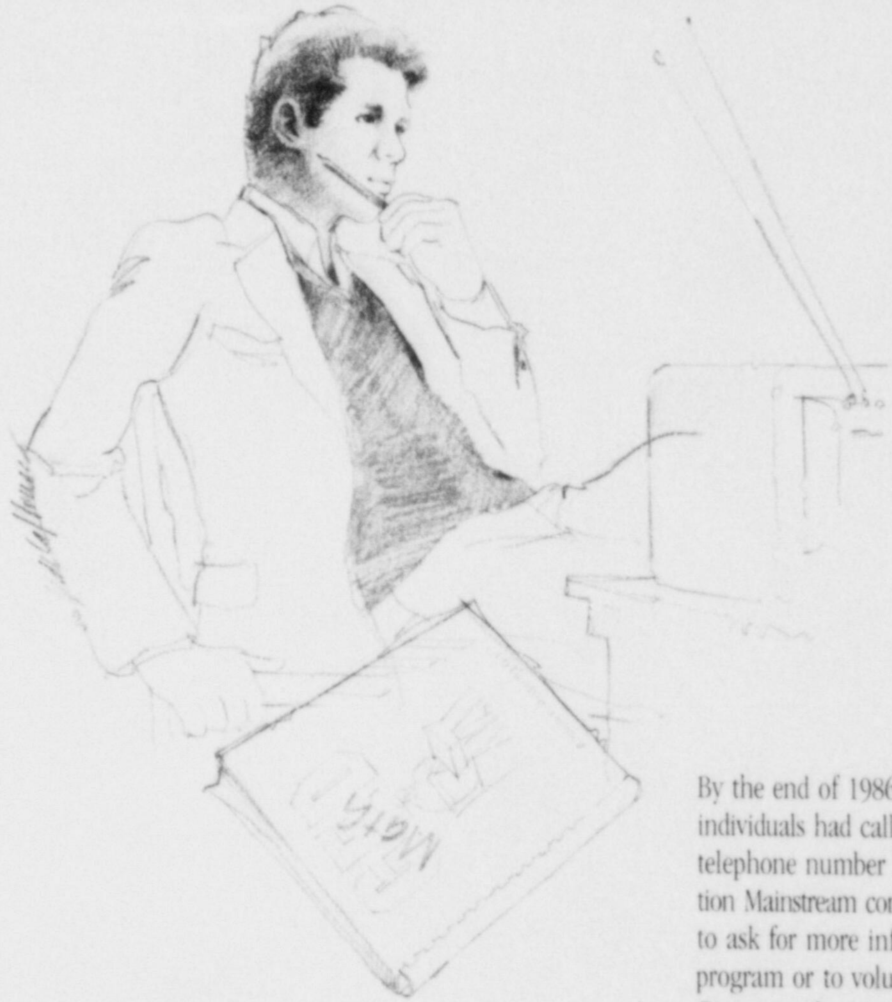
Although the wings of corporate social responsibility fan out far and wide and may differ from one business to the next, the achievements realized by the Company during the past year are a source of pride and accomplishment to the management, directors, and employees of Public Service. They, likewise, should be to the Company's stockholders and investors because they illustrate that Public Service cares about the community it serves and wants to help New Orleans become an even better place to live and work.

With this expanded sense of social responsibility now firmly in place, New Orleans Public Service pledges to continue working together to build a better community in every way possible.

Highlights Of The Outreach Activities During 1986

Operation Mainstream

Working jointly with the YMCA, Public Service produced television, radio, and newspaper advertising calling public attention to Operation Mainstream, a program aimed at combating adult illiteracy in New Orleans. Company President Jim Cain personally appeared in a series of television commercials, citing real-life examples of how Operation Mainstream had assisted many New Orleanians in learning to read. The commercials appealed for volunteer tutors and for interested students to join the program.



By the end of 1986, more than 4,200 individuals had called the special hotline telephone number listed in the Operation Mainstream commercials or the YMCA to ask for more information about the program or to volunteer as tutors. The Company plans to continue its support of Operation Mainstream in 1987.

G.E.D. On Television

This was another adult education program sponsored in part by Public Service in 1986 in the New Orleans area. "G.E.D. on Television" was a series carried by local affiliates of National Public Television which helped prepare viewers to qualify for the equivalent of a high school diploma. In addition to sponsoring television commercials calling public attention to the series, the Company also furnished free educational materials to the first group of students to sign up for the program.

Home Energy Shopping Sprees

Tips on home energy conservation techniques and free weatherization materials were featured as part of the four Home Energy Shopping Sprees sponsored by the Company during the past year. The energy fairs were held in low income areas of New Orleans and put together in conjunction with neighborhood community organizations. Two of the events were held for Hispanic and Vietnamese-speaking citizens, respectively, and were conducted by Public Service employees who were fluent in those languages. A combined total of almost 500 individuals attended these four events in 1986.

Helping Hands

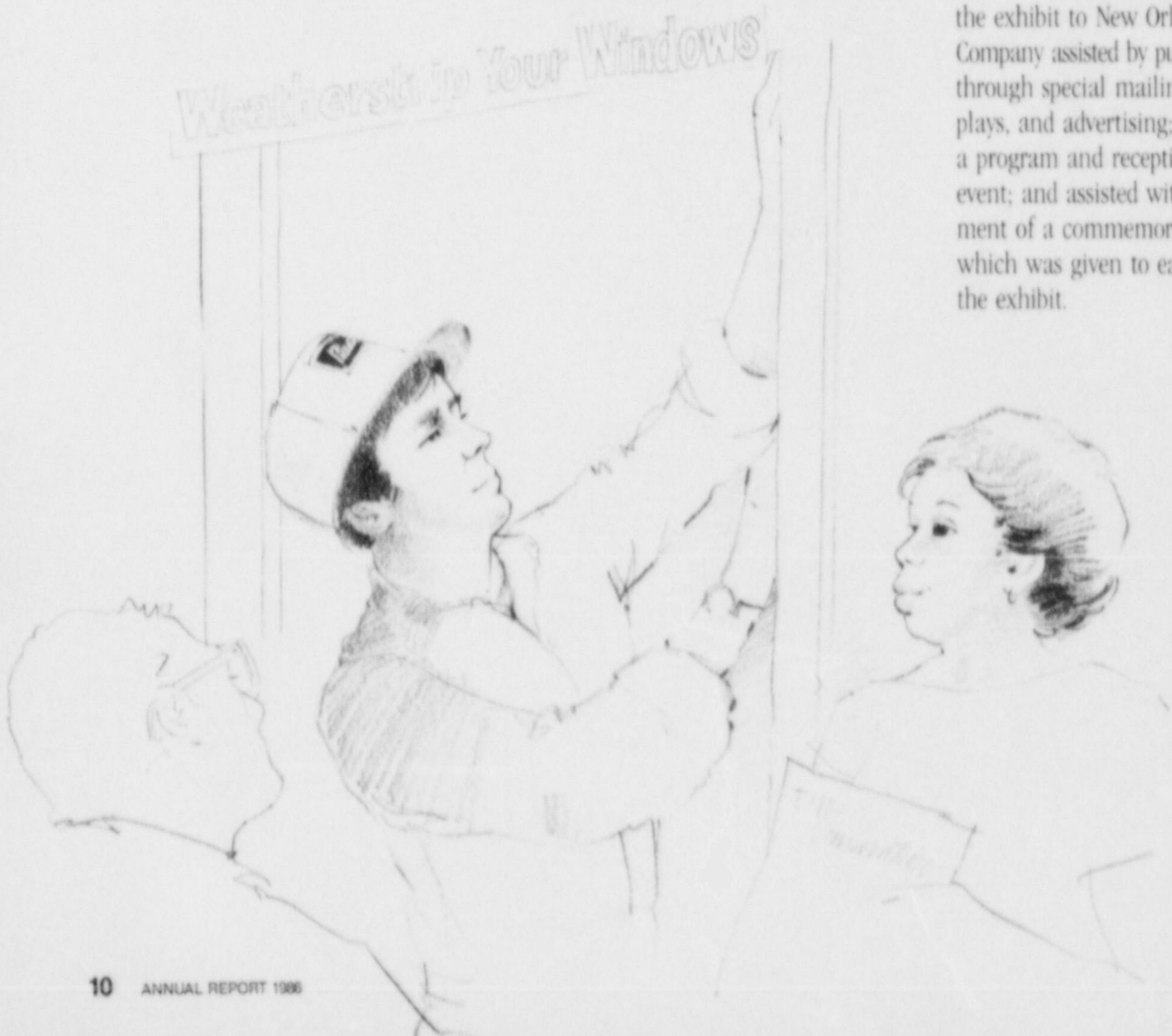
In 1986, contributions to HELPING HANDS, the energy assistance program originated by Public Service and its sister company, Louisiana Power & Light Company, surpassed the $1 million mark. Initiated in 1983 in conjunction with the Councils on Aging, this program provides emergency energy assistance to low-income people 60 years of age or older or handicapped individuals in the community. HELPING HANDS is funded through contributions from Company customers via their monthly bill payments, from payroll deductions by employees, and through other contributions. To date, over $298,000 in emergency energy assistance has been provided to eligible individuals in New Orleans alone through the HELPING HANDS program, with a total of 542 households helped in 1986 alone.

Energy Management For Religious Buildings

Working jointly with representatives of the Edison Electric Institute, the Company instituted a program in 1986 to assist local churches and their clergy in energy conservation and weatherizing techniques. Thirty-one representatives from 17 churches in the community attended four separate workshops conducted by Company energy specialists. The goal of this program was to help make the ministers more energy conscious and to assist them in weatherizing their religious facilities. Additional programs of this nature are being considered for the future.

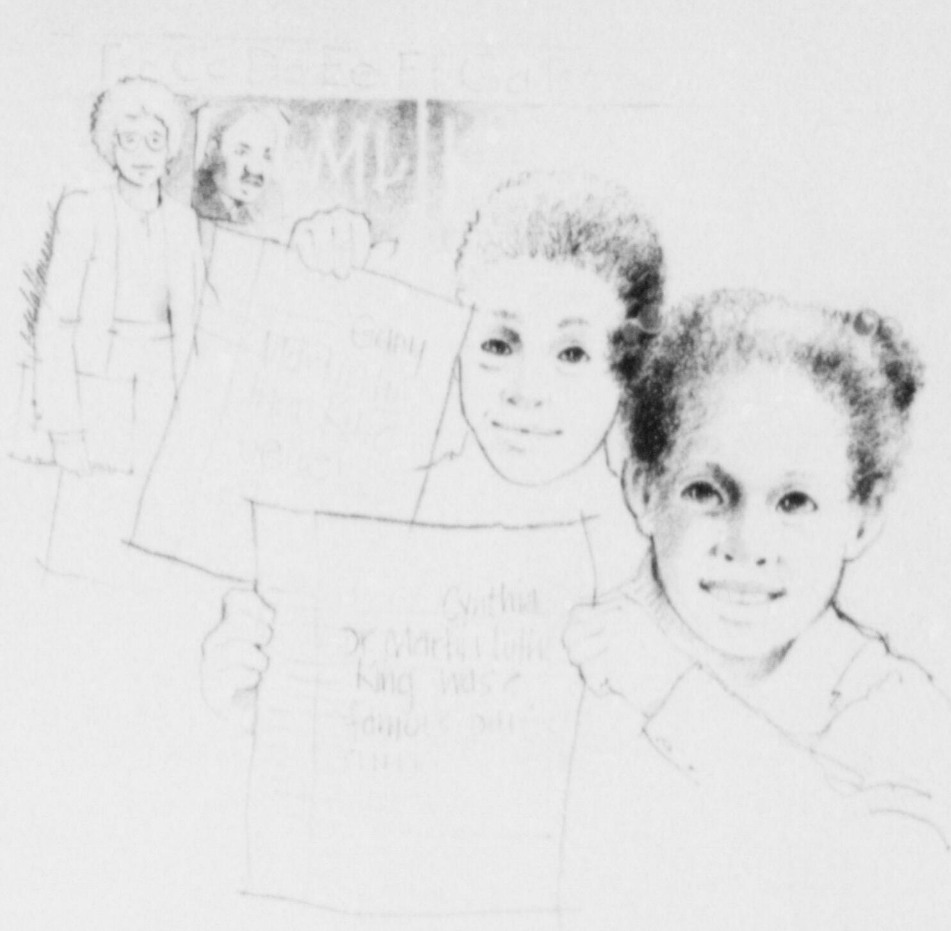
Dr. Martin Luther King Exhibit

"His Light Still Shines," an exhibit honoring the accomplishments of the late Dr. Martin Luther King, was co-sponsored in 1986 by Public Service in conjunction with the McDonald's Corporation and the Dryades Street YMCA. More than 12,000 people visited the exhibit during its stay at the Presbytere in New Orleans. In addition to helping bring the exhibit to New Orleans, the Company assisted by publicizing the event through special mailings, lobby displays, and advertising; helped organize a program and reception to open the event; and assisted with the development of a commemorative poster which was given to each person visiting the exhibit.



