ARIZONA PUBLIC SERVICE COMPANY

1982 Annual Report

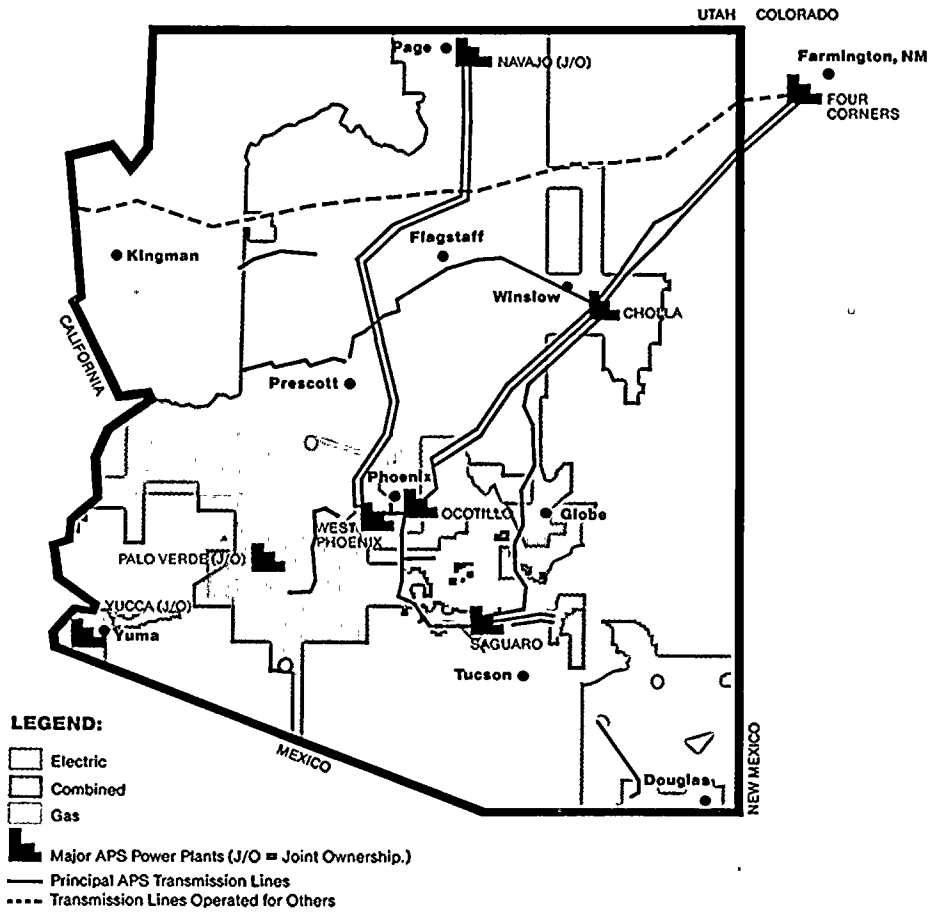
ABOUT THE COMPANY

Arizona Public Service Company is engaged principally in the generation and sale of electricity and in the purchase and sale of natural gas.

Successor to a series of small utility operations originating in 1886, the company was incorporated in 1920 under the laws of Arizona and has operated under its present name since 1952.

Serving in an area that includes all or part of 12 of Arizona's 15 counties, it is estimated that the company's electric and/or natural gas service reaches approximately 2,006,000 people, or about 70% of the state's population.

The company's principal executive offices are located at 411 North Central Avenue, Phoenix, Arizona. Phone: (602) 271-7900.



ANNUAL REPORT

This report is published to provide general information concerning the company and not in connection with any sale, offer for sale, or solicitation of an offer to buy, any securities.

ANNUAL MEETING OF STOCKHOLDERS

All stockholders are invited to attend the company's sixty-third annual meeting. It will be held at 10 a.m. Thursday, April 21, 1983 in The Grand Ballroom of the Ramada Townehouse, 100 West Clarendon, Phoenix, Arizona.

Executive offices of Arizona Public Service Company are located at 411 North Central Avenue, Phoenix, Arizona—(602) 271-7900

Shareholder contact:
Write to the Office of the Secretary, Sta. 1892, at the address below.

Mailing address:
P.O. Box 21666, Phoenix, AZ 85036

HIGHLIGHTS 1982

	1982	1981	1980
Property and Plant:			
Total utility plant, year end	$4,198,466,000	$3,688,270,000	$3,199,927,000
Capital expenditures	$ 531,997,000	$ 558,453,000	$ 504,120,000
Sales and Customers:			
Total operating revenues	$1,064,453,000	$ 882,154,000	$ 765,760,000
Total electric sales (mwh)	12,950,727	13,387,998	11,877,722
Electric customers, year end	449,244	438,853	421,803
Total gas sales (m therms)	397,394	412,846	432,277
Gas customers, year end	339,443	341,184	340,248
Income, Earnings, Dividends:			
Net income	$ 231,043,000	$ 197,434,000	$ 143,290,000
Earnings for common stock	$ 196,227,000	$ 170,648,000	$ 118,228,000
Average common shares outstanding	59,549,685	52,289,259	42,960,655
Earnings (based on average shares outstanding)	$ 3.30	$ 3.26	$ 2.75
Dividends paid per share of common stock	$ 2.40	$ 2.20	$ 2.06
Shareholders:			
Common	120,623	119,825	110,416
Preferred	9,033	6,339	6,745
Employees, year end:	7,047	6,231	5,538

COMMON STOCK PRICE RANGES

(Symbol: AZP)

1982	High	Low	Dividend Per Share
1st Quarter	$ 21½	$ 18	$ .57
2nd Quarter	22	19¼	.57
3rd Quarter	23½	19⅛	.63
4th Quarter	25⅛	21⅝	.63
1981			
1st Quarter	$ 18⅞	$ 15½	$ .53
2nd Quarter	18⅛	15⅛	.53
3rd Quarter	17⅞	16⅜	.57
4th Quarter	19⅝	16⅝	.57

O. Mark De Michele, Keith L. Turley

TO OUR SHAREHOLDERS:

We are pleased to report that, despite a difficult year for the Arizona economy, our earnings for 1982 reached $3.30 per share, up slightly from the $3.26 achieved in 1981. The actions we took to adjust to changing economic conditions, along with favorable rate decisions in 1981, resulted not only in better earnings, but improvements in a number of key financial ratios, particularly internal cash generation, which reached 18 percent of our capital expenditures, compared to 9 percent last year.

1982 was also the most successful "coal" year in our company's history, a year in which nearly 94 percent of our customers' electric needs were met with economical coal-fired generation. The details of this success can be found elsewhere in this report. Worth mentioning here is the fact that our decision made more than 20 years ago—to move from natural gas to coal, burned in large plants owned jointly with neighboring utilities—has proved to be a very sound one for our company as well as for our customers, whose monthly electric bills have reflected the resulting saving of over $1.5 billion in generation fuel costs over the past decade.

With the completion of the first of three Palo Verde Nuclear Generating Station units we'll be virtually independent of oil and natural gas as fuels for generating electric power, and our customers will be assured of abundant energy supplies produced by the most economical fuels available.

We recognize that a reasonably good financial year and efficient power plant operation are not reasons

for complacency. The fact is that we cannot expect to see an improvement in our earnings picture this year, or in the years ahead, until we begin to see Palo Verde reflected in the rate base.

While others are cutting back to adjust to the nation's economic downturn, we must continue to build; at a time when our ratepayers are already feeling the brunt of economic setbacks, we must ask for additional rate increases.

After 10 years of planning, engineering and building, the largest single investment our company has ever made to meet Arizona's energy needs—Palo Verde—must begin to earn a return. Consequently, we began a rate increase request program last August that is designed to gradually phase in our Palo Verde investment.

We recognize, of course, that a program of rate increases reflecting an investment of Palo Verde's magnitude will result in a sizable impact on our customers. But Palo Verde remains the best, most economical investment we could have made to meet Arizona's growing energy needs. Once the plant is fully incorporated into rates, our company and our customers should enter a period of long-term rate stability that will enhance our state's continued growth and prosperity.

As for the longer-term future, we recognize that expensive new power plants that might be required are by far the most significant factor in higher utility rates. This is why we are doing everything we can today to manage the growth in demand for power on our system, so that we can push the need for new generating facilities further into the future while improving our profitability.

We are also seriously examining the long-term direction of our company. As an investor-owned utility, our immediate obligation is to remain financially sound and successful; we must pursue a course of action that is best for our company and our shareholders, as well as our customers. Our program to phase Palo Verde into rates is a case in point.

To be ready for longer-term changes in our business environment, we have stepped up our strategic planning efforts. The issues we are examining are many and varied, but all are of major importance to the long-term future of the company.

For instance, we have begun to explore ways to better anticipate, program and manage our future capital expenditures so that burdensome financing requirements can be avoided while, at the same time, service requirements can be met at the lowest possible cost.

For the more immediate future, we're looking at ways to enhance revenues without increasing peak demands for power. We're tackling head-on an extremely difficult issue that is generic to the industry as a whole: whether there are new, creative ways for dealing with the problems customers on low or fixed incomes are having in paying increasing energy bills. We've already made a step forward on this issue through the establishment of a voluntary assistance program called Project S.H.A.R.E., highlighted later in this report.

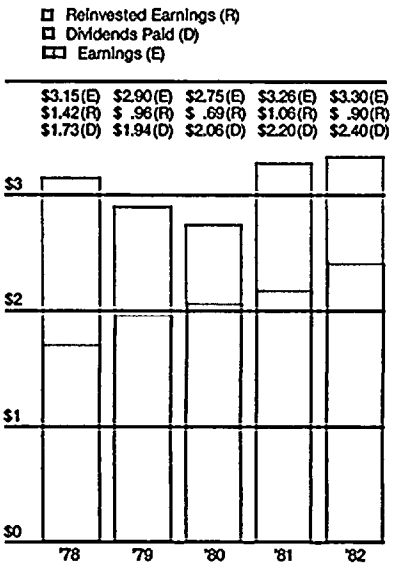
In our planning, and in our current operations, we will continue to conduct our business in a sound and profitable manner: one that is beneficial to our shareholders as well as to our customers. Our ability to maintain and improve our financial position and provide first-rate service to our customers is the direct result of a sustained effort by our employees. Their dedication and professionalism have been key to our success in the past and will continue to be mainstays of our performance in the future.

These are difficult times and solutions to the many complex problems a major utility must resolve are not easy to find. We appreciate the understanding and support you have shown in years past. We hope we will continue to earn your confidence in the challenging years ahead.

Keith L. Turley
Chairman and Chief Executive Officer

O. Mark De Michele
President and Chief Operating Officer

Earnings, Dividends, and Reinvested Earnings Per Average Share of Common Stock



THE YEAR IN REVIEW

As our nation and our state struggled with 1982's economic uncertainties, our company not only acted to adapt to the recessionary economy, but took a number of steps aimed at maintaining and strengthening the company's financial position. Our management structure was reorganized to improve efficiency; a company-wide effort to cut operating budgets for 1983 was launched; and we aggressively pursued rate case actions at both state and federal levels.

We improved our earnings in 1982, due primarily to the rate increase granted in the fall of 1981, lowered interest costs and an overall effort to control our costs and operate more efficiently. Year-end 1982 earnings were $3.30 per share, up from $3.26 per share last year.

Dividends paid per common share totaled $2.40 in 1982, up from the $2.20 paid in 1981. The current annual dividend rate is $2.52 per share and represents the seventh consecutive year in which the company has increased its dividend on common stock.

RATE ACTIVITIES

As a part of an October, 1981 rate case settlement, we agreed not to file for further general rate increases that would become effective in 1982. However, if we are to preserve our earnings position in 1983—and the financial health so important to the success of our construction program—we must have assurance of adequate rate levels in the years ahead. Thus we have asked for 1983 increases in our retail electric and natural gas rates totaling $101 million.

The essence of our electric rate filing is a request to begin including a share of the investment in the Palo Verde Nuclear Generating Station in the rate base. This will begin a process designed to phase our investment in Palo Verde into rates over a period of years. Such a program will minimize costs over the long run, avoid sudden large jumps in rates, and reduce— or eliminate—the need for rate increases later in the decade.

Testimony filed at the end of January by independent consultants to the Arizona Corporation Commission's staff supported an increase in basic rates of $62.3 million, and additional amounts, via changes in the fuel adjustment clause, which provide further incentive for economy interchange sales to other utilities.

Though the consultants recommended that a lesser amount of Palo Verde construction work in progress be included in the rate base than had been requested (from $400 million to $150 million), they did recommend additional increases in tax normalization, which would also improve the company's internal cash generation.