Black History Month Activities

Along with the Dr. Martin Luther King exhibit, Public Service in 1986 saluted the contributions of other notable blacks in the field of science and energy technology during a month of various activities. Included among the activities were lobby displays, special essay contests, and programs for students on careers in science and technology. A calendar entitled "Etches of Ebony Louisiana" was provided to everyone visiting the lobby display to commemorate Black History Week in the community.



Consumer Roundtable

In 1986, Public Service management continued to meet regularly with a cross-section of the Company's customers in a roundtable discussion format known as the Consumer Roundtable. During these sessions, management listens to customer input about energy-related matters, discusses Company policies and practices, and answers questions on current issues. Since 1984 when the Consumer Roundtable was first established, the Roundtable has afforded the Company a valuable insight to particular customer problems and how Public Service can better contribute meaningfully to the community.

Minority Vendor Program

As an off-shoot of the NAACP Fair Share Agreement signed in 1984, the Company's Minority Vendor Program is designed to seek additional business opportunities for minority and women vendors. To provide further emphasis to this program, in 1986, Public Service authorized a slot for a full-time minority vendor specialist in its Purchasing Department. As a result, the dollar value of purchases from minority vendors has increased — and is expected to increase even more in the future — as well as the total number of minority firms doing business with the Company.

FOCUS

A volunteer employee organization known as FOCUS came into being in 1986 and during the year logged more than 2,800 hours of volunteer work in the community. A highlight of its activities was the collection of a record-breaking number of food items by FOCUS members for the New Orleans Food Bank for distribution to needy families. FOCUS volunteers also participated in four telethons or Walk-a-Thons for charitable causes; money-raisers for the Child's Wish program and Ronald McDonald House; and Christmas carolling at a number of local nursing homes during the holiday season. The group's acronym (FOCUS) is derived from its formal name — "Family of Community and Utility Supporters" — a cross-section of Company employees who are dedicated to assisting their community.

School Programs

In 1986, the Company both continued and expanded its school-related activities by working more closely with educators, school administrators, and individual students. As part of these activities, seven major educational displays were erected by the Company in various business office locations during the year and a half-dozen other topics were covered in portable displays designed for educational purposes. Additionally, Public Service continued to work with McDonough 35 High School in New Orleans as part of the Business Partnership program of the Orleans Parish School System.

Presidential Citation

In recognition of the Company's community-mindedness, Public Service was honored in 1986 with a special Presidential Citation, one of the highest awards given for Private Sector Initiatives. The award was accepted in Washington, D.C. by Company President Jim Cain following special ceremonies at the U.S. Chamber of Commerce Building where Public Service and 70 other business and trade associations from across the nation were recognized for their community service. It was a fitting tribute to Public Service and its 1,450 employees for their community spirit and the personal care exhibited for their fellow New Orleanians as a result of these outreach activities. Call it corporate social responsibility, a sense of caring, or merely reaching out to help, New Orleans Public Service is proud to be working together with the community to build a better New Orleans.

REPORT OF MANAGEMENT

The management of New Orleans Public Service Inc. has prepared and is responsible for the financial statements and related financial information included in this annual report. The financial statements are based on generally accepted accounting principles, consistently applied. Financial information included elsewhere in this report is consistent with the financial statements.

To meet its responsibilities with respect to financial information, management maintains and enforces a system of internal accounting controls that is designed to provide reasonable assurance, on a cost effective basis, as to the integrity, objectivity, and reliability of the financial records and as to protection of assets. This system includes communication through written policies and procedures, as well as an organizational structure that provides for appropriate division of responsibility and the training of personnel. This system is also tested by a comprehensive internal audit program.

The board of directors pursues its responsibility for reported financial information through its audit committee, composed of outside directors. The audit committee meets periodically with management, the internal auditors, and the independent public accountants to discuss auditing, internal control, and financial reporting matters. The independent public accountants and the internal auditors have free access to the audit committee at any time.

The independent public accountants provide an objective assessment of the degree to which management meets its responsibility for fairness of financial reporting. They regularly evaluate the system of internal accounting control and perform such tests and other procedures they deem necessary to reach and express an opinion on the fairness of the financial statements.

Management believes that these policies and procedures provide reasonable assurance that our operations are carried out with a high standard of business conduct.

AUDITORS' OPINION

New Orleans Public Service Inc.:

We have examined the balance sheets of New Orleans Public Service Inc. as of December 31, 1986 and 1985 and the related statements of income, retained earnings and changes in financial position for each of the three years in the period ended December 31, 1986. 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.

The accompanying financial statements include $146.4 million of Grand Gulf 1 costs deferred for future recovery. As described in Note 2 of Notes to Financial Statements, the Council of the City of New Orleans (Council) is conducting an investigation into all aspects of the Company's prudence regarding its involvement with Grand Gulf 1. If the Council determines that any actions or decisions of the Company associated with Grand Gulf 1 were imprudent, it may attempt to prohibit the Company from recovering from its ratepayers Grand Gulf 1 costs found to be imprudent.

In our opinion, subject to the effects on the 1986 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, 1986 and 1985 and the results of its operations and changes in its financial position for each of the three years in the period ended December 31, 1986, in conformity with generally accepted accounting principles applied on a consistent basis.

Deloitte Haskins + Sells

New Orleans, Louisiana
February 27, 1987

STATEMENTS OF INCOME (LOSS)

For the years ended December 31, 1986, 1985, and 1984

	1986	1985	1984
	(In Thousands)		
OPERATING REVENUES (Note 9):			
Electric	$326,095	$315,034	$322,060
Natural gas	102,700	105,593	126,379
Total	428,795	420,627	448,439
OPERATING EXPENSES:			
Operations:			
Fuel for electric generation	48,533	88,783	107,291
Purchased power (Note 8D)	247,971	173,024	91,252
Deferred electric fuel costs	(4,143)	1,850	2,598
Gas purchased for resale	66,744	84,726	89,529
Deferred resale gas costs	5,699	(9,502)	3,084
Other	70,144	68,011	63,311
Maintenance	18,114	18,162	17,903
Depreciation	14,654	14,548	16,110
Taxes other than income taxes	22,312	20,293	20,181
Income taxes (Note 3)	(34,527)	(26,305)	13,895
Rate deferrals:			
Deferred Grand Gulf 1 expenses (Notes 1G, 2, and 8A)	(146,409)	—	—
Income taxes (Note 3)	67,348	—	—
Total operating expenses	376,440	433,590	425,154
OPERATING INCOME (LOSS)	52,355	(12,963)	23,285
OTHER INCOME (DEDUCTIONS):			
Allowance for equity funds used during construction (Note 1F)	—	—	34
Miscellaneous — net	619	9,094	9,567
Income taxes (Note 3)	(285)	(4,386)	(4,008)
Total	334	4,708	5,593
INTEREST AND OTHER CHARGES:			
Interest on long-term debt	9,632	8,318	8,496
Other interest — net	1,133	2,328	2,035
Allowance for borrowed funds used during construction (Note 1F)	(57)	(84)	(37)
Total	10,708	10,562	10,494
NET INCOME (LOSS)	$ 41,981	$(18,817)	$ 18,384

STATEMENTS OF RETAINED EARNINGS (DEFICIT)

For the years ended December 31, 1986, 1985, and 1984

	1986	1985	1984
	(In Thousands)		
RETAINED EARNINGS (DEFICIT), January 1	$(16,951)	$ 10,151	$ 9,944
ADD: Net income (loss)	41,981	(18,817)	18,384
Total	25,030	(8,666)	28,328
DEDUCT:			
Dividends (Note 5):			
Preferred stock	3,814	2,288	3,281
Common stock	—	5,997	14,875
Other	—	—	21
Total	3,814	8,285	18,177
RETAINED EARNINGS (DEFICIT), December 31 (Note 7)	$ 21,216	$(16,951)	$ 10,151

See Notes to Financial Statements.

BALANCE SHEETS

December 31, 1986 and 1985

ASSETS

	1986	1985
	(In Thousands)	
UTILITY PLANT:		
Electric	**$395,619**	$390,215
Natural gas	**88,676**	85,316
Construction work in progress	**2,052**	1,077
Total	**486,347**	476,608
Less accumulated depreciation	**237,820**	227,013
Utility plant — net	**248,527**	249,595
OTHER PROPERTY AND INVESTMENT:		
Investment in subsidiary company — at equity (Note 8I)	**11,378**	12,098
CURRENT ASSETS:		
Cash and special deposits	**1,966**	330
Temporary investments — at cost, which approximates market:		
Associated companies (Note 4)	**700**	25,000
Other	**4,900**	—
Accounts receivable:		
Customer and other (less allowance for doubtful accounts of $1,300,000 in 1986 and $1,000,000 in 1985)	**27,577**	27,054
Income taxes receivable (Note 3)	**4,998**	7,402
Accumulated deferred income taxes (Note 3)	**2,843**	2,127
Materials and supplies — at average cost	**7,686**	7,420
Power purchase advance payments (Note 8D)	**—**	13,884
Prepayments and other	**1,937**	1,045
Total	**52,607**	84,262
DEFERRED DEBITS:		
Deferred Grand Gulf 1 expenses (Notes 1G, 2, and 8A)	**146,409**	—
Other	**1,560**	931
Total	**147,969**	931
TOTAL	**$460,481**	$346,886

See Notes to Financial Statements

CAPITALIZATION AND LIABILITIES

	1986	1985
	(In Thousands)	
CAPITALIZATION:		
Common stock, $10 par value, authorized 10,000,000 shares; issued and outstanding 8,435,900 shares (Note 5)	**$ 84,359**	$ 84,359
Retained earnings (deficit) (Notes 5 and 7)	**21,216**	(16,951)
Total common shareholder's equity	**105,575**	67,408
Preferred stock without sinking fund (Note 5)	**20,117**	20,117
Preferred stock with sinking fund (Note 5)	**13,248**	13,257
Long-term debt (Note 6)	**133,415**	114,428
Total	**272,355**	215,210
OTHER NONCURRENT LIABILITIES:		
Accumulated provision for property insurance	**10,490**	9,741
Accumulated provision for injuries and damages	**2,213**	3,943
Other	**—**	50
Total	**12,703**	13,734
CURRENT LIABILITIES:		
Notes payable (Note 4)	**5,000**	—
Currently maturing long-term debt (Note 6)	**6,000**	—
Accounts payable:		
Associated companies	**21,799**	22,579
Other	**19,011**	23,795
Customer deposits	**11,459**	10,850
Taxes accrued	**7,702**	7,152
Interest accrued	**3,526**	2,143
Dividends declared (Note 5)	**6,759**	5,997
Deferred electric fuel and resale gas costs	**6,180**	4,626
Other	**1,367**	1,053
Total	**88,803**	78,195
DEFERRED CREDITS:		
Accumulated deferred income taxes (Note 3)	**64,103**	17,425
Accumulated deferred investment tax credits (Note 3)	**13,874**	14,141
Unamortized pension expense (Notes 1D and 10)	**7,168**	6,692
Customer advances for construction and other	**1,475**	1,489
Total	**86,620**	39,747
COMMITMENTS AND CONTINGENCIES (Notes 2 and 8)		
TOTAL	**$460,481**	$346,886

See Notes to Financial Statements.

STATEMENTS OF CHANGES IN FINANCIAL POSITION

For the years ended December 31, 1986, 1985, and 1984

	1986	1985	1984
		(In Thousands)	
FUNDS PROVIDED BY:			
Operations:			
Net income	—	—	$ 18,384
Depreciation	—	—	16,110
Deferred income taxes and investment tax credit adjustments — net	—	—	(4,444)
Allowance for equity funds used during construction	—	—	(34)
Total funds provided by operations	—	—	30,016
Other:			
Allowance for equity funds used during construction	—	—	34
Power purchase advance payments (Note 8D)	**$ 13,884**	$ 63,804	—
Unamortized pension expense	—	6,692	—
Miscellaneous — net	—	4,084	—
Decrease in working capital*	—	5,843	11,881
Total funds provided excluding financing transactions	**13,884**	80,423	41,931
Financing transactions:			
Common stock	—	25,000	—
First mortgage bonds	**25,000**	—	—
Short-term securities — net	**24,400**	—	48,900
Total funds provided by financing transactions	**49,400**	25,000	48,900
Total funds provided	**$ 63,284**	$105,423	$ 90,831
FUNDS APPLIED TO:			
Operations:			
Net (income) loss	**$(41,981)**	$ 18,817	—
Depreciation	**(14,654)**	(14,548)	—
Deferred income taxes and investment tax credit adjustments — net	**(45,695)**	7,020	—
Deferred Grand Gulf 1 expenses (Notes 1G and 2)	**146,409**	—	—
Total funds applied to operations	**44,079**	11,289	—
Utility plant additions:			
Construction expenditures (includes allowance for funds used during construction)	**13,655**	14,814	$ 14,916
Other:			
Dividends declared on common stock	—	5,997	14,875
Dividends declared on preferred stock	**3,814**	2,287	3,281
Investment in subsidiary company	—	441	969
Power purchase advance payments (Note 8D)	—	29,495	48,194
Miscellaneous — net	**421**	—	1,112
Increase in working capital*	**1,305**	—	—
Total funds applied excluding financing transactions	**63,274**	64,323	83,347
Financing transactions:			
Redemption of preferred stock	**10**	—	1,484
Retirement of first mortgage bonds	—	—	6,000
Short-term securities — net	—	41,100	—
Total funds applied to financing transactions	**10**	41,100	7,484
Total funds applied	**$ 63,284**	$105,423	$ 90,831
Increase (decrease) in working capital*:			
Cash and special deposits	**$ 1,636**	$ (1,699)	$ (297)
Income taxes and accounts receivable	**(1,881)**	5,011	(3,707)
Accounts payable:			
Associated companies	**780**	(16,563)	4,602
Other	**4,784**	5,255	(3,399)
Dividends declared	**(762)**	(5,177)	—
Deferred electric fuel and resale gas costs	**(1,554)**	7,651	(5,682)
Other	**(1,698)**	(321)	(3,398)
Total	**$ 1,305**	$ (5,843)	$(11,881)

*Working capital does not include short-term securities — net, current maturities of long-term debt, deferred taxes, and power purchase advance payments included in current assets or current liabilities.

See Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

For the years ended December 31, 1986, 1985, and 1984

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. System of Accounts

The accounts of the Company are maintained in accordance with the system of accounts prescribed by the Council of the City of New Orleans (Council), which system of accounts substantially conforms to that prescribed by the Federal Energy Regulatory Commission (FERC).

B. Revenues

The Company records electric and gas revenues as billed to its customers on a cycle billing basis. Revenue for energy delivered but not billed at the end of the fiscal period is not accrued.

The rate schedules of the Company include electric fuel adjustment and city gate gas cost adjustment clauses under which the cost of fuel for generation, purchased power, and gas purchased for resale above or below the levels allowed in the various rate schedules are permitted to be billed or required to be credited to customers. The Company defers on its books fuel and purchased gas costs in excess of the base rates until these costs are reflected in billings to customers pursuant to the fuel and gas cost adjustment clauses.

C. Utility Plant and Depreciation

Utility plant is stated at original cost. The cost of additions to utility plant includes contracted work, direct labor, materials, allocable overheads, and an allowance for the composite cost of 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 of items determined to be less than units of property are charged to operating expenses. Principally all of the utility plant is subject to the lien of the Company's "Mortgage and Deed of Trust."

Depreciation is computed on the straight-line basis at rates based on the estimated service lives of the various classes of property. Depreciation provided on average depreciable property in 1986, 1985, and 1984 amounted to approximately 3.11%, 3.15%, and 3.59%, respectively.

D. Postretirement Benefits

The Company has postretirement plans covering substantially all employees. The Company's policy is to fund pension costs in accordance with guidelines established by the Employee Retirement Income Security Act of 1974. Pension costs accrued in excess of amounts funded are amortized over 10 years. The costs of other postretirement benefit plans are funded as incurred.

E. Income Taxes

The Company joins its parent, Middle South Utilities, Inc. (MSU), 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. Income taxes receivable represents estimated amounts due under the tax allocation agreement.

Deferred income taxes are provided for differences between book and taxable income to the extent permitted by the Company's regulatory bodies for ratemaking purposes. Investment tax credits allocated to the Company are deferred and amortized based upon the average useful life of the related property beginning with the year allowed in the consolidated tax return.

F. Allowance For Funds Used During Construction

The Company capitalizes as an appropriate cost of utility plant an allowance for funds used during construction (AFDC) which is calculated and recorded as provided by the regulatory system of accounts. Under this utility industry practice, construction work in progress on the balance sheet is charged and the income statement is credited for the approximate composite interest cost of borrowed funds and for a reasonable return on the equity funds used for construction. This procedure is intended to remove from the income statement the effect of the cost of financing the construction program. It effectively results in treating the AFDC 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 income statement have no effect on current cash earnings. After the property is placed in service, the AFDC charged to construction costs is recoverable from customers through depreciation provisions included in rates charged for utility service. The effective composite AFDC rate for the Company was 7.0%, 8.5%, and 9.1% for 1986, 1985, and 1984, respectively.

The Company's policy is to continue to capitalize AFDC on projects during periods of interrupted construction when such interruption is temporary and the continuation can be justified as being reasonable under the circumstances.

G. Rate Deferrals

The Council has agreed to a rate phase-in plan for the Company as part of the March 1986 rate settlement in order to reduce the immediate effect on ratepayers of the inclusion of Grand Gulf 1 costs in rates. Under this plan, certain costs are deferred in the early years of commercial operation and collected in the later years from customers. The Company and the Council have agreed upon an estimated 11-year phase-in plan. By deferring these to the future when they will be collected through increased rates billed to customers, the impact of the costs associated with the phase-in plan on the income statement has been removed. Because the actual collection of revenues to recover the deferred amount will not occur until the future, the Company records a deferred asset representing the amount of the deferral and, at the same time, incurs additional capital requirements to finance this deferral (see Note 2, "Regulation and Rate Matters" and Note 8, "Commitments and Contingencies — New Accounting Standard").

H. Other Noncurrent Liabilities

It is the policy of the Company to provide for uninsured property risks and for claims for injuries and damages through charges to operating expenses on an accrual basis. Such expenses have been allowed for ratemaking purposes.

2. REGULATION AND RATE MATTERS

The Company holds indeterminate permits to provide electric and gas service in the City of New Orleans (City). The ordinances under which the Company operates state, among other things, that the City has a continuing option to purchase the Company's properties. A report by consultants for the Council, the Task Force on Municipalization, recommended that the City commence the steps necessary to effectively acquire the Company's electric properties and operations. The report was received by the Council on January 17, 1985. On March 7, 1985, a public power authority was created for the purpose, among other things, of acquiring and operating electric power utilities within the City.

On March 25, 1986, the Company accepted a March 20, 1986 settlement offer from the Council regarding the Company's May 17, 1985 application for an electric rate increase. The rate settlement provided that a portion of the Company's non-fuel Grand Gulf 1 costs be deferred and phased into rates and for current recovery of certain portions of such costs and of assumed carrying charges on the amounts deferred. The settlement provided, among other things, that (1) for bills rendered on and during the first year after April 9, 1986, the Company is allowed to increase its base rates by $60 million annually but shall cease charging a temporary 10% surcharge authorized on March 6, 1986 by the Council and shall "unfreeze" its fuel cost adjustment reducing same to a rate consistent with the provisions of the Company's tariffs, the net effect of all of the foregoing being an estimated increase in revenues for the first year of approximately $26 million; (2) for bills rendered on and after April 9, 1987, 1988, 1989, and 1990, the Company is allowed to increase its base rates by additional amounts of $29.4 million, $22.1 million, $23.4 million, and $24.8 million, respectively, on an annual basis; and (3) for bills rendered on and after April 9 of years subsequent to 1990, the Company is entitled to increase its base rates by 6% of $439 million compounded annually until its Grand Gulf 1 costs are being fully recovered on a current basis and the amounts previously deferred have been fully recovered.

Under the terms of the settlement, the Company agreed to absorb $51.2 million of Grand Gulf 1 costs that it had previously incurred and expensed and to withdraw a request for an additional $5.3 million increase in annual revenues related to non-Grand Gulf 1 issues. Additionally, the Company agreed not to request any non-Grand Gulf 1 electric rate increase to take effect prior to January 1, 1988.

As a result of this settlement, $29.5 million of the $80.7 million of unrecovered Grand Gulf 1 costs (including carrying charges) that had been expensed during 1985 were deferred in March 1986 and credited against first quarter 1986 operating expenses. The $29.5 million will be recovered over future periods. Had this event occurred in 1985, net income for that year would have increased $15.9 million reducing the net loss of $18.8 million to a net loss of $2.9 million.

Although the March 1986 rate settlement agreement continues in effect, the parties thereto agreed that the legal rights of the City, the Council, and the Company, as the case may be, regarding (1) potential municipalization of the Company, (2) the Council's continuing prudence investigation of the Company with regard to Grand Gulf 1 (discussed below) and (3) pending litigation concerning the Company's contractual arrangements with System Energy Resources, Inc. (SERI), (formerly Middle South Energy, Inc.), are not affected.

On October 17, 1985, the Council initiated an investigation into all aspects of the Company's prudence regarding its involvement with Grand Gulf 1. Although the Company has participated in the hearings before the Council, it has done so under a full reservation of rights in connection with its position that the Council is barred by federal law from conducting such a prudence inquiry. As part of the prudence inquiry and related proceedings, the Council has initiated reviews of the effect of the Tax Reform Act of 1986 upon the Company's base rates and Grand Gulf 1 cost recovery. If the Council determines that any actions or decisions of the Company associated with Grand Gulf 1 are imprudent and that it has jurisdiction to deny on that ground the recovery in rates of FERC-allocated costs of Grand Gulf 1, it may attempt to prohibit the Company from recovering from its ratepayers those costs associated with Grand Gulf 1 that the Council determines to have been incurred as a result of imprudent actions or decisions. In the event that the Council determines that any of the Company's actions or decisions associated with Grand Gulf 1 were imprudent, and imposes disallowances in addition to the $51.2 million of incurred Grand Gulf 1 costs that were absorbed by the Company pursuant to the March 1986 Rate Agreement, and in the event that such actions by the Council were not stayed pending judicial review thereof, the Company's earnings, liquidity, financial condition, and ability to meet its continuing obligations (including its ability to effect further financing necessary to meet such obligations) could, depending upon the extent of the disallowances, be severely impaired. The Company believes that all of its actions and decisions with respect to Grand Gulf 1 were prudent and that the Company would ultimately be successful in defending against a finding of imprudence.