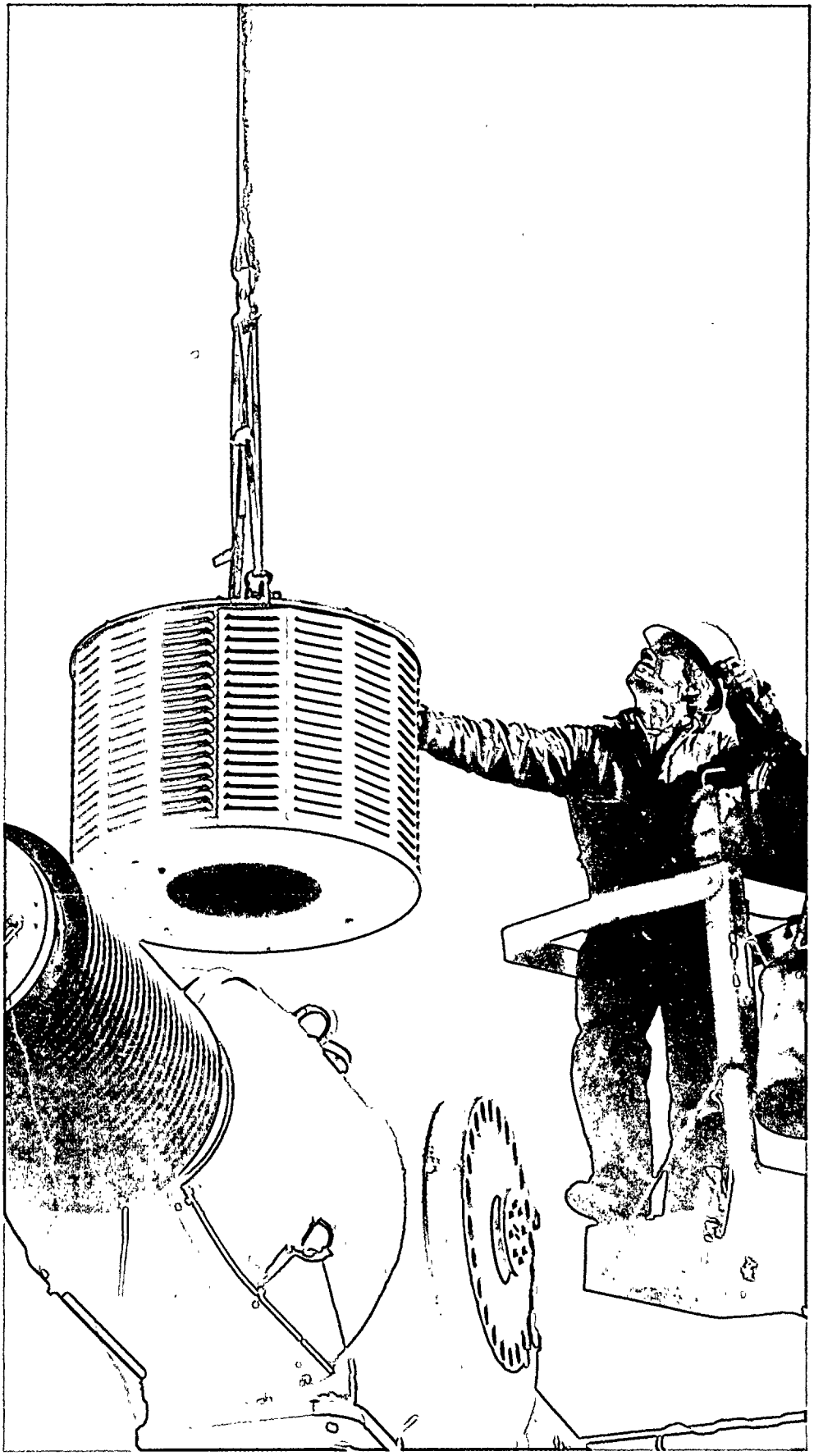
Hearings on our filing began February 22, 1983.

Last spring, the company also filed with the Federal Energy Regulatory Commission for an increase in wholesale electric rates, the first such APS case involving full normalization of income taxes. Hearings will begin this April. Meanwhile, two other cases filed prior to this one are still being considered by FERC.

Our projections indicate that, assuming favorable rulings on our pending rate cases as well as normal weather and other operating conditions, debt coverage should improve during 1983 and internal cash generation should approximate the level attained in 1982. However, it will be difficult to achieve growth in earnings until the first Palo Verde unit is in service and is earning a full return.

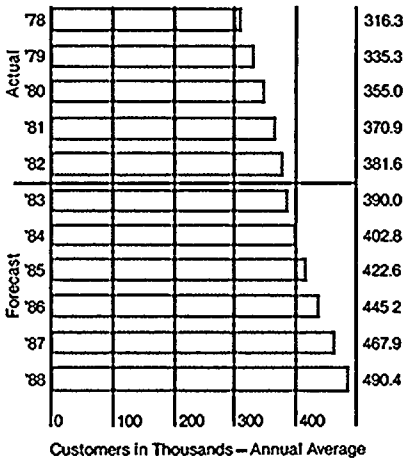
CUSTOMER GROWTH MODERATES

Though Arizona's continuing growth and unique industrial characteristics usually serve as a buffer against national economic fluctuations, the state saw its share of

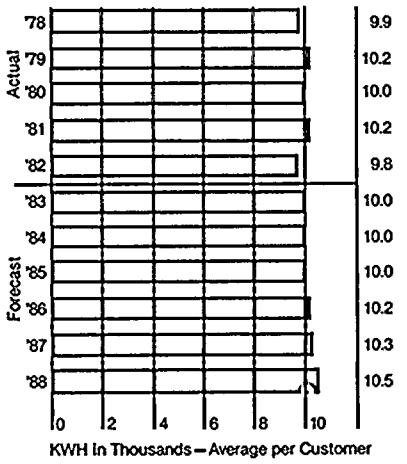


Our construction program must track the State's growth. Arizona's population has increased by 912,000 during the last 10 years and is projected to increase by almost one million in the next decade.

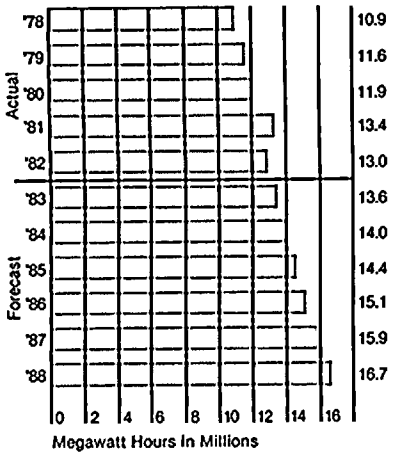
Customer Growth Expectations—Residential Electric



Customer Use Trends—Residential Electric



Total Electric Sales —



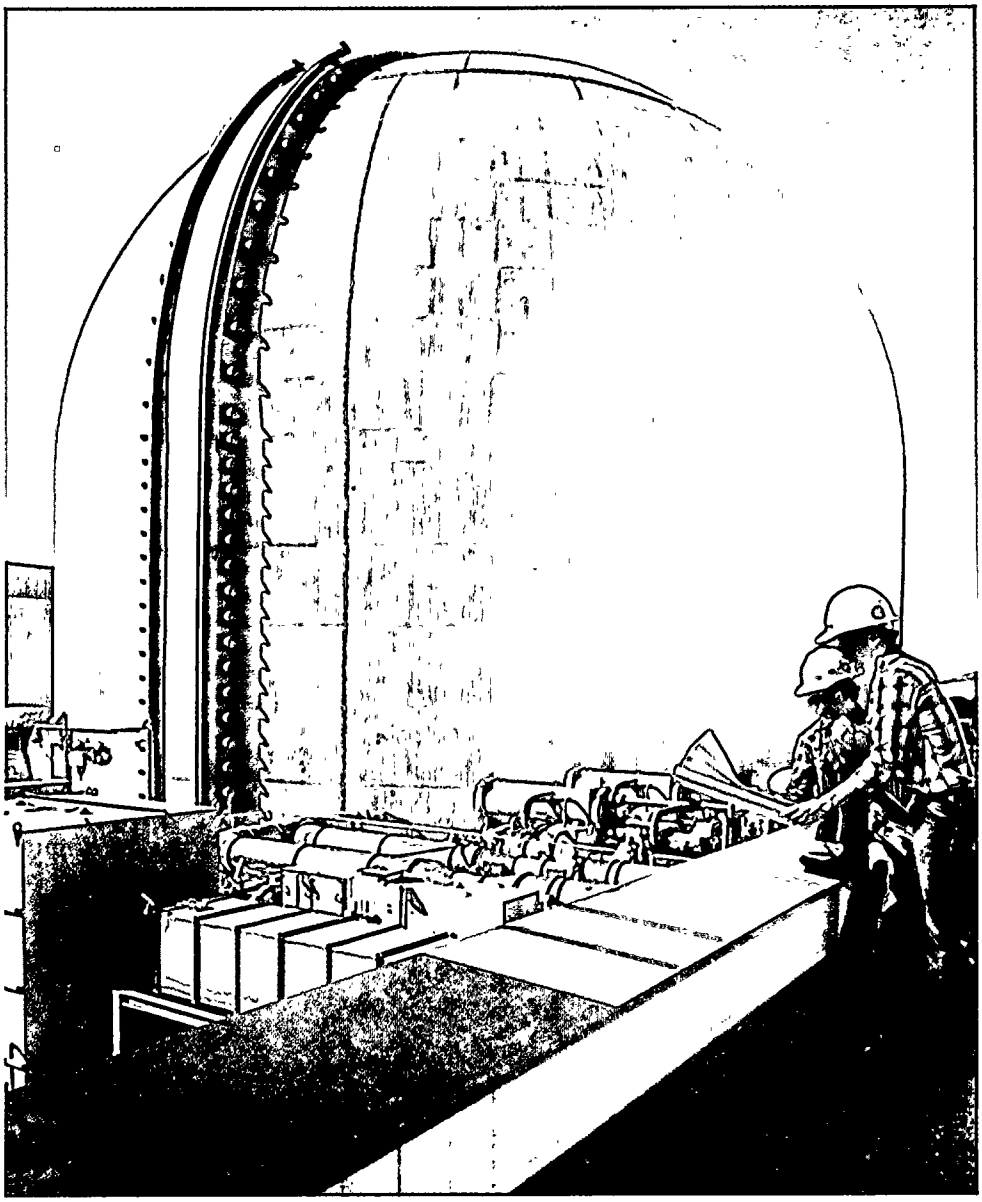
serious economic setbacks in 1982, particularly in mining and agricultural related industries. And although our earnings remained stable during 1982, Arizona's economic recession did have an impact on our operations.

Thus total electric sales—particularly industrial—decreased by a little more than three percent in 1982, to 12,951,000 megawatthours, and our system peak demand for electricity was 2,898,700 kilowatts, down four percent from the previous year. However, an upturn in new home permits which began during the last months of 1982 gives reason to believe the drop is a temporary one.

In 1982 we added 12,665 new electric customers to our system, less than a three percent gain from 1981's year-end number. Average residential electric use was 9,840 kilowatthours, down from 10,247 in 1981.

The state's economy and a warm winter also affected our natural gas operations in 1982. Sales totaled 397,394,000 therms, more than a three percent decrease from the previous year. A turn to all-electric homes, begun in the mid-1970s when gas supplies were uncertain, also contributed to the decline.

Our natural gas customers also saw higher monthly bills in 1982,



Palo Verde Unit 1 passed two major preoperational tests early in 1983. The tests—of the air-tightness and structural integrity of the unit's containment structure—were concluded ahead of schedule and results exceeded Nuclear Regulatory Commission standards.

triggered by a series of wholesale price hikes resulting from the phased deregulation of gas prices. We have intervened whenever possible at the federal level on behalf of our customers, but it's certain that the cost of gas will continue to rise in the years ahead.

BUILDING TOMORROW'S RESOURCES

While Arizona has not been immune to economic downturns, our state—unlike many areas of the country—has grown, and will continue to grow, at a rapid pace. Population grew by 46 percent during the 10 years ended in 1982, and forecasts are for a 32 percent increase over the next ten years.

Taking this growth and other key factors such as our ongoing load management and conservation programs into account, we expect that our peak electric demand will increase by an estimated four percent annually, reaching 4,315,000 megawatts by 1992.

Electric sales are expected to grow by 4.5 percent annually over the same period, reaching approximately 20 million megawatthours in 1992, compared to 13 million in 1982.

While our own generating plants are capable of producing all of our current electric needs, we make wholesale purchases or sales of electricity when such transactions will mean lower costs to our customers. Just such sales made in 1982 have resulted in customer electric bills which are about four percent lower than they were a year ago.

Our electric resources in 1982 totaled 3,532,900 kilowatts, consisting of 3,240,100 kilowatts of our own generation, plus 292,800 kilowatts of power available under purchase contracts.

Though we must have electric generation resources sufficient to supply our customers' requirements, we have adjusted our long-range schedule of plant additions to match changes in our load forecast. However, bringing into service the three Palo Verde units is key to meeting not only Arizona's but the entire Southwest's energy needs in the 80s and beyond.

To achieve this goal, our construction expenditures in 1983 will reach approximately $393 million, with the largest single portion again going to our 29.1 percent share of Palo Verde, approximately $231.5 million, including $141.1 million in direct and $56.1 million of preoperational costs, as well as $34.3 million for fuel.

By year-end 1983, however, we should see the beginning of a downward trend in construction expenditures.

We are proud of the progress we have made at Palo Verde, as well as of the fact that cost increases have been kept very low.

The first of Palo Verde's three 1,270,000-kilowatt units was 98.1 percent complete at year-end 1982. Units 2 and 3 were 94 and 52.5 percent complete, respectively.

In January of 1983 the Nuclear Regulatory Commission's Atomic Safety and Licensing Board authorized the Director of the NRC to issue an operating license for Unit 1 when its construction and testing is completed. Assuming concurrence by the NRC after its own review, this clears the way for fuel loading later this year.

We're also pleased with the way Units 2 and 3 are progressing. We anticipate that Unit 2 will be on-line within a year of Unit 1, while Unit 3 remains on schedule for 1986.

Our most recent estimates indicate the total construction cost of Palo Verde—shared by the six participants in the project—will be approximately $4.3 billion, only 55 percent above the original baseline cost estimate made in 1974, and an increase

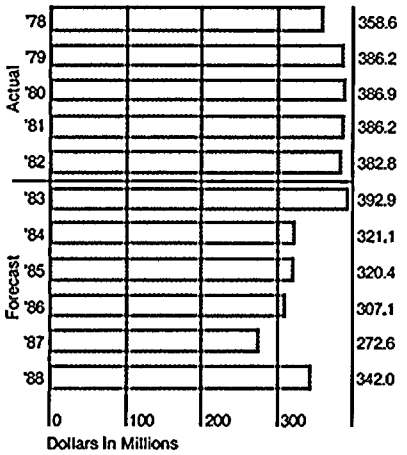
Palo Verde Ownership

Arizona Public Service Company-29.1%
Salt River Project-23.19%
Public Service Company of New Mexico-10.2%
El Paso Electric Company-15.8%
So. California Edison-15.8%
So. California Public Power Authority-5.91%

As Unit 1 goes into operation, the SRP will transfer 5.7% of its ownership in Palo Verde to the Los Angeles Department of Water and Power.

Construction Expenditures

(Excl. AFC)



Our EC-1 rate is making a difference for many customers like the Greg Canada family of Scottsdale.

EC-1 is part of our company's overall load-management effort. Under the innovative rate, customers can shave dollars from monthly utility bills by controlling peak electric demand. In turn, the rate benefits APS by lessening the need for construction of new generating units.

As the Canadas—who have installed an electronic programming device to regulate their home's electric energy use—have discovered, EC-1 has a minimal effect on their lifestyle.

which is considerably below those realized by other nuclear power plants being built within the same time frame. Our company's share of the total cost will be approximately $1.25 billion.

The installed-capacity cost of Palo Verde units is expected to be within the $1,800-1,900 per-kilowatt range, which includes the allowance for funds used during construction, property taxes, start-up and pre-operation costs, depending on the amount, if any, of construction work in progress included in the rate base. Though that is more than double the cost of the coal-fired Cholla Power Plant units completed in the late 1970s and early 1980s, independent analyses of Palo Verde economics indicate that power produced at the plant will be 30 percent cheaper than from any other alternative we might have considered in the same time frame, including coal-fired generation.

A Corporation Commission-ordered independent assessment of the company's current construction program supports the company's position that, in the long run, the construction of Palo Verde is in the best interest of our customers... and the State of Arizona.

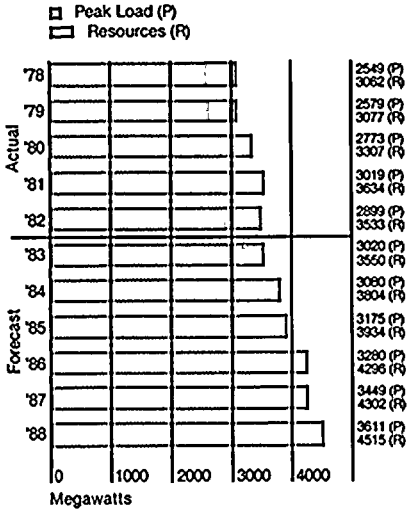
Still another independent quality assurance evaluation of Palo Verde, completed late in 1982, gave high marks to the project's organization structure and management support "which has had a very positive effect in assuring quality" and a "strong positive influence on the Palo Verde quality assurance program for design and construction." The study found "no reason to prohibit issuance" of a full power license to the plant.

AN ECONOMIC 'MIX'

More than a decade before oil prices began to skyrocket, we made a decision to begin building our reliance on coal as a primary fuel for power generation, along with nuclear power. The choice has proved to be a wise one, for us and for our customers.

Our Four Corners Power Plant, near Farmington, New Mexico, consumes an average of 19,000 tons of low-sulfur coal each day. The sub-bituminous coal is dug from a mine adjacent to the plant.

Peak Load and Electric Resources



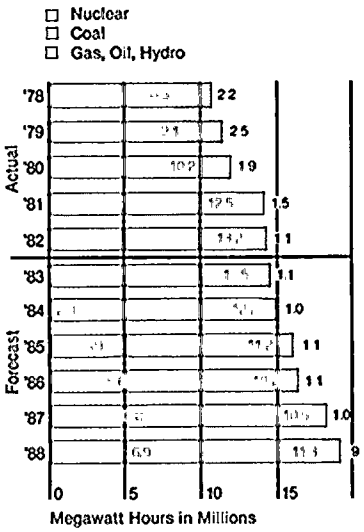
Thus, for the year 1982, we were able to meet 93.8 percent of our customers' electric needs with coal-fired generation, while just 6.2 percent was met with far more expensive gas and oil.

And recognizing the burden the addition of new generating plants in our system can have on both customers and company, we have worked hard to make our present plants operate as efficiently and as reliably as possible. Our coal-fired plants operated at a 77.9 percent capacity factor during the year, even better than the record set in 1981 and well above the industry average.

We anticipate that by 1990—even with substantial increases in our electric load—well over 90 percent of our customers' energy requirements will continue to be met with coal and nuclear fuel. By that time, all three of Palo Verde's units will be on line.

In one of several upgrading efforts at our coal-fired power plants, a new $170-million particulate-removal system at the Four Corners Power Plant was placed in commercial operation on December 31. The system is designed to collect 99.9

Generation Fuel Mix Trend



percent of the flyash from the boilers of units 4 and 5. A $285-million sulfur-dioxide removal project is slated for operation at the units at the end of 1984. Both projects, the cost of which has been shared* by the units' six owners, were constructed to bring the plant into compliance with stringent environmental standards.

FINANCING INNOVATION

At today's high construction and financing costs, the addition of new generating plants in our system can have a significant impact on both customers and company. This fact, and the nation's economic downturn and high interest rates which continued through most of 1982, made it even more important that we find alternative, lower-cost financing options for funding our construction program.

In February of 1982, we borrowed the proceeds of a $60,250,000 offering of pollution control revenue bonds for construction of sulfur dioxide removal units at the Four Corners Power Plant.

In addition to a $100-million, 10-year domestic debt issue, we turned again to foreign markets to meet our financing needs. We sold two issues of Eurodollar debentures totalling $100 million in February and, early in 1983, a third Eurodollar issue of $60 million.

With the August sale of 4 million shares of common stock at a price to the public of $22.75 per share (the first time since November of 1972 that APS stock sold above book value) and the raising of almost $25 million through the issuance of more than 1,140,000 shares under the company's dividend reinvestment plan, we improved our common equity ratio to 41.4 percent.

Additionally, in March, we issued $37 million of leveraged preferred stock; in May we sold 2 million shares of $25 par, $3.58 cumulative preferred stock; and in December we made a private placement of $10 million of adjustable rate cumulative preferred stock.

One of our major financial goals has been to strengthen capitalization ratios by reducing the debt portion of total capitalization. Debt financing (including short-term debt) now constitutes about 47 percent of total capital, with preferred and common stock making up the balance.

In December, the Arizona Corporation Commission approved our financing plans for 1983, the second consecutive year that we've received such advance approval.

The Commission okayed up to $450 million in long-term debt and up to $100 million in preferred stock. Although we do not expect to need that level of financing, advance approval gives us the flexibility to take advantage of the best interest rates and markets available.

And while the Commission also approved the sale of up to 2 million shares of common stock in 1983, we do not plan to take such action if we receive adequate rate increases during the year, and if interest rates remain at or near today's levels.

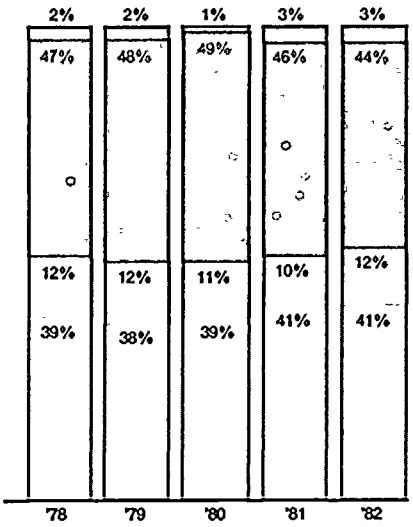
CONTROLLING OUR COSTS

In 1982, anticipating the impact of a slowing economy on our financial picture, we cut deep into overall operating expenses. The changes made—including the delay of new computer systems, reduction of overtime and other operational expenses and a number of other program cutbacks—are expected to produce savings of more than $11.3 million in 1983. About $2.5 million of the total will come from a voluntary early retirement offered to some 500 employees in 1982. Nearly 70 percent of those eligible opted for the plan.

A management and operational review of APS, completed at the order of the Arizona Corporation Commission, gave the company generally high marks, citing an

*APS' share is 15 percent

Capitalization Ratios

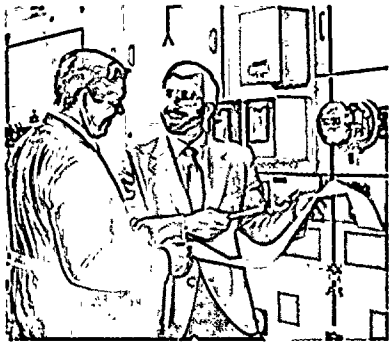


Summary of 1982 Financings

($ Millions)

	Amount	Rate	Date Issued	Maturity Date
Debt				
Eurobonds	$ 75.0	16.25%	Feb.	1989
	25.0	16.00	Feb.	1989
	60.0	11.75	Jan. 1983*	1990
Pollution Control Bonds	60.25	10.375	Feb.	1985
First Mortgage Bonds	100.0	16.00	April	1992
Preferred Stock				
Series N-Leveraged	37.0	$12.90	April	Final Maturity 2002
Series O-Public	50.0	$ 3.58	May	–
Series P-Private Placement	10.0	$12.50	Dec.	Final Maturity 1992
Common Stock		Price to Public		
4 Million Shares	91.0	$22.75	Sept.	–

*Priced in November 1982

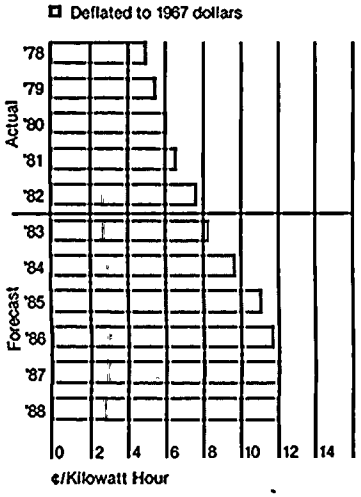


With our help, Sentry Insurance is taking steps to reduce their energy demand and, in turn, save energy dollars.

Sentry was an early participant in our Energy Demand Reduction program for large commercial and industrial customers. Based on our computer-calculated guidelines, Sentry has reduced its outdoor lighting load, increased reliance on fresh air for air conditioning, programmed start-up times of air conditioning compressors to off-peak times and shut down their use on weekends.

Sentry's efforts benefit both its company and our own.

Residential Cost per KWH



"unusually progressive" management philosophy, a cost-effective organizational structure and ongoing efforts to improve both management and operations. And though we were already aware of and working toward improving a number of the areas the audit discussed, still others, relating to expediting cash receipts, improving operating and maintenance practices and more, were identified for their efficiency-improvement potential.

Following up on the audit, our customer services organization was restructured to allow the closing of a dozen customer service offices and the partial staffing of several others.

And early this year we launched a test program of bi-monthly meter reading in two northern Arizona communities to evaluate potential cost savings and customer acceptance.

There is no question that these and other cost-cutting changes will have an impact on how we conduct our business, but we are convinced that both customers and investors are best served in these difficult times by our taking appropriate, effective action to control costs.

CHOICES AND INCENTIVES

While electric and natural gas base rates remained unchanged through 1982, the electric rate increases approved in late 1981, combined with major changes in the fuel adjustment factor, resulted in substantially higher bills for many of our customers.

To control the growth of peak electric demand—a major contributor to the higher costs which directly impact on customer rates—we continued to offer our customers ways to cut their peak electric energy use and exercise greater control over monthly bills.

One program involves offering customers a choice of alternative rate options. In addition to our EC-1 rate, which measures the peak demand for electricity as well as the total amount of energy used, two others were offered in 1982. The first is a straight time-of-use consumption rate, while the second is a rate combining both demand and time-of-use factors.

Our goal is to make available to our customers rate options through which they can control their own demands for energy and thereby help reduce seasonal peak demands on our system and the need for new generating units. The result will be a decrease in costs for both APS and its customers.

A good example of our desire to establish a partnership with our customers in this effort is our Energy Control Credit program, established in 1982. Through the program, we are paying customers specific sums—as credits on their electric bills—when they buy and install certain load-management and energy-efficient equipment. The result is a lower demand on our system and a reduction in the need for additional generating capacity.