On November 14, 1985, the Company and SERI filed a complaint in the District Court seeking a temporary restraining order, preliminary and permanent injunctive relief, and a declaratory judgment enjoining the Council and its individual members from proceeding with its prudence investigation. On December 18, 1986, the District Court granted the Council's motion to dismiss the complaint, without prejudice to the right to refile the complaint, on the grounds, that since the Council has not yet acted in the prudence investigation, the issues presented are not ripe for adjudication and that in any event the federal court should abstain from taking jurisdiction in a local regulatory matter. On January 16, 1987, the Company and SERI filed a Notice of Appeal with the United States Court of Appeals for the Fifth Circuit (Fifth Circuit). Recently, the Company and SERI filed a motion to stay further proceedings in the Fifth Circuit pending disposition by the U.S. Supreme Court of a petition for writ of certiorari to review a September 2, 1986 ruling of the Fifth Circuit. Specifically, on August 1, 1985, the Company filed a petition in the District Court for injunctive relief against the Council, the City, and the individual councilmen to legally require these parties to recognize the legitimacy of the Company's portion of FERC-allocated costs associated with Grand Gulf 1. The District Court dismissed the case, and on February 14, 1986, the Fifth Circuit reversed the District Court but subsequently, on September 2, 1986, the Fifth Circuit modified its opinion so as to uphold the District Court's dismissal. The Company then filed, on October 3, 1986, its petition for writ of certiorari with the U.S. Supreme Court for review of the September 2, 1986 ruling of the Fifth Circuit. The matter is pending.

3. INCOME TAXES

Income tax expense (benefit) consists of the following:

	1986	198	1984
	(In Thousands)		
Current:			
Federal	$(12,589)	$(16,241)	$22,347
State	—	1,342	—
Total	(12,589)	(14,899)	22,347
Deferred — net:			
Deferred Grand Gulf 1 expenses	67,349	—	—
Reduction due to tax loss carryforward	(20,053)	—	—
Deferred fuel costs	(716)	3,520	(2,613)
Unbilled revenue	1,264	(921)	(918)
Pension expense	(187)	(2,824)	—
Adjustment of prior years' tax provisions	(356)	(5,103)	—
Provision for estimated losses	(1,683)	(1,890)	—
Other	344	(683)	(1,823)
Total	45,962	(7,901)	(5,354)
Investment tax credit adjustments — net	(267)	881	910
Recorded income tax expense (benefit)	$ 33,106	$(21,919)	$17,903
Charged to operations	$ 32,821	$(26,305)	$13,895
Charged to other income	285	4,386	4,008
Total income taxes	$ 33,106	$(21,919)	$17,903

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 (dollars in thousands):

	1986		1985		1984	
	Amount	% of Pre-Tax Income	Amount	% of Pre-Tax Income	Amount	% of Pre-Tax Income
Computed at statutory rate	$34,540	46.0%	$(18,739)	46.0%	$16,692	46.0%
Increases (reductions) in tax resulting from:						
Adjustment of prior years' tax provisions	(355)	(0.5)	(1,919)	4.7	—	—
Difference between book depreciation and tax straight-line depreciation	(495)	(0.6)	(1,215)	3.0	1,586	4.4
Other — net	(584)	(0.8)	(46)	0.1	(375)	(1.1)
Total income taxes	$33,106	44.1%	$(21,919)	53.8%	$17,903	49.3%

The tax effect of the portion of the 1986 federal tax loss that is carried forward has been recorded as a reduction of deferred income taxes. This loss of $43.6 million is available to offset taxable income in future years and, if not utilized, will expire in the year 2001. Unused investment tax credits at December 31, 1986 amounted to $2.9 million before any reduction resulting from 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 1992 through 2001.

Cumulative income tax timing differences for which deferred income taxes have not been provided are $25.7 million, $22.4 million, and $18.6 million as of the end of 1986, 1985, and 1984, respectively.

See Management's Financial Discussion and Analysis for a discussion of the Tax Reform Act of 1986 on page 29 of this report and its impact on the Company.

4. LINES OF CREDIT AND RELATED BORROWINGS

At December 31, 1986, the Company had a revolving credit agreement with borrowings to be secured by a security interest in or lien upon accounts receivable of the Company subject to certain limitations contained in the agreement. The amount of borrowings shall not exceed the lesser of (1) 90% of current aggregate eligible receivables, (2) 125% of the amount of the prior year's aggregate eligible receivables, or (3) $30,000,000. This agreement expires August 21, 1987. The Company also shares with Louisiana Power & Light Company (LP&L) a $10 million line of credit with a New Orleans bank. Additionally, the Company participates with certain other companies of the Middle South System in a money pool arrangement whereby those companies with available funds make short-term loans to other companies in the System having short-term borrowing requirements. The Company may borrow from the money pool and other available sources subject only to its maximum authorized level of short-term borrowings and the availability of funds. The Company has received authorization from the Securities and Exchange Commission (SEC) under the Public Utility Holding Company Act of 1935 to have outstanding at any one time short-term borrowings aggregating not more than 10% of the Company's capitalization. At the end of 1986, subject to certain limitations listed above, $16.3 million remained available for borrowing under the revolving credit agreement while all $10 million of the shared line of credit with a New Orleans bank remained unused. At the end of 1985, the Company's only available source of short-term borrowings was the Middle South System Money Pool.

During the period March 1985 through August 1985, MSU made interest-free extensions of credit to the Company totalling $15 million in order to enable the Company to continue to meet its financial obligations.

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

	1986	1985	1984
	(Dollars In Thousands)		
Maximum borrowing	$9,700	$19,300	$16,100
Year-end borrowing	$5,000	—	$16,100
Average borrowing:			
Bank loans	—	$ 1,850	—
Associated companies	$1,003	$ 8,793	$ 356
Other	$ 419	—	—
Average interest rate during the period:			
Bank loans	—	9.8%	—
Associated companies	6.5%	8.2%	8.2%
Other	9.0%	—	—
Average interest rate at end of period:			
Bank loans	—	—	—
Associated companies	—	—	8.7%
Other	9.0%	—	—

5. PREFERRED AND COMMON STOCK

Preferred stock at December 31, 1986 and 1985 consisted of the following:

Cumulative, $100 Par Value	Shares Authorized and Outstanding at December 31, 1986	1985	Amounts at December 31, 1986	1985	Current Call Price Per Share
			(In Thousands)		
Without sinking fund:					
4.75% Series	77,798	77,798	$ 7,780	$ 7,780	$105.00
4.36% Series	60,000	60,000	6,000	6,000	104.58
5.56% Series	60,000	60,000	6,000	6,000	102.59
Premium	—	—	337	337	
Total	197,798	197,798	$20,117	$20,117	
With sinking fund:					
15.44% Series	134,995	135,095	$13,500	$13,509	$111.58
Issuance Expense	—	—	(252)	(252)	
Total	134,995	135,095	$13,248	$13,257	

The 15.44% preferred stock series has provisions for a sinking fund sufficient to retire annually a minimum of 7,500 shares and a maximum of 15,000 shares at $100 per share plus accrued dividends. The sinking fund requirements commenced in 1985. In 1984, the Company retired 14,905 shares of the Company's 15.44% series of preferred stock in order to meet its 1985 and substantially all of the 1986 requirements. The Company was able to satisfy the remainder of its 1986 requirements and thereby eliminate all sinking fund arrearages by retiring an additional 100 shares in July 1986. In August 1985, the Company sold 2,500,000 shares of common stock at $10 per share to MSU. There were no changes with respect to the Company's common stock, $10 par value, in the years 1986 and 1984. In 1985, the Company's Articles of Incorporation were amended to increase the number of authorized shares of common stock from 7,000,000 to 10,000,000 shares.

During the second quarter of 1986, the Company eliminated all arrearages that existed with respect to preferred stock dividends and remained current with respect to payment of its quarterly preferred stock dividends throughout 1986. The Company has determined that, primarily as a result of the operation of the phase-in plan provided by the March 20, 1986 rate settlement with the Council, all dividends on all outstanding shares of the Company's preferred stock that were paid in 1986 constitute a return of capital for federal income tax purposes. The Company also believes that a substantial portion of any preferred stock dividends that may be paid in 1987 and proximal subsequent years may also constitute a return of capital. Common stock dividends have not been paid since December 1984 and have not been declared since June 1985. As of December 31, 1986, $5,997,000 of common stock dividends that were declared in 1985 had not been paid.

6. LONG-TERM DEBT

Long-term debt at December 31, 1986 and 1985 consisted of the following:

	1986	1985
	(In Thousands)	
First Mortgage Bonds:		
4½% Series due 1987	$ 6,000	$ 6,000
5 % Series due 1991	15,000	15,000
4½% Series due 1992	8,000	8,000
5⅞% Series due 1996	23,250	23,250
11 % Series due 1996*	25,000	—
5⅞% Series due 1997	12,000	12,000
10 % Series due 2004	35,000	35,000
9½% Series due 2008	15,000	15,000
Unamortized premium and discount on long-term debt — net	165	178
Total Long-Term Debt	139,415	114,428
Less: Amount due within one year	6,000	—
Long-Term debt excluding amount due within one year	$133,415	$114,428

* In July 1986, the Company sold $25 million principal amount of intermediate-term secured notes at an annual interest rate of 11%. On September 25, 1986, the Company collateralized these secured notes by depositing first mortgage bonds in that amount with the trustee for such notes effectively making such notes of equal rank with the outstanding first mortgage bonds of the Company.

The Company has made an application to the SEC and the Council to issue and sell up to $75 million of an initial series of General and Refunding Rate Recovery Mortgage Bonds issued under a General and Refunding Mortgage. The proceeds from the bond sale would be used to finance a portion of deferred Grand Gulf 1 costs which a[illegible] be recovered through revenues pursuant to the March 1986 rate settlement between the Company and the Council. (See Note 2, "Regulation and Rate Matters.")

At December 31, 1986, the sinking fund requirements and maturities for long-term debt for the years 1987 through 1991 are as follows (in thousands):

	Sinking Fund**	Maturities
1987	$1,065	$ 6,000
1988	1,005	—
1989	1,005	—
1990	1,173	—
1991	1,023	15,000

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

7. RETAINED EARNINGS

The indentures relating to the Company's long-term debt and provisions of the Articles of Incorporation relating to the Company's preferred stock provide for restrictions on the payment of cash dividends on common stock. As of December 31, 1986, $11,926,000 were free from such restrictions.

8. COMMITMENTS AND CONTINGENCIES

A. Capital Requirements and Financing

At December 31, 1986, the Company's most significant commitments and contingencies related to (1) the financing of the costs associated with the phase-in plan included in rate relief obtained for Grand Gulf 1-related costs, (2) the future status of Grand Gulf 2 and the possible allocation to the Company of costs associated with that unit (see "Grand Gulf 2" below), (3) the outcome of a prudence investigation by the Council with regard to the Company's involvement with Grand Gulf 1 (See Note 2, "Regulation and Rate Matters"), and (4) the outcome of challenges to the FERC allocation of capacity and energy from Grand Gulf 1, which could have a significant impact on the Company.

The Company's obligation for payments to SERI for Grand Gulf 1 capacity and energy is approximately $13 million per month. Deferred purchased power costs in connection with the Company's phase-in plan were $116.9 million (excluding $29.5 million of 1985 expenses deferred in March 1986) in 1986. The Company estimates that it will incur total capital requirements of approximately $250 million during the period of 1987-1989 in connection with the deferral or phase-in of Grand Gulf 1 costs pursuant to the terms of its settlement agreement as discussed in Note 2, "Regulation and Rate Matters."

The Company's construction program contemplates expenditures (including AFDC) of approximately $28.4 million in 1987, $30 million in 1988, and $38.9 million in 1989.

B. Potential Debt Acceleration and Related Matters

Certain of the other Middle South System operating companies' (System operating companies) retail rate orders with respect to their allocated costs for Grand Gulf 1 capacity and energy are still being challenged and reconsidered. On February 25, 1987, Mississippi Power and Light Company's (MP&L) rate order was reversed on appeal by the Mississippi Supreme Court and remanded to the Mississippi Public Service Commission for reconsideration.

Certain of System Fuels, Inc.'s (SFI) financing agreements and leases may require payments by the Company and the other System operating companies, MSU, or SERI in the event SFI's obligations under such documents 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. Insolvency of any System operating company would cause acceleration of SERI's indebtedness under certain agreements unless waivers were obtained under these agreements. Acceleration of such indebtedness of SERI could also occur if a Mississippi Public Service Commission proceeding relating to the certificate of convenience and necessity for the Grand Gulf Station were to make the continued operation of Grand Gulf 1 impractical. Given the substantial amount of these obligations, SERI, with its financial resources currently limited, would not be able to meet these obligations, if accelerated. Under SERI's financing agreements, MSU, and not the System operating companies, would be responsible to pay SERI's accelerated obligations. MSU, with its financial resources currently limited, including limitations on its ability to borrow funds or issue additional shares of its common stock, would not be in a position to satisfy SERI's accelerated obligations and/or provide the Company with desired common stock equity. In addition, insolvency of one or more Middle South System companies could impair the ability to obtain financing in the capital markets for other Middle South System companies.