SERVICE ASSURANCE

A three-year program to replace a specific type of polyethylene plastic natural gas service pipe installed by the company in the early 1970s was begun in July. More than two dozen contract crews are now at work in an effort to replace approximately 40,000 service lines by mid-1985.

The replacement program is one of a series of actions taken after two accidents, involving failures of gas services, prompted inspection and reevaluation of these gas distribution facilities.

Three intensive surveys made of all services where the pipe was in use turned up fewer leaks than would typically be found in a gas distribution system. But because we remain concerned about the pipe's long-term strength characteristics, all of the pipe will be replaced, at an estimated cost of $40 million. We are attempting to recover certain

Better than 97 percent of our customers whose gas lines have been replaced say work done in our Gas Service Replacement Program is either "good" or "excellent."

Mr. and Mrs. Donald Sapp recently installed a pre-cooler on their home's central air conditioning unit. In southern-Arizona's blistering summer heat, water cools the outside air flowing through the unit, allowing the air conditioner to work more efficiently.

Not only do the Sapps save summer air-conditioning dollars, but they earned a cash credit on their monthly electric bills under our Energy Control Credit program, which rewards customers, like the Donald Sapps, who help hold down the peak demand for electricity.

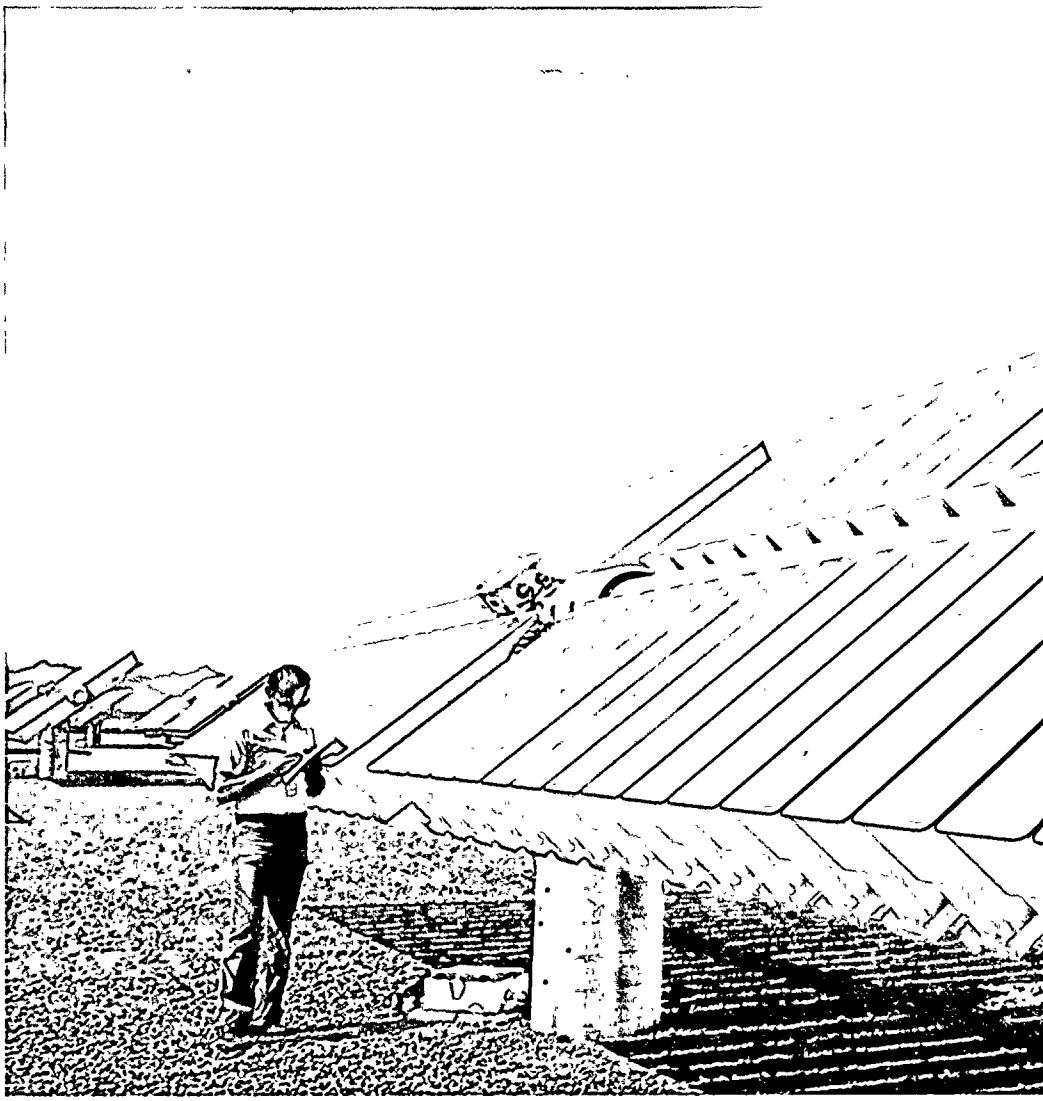
of the related costs from the various manufacturers involved in the pipe's fabrication.

RESEARCH CONTINUES

Though we are attempting to make our company's operation as lean as possible, we cannot afford to sacrifice our research into promising areas—particularly solar energy—which have real potential for helping to meet future energy requirements.

Progress continues on several major research efforts. In May, we dedicated the 225-kilowatt photovoltaic solar power plant at Sky Harbor International Airport in Phoenix. The $3.93 million facility, funded primarily by the U.S. Department of Energy, is expected to supply about 440,000 kilowatt-hours

APS and the Salt River Project co-sponsor Project S.H.A.R.E., a program administered by the Salvation Army, which makes one-time payments for needy families who qualify. Many of our customers are donating to Project S.H.A.R.E. by adding an extra $1 to their monthly bill payments. We announced the program early in 1982. By mid-December, contributions from utility employees and shareholders, matching funds from APS and SRP management and contributions from our customers totaled more than $204,500 and 1,650 families had been provided assistance. Other utilities across the country are now introducing similar programs in their own service areas.



of energy annually to our power grid system—enough to meet the annual electric needs of about 40 average-size Phoenix-area homes.

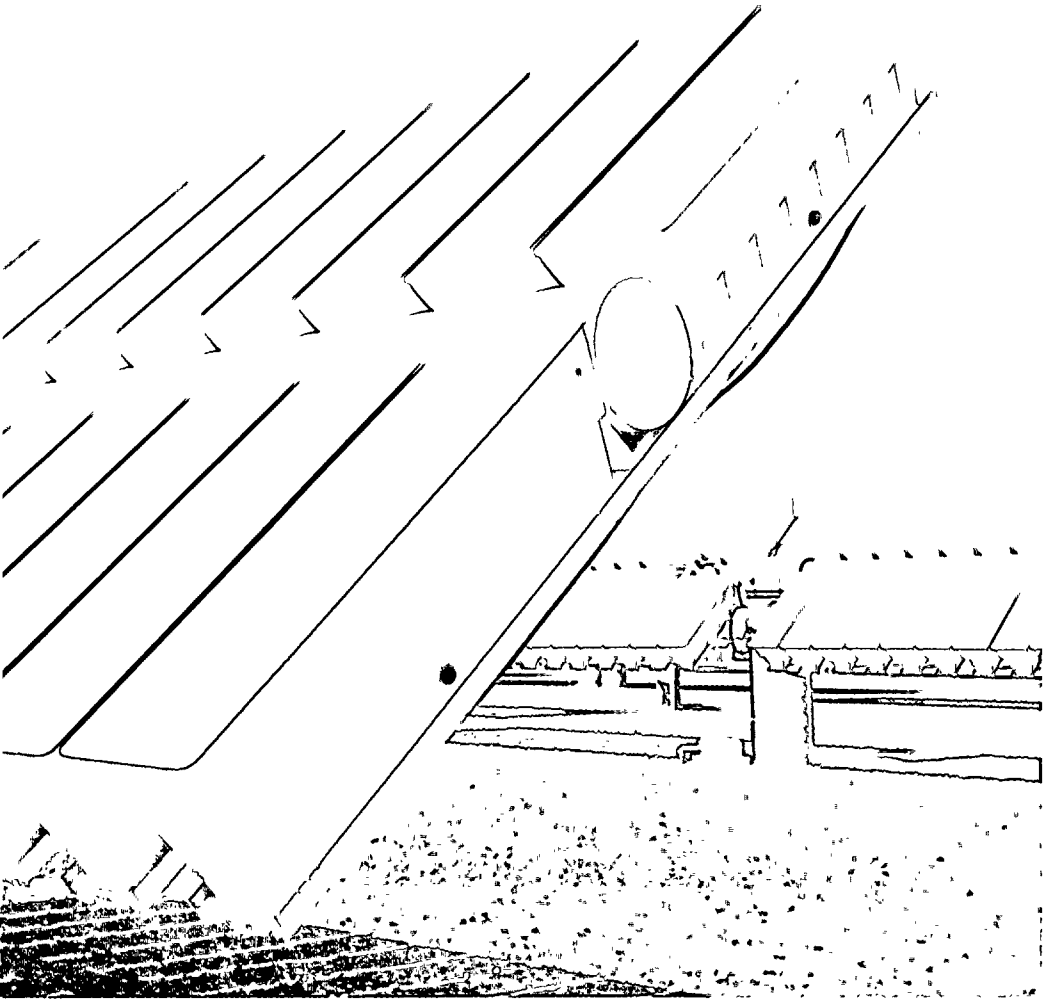
In addition, we received funding for the preliminary design of a solar project at our Saguaro Power Plant near Tucson where 60 megawatts of the plant's output will be converted from oil and gas to solar energy.

A smaller photovoltaic project of equal importance was dedicated in November at a home in Yuma. It will provide information on how such residential systems might fit into our operations.

ADAPTING TO CHANGE...

We're well aware of the impact rising costs are having on our customers. We also understand the obligation we have to keep our customers aware of the state's energy picture, especially as it may affect them today as well as in the future. During 1982 we conducted an aggressive advertising program, using both print and broadcast media, which informed our customers about what they might expect in terms of summer energy bills, how our rates compare with those charged by other electric utilities and how rate increases compare with general inflation.

Additionally, both television and print media were used to demon-

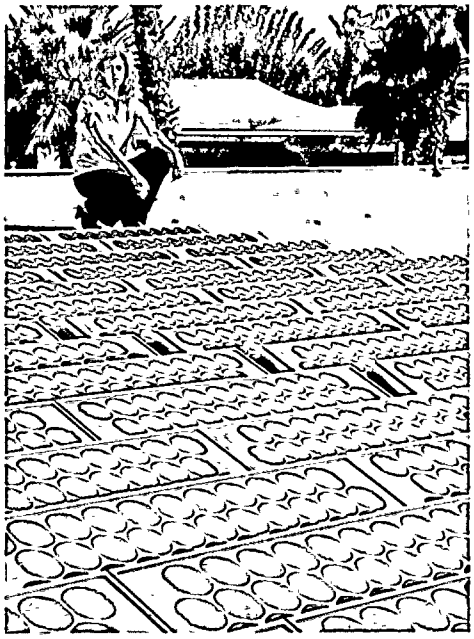


Eighty concentrator arrays gather the sun's rays and convert them to direct current electricity at our Sky Harbor Solar Project. The arrays use Fresnel lenses to concentrate the sunlight about 36 times, reducing the number of photovoltaic cells required. Photovoltaic cells are also used to generate electricity at a residential research project in Yuma.

strate the value of electricity in today's economy.

Later in the year, in conjunction with the Committee on Energy Awareness (an industry communications group), we launched a major television advertising effort aimed at maintaining and improving support for Palo Verde and gaining new support for nuclear power.

Meanwhile, we stepped up our person-to-person communication efforts as a means of explaining the company's position on a wide range of issues and eliminating misconceptions or misunderstandings about how we conduct our business.



In 1982, we proved our commitment to safety by achieving perhaps the best safety record in the history of the company and one which, according to the Edison Electric Institute, is among the best safety records of utilities nationwide.

During the first eleven months of 1982, total injuries decreased by 45 percent, while manhours worked increased by 9 percent. Medical injuries requiring a physician's attention were also down by over 50 percent.

These improvements are a result of a strong commitment by our employees and an increase in field monitoring. We look for further improvement in 1983.

...AND READYING FOR IT

The coming months will test the soundness of the financial decisions we have made and the ability of our employees to make the best of a very difficult situation that is placing a strain on every industry, nationwide.

We'll make it. Our company is healthy and our skills are many. We believe in the goals we have set and in the managers and employees who are responsible for seeing that we reach our objectives.

And we believe that, when all is said and done, we will have proved our dedication to those we serve and to those who have provided us their financial support.

SELECTED CONSOLIDATED FINANCIAL DATA

	1982	1981	1980	1979	1978
	(Thousands of Dollars, Except Common Stock Data)				
Operating Revenues	$1,064,453	$ 882,154	$ 765,760	$ 664,423	$ 562,217
Operating Expenses:					
Operation and maintenance	522,229	445,111	432,886	371,983	291,908
Depreciation and amortization	85,285	76,178	64,412	57,021	48,295
Taxes*	186,438	109,947	98,886	84,549	83,314
Total	793,952	631,236	596,184	513,553	423,517
Operating income	270,501	250,918	169,576	150,870	138,700
Other income*	83,335	58,748	43,341	26,760	14,914
Interest Deductions—Net	122,793	112,232	69,627	56,052	46,855
Net Income	231,043	197,434	143,290	121,578	106,759
Preferred Dividend Requirements	34,816	26,786	25,062	21,882	17,471
Earnings for Common Stock	$ 196,227	$ 170,648	$ 118,228	$ 99,696	$ 89,288
Total Assets	$3,888,536	$3,396,790	$2,928,484	$2,475,332	$2,039,420
Long-term Obligations and Redeemable Preferred Stock	$1,610,486	$1,618,048	$1,455,286	$1,180,120	$ 991,173
Common Stock Data:					
Book value per share	$ 22.94	$ 22.13	$ 21.97	$ 22.75	$ 22.56
Earnings per share (based on average shares outstanding)	$ 3.30	$ 3.26	$ 2.75	$ 2.90	$ 3.15
Dividends declared per share	$ 2.40	$ 2.20	$ 2.06	$ 1.94	$ 1.73
Shares of common					
—year end	62,894,490	57,648,791	47,813,847	38,181,297	32,777,258
—average	59,549,685	52,289,259	42,960,655	34,426,346	28,363,223
Number of common shareholders	120,623**	119,825	110,416	92,396	78,275

*Federal and State income taxes are included in Taxes and Other Income.
Total income tax expense was as follows (in thousands): 1982, $92,102; 1981, $19,638; 1980, $16,519; 1979, $14,422; 1978, $13,937.

**As of February 28, 1983.

OTHER FINANCIAL AND OPERATING STATISTICS

	1982	1981	1980	1979	1978
			(Thousands of Dollars)		
Capitalization:					
Common equity	$1,442,639	$1,275,623	$1,050,651	$ 868,658	$ 739,349
Non-redeemable preferred stock	168,561	118,561	118,561	118,561	118,561
Redeemable preferred stock	241,220	199,280	185,280	156,000	100,000
Long-term debt	1,369,266	1,418,768	1,048,500	828,464	763,450
Project financing liability	—	—	221,506	195,656	127,723
Total	$3,221,686	$3,012,232	$2,624,498	$2,167,339	$1,849,083
Utility Plant—Gross	$4,198,466	$3,688,270	$3,199,927	$2,735,073	$2,288,604
Utility Plant—Net	$3,551,949	$3,111,773	$2,694,408	$2,292,341	$1,901,044
Number of Employees at Year End	7,047	6,231	5,538	5,263	4,951
Average Wage per Hour	$ 12.27	$ 11.20	$ 10.12	$ 9.20	$ 8.57
Electric:					
Electric resources (kw)	3,532,900	3,634,300	3,307,200	3,077,200	3,061,600
Peak load (kw)	2,898,700	3,018,700	2,772,700	2,579,300	2,548,900
Electric sales—total (mwh)	12,950,727	13,387,998	11,877,722	11,584,898	10,912,704
Number of customers at year end	449,244	438,853	421,803	401,983	378,553
Gas:					
Total gas sales (m therms)	397,394	412,846	432,277	467,088	449,451
Number of customers at year end	339,443	341,184	340,248	340,343	339,803

BUSINESS SEGMENTS

Operating revenues, and operating income before income taxes, attributable to electric and gas operations of the company for each of the five years in the period ended December 31, 1982 were as follows:

	Operating Revenues (Millions of Dollars)				Operating Income Before Income Taxes (Millions of Dollars)			
	Electric		Gas		Electric		Gas	
Year Ended December 31,	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
1982	$866.5	81.4	$198.0	18.6	$353.3	98.2	$ 6.4	1.8
1981	730.8	82.8	151.4	17.2	272.3	99.6	1.0	0.4
1980	621.9	81.2	143.9	18.8	180.5	96.6	6.3	3.4
1979	533.2	80.3	131.2	19.7	151.5	92.2	12.9	7.8
1978	452.4	80.5	109.8	19.5	141.0	92.4	11.6	7.6

See note 12 of Notes to Consolidated Financial Statements.

OPERATING REVENUES

	1982	1981	1980	1979	1978
	(Thousands of Dollars)				
Electric:					
Residential	$ 294,498	$ 252,907	$ 220,920	$ 191,066	$ 158,383
Commercial	286,262	238,975	210,226	179,534	155,669
Industrial	128,464	113,736	95,644	86,563	72,677
Irrigation	23,391	22,916	19,215	14,193	12,252
Other	92,490	81,565	59,391	50,402	41,716
Total	825,105	710,099	605,396	521,758	440,697
Transmission for others	11,104	9,173	8,817	8,731	9,021
Miscellaneous services	30,277	11,516	7,651	2,696	2,713
Total Electric Operating Revenue	866,486	730,788	621,864	533,185	452,431
Gas:					
Residential	94,171	66,469	65,470	64,123	53,879
Commercial	50,342	34,307	31,727	29,371	24,223
Industrial	35,461	30,858	27,145	22,128	17,646
Irrigation	14,716	17,274	17,218	13,400	11,969
Other	2,272	1,653	1,510	1,324	1,169
Miscellaneous services	1,005	805	826	892	900
Total Gas Operating Revenue	197,967	151,366	143,896	131,238	109,786
Total Operating Revenues	$1,064,453	$ 882,154	$ 765,760	$ 664,423	$ 562,217

MANAGEMENT'S DISCUSSION OF FINANCIAL CONSIDERATIONS

Liquidity and Capital Resources

The company needs large amounts of capital for its on-going construction program and for the refunding of maturing securities and is heavily reliant on external financing to meet these requirements as indicated earlier in this Annual Report and in Notes 3, 4 and 5 to the Consolidated Financial Statements. The company has a certain degree of flexibility in adjusting its construction program to its financing capability. However, that flexibility is limited, and the company's long-term liquidity will depend on its access to the capital markets, which in turn will depend on sufficiency of the company's rates to provide adequate coverages on its senior securities and an adequate rate of return on its common stock equity. Adequate earnings and coverages are critical to the maintenance of credit ratings on the company's senior securities and, as calculated in accordance with the governing instruments, are prerequisite to the company's legal ability to issue such securities.

See page 18 with respect to the company's historical capital structure. Its target structure consists of no more than 50% debt (including current maturities and short-term obligations) and 40% common stock equity, with the balance consisting of preferred stock. The company regards common stock equity as its most expensive form of permanent financing, but it intends to maintain that category at approximately the 40% level in order to support the credit ratings on its senior securities. It appears to the company that purchasers of new issues of long-term debt and preferred stock will continue to demand relatively high interest and dividend rates for some time to come, and that its embedded cost of capital will therefore continue to rise rapidly as maturing securities, bearing relatively low rates, are refunded and the company's plant expands.

See Note 6 to the Consolidated Financial Statements with respect to short-term borrowings available to the company (there being a statutory limitation on the amount of such borrowings that can be outstanding without an order from the Arizona Corporation Commission). Funds from operations have contributed only marginally to total sources of funds in the last few years (see page 23). That situation is expected to continue in some degree until Palo Verde Unit 1 is included in rate base so as to give rise to cash earnings rather than the non-cash allowance for funds used during construction (AFC). The company's retention of funds from operations has also been affected by the company's policy of increasing common stock dividends periodically.

Operating Results

Total operating revenues reflect effects of rate increases and adjustment clauses (see Note 1(d) to the Consolidated Financial Statements) on prices of units sold. Operating revenues also reflect the volume changes in unit sales shown on page 18. The foregoing factors contributed to annual increases (decreases) in revenues over revenues for the preceding calendar year as follows:

	1982	1981	1980
	(Thousands of Dollars)		
Electric:			
Volume increases (decreases) (1)	$ (20,125)	$ 69,509	$ 13,477
Price increases (2)	155,823	39,415	75,202
Net increase	$135,698	$108,924	$ 88,679
Gas:			
Volume increases (decreases) (1)	$ (4,342)	$ (5,460)	$ (9,781)
Price increases (2)	50,943	12,930	22,439
Net increase	$ 46,601	$ 7,470	$ 12,658

(1) Derived by multiplying year-to-year increases in units sold by the weighted average of rate levels in effect during 1979.

(2) Year-to-year increases in revenues less the amounts shown for volume increases. Relative contributions by rate increases and by effects of the adjustment clauses vary according to the timing of general rate proceedings and the extent to which accumulated effects of the adjustment clauses are incorporated in new rates.

The decline in electric sales in 1982 was primarily due to a general slowdown in the economy as well as more normal temperatures in 1982 than had prevailed in the previous two years (particularly in 1981). The impact of adverse economic conditions on 1982 sales was particularly evident in the industrial and irrigation classes. Unit sales of electricity in 1980 were depressed by effects of a copper industry labor strike. Conservation efforts by customers in response to higher energy costs have affected unit sales, are expected to continue to do so, and are being aided by the Company's own load management program. Unit sales of gas were affected substantially by weather and, in 1982, economic conditions.

Increases in fuel expenses reflect increases in the unit cost of fuel for generation and resale gas, as well as volume of unit sales. Additional fuel cost increases resulted in 1981 and 1982 from increased generation for sale to other utilities. Although unit fuel costs continued to rise in 1981 and 1982, increases in the Company's cost of fuel per kilowatt hour generated have been mitigated by a favorable change in fuel mix resulting from the startup of coal-fired Cholla Units 3 and 4 in May 1980 and June 1981, respectively, and improved capacity factors at the Company's coal-fired plants. Any increased prices of gas (whether for boiler fuel or for resale) or fuel oil that may result from price deregulation would accelerate upward cost trends.

Variations in purchased power and interchange—net reflect varying degrees of availability of relatively low-priced power from other sources, the needs of the Company to augment its own generating sources from time to time and the Company's ability to sell energy to neighboring utilities. However, the substantial balance of this account in 1980 and 1982 was due instead to the accounting treatment for over-recovered fuel and purchased power expense which is discussed in Note 1(d) to the Consolidated Financial Statements. The marked decrease in 1981 resulted from the reversal of this treatment as well as from large interchange sales to other utilities.

See "Effects of Inflation" below in regard to maintenance expense, which is also a function of the size of the Company's utility plant and is affected by the timing of major overhauls (as most notably occurred in 1981) and by other factors (including, in 1981, the reserving of an amount for the gas line inspection program and, in 1981 and subsequently, an intensive maintenance program designed to achieve a more favorable fuel mix). Other operating expenses, excluding fuel expenses, and the "other" portion of other income (deductions) include amortization or write-off of certain assets in 1981 in an aggregate amount of $10,349,000.

Depreciation and amortization expenses increase with the size of the Company's utility plant, as do ad valorem taxes which are also affected by growth in the Company's operating income as used by the taxing authorities in computing assessed valuation. See Note 11 to the Consolidated Financial Statements for both ad valorem and sales taxes (the latter being a function of operating revenues), which are the principal components of other taxes.

Income taxes increased in 1982 as a result of the Company's compliance with an Arizona Corporation Commission order requiring the Company to defer amounts equal to the reduction in federal income taxes arising from investment tax credits and to amortize such amounts over the estimated life of the related assets (see Note 1(f) to the Consolidated Financial Statements).

The aggregate amount of the AFC, shown as other income and as a credit to interest deductions, is primarily a function of the amount of construction work in progress during any given period. See Note 1(e) to the Consolidated Financial Statements for increased rates of AFC and cessation of its accrual on those portions of construction work in progress that are included in rate base. See "Liquidity and Capital Resources" above with respect to the non-cash aspect of AFC.

The substantial increase in interest on long-term debt and project financing in recent years reflects large amounts of new borrowings at relatively high interest rates (see "Liquidity and Capital Resources" above and Note 5 to the Consolidated Financial Statements). The increase in interest on short-term borrowings has resulted primarily from increased borrowings and, in 1980 and 1981, increased interest rates (see Note 6 to the Consolidated Financial Statements).

Consolidated net income and earnings for common stock represent composites of cash and non-cash items (see the Consolidated Statements of Changes in Financial Position) and, in part, reflect accounting practices unique to regulated public utilities (see Note 1 to the Consolidated Financial Statements).

Effects of Inflation

In contrast to the analysis of increases in operating revenues in the table at the beginning of "Operating Results" above, it is sometimes difficult, in the case of operation and maintenance expenses, to distinguish between effects of volume increases and rises in unit costs (which, for purposes of this discussion, are all attributed to inflationary pressures).

Certain inflationary effects, such as those on costs of generating fuel, are passed through to customers pursuant to the rate adjustment procedures summarized in Note 1(d) to the Consolidated Financial Statements. Nevertheless, the Company attempts to minimize such effects by means that include increasing the availability of its coal-fired units to result in a more economical fuel mix; that increase has been achieved by an intensive maintenance program, the cost of which is not covered by the adjustment clauses. There are a number of other major expense items that are also beyond the scope of the adjustment clauses. Inflationary pressures on these items have given rise to a significant earnings attrition between general rate increases.

See Note 14 to the Consolidated Financial Statements for perspectives of other effects of inflation.

ACCOUNTANTS' OPINION

Arizona Public Service Company:

We have examined the consolidated balance sheets of Arizona Public Service Company and its subsidiaries as of December 31, 1982 and 1981 and the related consolidated statements of income, retained earnings and changes in financial position for each of the three years in the period ended December 31, 1982. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such consolidated financial statements present fairly the financial position of Arizona Public Service Company and its subsidiaries at December 31, 1982 and 1981 and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1982, in conformity with generally accepted accounting principles applied on a consistent basis.