C. Dividend Suspension

In light of the uncertainties continuing to face the Middle South System as well as the need to conserve cash resources in view of these uncertainties, the Company and the other System operating companies have not declared dividends on their common stock since the second quarter of 1985. MSU has been unable to declare its own common stock dividend since that time. Resumption of the Company's and MSU's common stock dividends may depend, among other things, upon the further resolution or moderation of these uncertainties and further improvement in the financial condition of the Middle South System.

D. Unit Power Sales Agreement

The Unit Power Sales Agreement, as approved by the FERC on June 13, 1985 (June 13 Decision), obligates the System operating companies to purchase from SERI at SERI's full cost of service all of SERI's 90% share of the capacity and energy from Grand Gulf 1 in accordance with the following percentage allocations: the Company, 17%; Arkansas Power & Light Company (AP&L), 36%; LP&L, 14%; and MP&L, 33%. Payments through the March 15, 1986 payment were reduced by credits for power purchase advance payments previously made to SERI. On January 6, 1987, the United States Court of Appeals for the District of Columbia Circuit affirmed the FERC's June 13 Decision. Various parties have filed requests for rehearing with the Court of Appeals and petitions for certiorari with the United States Supreme Court.

On March 23, 1984, the City filed suit against the Company, MSU, and SERI in the Civil District Court for the Parish of Orleans, State of Louisiana, seeking a declaratory judgment and a permanent injunction or other order alleging that the Company's obligations under certain Grand Gulf Station-related agreements are unenforceable until the Company obtains a Certificate of Public Convenience and Necessity from the Council. During oral arguments, the City voluntarily withdrew the Request for Injunctive Relief and limited the City's suit to a Request for Declaratory Judgment. The Company, MSU, and SERI intend to take all necessary and appropriate action and have filed pleadings denying the City's contentions and have asserted special defenses under state and federal law. The matter is pending.

E. Availability and Reallocation Agreements

The System operating companies are severally obligated to SERI under the Availability Agreement in accordance with stated percentages (the Company, 24.7%; AP&L, 17.1%; LP&L, 26.9%; MP&L, 31.3%) to make payments or subordinated advances adequate to cover all of the operating expenses including depreciation of SERI. The System operating companies in November 1981 entered into a Reallocation Agreement that would have allocated the capacity and energy available to SERI from the Grand Gulf Station to the Company, LP&L, and MP&L. These companies had agreed to assume all the responsibilities and obligations of AP&L with respect to the Grand Gulf Station under the Availability Agreement and Power Purchase Advance Payment Agreement, with AP&L relinquishing its rights with respect to the Grand Gulf Station. Each of the System operating companies, including AP&L, individually would have remained primarily liable to SERI and its assignees for payments or 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 FERC's June 13 Decision supersedes the Reallocation Agreement insofar as it relates to Grand Gulf 1.

F. Grand Gulf 2

As of December 31, 1986, SERI had invested approximately $908 million in Grand Gulf 2 (including approximately $390 million of AFDC), 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. Effective September 18, 1985, construction activities on Grand Gulf 2 were suspended following an order of the Mississippi Public Service Commission. Since that time, SERI has continued suspension of construction on Grand Gulf 2 and has limited expenditures to only those activities that are absolutely necessary for demobilization and suspension. In December 1986, SERI's Board of Directors (with the MSU Board concurring) adopted the recommendation of a special group of Middle South System officials that suspension of construction 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 continued suspension, SERI's expenditures on Grand Gulf 2, as well as the increase in its investment in the unit will be limited. Further, SERI does not intend to make an application to the FERC during the period of suspension with respect to recovery through rates of its investment in Grand Gulf 2. In addition, SERI will consider, among other things, 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 affect various companies in the Middle South System, including the Company.

In connection with the ultimate decision regarding the future of Grand Gulf 2, SERI will, at an appropriate time, make a determination as to the appropriate recovery of its investment. Any action by SERI to seek recovery of Grand Gulf 2 costs would likely involve a filing 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. Such proceedings could be protracted and strongly contested on various grounds, including imprudence. If costs associated with Grand Gulf 2 were allocated to the Company and it were unable to recover these costs from its customers, the Company's financial condition could be materially, adversely affected.

G. New Accounting Standard

The accounting standards related specifically to public utilities and certain other regulated enterprises are set forth by the Financial Accounting Standards Board (FASB) in Statement of Financial Accounting Standards (SFAS) No. 71. In December 1986, the FASB issued SFAS No. 90, "Regulated Enterprises Accounting for Abandonments and Disallowances of Plant Costs", as an amendment of SFAS No. 71. SFAS No. 90 provides that, when an abandonment of a plant or a disallowance of newly completed plant becomes probable, the following amounts, net of related tax benefits, should be reported either by restating the appropriate prior years' financial statements or by charging it against current income: (1) costs of abandoned generating plants in excess of the present value of estimated recoveries and (2) the amount of partial disallowances of recently completed generating plants for ratemaking purposes. The FASB had previously indicated that the new standard would also include revisions in accounting for the phase-in of rates associated with the costs of new generating plants. While SFAS No. 90 did not address the accounting for rate phase-in plans and thus does not affect the Company, the FASB has resumed deliberations on the appropriate accounting for phase-in plans. The Company's rate phase-in plan for recovery of its share of the costs of Grand Gulf 1 currently meets the requirements of SFAS No. 71.

H. MSU Shareholder Litigation

MSU, certain other Middle South 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) and was 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, certain officers (and former officers) and directors of MSU, the Company's outside auditors, and certain underwriters of MSU Common Stock. 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' motion for summary judgment and dismissed the suit. On February 6, 1987, the plaintiffs in the consolidated action filed a Notice of Appeal in the U.S. Court of Appeals for the Fifth Circuit. The defendants intend to oppose vigorously the appeal of the District Court's decision.

I. System Fuels, Inc.

The Company has a 13% interest in SFI, a jointly owned subsidiary of the Company, LP&L, AP&L, and MP&L. 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 operating companies and SERI. Its costs are primarily recovered through charges for fuel delivered.

The parent companies of SFI have made loans to SFI to finance its fuel supply business under a loan agreement dated January 1, 1984, as amended January 1, 1987, which provides for SFI to borrow up to \$51,000,000 from its parent companies through December 31, 1987. As of December 31, 1986, the Company had loaned \$990,000 to SFI pursuant to this loan agreement and the Company's share of the unused loan commitment was \$4,000,000. Notes under this agreement mature December 31, 1992. In addition, the Company had loaned SFI \$10,385,000 under previous loan agreements. Notes mature in 2002 and 2008 under the provisions of the previous loan agreements.

In connection with certain of SFI's 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, 1987, the total loan commitment under these arrangements amounted to \$160,000,000 of which \$131,000,000 was outstanding at that date. Also, SFI's parent companies, including the Company, have made similar convenants and agreements in connection with long-term leases by SFI of oil storage and handling facililties and coal hopper cars. At December 31, 1986, the aggregate discounted value of these lease arrangements was \$76,100,000.

SFI has contracted with a joint venture for a supply of coal from a mine in Wyoming, which based on estimated reserves is presently expected to provide for at least thirty years of the projected requirements of the Independence Station. SFI's parent companies, including the Company, each acting in accordance with their share of the ownership of SFI's common stock, joined in, ratified, confirmed, and adopted the contract and the obligations of SFI thereunder.

J. Transit Divestiture Obligation

On June 30, 1983, the Company sold its transit operations to a political subdivision of the State of Louisiana. In accordance with the sale agreement, the Company is obligated to reimburse the purchaser, the Regional Transit Authority, \$13 million plus a 9% upward adjustment factor per annum for future insurance premiums or benefit payments. As of December 31, 1986, the balance for such premiums and payments was \$7.8 million.

K. Consolidation with LP&L

In the interest of increased economic efficiency, the Company and LP&L have developed a long-term plan to consolidate the two companies and their operations. Under the proposed arrangement, subject to the receipt of necessary regulatory and other approvals, the two companies would be consolidated into a new company to be called Louisiana Power & Light Company. MSU, which currently owns all the outstanding common stock of the Company and LP&L, would own all of the common stock of the new company.

L. Gas Contract Settlement

A settlement has been negotiated between the Company and a gas supplier in long-standing litigation stemming from the gas supplier's failure to deliver obligated quantities of natural gas for power plant use during the period 1973-1975. If approved by the parties to the suit and the courts, the settlement would result in the refund of approximately \$70 million to electric customers served by the Company in that time frame. Announcement of the settlement was made in February 1987.

9. BUSINESS SEGMENT INFORMATION

As an operating public utility, the Company supplies electric and natural gas services in the City. Segment information about the Company's operations is as follows (in thousands):

	1986		1985		1984	
	Electric	Gas	Electric	Gas	Electric	Gas
Operating revenues	$326,095	$102,701	$315,034	$105,593	$322,060	$126,379
Revenue from sales to unaffiliated customers	325,639	102,701	303,978	105,593	317,200	126,379
Operating income (loss) before income taxes	84,365*	812	(41,822)	2,555	31,780	5,400
Operating income (loss)	50,889*	1,467	(13,771)	808	19,261	4,024
Net utility plant	197,978	50,550	200,316	49,279	201,037	48,360
Depreciation expense	11,882	2,772	11,860	2,688	13,486	2,624
Capital expenditures	9,585	4,070	11,186	3,628	11,439	3,478

* Includes the deferral of Grand Gulf 1 expenses applicable to 1985, the effect of which increased operating income before income taxes and operating income by $29.5 million and $15.9 million, respectively.

10. POSTRETIREMENT BENEFITS

The companies of the Middle South System have various postretirement benefit plans covering substantially all of their employees.

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.

Total pension expense of the Company for 1986, 1985, and 1984 was $477,000, $2,509,000, and $4,138,000, respectively. The decrease in 1986 expense compared to 1985 resulted primarily from inclusion of $1,560,000 in 1985 for a special early retirement program that was offered for a limited period and was not available in 1986. The decrease in 1985 pension expense compared with 1984 resulted from changes in actuarial assumptions and cost methods used by the Company. These changes included an increase in the assumed rate of return used in determining the actuarial present value of projected plan benefits from 7% to 9% and an increase of 2% at each age in expected salary increases for active plan participants. Additionally, the Company changed the actuarial cost method and amortization method for recognizing the difference between assets and past service liabilities and amended the plan effective January 1, 1985 to comply with the Retirement Equity Act.

During 1985, new standards for employers' accounting for pensions were issued (SFAS No. 87). The System companies will adopt the new pension accounting and disclosure standards in 1987. However, it is not expected that the new standards will have a material impact on the System companies' financial position or results of operations.

As part of the sale of the transit operation on June 30, 1983, the Company agreed to transfer the pension plan assets and liabilities of the transit related participants to a separate plan to be maintained by the successor employer. While such transfer was effective as of the date of the sale, the transfer was not completed until October 1986.

A comparison of the actuarial present values of accumulated pension plan benefits and plan net assets for the defined benefit plans is presented below. This comparison was determined in accordance with the provisions of SFAS No. 36 which requires the use of certain assumptions that are different from those used by the Company's actuary in determining an appropriate level of funding for the Company.

	January 1,	
	1986	1985
	(In Thousands)	
Actuarial present value of accumulated pension plan benefits:*		
Vested	$ 68,239	$59,563
Nonvested	1,661	2,150
Total	$ 69,900	$61,713
Net assets available for pension benefits*	$108,228	$91,186

* Excludes amounts attributable to former transit participants as discussed above.

The assumed rate of return used in determining the actuarial present value of accumulated pension plan benefits was 9%.

The Company also 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 working for the Company. These benefits and similar benefits for active employees are provided through various means including payments of premiums to insurance companies and/or accruals for self-insurance policies managed by insurance companies. The Company recognizes the cost of providing these benefits by expensing the payments made to the insurance companies or accruing the cost as recommended by the managing insurance company. 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 fiscal years were as follows:

	1986	1985	1984
Total cost of health care and life insurance (in thousands)	$5,188	$2,171*	$3,891
Number of active employees	1,428	1,455	1,520
Number of retirees	775	687	651

*Reflects a group life insurance refund of $2.3 million.

11. TRANSACTIONS WITH AFFILIATES

The Company buys electricity 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 fuel from SFI and receives technical and advisory services from MSU System Services, Inc. (formerly Middle South Services, Inc.).

Operating revenues include revenues from sales to affiliates amounting to $.5 million in 1986, $11.1 million in 1985, and $4.9 million in 1984. Operating expenses include charges from affiliates for fuel cost, purchased power, and technical and advisory services totalling $255.2 million in 1986, $170.4 million in 1985, and $82.3 million in 1984.

12. QUARTERLY RESULTS (Unaudited)

Unaudited operating results for the four quarters of 1986 and 1985 follow:

Quarter Ended	Operating Revenues	Operating Income (Loss)	Net Income (Loss)
	(In Thousands)		
1986:			
March (1)	$109,115	$25,686	$23,854
June	98,569	7,949	5,685
September	118,166	12,478	9,489
December (2)	102,925	6,242	2,953
1985:			
March	$105,065	$ 7,384	$ 6,132
June	96,617	5,524	4,413
September (3)	115,960	(9,741)	(11,150)
December (4)	102,985	(16,130)	(18,212)

(1) Operating income and net income for the quarter ended March 31, 1986 reflect the net of tax one time impact of deferring Grand Gulf 1 expenses applicable to 1985, the effect of which increased operating income and net income by $15.9 million.

(2) The quarter ended December 31, 1986 reflects a decrease in operating income and net income of $2.1 million net of tax due to the provision for estimated losses for the Company's share of certain costs associated with indefinitely delayed fossil-fuel generating facilities.

(3) Operating income (loss) and net income (loss) for the third quarter of 1985 include a decrease of $23.3 million due to Grand Gulf 1 expenses, an increase of $1.1 million from revenues applicable to nuclear fuel savings, and an increase of $1.1 million resulting from pension expense adjustments.

(4) Operating income (loss) and net income (loss) for the last quarter of 1985 include a decrease of $22.1 million due to Grand Gulf 1 expenses, a decrease of $5.5 million as a result of a provision for estimated losses for the Company's share of certain costs associated with indefinitely delayed future fossil generating facilities, an increase of $4.4 million from revenues applicable to nuclear fuel savings, and an increase of $1.9 million due to an adjustment of prior years' income taxes.

The business of the Company is subject to seasonal fluctuations with peak periods occurring during the summer months for electric and during the winter months for gas. 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.

Management's Financial Discussion And Analysis

FINANCIAL CONDITION

The Company's improved financial condition at December 31, 1986 reflects the effects of a rate settlement agreement reached between the Company and the Council of the City of New Orleans (Council) on March 25, 1986 with respect to Grand Gulf 1-related costs. The rate settlement agreement provided for current recovery of certain portions of non-fuel Grand Gulf 1-related costs and portions of the carrying costs and for a portion of such costs and carrying costs to be deferred and phased into rates in the future. Included in the settlement is a provision that the Council is not required to cease its inquiry into the prudence of the Company's involvement in the Grand Gulf Station or refrain from issuing orders with respect thereto unless so ordered by a court of competent jurisdiction. (See Note 2, "Regulation and Rate Matters.") The Council has continued to conduct proceedings regarding the prudence of the Company's involvement in Grand Gulf 1 and, in late 1986, the Council's consultants recommended that the Company could financially sustain substantial disallowances with respect to its allocated share of Grand Gulf 1 costs. If the Council, in conjunction with the prudence inquiry, should attempt to take action to disallow, and thereby force the Company to absorb, costs associated with Grand Gulf 1 in excess of the $51.2 million of such costs previously absorbed pursuant to the rate settlement agreement, and such action by the Council is not stayed by the courts, the Company's earnings, liquidity, financial condition, and ability to meet its continuing obligations (including its ability to effect further financing to meet such obligations) could, depending upon the extent of the disallowance, be severely impaired. The Company would vigorously oppose any such action by the Council through the courts.

Net income for 1986 was approximately $42 million, an increase of $60.8 million over 1985. In March 1986, $29.5 million of unrecovered 1985 Grand Gulf 1-related costs were deferred and credited against 1986 operating expenses. The after tax effect on net income for 1986 was $15.9 million. The amount deferred will be recovered over future periods.

As a result of the Company's improved financial condition, the Company became current with respect to payment of its preferred stock dividends. Preferred stock sinking fund redemptions were also brought up to date. However, the Company has not declared or paid common stock dividends since June 1985. At year-end 1986, approximately $6 million of common stock dividends that were declared in 1985 had not been paid.

LIQUIDITY AND CAPITAL RESOURCES

During 1986, the Company's primary capital requirements included the financing of the costs related to Grand Gulf 1 that were deferred and must be financed until phased into rates, and the costs of its construction program. In order to meet its capital needs, the Company obtained $25 million from the sale of intermediate-term secured notes in the second quarter of 1986 (such notes were collateralized by a like amount of first mortgage bonds in September 1986), and secured a revolving credit agreement with an institutional lender thereby enabling the Company to obtain up to an additional $30 million on a short-term basis (the borrowings being secured by a security interest in or lien upon accounts receivable of the Company). At December 31, 1986, the Company had borrowed approximately $5 million under this revolving credit agreement. The balance of the Company's cash needs was satisfied through internally generated funds.

Over the next three years, the Company projects that capital will be required for the financing of deferred Grand Gulf 1 costs of approximately $103.1 million in 1987, $82 million in 1988, and $65 million in 1989; construction expenditures of approximately $28.4 million in 1987, $30 million in 1988, and $38.9 million in 1989; retirement of short-term borrowings and preferred stock totalling $5.7 million in 1987; retirement of additional preferred stock issues of $0.7 million in both 1988 and 1989, and retirement of first mortgage bonds of $6 million in 1987. The Company plans to meet a portion of these requirements through internally generated funds and to obtain the balance from external sources, including the issuance of long-term debt of approximately $75 million, $30 million, and $40 million in 1987, 1988, and 1989, respectively; the sale of approximately $30 million of preferred stock in 1988; and the sale of approximately $20 million, $10 million, and $25 million of common stock to its parent, Middle South Utilities, Inc. (MSU) in 1987, 1988, and 1989, respectively.

With regard to long-term debt, in view of the Company's lack of unfunded bondable property (approximately $9.3 million at 1986 year-end) to support the issuance of additional bonds under its first mortgage indenture, the Company contemplates establishing a new general and refunding mortgage indenture to provide for all future issuances of long-term debt. Under this new indenture, the Company would be permitted, among other things, to issue up to an aggregate of $280 million of long-term debt (designated as Rate Recovery Mortgage Bonds) to finance or refinance deferred Grand Gulf 1 costs without having to fund unfunded property additions, although the Company would have to satisfy certain other issuance conditions, including an appropriate two-times interest coverage earnings test. In this connection, the Company has filed with the Securities and Exchange Commission (SEC) and the Council for authority to issue up to $75 million of an initial series of Rate Recovery Mortgage Bonds.

Concerning possible sales by the Company of additional common stock to its parent, MSU, the Company believes that MSU would be willing to provide additional common equity capital to the Company if the Company is able to obtain additional long-term debt financing (such as the Rate Recovery Mortgage Bonds) to meet a substantial portion of its capital requirements, the Company's financial condition continues to improve so that the Company can resume paying common dividends to MSU, and the rate structure provided for in the March 1986 rate settlement agreement between the Company and the Council remains in effect.

In order to satisy its short-term needs for cash, pending permanent financing, the Company is currently authorized by the SEC to effect short-term borrowings of up to 10% of capitalization, subject to the availability of short-term credit sources. The Company also has an unsecured bank line of credit of approximately $10 million, none of which was utilized at December 31, 1986. This line of credit, from a Louisiana bank, is shared by the Company and Louisiana Power & Light Company. Additional borrowings can be effected through the Middle South System Money Pool, subject to the availability of funds, which at any particular time may be limited. At December 31, 1986, the Company had no outstanding short-term borrowings from associated companies through the Money Pool.

The Company's earnings coverage for its first mortgage bonds increased to positive 7.75 times the annual mortgage bond interest requirements at year-end 1986 from negative 4.72 times at year-end 1985. At year-end 1984, the earnings coverage for first mortgage bonds was 5.31 times the annual mortgage bond interest requirements. Earnings coverages for its preferred stock increased to positive 3.45 times the annual interest charges and preferred stock dividend requirements in 1986 from a negative 0.60 times at year-end 1985. The preferred stock earnings coverage was 2.16 times at year-end 1984.

The 1986 earnings coverages reflect the net of tax one time impact of deferring in 1986 $15.9 million of Grand Gulf 1 expenses applicable to 1985. The minimum earnings coverage requirements for issuing first mortgage bonds (other than for refunding purposes) and preferred stock are 2.0 times and 1.5 times, respectively, on a pro forma basis. Based solely on earnings coverages at December 31, 1986, and an assumed interest rate of 10%, the Company could have issued up to approximately $318 million of first mortgage bonds (if adequate property additions were available for that purpose) or approximately $199 million of preferred stock. However, the amount of first mortgage bonds that could have been issued at December 31, 1986, based upon available property additions, was only $5.6 million. As noted above, the amount of long-term debt that the Company may issue in the future will depend upon the terms and conditions of a proposed new general and refunding bond mortgage indenture. The Company has filed for regulatory authorization of the issuance of the initial series of long-term debt thereunder.

RESULTS OF OPERATIONS

Net income for 1986 was $42 million, a $60.8 million increase over the 1985 net loss of $18.8 million. This increase was due in substantial part to the fact that in 1985, the Company had incurred $43.6 million of Grand Gulf 1 expenses, net of tax, without significant rate relief, and that in 1986, $15.9 million, net of tax, of Grand Gulf 1 expenses applicable to 1985 were deferred. The net loss for 1985 was $18.8 million, which was $37.2 million less than 1984 net income. This loss was due principally to Grand Gulf 1 power purchases which were not deferred and therefore expensed, and a write-off of the Company's share of certain costs associated with indefinitely delayed future fossil-fuel generating facilities partially offset by interim rate relief and income taxes. (See Note 12, "Quarterly Results (Unaudited).")

Electric operating revenues increased $11.1 million or 4% in 1986 and decreased $7 million or 2% in 1985 when compared to 1985 and 1984, respectively. The increase in 1986 was due primarily to a $52.8 million increase in base rates resulting from the March 1986 rate settlement with the City Council partially offset by a $32.6 million decrease in the recovery of fuel costs through the fuel adjustment clause and a $10.6 million decrease in sales to affiliated utilities. The 1985 decrease in electric operating revenues was due primarily to decreased fuel recovery of approximately $35.4 million partially offset by increased sales to other utilities of $8.6 million, increased revenues of $9.1 million reflecting increases in base rates and energy sales, and interim rate relief of approximately $10.1 million. Although all other classes of customer usage increased in 1985, industrial usage declined 26% as compared to the previous year.

Gas operating revenues decreased $2.9 million or 3% in 1986 and $20.8 million or 16% in 1985 as compared in each case to the preceding year. The decrease in 1986 was due to a $2.2 million decrease in the recovery of gas costs and a 13% decrease in governmental sales. In 1985, the decrease in gas operating revenues was due primarily to a decrease in the recovery of gas costs of $16.8 million and a 13% decrease in gas sales. The decrease in 1985 sales was due primarily to a 26% decrease in industrial gas sales.

In 1986, the Company deferred for future recovery through rates $146.4 million of Grand Gulf 1-related costs pursuant to the phase-in plan. Included in this amount was $29.5 million of costs applicable to 1985. By deferring these costs to the future when revenues will be collected through increased rates billed to customers, the impact of the phase-in plan on the income statement has been removed. Because the actual collection of revenues to recover the deferred amounts will not occur until the future, the phase-in plan results in additional capital requirements.

The combined fuel, purchased power, and deferred electric fuel costs increased $28.7 million or 11% in 1986 and $62.5 million or 31% in 1985 as compared in each case to the prior year. These increases are due to power purchases from Grand Gulf 1 partially offset by decreases in the cost of power plant gas and decreased generation.