DELOITTE HASKINS & SELLS

Phoenix, Arizona
February 22, 1983

CONSOLIDATED STATEMENTS OF INCOME

For Each of the Three Years in the Period Ended December 31, 1982

	1982	1981	1980
	(Thousands of Dollars)		
Operating Revenues:			
Electric	$ 866,486	$ 730,788	$ 621,864
Gas	197,967	151,366	143,896
Total	1,064,453	882,154	765,760
Fuel Expenses:			
Fuel for electric generation	177,095	168,227	133,557
Purchased power and interchange—net	27,358	(823)	65,292
Purchased gas for resale	135,715	101,310	96,695
Total	340,168	268,714	295,544
Operating Revenue Less Fuel Expenses	724,285	613,440	470,216
Other Operating Expenses:			
Operations excluding fuel expenses	114,844	105,237	85,777
Maintenance	67,217	71,160	51,565
Depreciation and amortization	85,285	76,178	64,412
Income taxes (Note 8)	89,250	22,381	17,209
Other taxes (Note 11)	97,188	87,566	81,677
Total	453,784	362,522	300,640
Operating Income	270,501	250,918	169,576
Other Income (Deductions):			
Allowance for equity funds used during construction	80,141	57,421	39,076
Income taxes (Note 8)	(2,852)	2,743	690
Other—net	6,046	(1,416)	3,575
Total	83,335	58,748	43,341
Income Before Interest Deductions	353,836	309,666	212,917
Interest Deductions:			
Interest on long-term debt and project financing	165,931	155,086	118,403
Interest on short-term borrowings	14,917	11,853	8,624
Debt discount, premium and expense	2,265	1,169	710
Allowance for borrowed funds used during construction—credit	(60,320)	(55,876)	(58,110)
Total	122,793	112,232	69,627
Net Income	231,043	197,434	143,290
Preferred Stock Dividend Requirements	34,816	26,786	25,062
Earnings for Common Stock	$ 196,227	$ 170,648	$ 118,228
Average Common Shares Outstanding	59,549,685	52,289,259	42,960,655
Per Share of Common Stock:			
Earnings (based on average shares outstanding)	$3.30	$3.26	$2.75
Dividends declared	$2.40	$2.20	$2.06

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

For Each of the Three Years in the Period Ended December 31, 1982

	1982	1981	1980
		(Thousands of Dollars)	
Source of Funds:			
Funds from operations:			
Net income	$ 231,043	$ 197,434	$ 143,290
Principal non-fund charges (credits) to income:			
Depreciation and amortization	85,285	76,178	64,412
Allowance for equity funds used during construction	(80,141)	(57,421)	(39,076)
Deferred income taxes—net	23,651	4,718	5,651
Deferred investment tax credit—net	52,158	—	—
Other	(3,955)	4,374	2,241
Total funds from operations	308,041	225,283	176,518
Funds from external sources:			
Common stock	115,707	169,017	152,332
Preferred stock	94,843	19,500	48,000
Long-term debt	298,278	426,687	223,905
Project financing liability	—	15,000	70,851
Short-term borrowings—net	1,616	55,000	(21,000)
Sale of tax benefits	—	50,625	—
Other—net	(3,080)	25,660	6,557
Total funds from external sources	507,364	761,489	480,645
Total source of funds	$ 815,405	$ 986,772	$ 657,163
Application of Funds:			
Capital expenditures	$ 531,997	$ 558,453	$ 504,120
Allowance for equity funds used during construction	(80,141)	(57,421)	(39,076)
Funds used for capital expenditures	451,856	501,032	465,044
Repayment and assumption of project financing liability	—	281,507	—
Investments and other assets	15,277	—	—
Repayment of long-term debt	174,085	51,987	86,639
Redemption of redeemable preferred stock	5,060	5,500	18,720
Dividends on preferred and common stock	176,953	141,123	113,170
Increase (Decrease) in working capital*	(7,826)	5,623	(26,410)
Total application of funds	$ 815,405	$ 986,772	$ 657,163
Increase (Decrease) in Working Capital*:			
Cash and temporary cash investments	$ 1,098	$ 1,035	$ 781
Accounts receivable	16,160	16,623	9,408
Materials, supplies and fuel	6,662	(1,652)	9,214
Deferred fuel costs and other	4,400	2,631	(3,186)
Accounts payable and accrued expenses	(16,241)	(24,163)	(8,124)
Deferred fuel and other liabilities	(19,905)	11,149	(34,503)
Net increase (decrease)	$ (7,826)	$ 5,623	$ (26,410)

*Excluding short-term borrowings—net and current maturities of long-term debt and project financing liability.

See Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

December 31, 1982 and 1981

Assets	1982	1981
Utility Plant (Notes 4 and 7):	(Thousands of Dollars)	
Plant in service:		
Electric	$2,402,640	$2,261,437
Gas	151,411	138,333
Common, used in all services	85,131	74,991
Total	2,639,182	2,474,761
Less accumulated depreciation and amortization	646,517	576,497
Plant in service—net	1,992,665	1,898,264
Construction work in progress (Note 5)	1,539,453	1,195,075
Plant held for future use	19,831	18,434
Utility plant—net	3,551,949	3,111,773
Investments and Other Assets:		
Investments in and receivables from subsidiaries	30,269	21,889
Time deposits designated for capital expenditures	49,516	42,491
Other investments and notes receivable	5,750	5,878
Total investments and other assets	85,535	70,258
Current Assets:		
Cash (Note 6)	7,930	6,824
Special deposits and working funds (Note 6)	3,877	3,885
Accounts receivable:		
Service customers	80,030	76,701
Other	29,596	16,682
Allowance for doubtful accounts	(2,005)	(1,922)
Materials and supplies (at average cost)	39,937	39,484
Fuel (at average cost)	37,348	31,139
Deferred fuel costs and other	13,202	8,802
Total current assets	209,915	181,595
Deferred Debits:		
Unamortized gas exploration cost	16,497	18,539
Unamortized debt issue costs	11,836	8,952
Other	12,804	5,673
Total deferred debits	41,137	33,164
Total	$3,888,536	$3,396,790

Liabilities	1982	1981
	(Thousands of Dollars)	
Capitalization (Notes 2, 3, 4 and 5):		
Common stock	$ 157,236	$ 144,122
Premiums and expenses—net	883,680	783,868
Retained earnings	401,723	347,633
Common stock equity	1,442,639	1,275,623
Non-redeemable preferred stock	168,561	118,561
Redeemable preferred stock	241,220	199,280
Long-term debt less current maturities	1,369,266	1,418,768
Total capitalization	3,221,686	3,012,232
Current Liabilities:		
Notes payable to banks (Note 6)	49,516	88,000
Commercial paper (Note 6)	40,100	—
Current maturities of long-term debt (Note 4)	171,153	4,062
Accounts payable	76,604	76,588
Accrued taxes	55,974	51,188
Accrued interest	50,559	40,177
Accrued dividends	3,327	2,270
Deferred fuel and other	53,344	33,439
Total current liabilities	500,577	295,724
Deferred Credits and Other:		
Unamortized credit related to sale of tax benefits (Note 8)	48,708	50,395
Deferred income taxes	41,585	17,934
Deferred investment tax credit	52,158	—
Customers' advances for construction	14,619	13,414
Other	9,203	7,091
Total deferred credits and other	166,273	88,834
Commitments and Contingencies (Note 10)		
Total	$3,888,536	$3,396,790

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

For Each of the Three Years in the Period Ended December 31, 1982

	1982	1981	1980
		(Thousands of Dollars)	
Retained earnings at beginning of year	$ 347,633	$ 291,322	$ 261,202
Add—Net income	231,043	197,434	143,290
Total	578,676	488,756	404,492
Deduct—Dividends:			
Common stock (Notes 2, 3, 4 and 5)	142,137	114,337	88,108
Preferred stock (see below)	34,816	26,786	25,062
Total	176,953	141,123	113,170
Retained earnings at end of year	$ 401,723	$ 347,633	$ 291,322
Dividends on preferred stock:			
$1.10 preferred	$ 172	$ 172	$ 172
$2.50 preferred	258	258	258
$2.36 preferred	94	94	94
$4.35 preferred	326	326	326
Serial preferred:			
$2.40 Series A	576	576	576
$2.625 Series C	630	630	630
$2.275 Series D	455	455	455
$3.25 Series E	1,040	1,040	1,040
$8.50 Series F	61	201	614
$8.50 Series G	561	622	683
$10 Series H	3,467	3,627	3,787
$10.70 Series I	2,956	3,116	3,210
$8.32 Series J	4,160	4,160	4,160
$8.80 Series K	5,280	5,280	5,280
$9.70 Series L	4,656	4,656	3,777
$11.95 Series M	2,330	1,573	—
$12.90 Series N	3,235	—	—
$3.58 Series O	4,455	—	—
Adjustable Rate Series P	104	—	—
Total	$ 34,816	$ 26,786	$ 25,062

See Consolidated Statements of Income for dividends per share of common stock.

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies.

a. System of accounts—The accounting records of Arizona Public Service Company (the "Company") are maintained in accordance with the uniform system of accounts prescribed by the Federal Energy Regulatory Commission ("FERC").

b. Consolidation—The consolidated financial statements include the accounts of the Company and those of two of its wholly-owned subsidiaries, APS Finance Company, N.V. ("Finance"), organized to serve as a financing corporation to raise funds outside the United States of America and APS Fuels Company, organized to manage investments in certain fuel resources. All significant intercompany balances and transactions have been eliminated. The investments in other subsidiaries (primarily in unrelated businesses) are carried on the equity basis.

c. Plant and depreciation—Property is stated at original cost as defined for regulatory purposes. The cost of additions to utility plant and replacements of retirement units is capitalized. Replacements of minor items of property are charged to expense as incurred. In addition to direct costs, capitalized items include the present value of certain future lease payments (see Note 4), research and development expenditures pertaining to construction projects, indirect charges for engineering, supervision, transportation and similar costs, and an allowance for funds used during construction. Costs of depreciable units of plant retired are eliminated from plant accounts and such costs plus removal expenses less salvage are charged to accumulated depreciation.

Depreciation is provided on a straight-line basis at rates authorized by the Arizona Corporation Commission ("ACC") annually. The applicable rates have ranged from 3.07% to 4.16% for electric plant and 2.86% to 12.50% for common

and general plant, and remained at 3.49% for gas plant.

d. Revenues and fuel costs—Operating revenues are recognized when billed on a monthly cycle billing basis. Retail rate schedules include adjustment clauses which permit recovery of costs of certain fuel, purchased power and purchased gas for resale. Temporary net under- or over-recoveries of costs resulting from application of the adjustment clauses are recognized as a deferred fuel asset or liability, respectively, with an offsetting amount recognized in purchased power and interchange—net expense. Regulatory hearings are held periodically to adjust the rates applicable under fuel adjustment clauses to more nearly match actual fuel costs.

Other procedures apply to the recovery of fuel costs to wholesale customers and of specified taxes. The estimated cost of purchased gas for resale not billed to gas customers is deferred and matched with revenues in the period billed.

e. Allowance for funds used during construction—In accordance with the regulatory accounting practice prescribed by the FERC and the ACC, the Company capitalizes an allowance for the cost of funds used to finance its construction program ("AFC"). AFC, which does not represent current cash earnings, is defined as the net cost during the period of construction of borrowed funds used for construction, and a reasonable rate of return on equity funds so used. The calculated amount is capitalized as a part of the cost of utility plant.

AFC has been calculated using composite rates of 13.25% in 1982, 12.25% in 1981, and 11%in 1980, except for AFC related to project financing which was computed at the actual rate thereon. AFC ceases to accrue on those portions of construction work in progress allowed in rate base.

f. Income taxes—The Company uses accelerated depreciation methods for income tax purposes. As prescribed by the ACC, deferred income taxes are provided for certain timing differences arising from the recording, for income tax and financial reporting purposes, of depreciation of property placed in service after January 1, 1977. Income tax reductions arising from timing differences respecting certain other items of income and expense are reflected currently in income.

In 1982 the Company, in compliance with an ACC order, began deferring amounts equal to the reduction in federal income taxes arising from investment tax credits and amortizing these amounts over the estimated life of the related assets. Before 1982 such amounts were flowed through income currently. Investment tax credits previously recognized as a reduction of deferred income taxes (see Note 8) are being recovered over a twelve-year period.

g. Research and development costs—The Company expenses research and development costs on a current basis, except that costs which may result in utility plant are deferred for subsequent inclusion in plant or to be written off if the applicable project is abandoned.

h. Gas exploration costs—The excess of costs over sales proceeds of the Company's discontinued gas exploration program has been deferred to be recovered, without interest, from certain classes of the Company's customers and is being amortized over a ten-year period pursuant to an order of the ACC.

2. Common and Non-Redeemable Preferred Stock.

The balances at December 31, 1982 and 1981 of common stock, and of preferred stock which is not redeemable except pursuant to call by the Company at its option, are shown below.