The total of gas purchased for resale and deferred resale gas costs decreased $2.8 million or 4% in 1986 and $17.4 million or 19% in 1985 as compared to 1985 and 1984, respectively. In both years, the decreases were due to decreases in the per-unit gas costs and decreases in the volume of gas purchased.

Income taxes included in operating income increased $59.1 million in 1986 and decreased $40.2 million in 1985 as compared in each case to the prior year. This increase and decrease were due to a corresponding increase and decrease in book income before income taxes for each year.

Other income and deductions decreased $4.4 million or 93% in 1986 as compared to 1985. This was due primarily to reductions in interest income on power purchase advance payments previously made to System Energy Resources, Inc.

EFFECTS OF INFLATION

In December 1986, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 89 which rescinded the requirement to provide certain supplementary information concerning the effect of changing prices on the System. This information, which was presented in previous years as a note to the financial statements, has been deleted from this year's report.

The Company's operations were not significantly impacted by inflation in 1986, 1985, and 1984 as inflation rates were below prior year levels. The opposite was the case in certain previous years when inflation rates were high. In the future, should inflation rates increase, the Company's operations could be negatively affected if timely and adequate rate relief is not received.

EFFECTS OF THE TAX REFORM ACT OF 1986

On October 22, 1986, the President signed into law the Tax Reform Act of 1986 (Act), portions of which could have a significant impact on the utility industry. The Act has provisions that repeal the investment tax credit, diminish the value of investment tax credit carryforwards, impose an alternative minimum tax, and reduce the marginal corporate income tax rate. It is anticipated that the Company will experience a reduction in its 1987 income tax expense due to the effects of the tax rate change, to changes in the treatment of unbilled revenues, and to the effects of the tax rate change on previously deferred income taxes not related to accelerated depreciation. It is further anticipated that the Council will reduce the Company's base rates to reflect the changes resulting from the Act. In the event of such reduction, the Company would experience a reduction of cash flow in 1987. While these reduced collections will lower internal cash generation, cash flow is not expected to be so severely impacted as to substantially increase the need for external financings.

SUMMARY

Receipt of rate relief has improved the financial condition of the Company. The future financial viability of the Company will depend upon the continued effectiveness of the retail rate phase-in plan provided by the Company's March 1986 rate settlement agreement with the Council, the outcome of the prudence inquiry being conducted by the Council (or litigation related thereto), the ability of the Company to secure necessary financing to fund a substantial portion of its deferred Grand Gulf 1-related costs until they are collected through rates, and upon various other factors. (See Notes 2 and 8, "Regulation and Rate Matters" and "Commitments and Contingencies," respectively.)

FINANCIAL AND OPERATING STATISTICS

Selected Financial Data

Selected Financial Data	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976
(Dollars in Millions)											
Total Assets	**$ 460.5**	$ 346.9	$ 359.8	$ 345.2	$ 348.0	$ 345.3	$ 331.0	$ 305.8	$ 292.8	$ 289.8	$ 282.8
Total Utility Plant	**$ 486.3**	$ 476.6	$ 463.9	$ 450.5	$ 450.8	$ 436.6	$ 424.0	$ 412.0	$ 394.5	$ 380.3	$ 370.9
Accumulated Provision for Depreciation	**$ 237.8**	$ 227.0	$ 214.5	$ 199.8	$ 196.1	$ 183.4	$ 171.3	$ 162.3	$ 155.0	$ 146.3	$ 137.6
Capitalization:											
Long-Term Debt	**$ 139.4**	$ 114.4	$ 114.4	$ 120.5	$ 126.5	$ 126.5	$ 126.5	$ 126.5	$ 126.6	$ 121.7	$ 121.7
Preferred Stock with Sinking Fund	**13.3**	13.3	13.3	14.6	14.6	14.6	14.6	—	—	—	—
Preferred Stock without Sinking Fund	**20.1**	20.1	20.1	20.1	20.1	20.1	20.1	20.1	20.1	20.1	20.1
Common Stock	**84.4**	84.4	59.4	59.4	59.4	59.4	59.4	59.4	59.4	59.4	59.4
Retained Earnings	**21.2**	(17.0)	10.1	10.0	7.8	10.3	13.1	19.3	19.4	18.2	15.5
Total	**$ 278.4**	$ 215.2	$ 217.3	$ 224.6	$ 228.4	$ 230.9	$ 233.7	$ 225.3	$ 225.5	$ 219.4	$ 216.7
Total Operating Revenues (Excluding Interdepartmental)	**$ 428.8**	$ 420.6	$ 448.4	$ 423.4	$ 457.7	$ 438.9	$ 348.5	$ 329.6	$ 260.1	$ 238.4	$ 203.7
Operating Income	**$ 52.4**	$ (13.0)	$ 23.3	$ 13.0	$ 13.6	$ 16.1	$ 14.1	$ 17.3	$ 17.8	$ 17.2	$ 23.6
Income from Continuing Operations	**$ 42.0**	$ (18.8)	$ 18.4	$ 5.3	$ 7.7	$ 9.4	$ 6.0	$ 9.3	$ 10.1	$ 10.1	$ 16.6
Net Income (Note 1)	**$ 42.0**	$ (18.8)	$ 18.4	$ 8.4	$ 9.0	$ 10.5	$ 6.7	$ 10.0	$ 10.6	$ 10.5	$ 10.4
Capitalization Ratios:											
Long-Term Debt	**50.1%**	53.2%	52.7%	53.6%	55.4%	54.8%	54.1%	56.2%	56.2%	55.5%	56.2%
Preferred Stock with Sinking Fund	**4.8**	6.2	6.1	6.5	6.4	6.3	6.3	—	—	—	—
Preferred Stock without Sinking Fund	**7.2**	9.3	9.2	9.0	8.8	8.7	8.6	8.9	8.9	9.1	9.2
Common Stock	**30.3**	39.2	27.3	26.5	26.0	25.7	25.4	26.3	26.3	27.1	27.4
Retained Earnings	**7.6**	(7.9)	4.7	4.4	3.4	4.5	5.6	8.6	8.6	8.3	7.2
Total	**100.0%**	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Dividends Declared on Preferred Stock	**$ 3.8**	$ 2.3	$ 3.3	$ 3.3	$ 3.3	$ 3.3	$ 2.7	$ 1.0	$ 1.0	$ 1.0	$ 1.0
Employees — Year End (Note 2)	**1,424**	1,452	1,512	1,522	2,786	2,878	2,913	2,945	2,895	2,851	2,755
Gas Operations											
Operating Revenues (Excluding Interdepartmental) (Dollars in Millions):											
Residential	**$ 54.7**	$ 53.2	$ 67.0	$ 68.4	$ 58.7	$ 44.8	$ 37.2	$ 37.1	$ 32.4	$ 27.7	$ 22.4
Commercial	**19.1**	18.6	21.6	25.1	22.8	17.5	13.2	13.5	11.6	9.9	7.3
Industrial	**7.4**	9.0	12.2	13.9	14.5	15.4	14.7	22.3	13.8	12.5	9.0
Government and Municipal	**20.1**	23.3	23.4	27.2	23.5	18.8	12.1	12.7	11.1	9.6	6.5
Total Revenue from Retail Customers	**$ 101.3**	$ 104.1	$ 124.2	$ 134.6	$ 119.5	$ 96.5	$ 77.2	$ 85.6	$ 68.9	$ 59.7	$ 45.2
Miscellaneous	**1.4**	1.5	2.2	1.5	1.2	1.9	1.7	.7	.5	.6	.3
Total	**$ 102.7**	$ 105.6	$ 126.4	$ 136.1	$ 120.7	$ 98.4	$ 78.9	$ 86.3	$ 69.4	$ 60.3	$ 45.5
Sales (Excluding Interdepartmental) (Billions of Cubic Feet):											
Residential	**9.5**	9.5	11.3	10.9	10.6	11.3	11.6	12.7	13.3	12.9	13.2
Commercial	**3.6**	3.6	[illegible]	4.2	4.4	4.6	4.7	5.3	5.6	5.4	5.5
Industrial	**1.9**	1.9	2.6	2.7	2.9	4.2	6.3	9.6	7.7	7.9	8.1
Government and Municipal	**4.1**	4.7	4.8	4.7	4.7	5.1	5.0	5.5	6.2	6.1	6.1
Total	**19.1**	19.7	22.7	22.5	22.6	25.2	27.6	33.1	32.8	32.3	32.9
Customers — Year End (Thousands):											
Residential	**153.7**	156.5	159.5	160.8	162.4	163.3	163.9	164.4	165.1	165.3	165.8
Total	**165.1**	168.2	171.5	173.0	174.9	175.9	176.5	177.1	177.9	178.0	178.6
Natural Gas Purchased (Billions of Cubic Feet):											
For Resale	**19.5**	22.1	22.1	23.8	22.7	25.4	28.3	33.8	33.5	33.2	33.9
For Fuel in Company's Electric Generating Stations	**24.9**	28.5	30.3	23.7	36.6	46.7	44.1	34.8	14.2	16.6	8.6
Total	**44.4**	50.6	52.4	47.5	59.3	72.1	72.4	68.6	47.7	49.8	42.5
Maximum 24-Hour Resale Demand (Millions of Cubic Feet)	**198**	258	239	238	225	235	232	267	272	293	239
Heating Degree Days (Note 3):											
Actual	**1,111**	1,343	1,183	1,376	951	1,115	1,104	1,445	1,492	1,333	1,565
Normal	**1,319**	1,314	1,334	1,338	1,352	1,355	1,384	1,372	1,379	1,359	1,342
Residential Customer Data:											
Average Annual Use (Thousands of Cubic Feet)	**61.18**	60.62	70.89	67.63	65.48	69.49	70.38	77.36	80.92	78.01	79.85
Average Annual Bill	**$352.83**	$337.81	$419.57	$424.42	$361.28	$274.06	$227.06	$225.33	$196.02	$167.57	$135.54
Average Revenue per Thousand Cubic Feet	**$ 5.77**	$ 5.57	$ 5.92	$ 6.28	$ 5.52	$ 3.94	$ 3.23	$ 2.91	$ 2.42	$ 2.15	$ 1.70