	Number of Shares			Par Value			
		Outstanding at December 31,			Outstanding at December 31,		Call Price Per Share(b)
	Authorized	1982	1981	Per Share	1982	1981	
					(Thousands of Dollars)		
Common Stock	100,000,000	62,894,490	57,648,791	$ 2.50	$ 157,236	$ 144,122	—
Non-Redeemable Preferred Stock (cumulative)							
$1.10 preferred	160,000	155,945	155,945	$ 25.00	$ 3,898	$ 3,898	$ 27.50
$2.50 preferred	105,000	103,254	103,254	50.00	5,163	5,163	51.00
$2.36 preferred	120,000	40,000	40,000	50.00	2,000	2,000	51.00
$4.35 preferred	150,000	75,000	75,000	100.00	7,500	7,500	102.00
Serial preferred	1,000,000						
$2.40 Series A		240,000	240,000	50.00	12,000	12,000	50.50
$2.625 Series C		240,000	240,000	50.00	12,000	12,000	51.00
$2.275 Series D		200,000	200,000	50.00	10,000	10,000	50.50
$3.25 Series E		320,000	320,000	50.00	16,000	16,000	(c)
Serial preferred	4,000,000(a)						
$8.32 Series J		500,000	500,000	100.00	50,000	50,000	(d)
Serial preferred	10,000,000						
$3.58 Series O		2,000,000	—	25.00	50,000	—	(e)
Total		3,874,199	1,874,199		$ 168,561	$ 118,561	

(a) This authorization also covers the outstanding redeemable preferred shares shown in Note 3.
(b) In each case plus accrued dividends.
(c) At $51.50 through February 28, 1983; thereafter at $51.00.
(d) At $105.50 through August 31, 1987; at $103.00 through August 31, 1992; and at $101.00 thereafter.
(e) Not redeemable prior to June 1, 1987 through certain refunding operations; otherwise at $28.58 through May 31, 1987; at $27.39 through May 31, 1992; at $26.19 through May 31, 1997; and at $25.00 thereafter.

The holders of Preferred Stock are entitled to one vote for each share held of record, as are holders of Common Stock. Special requirements for favorable votes of holders of Preferred Stock, voting by the classes respectively prescribed for the several purposes, pertain to (i) certain conversions or exchanges of outstanding Preferred Stock, (ii) the authorization of any stock ranking prior to the Preferred Stock, (iii) making any change in the terms and provisions of the Preferred Stock that would adversely affect the rights and preferences of the holders thereof, (iv) the issuance of any additional shares of Preferred Stock except under prescribed circumstances or (v) a merger, consolidation or sale of substantially all the assets of the Company. The foregoing voting rights attach to both redeemable and non-redeemable Preferred Stock, as do the rights that would arise out of dividend arrearages as discussed in Note 3.

Common and non-redeemable Preferred Stock sales and changes in premiums and expenses during each of the three years in the period ended December 31, 1982 were as follows (dollars in thousands):

	Common Stock		Non-Redeemable Preferred Stock (cumulative)		Premiums and Expenses Net*
Description	Number of Shares	Par Value Amount	Number of Shares	Par Value Amount	
Balance, December 31, 1979	38,181,297	$ 95,453	1,874,199	$118,561	$512,003
Common Stock	9,632,550	24,082	—	—	127,791
Balance, December 31, 1980	47,813,847	119,535	1,874,199	118,561	639,794
Common Stock	9,834,944	24,587	—	—	144,074
Balance, December 31, 1981	57,648,791	144,122	1,874,199	118,561	783,868
Common Stock	5,245,699	13,114	—	—	101,744
Non-Redeemable Preferred Stock, $3.58 Series O	—	—	2,000,000	50,000	(1,932)
Balance, December 31, 1982	62,894,490	$157,236	3,874,199	$168,561	$883,680

*Premiums and expenses—net also include those of redeemable preferred stock issues (see Note 3).

The Company has a dividend reinvestment and stock purchase plan whereby newly issued shares of its Common Stock may be purchased at market on the applicable dates by any participant in the plan. It also has an employee savings plan under which its own periodic contributions would, and the investment of certain funds contributed by participating employees could, involve its issuance of new shares of Common Stock.

The Company plans to file in the near future a registration statement with the Securities and Exchange Commission relating to a proposed sale to the public of up to 750,000 shares of adjustable rate cumulative preferred stock ($100 par value).

3. Redeemable Preferred Stock.

The balances at December 31, 1982 and 1981 of Preferred Stock which is redeemable at the option of the holders or pursuant to sinking fund obligations, in addition to being callable by the Company, are shown below.

	Number of Shares Outstanding at December 31,		Par Value	Par Value Outstanding at December 31,		Call Price Per Share(b)
	1982	1981	Per Share	1982	1981	
				(Thousands of Dollars)		
Redeemable Preferred Stock (cumulative) serial preferred: (a)						
$8.50 Series F	—	12,400	$100.00	$ —	$ 1,240	
$8.50 Series G	61,200	68,400	100.00	6,120	6,840	(c)
$10 Series H	336,000	352,000	100.00	33,600	35,200	(d)
$10.70 Series I	270,000	285,000	100.00	27,000	28,500	(e)
$8.80 Series K	600,000	600,000	100.00	60,000	60,000	(f)
$9.70 Series L	480,000	480,000	100.00	48,000	48,000	(g)
$11.95 Series M	195,000	195,000	100.00	19,500	19,500	(h)
$12.90 Series N	370,000	—	100.00	37,000	—	(i)
Adjustable Rate Series P	100,000	—	100.00	10,000	—	(j)
Total	2,412,200	1,992,800		$ 241,220	$ 199,280	

(a) See Note 2 for authorized number of shares.

(b) In each case plus accrued dividends.

(c) Redeemable at par at the option of either the Company or the respective holders. Sinking fund provisions require the redemption of a total of 3,600 shares at par semiannually (representing annual payments of $720,000).

(d) Not callable by the Company prior to September 1, 1984 through certain refunding operations that would involve the issuance of Common Stock or result in a lower rate of cost to the Company than the dividend rate on the shares to be redeemed; otherwise at $107.20 to September 1, 1983, thereafter declining by $.36 per year to par after September 1, 2002. Applicable sinking fund provisions require the redemption of 16,000 shares at par annually (representing annual payments of $1,600,000).

(e) Not callable by the Company prior to December 1, 1985 through certain refunding operations that would result in a lower rate of cost to the Company than the dividend rate on the shares to be redeemed; otherwise at $107.00 through November 30, 1985, to $103.00 through November 30, 1990, and to $101.00 thereafter. Applicable sinking fund provisions require the redemption of 15,000 shares at par annually (representing annual payments of $1,500,000). The Company may, but is not required to, redeem an additional 15,000 shares at par on December 1 in any year.

(f) Not callable by the Company prior to March 1, 1984 through certain refunding operations that would result in a lower rate of cost to the Company than the dividend rate on the shares to be redeemed; otherwise at $108.80 through February 29, 1984, to $106.00 through February 28, 1989, to $103.00 through February 28, 1994, and thereafter declining in steps to $101.00. Applicable sinking fund provisions require the redemption of 22,500 shares at par annually commencing March 1, 1986 (representing annual payments of $2,250,000). The Company may, but is not required to, redeem an additional 22,500 shares at par on March 1 in any year beginning in 1986.

(g) Redeemable on or after March 1, 1983 at the option of the Company at $106.47 through February 29, 1984, declining by $1.08 per year to $101.07 after March 1, 1989. Applicable sinking fund provisions require the redemption of 96,000 shares at par annually commencing March 1, 1986 (representing annual payments of $9,600,000).

(h) Redeemable on or after May 1, 1986 at the option of the Company at $101.99 through April 30, 1987, thereafter at par. All shares then outstanding are required to be redeemed on May 1, 1988 at par.

(i) Redeemable after June 1, 1992 at the option of the Company at $106.11 through June 1, 1993, declining by $.68 per year to $100.00 after June 1, 2002. Applicable sinking fund provisions require the redemption of all the shares between 1988 and 2002 according to a predetermined schedule.

(j) Bears a dividend of $12.50 per share through 1987 and a dividend thereafter to be fixed by a formula related to the average prime interest rate in 1987. Redeemable at par on or after December 1, 1987 at the option of the Company. Applicable sinking fund provisions require the redemption of 20,000 shares at par each December 1 beginning in 1988 (representing annual payments of $2,000,000). All shares then outstanding are required to be redeemed on December 1, 1992.

If there were to be any arrearage in dividends on any of its Preferred Stock or in the sinking fund requirements applicable to any of its redeemable Preferred Stock (each such dividend being cumulative and of equal ranking with other such dividends, and each such requirement being cumulative and of equal ranking with other such requirements), the Company could not pay dividends on its Common Stock or acquire any shares thereof for consideration. If any such dividend arrearage were to equal six or more quarterly dividends, the holders of Preferred Stock, in addition to their other voting rights and voting by the classes prescribed for this purpose, could elect a total of six directors (all series of Serial Preferred Stock, regardless of par value and whether redeemable or non-redeemable, comprising one such class and being entitled to elect two of the six directors). See Note 2 in regard to other voting rights of holders of Preferred Stock.

The combined aggregate amount of sinking fund requirements for the above issues each year through 1987 are as follows: $3,820,000 in 1983 through 1985 and $15,670,000 in 1986 and 1987.

Redeemable preferred stock transactions during each of the three years in the period ended December 31, 1982 were as follows (dollars in thousands):

Description	Number of Shares	Par Value Amount
Balance, December 31, 1979	1,560,000	$ 156,000
$9.70 Series L	480,000	48,000
Sinking fund retirements:		
$8.50 Series F	(164,000)	(16,400)
$8.50 Series G	(7,200)	(720)
$10 Series H	(16,000)	(1,600)
Balance, December 31, 1980	1,852,800	185,280
$11.95 Series M	195,000	19,500
Sinking fund retirements:		
$8.50 Series F	(16,800)	(1,680)
$8.50 Series G	(7,200)	(720)
$10 Series H	(16,000)	(1,600)
$10.70 Series I	(15,000)	(1,500)
Balance, December 31, 1981	1,992,800	199,280
$12.90 Series N	370,000	37,000
Adjustable Rate Series P	100,000	10,000
Sinking fund retirements:		
$8.50 Series F	(12,400)	(1,240)
$8.50 Series G	(7,200)	(720)
$10 Series H	(16,000)	(1,600)
$10.70 Series I	(15,000)	(1,500)
Balance, December 31, 1982	2,412,200	$ 241,220

Premiums and expenses—net related to redeemable preferred stock issues are included in the amounts presented in the second table in Note 2.

4. Long-Term Debt.

Details of long-term debt outstanding at December 31, 1982 and 1981 are as follows:

	December 31, 1982	December 31, 1981
	(Thousands of Dollars)	
First mortgage bonds:		
9.50% series due February 15, 1982 (a)	$ —	$ 100,000
3½% series due February 1, 1983 (a)	14,500	14,500
3½% series due November 1, 1983	5,723	5,723
3¼% series due March 1, 1984	15,000	15,000
10⅞% series due February 1, 1985	60,250	—
Less securities held by trustee (b)	(47,654)	—
5⅛% series due October 1, 1987	15,000	15,000
4.70% series due March 1, 1989	20,000	20,000
4.80% series due November 1, 1991	35,000	35,000
16% series due April 15, 1992	100,000	—
4.45% series due June 1, 1992	25,000	25,000
4.40% series due December 1, 1992	25,000	25,000
4.50% series due September 1, 1993	15,000	15,000
6.25% series due September 1, 1997	25,000	25,000
12.875% series due May 15, 2000	185,000	185,000
10.625% series due November 15, 2000	68,977	72,000
7.45% series due March 15, 2002	60,000	60,000
9.95% series due March 1, 2004	75,000	75,000
6.20% series due April 1, 2004	50,000	50,000
6.45% series due April 15, 2007	43,000	43,000
6% series due January 15, 2008	34,000	34,000
12⅛% series due October 15, 2009	75,000	75,000
Unamortized discount and premium	(1,136)	(956)
Total first mortgage bonds	897,660	888,267
6.60% pollution control indebtedness due October 1, 1983 (c)	65,000	65,000
Less securities held by trustee (b)	(2,849)	(12,109)
Unsecured notes payable due 1983 through 1984 (d)	192,006	192,006
Pollution control indebtedness due April 1, 1986 (e)	55,200	55,200
17¼% guaranteed debentures due October 15, 1986 (f)	60,000	60,000
16¼% guaranteed debentures due July 15, 1988 (f)	50,000	50,000
16¼% guaranteed debentures due February 1, 1989 (f)	75,000	—
16% guaranteed debentures due February 15, 1989 (f)	25,000	—
Unsecured notes payable due 1987 (g)	70,000	70,000
Capitalized lease obligation (h)	51,005	51,746
Unamortized discount	(707)	(705)
Other	3,104	3,425
Total long-term debt	1,540,419	1,422,830
Less current maturities:		
3½% series due November 1, 1983	(5,723)	—
Sinking fund requirement on 10.625% series due November 15, 2000	(3,000)	(3,000)
6.60% pollution control indebtedness due October 1, 1983 (c)	(65,000)	—
Unsecured notes payable due 1983 (d)	(96,003)	—
Capitalized lease obligation (h)	(1,079)	(740)
Other	(348)	(322)
Total long-term debt less current maturities	$1,369,266	$ 1,418,768

(a) The $14,500,000 of 3½% first mortgage bonds due February 1, 1983 and the $100,000,000 of 9.50% first mortgage bonds due February 15, 1982 were classified as long-term at December 31, 1982 and 1981, respectively, as such debts were refinanced on their due dates through application of the proceeds of debentures described in (f) below.