FINANCIAL AND OPERATING STATISTICS

Electric Operations

	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976
Operating Revenues (Excluding Interdepartmental) (Dollars in Millions):											
Residential	**$ 118.1**	$ 107.9	$ 109.2	$ 97.8	$ 107.1	$ 106.8	$ 84.3	$ 73.2	$ 65.8	$ 64.2	$ 53.9
Commercial	**131.9**	120.5	123.0	104.3	109.1	105.0	82.8	75.6	66.4	64.8	57.0
Industrial	**22.9**	25.1	35.4	36.4	40.8	41.1	34.8	31.6	27.0	26.2	23.1
Government and Municipal	**43.4**	42.5	44.6	41.1	43.3	39.6	29.5	25.3	21.5	20.8	18.2
Total Revenues from Retail Customers	**$ 316.3**	$ 296.0	$ 312.2	$ 279.6	$ 300.3	$ 292.5	$ 231.4	$ 205.7	$ 180.7	$ 176.0	$ 152.2
Public Utility	**5.1**	14.2	5.6	4.5	34.5	45.8	36.2	38.1	15.7	13.0	4.8
Miscellaneous	**4.7**	4.8	4.3	3.2	2.3	2.2	2.0	(.5)	(5.7)	(10.9)	1.2
Total	**$ 326.1**	$ 315.0	$ 322.1	$ 287.3	$ 337.1	$ 340.5	$ 269.6	$ 243.3	$ 190.7	$ 178.1	$ 158.2
Sales (Excluding Interdepartmental) (Millions of Kilowatt-Hours):											
Residential	**1,904**	1,833	1,722	1,643	1,700	1,706	1,685	1,565	1,618	1,587	1,455
Commercial	**1,990**	1,939	1,855	1,654	1,631	1,622	1,571	1,537	1,537	1,492	1,386
Industrial	**448**	496	670	728	756	823	881	873	875	843	816
Government and Municipal	**804**	809	786	762	756	723	673	627	624	602	573
Total Sales to Retail Customers	**5,146**	5,077	5,033	4,787	4,843	4,874	4,810	4,602	4,654	4,524	4,230
Public Utility	**198**	333	118	91	688	891	909	1,226	559	488	202
Total	**5,344**	5,410	5,151	4,878	5,531	5,765	5,719	5,828	5,213	5,012	4,432
Customers—Year End (Thousands):											
Residential	**176.0**	178.0	179.9	178.1	177.7	176.2	174.8	173.3	172.4	170.8	169.3
Total	**196.8**	199.0	201.0	199.2	198.4	196.8	195.3	193.8	193.0	191.1	189.5
Summer Net Generating Capability (Thousands of Kilowatts)	**1,077**	1,077	1,077	1,270	1,257	1,257	1,257	1,257	1,257	1,257	1,257
Maximum Hour Net Demand (Company Area) (Thousands of Kilowatts)	**1,185**	1,115	1,092	1,106	1,035	1,067	1,091	981	967	965	917
Net Output—(Company Area) (Millions of Kilowatt-Hours)	**5,495**	5,469	5,341	5,057	5,122	5,196	5,120	4,867	4,944	4,804	4,467
Net Output—Total (Millions of Kilowatt-Hours)	**5,700**	5,811	5,465	5,171	5,835	6,110	6,070	6,142	5,561	5,352	4,730
Annual Load Factor (Company Area)	**52.9%**	56.0%	55.7%	52.2%	56.5%	55.6%	53.4%	56.6%	58.4%	56.8%	55.5%
Cooling Degree Days (Note 4):											
Actual	**3,218**	2,857	2,739	2,689	3,399	3,449	3,558	3,031	3,369	3,386	2,410
Normal	**2,940**	2,934	2,934	2,958	2,942	2,899	2,865	2,851	2,820	2,791	2,812
Residential Customer Data:											
Average Annual Use (Kilowatt-Hours)	**10,748**	10,254	9,622	9,248	9,590	9,723	9,677	9,049	9,437	9,347	8,623
Average Annual Bill	**$666.58**	$603.48	$609.98	$550.80	$604.03	$608.63	$484.11	$423.32	$383.70	$377.90	$319.21
Average Revenue per Kilowatt-Hour	**6.20¢**	5.89¢	6.34¢	5.96¢	6.30¢	6.26¢	5.00¢	4.68¢	4.07¢	4.04¢	3.70¢
Miles of Conductors (Overhead and Underground)	**7,930**	7,935	7,917	7,870	7,835	7,803	7,814	7,768	7,730	7,625	7,583

(1) Net income for 1986 includes $15.9 million of deferred Grand Gulf 1-related expenses, net of tax, applicable to 1985.

(2) The Company sold its transit operations on June 30, 1983.

(3) Values are indicative of the relative heating requirements and represent the summation of differences between 65°F and actual mean daily atmospheric dry bulb temperatures for all days of less than 65°F mean. Normal represents 20-year running average ended previous year.

(4) Values are indicative of the relative cooling requirements and represent the summation of differences between 65°F and actual mean daily atmospheric dry bulb temperatures for all days of more than 65°F mean. Normal represents 20-year running average ended previous year.

Transfer Agent

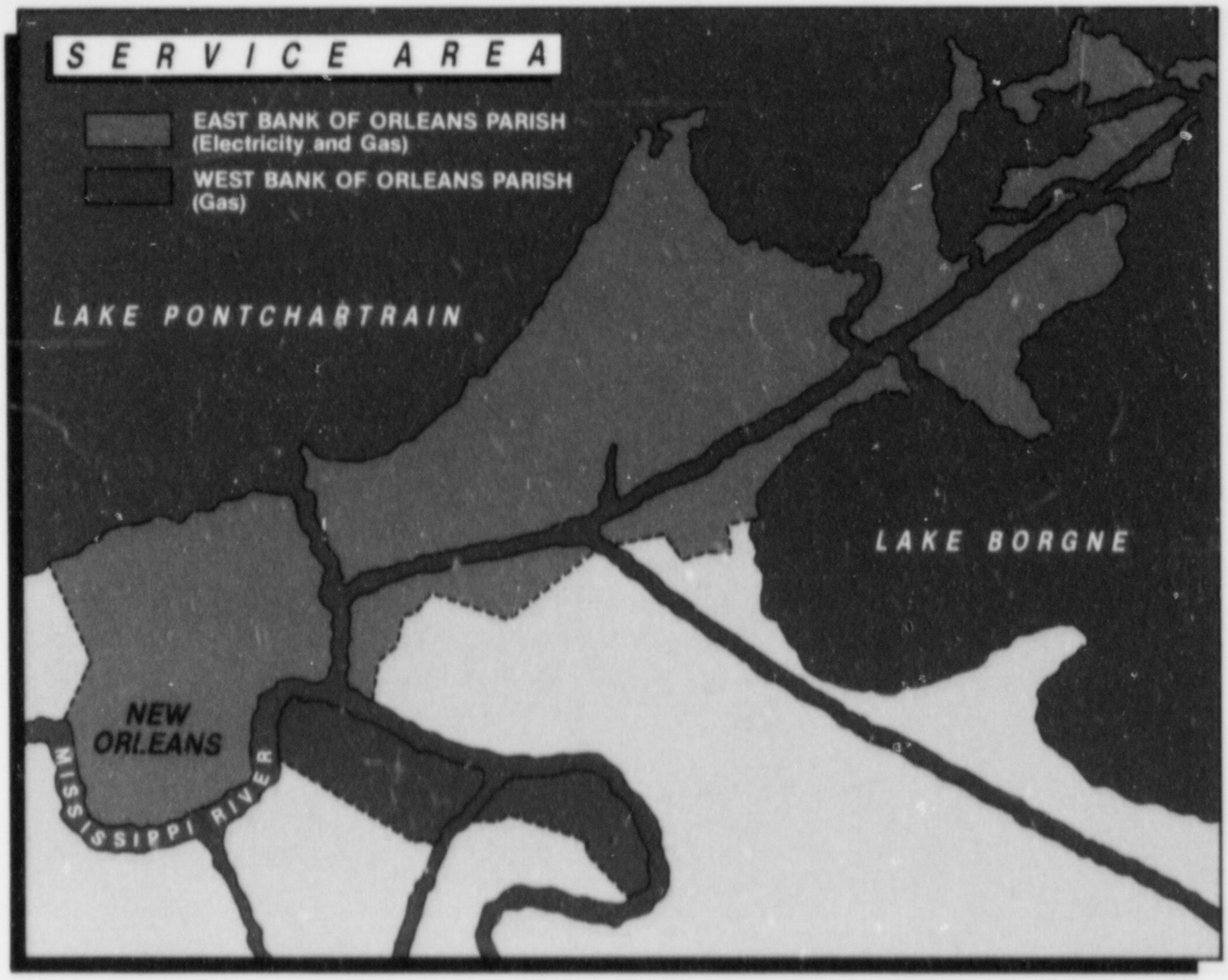
(For Preferred Stock)
Mellon Securities Trust Company
67 Broad Street
New York, New York 10004

Registrar

(For Preferred Stock)
Harris Trust Company of New York
Ninth Floor
110 William Street
New York, New York 10038

Trustee

(For First Mortgage Bonds)
The Chase Manhatten Bank, N.A.
Corporate Trust
Administrative Division
1 New York Plaza, 14th Floor
New York, New York 10081



SERVICE AREA/
New Orleans Public Service Inc.

New Orleans Public Service Inc. serves the City of New Orleans (Orleans Parish), a land area of approximately 200 square miles. Natural gas is provided for the entire parish while electricity is supplied for all areas of the parish except the 15th Ward (Algiers), an 18-square mile section on the west bank of the Mississippi River. The Company's electric and gas operations are regulated by the Council of the City of New Orleans.

Through their affiliation with Middle South Utilities, Inc., Public Service and the other Middle South Utilities System companies gain operating and income tax benefits, a source of common equity capital, and expert assistance when selling senior securities to finance property additions and for other corporate purposes. Interconnections make it possible to provide more dependable electric service with less total generating capacity and to install larger generating units having lower investment costs per kilowatt and higher efficiencies.

SERVICE TERRITORY
Middle South Utilities System
January 1, 1987

The Middle South Utilities System companies provide electric service to more than 1.7 million customers in a 92,000-square-mile area within Arkansas, Louisiana, Mississippi, and Southeast Missouri. New Orleans Public Service Inc. also serves gas customers in the City of New Orleans. Associated Natural Gas Company, a subsidiary of Arkansas Power & Light Company, serves gas customers in parts of Arkansas and Missouri.

The four System operating companies — Arkansas Power & Light Company, Louisiana Power & Light Company, Mississippi Power & Light Company, and New Orleans Public Service Inc. — have served under common ownership and on an interconnected basis for more than 60 years.

DIRECTORS

DR. HENRY E. BRADEN, III[A]
Private Physician

JAMES M. CAIN
President of the Company
President
Louisiana Power & Light Company

REV. JAMES C. CARTER, S.J.[B]
President
Loyola University

BROOKE H. DUNCAN[B]
President
The Foster Company, Inc.

A. L. JUNG, JR.[C]
Chairman of the Board
Jung Realty Company, Inc.

JOSEPH J. KREBS, JR.
Chairman and
Chief Executive Officer
J. J. Krebs & Sons, Inc.

EDWIN LUPBERGER[D]
Chairman and President
Middle South Utilities, Inc.

GERALD D. McLENDON[E]
Executive Vice President
of the Company
Executive Vice President
Louisiana Power & Light Company

JOHN B. SMALLPAGE[B]
Chairman and Secretary
Donovan Marine, Inc.

CHARLES C. TEAMER, SR.[B]
Vice President for
Fiscal Affairs
Dillard University

JACK M. WYATT
Retired Chairman and
Chief Executive Officer
Louisiana Power
& Light Company

[A]Elected effective 11-17-86
[B]Members of Audit Committee
[C]Retired effective 5-12-86
[D]Elected effective 3-21-86
[E]Elected effective 5-12-86

OFFICERS

JAMES M. CAIN
President

DONALD HUNTER[1]
Executive Vice President

R. DRAKE KEITH[2]
Executive Vice President

GERALD D. McLENDON[3]
Executive Vice President

D. L. ASWELL
Senior Vice President —
Energy Supply-Fossil

JOHN J. CORDARO
Senior Vice President —
External Affairs

S. G. CUNNINGHAM, JR.
Senior Vice President —
Marketing & Rates

MALCOLM L. HURSTELL
Senior Vice President —
Energy Delivery

M. H. McLETCHIE
Senior Vice President —
Accounting & Finance,
and Treasurer

RICHARD L. MURLOWSKI
Senior Vice President —
Administration & Planning

J. J. SAACKS[4]
Group Vice President —
Division Operations

G. F. DELERY, III
Vice President —
Marketing

ROBERT J. DUNN
Vice President —
Administrative Services

HERO J. EDWARDS, JR.
Vice President —
Division Manager

RICHARD C. GUTHRIE
Vice President —
Public Affairs

W. J. LANNES, III
Vice President —
System Engineering

THOMAS O. LIND
Vice President —
Regulatory Counsel,
and Assistant Secretary

LEE V. MAURIN
Vice President —
Fossil Operations

LEE W. RANDALL
Vice President —
Accounting & Treasury,
and Assistant Treasurer

W. H. TALBOT
Vice President —
Assistant to the President,
and Secretary

ROBERT J. ABADIE
Controller

JAMES C. ALACK
Assistant Controller

T. W. BOATRIGHT
Assistant Controller

R. N. GARRETT, JR.
Assistant Controller

S. F. OHLMEYER
Assistant Treasurer

N. J. BRILEY
Assistant Secretary

CARY J. DUDENHEFER
Assistant Secretary

[1]Elected effective 1-26-87
[2]Elected effective 3-1-87
[3]To retire effective 4-1-87
[4]Resigned effective 2-1-87

William H. Talbot, Vice President-Assistant to the President, and Secretary of the Company since 1983, passed away on March 12, 1987. The Company is grateful for his many years of service and is deeply saddened by his death.

MIDDLE SOUTH
UTILITIES SYSTEM

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New Orleans, Louisiana 70161
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