(b) Representing pollution control funds deposited with a revenue bond trustee and to be disbursed as construction progresses on the facilities financed.

(c) Secured by a long-term letter of credit from a bank.

(d) Due in four installments, two each in 1983 and 1984. As required by the related agreement, the declaration by the Company of any dividend on its Common Stock, if the per share dividend thus declared would exceed the previous per share dividend, is subject to certain restrictions related to earnings; during 1982 up to $166,793,000 could have been paid in dividends on Common Stock compared to the $142,137,000 actually paid.

On November 1, 1982, the Company entered into an amendment of this loan agreement allowing the Company to select from time to time one or more of the following options with respect to the annual interest rate: (a) the prime interest rate (the "Prime Rate"), (b) the rate of interest on certificates of deposit of varying maturities (the "CD Rate") plus ⅝%, or (c) the interest rate offered to major banks in the interbank Eurodollar market for deposits of varying periods (the "Eurodollar Rate") plus ½%.

(e) Consisting of a borrowing from a governmental authority which is funding that amount with a series of commercial paper borrowings supported by irrevocable letters of credit from banks and with five year, revolving loan commitments from the banks allowing the authority to obtain borrowings thereunder in the event of disruptions in the commercial paper market; the cost to the Company of its borrowings from the authority is equal to the latter's cost of money in the commercial paper market plus fees and interest payable to the banks.

(f) Representing debentures issued by Finance, the payment of principal and interest on which has been unconditionally guaranteed by the Company. The debentures are redeemable at the option of Finance as follows:

- 17¼% debentures due October 15, 1986; redeemable at 101½% from October 15, 1984 through October 14, 1985; and thereafter at 100%
- 16¼% debentures due July 15, 1988; redeemable at 101½% from July 15, 1985 through July 14, 1986; then at 100¾% through July 14, 1987; and thereafter at 100%
- 16¼% debentures due February 1, 1989; redeemable at 101% from February 1, 1986 through January 31, 1987; and thereafter at 100%
- 16% debentures due February 15, 1989; redeemable at 101% from February 15, 1986 through February 14, 1987; and thereafter at 100%.

On January 26, 1983 Finance issued $60,000,000 of 11¾% debentures due January 15, 1990, the payment of principal and interest on which has been unconditionally guaranteed by the Company. The debentures are redeemable at the option of Finance at 101½% from January 15, 1987 through January 14, 1988, at 100¾% through January 14, 1989, and thereafter at 100%.

(g) Consisting of $70,000,000 of long-term borrowings refinanced in September 1982 with funds attributable to two new long-term bank loans consisting of $50,000,000 and $20,000,000, both due in 1987. The principal amounts of such loans bear interest, at the Company's option, at one or more of the following annual interest rates through mid-September 1985: (a) the Prime Rate, (b) the CD Rate plus ½%, or (c) the Eurodollar Rate plus ⅜%. Thereafter, at the Company's option,

the annual interest rates will become: (a) in the case of the first loan, 102% of the Prime Rate or, in the case of the second loan, the Prime Rate plus ¼%, (b) the CD Rate plus ⅝%, or (c) the Eurodollar Rate plus ½%.

(h) Represents the present value of future lease payments (discounted at the interest rate of 7.48%) on a combined cycle plant sold and leased back from the independent owner-trustee formed to own the facility. The lease requires semi-annual payments of $2,299,000 through June 1983 and then $2,582,000 through June 2001, and includes renewal and purchase options based on fair market value. This plant is included in plant in service at its original cost of $54,405,000; accumulated amortization at December 31, 1982 was $14,611,000.

Aggregate annual payments due on long-term debt and for sinking fund requirements through 1987 are as follows: 1983, $185,653,000; 1984, $115,833,000; 1985, $65,221,000; 1986, $132,656,000 and 1987, $102,619,000. Other sinking fund requirements for each year through 1987 for the outstanding First Mortgage Bonds are as follows: 1983, $2,350,000; 1984 through 1986, $2,200,000; and 1987, $2,050,000; as allowed in the bond indenture, requirements of this type have in the past been satisfied by certification of property additions of 1⅔ times the amount stated and the Company expects to meet similar requirements in that manner in the future. For sinking fund requirements and redemptions at the option of the holders of redeemable Preferred Stock, see Note 3.

Substantially all utility plant, other than the combined cycle plant mentioned above, is subject to the lien of the First Mortgage Bonds. The indenture respecting the First Mortgage Bonds includes provisions which would restrict the payment of dividends on Common Stock under certain conditions which did not exist at December 31, 1982.

5. Project Financing.

In 1977 the Company initiated, and in May 1981 concluded, a "project financing" of the cost of construction of Unit 4 of its Cholla Plant, which went into commercial operation in June 1981. The project financing involved the interim ownership of the Unit by an independent corporation and a commitment by the Company to purchase the Unit shortly before its completion for an amount equal to the interim owner's cost of acquiring, completing and financing the Unit. Such financing was provided by bank loans in two categories consisting of conventional loans and pollution control financing provided through a governmental authority.

The project financing had been accounted for by including the costs of construction of the Unit in construction work in progress and net outstanding balances of the bank loans as a liability in the balance sheet.

The Company funded its purchase of the Unit in May 1981 with an assumption and modification of the conventional portion of the former project financing and with a new form of pollution control financing as described in Notes 4(d) and (e).

6. Short-Term Borrowings and Compensating Balances.

The Company had bank lines of credit of approximately $131,000,000 at December 31, 1982 and 1981 for which commitment fees are payable primarily at ½% per annum. The lines were segregated into working lines of $51,000,000 and commercial paper backup lines of approximately $80,000,000. No amounts were outstanding under the lines at December 31, 1982 or 1981. Compensating balances required at banks for the working lines, but which were not legally restricted, were generally 10% of the line plus 5% (10% in some instances) of borrowings. Substantially all cash shown in the Balance Sheets is considered compensating balances.

The bank lines were augmented by a $60,000,000 credit facility with foreign banks, under which $48,000,000 was outstanding at December 31, 1981 at an effective rate of 14.69% and no amounts were outstanding at December 31, 1982, the date as of which the facility expired. The commitment fee for such facility was ⅜% per annum, and the rate of interest fluctuated at ½% over the applicable Eurodollar Rate. The Company is in the process of negotiating new credit facilities, aggregating up to $50,000,000, with several foreign banks.

At December 31, 1982 and 1981, the Company also had outstanding $49,516,000 and $40,000,000, respectively, of borrowings from foreign banks which are not participants in the above mentioned credit facilities. Effective rates on such borrowings were 10.10% and 17.74%, respectively.

By statute the Company's short-term borrowings cannot exceed 7% of its total capitalization without the consent of the ACC.

7. Jointly-Owned Facilities.

At December 31, 1982, the Company owned the following interests in jointly-owned electric generating and transmission facilities (dollars in thousands):

	Percent owned by Company	Plant in Service	Accumulated Depreciation	Net Plant in Service	Construction Work in Progress
Navajo Plant	14.0%	$115,988	$26,527	$ 89,461	$ 1,334
Four Corners Units 4 and 5	15.0	72,277	12,024	60,253	15,251
Palo Verde Nuclear Generating Station Units 1, 2 and 3	29.1	—	—	—	1,350,223
Certain transmission lines from:					
The Navajo Plant (the Company's interest varying from 14% to 100%)	31.4	27,586	6,037	21,549	83
The Palo Verde Nuclear Generating Station (the Company's interest varying from 11% to 100%)	29.7	7,253	157	7,096	27,386
Total		$223,104	$44,745	$178,359	$1,394,277

The foregoing dollar amounts correlate to the Company's percentage interest in each facility. Financing for such interests is provided by the Company. Its share of related operating and maintenance expenses is included in its corresponding operating expenses.

8. Income Tax Expense.

The components of income tax expense for each of the three years in the period ended December 31, 1982 are as follows (dollars in thousands):

	Year Ended December 31,		
	1982	1981	1980
Currently payable:			
Federal	$ 6,535	$ 8,206	$ 7,128
State	11,445	6,714	3,740
Total current	17,980	14,920	10,868
Deferred:			
Depreciation—net	23,651	15,861	14,476
Investment tax credit—net	52,158	(10,912)	(8,825)
Total deferred	75,809	4,949	5,651
Amortization of tax benefits sold	(1,687)	(231)	—
Total	$92,102	$19,638	$16,519

In 1981 the Company sold to another corporation certain federal income tax benefits in exchange for cash. The Company, pursuant to an order of the ACC, has recorded the proceeds of the sale as a deferred credit and is amortizing the amount of such proceeds on a straight-line basis over approximately 30 years.

Federal and state income taxes are included in the components of net income as follows (dollars in thousands):

	Year Ended December 31,		
	1982	1981	1980
Operating expenses	$89,250	$22,381	$17,209
Other income	2,852	(2,743)	(690)
Total	$92,102	$19,638	$16,519

Following is a summary of the difference between income tax expense and the amount obtained by multiplying income before income taxes by the statutory federal income tax rate of 46% (dollars in thousands):

	Year Ended December 31,		
	1982	1981	1980
Federal income tax at statutory rate	$148,647	$99,853	$73,512
Increases (reductions) in taxes resulting from:			
Tax under book depreciation	9,414	6,055	1,895
Allowance for funds used during construction	(63,407)	(42,067)	(29,232)
Investment tax credit	(1,378)	(43,969)	(25,481)
Taxes, pension costs and other items capitalized	(8,894)	(6,868)	(6,202)
State income tax—net of federal income tax benefit	7,282	4,869	3,107
Other	438	1,765	(1,080)
Total provision for federal and state income tax	$ 92,102	$19,638	$16,519

At December 31, 1982 the Company had approximately $47,000,000 of investment tax credit carryforwards which will expire through 1997. Of this amount, approximately $30,000,000 has been recognized as a reduction of deferred taxes.

9. Pension Plan.

The Company's pension plan, a defined benefit plan, covers virtually all employees. Pension cost for 1982, 1981 and 1980 was $11,539,000, $10,019,000 and $10,434,000, respectively, of which approximately $4,971,000, $4,147,000 and $5,029,000, respectively, was charged to expense; the remainder was capitalized as a component of construction costs. The Company makes annual contributions to the plan as pension cost accrues.

The following is a summary of plan data as of the most recent benefit information date:

	January 1,	
	1982	1981
	(Thousands of Dollars)	
Actuarial present value of accumulated plan benefits:		
Vested	$ 65,993	$ 62,959
Non-vested	2,891	2,851
Total	$ 68,884	$ 65,810
Net assets available for benefits	$115,881	$105,171

The actuarial present value (assuming rates of return of 10.50% and 9.75%, respectively) of accumulated plan benefits presented above has not been calculated with reference to the effects of projected inflation, whereas such effects are considered by the Company with reference to the adequacy of plan assets; accordingly, the Company considers the utility of the comparison suggested to be extremely limited.

10. Commitments and Contingencies.

At December 31, 1982, the Company had collected approximately $39,000,000 of wholesale revenues subject to refund as a result of federal regulatory proceedings involving the Company. The Company believes that any amounts which may be refundable as a result of these proceedings should not have a material financial effect on the Company.

The Company has significant purchase commitments in connection with its continuing construction program. Construction expenditures in 1983 have been estimated at $393,000,000.

11. Supplementary Income Statement Information.

General taxes during each of the three years in the period ended December 31, 1982 included in other taxes are as follows:

	Year ended December 31,		
	1982	1981	1980
	(Thousands of Dollars)		
Ad valorem	$52,016	$49,457	$48,191
Sales	39,519	33,152	29,273

12. Business Segments.

Listed below is selected information relating to the Company's electric and gas operations:

	Year Ended or As Of December 31,					
	1982		1981		1980	
	Electric	Gas	Electric	Gas	Electric	Gas
	(Thousands of Dollars)					
Operating revenues	$ 866,486	$197,967	$ 730,788	$151,366	$ 621,864	$143,896
Operating income before income taxes	353,347	6,404	272,343	956	180,455	6,330
Utility plant	4,025,697	172,769	3,532,518	155,752	3,055,697	144,230
Accumulated depreciation and amortization	577,481	69,036	510,585	65,912	444,537	60,982
Capital expenditures	511,913	20,307	538,814	19,639	483,392	20,728

13. Selected Quarterly Financial Data (Unaudited).

Quarter	Operating Revenues	Operating Income	Net Income	Earnings for Common Stock	Earnings per Share of Common Stock
	(Thousands of Dollars, Except Per Share Data)				
1981					
First	$191,582	$34,628	$26,015	$19,658	$0.41
Second	205,428	53,774	46,285	39,553	0.75
Third	258,678	89,522	67,441	60,569	1.14
Fourth	226,466	72,994	57,693	50,868	0.93
1982					
First	255,522	56,306	44,304	37,496	0.65
Second	242,935	55,100	42,049	33,532	0.58
Third	307,914	93,325	83,447	73,741	1.24
Fourth	258,082	65,770	61,243	51,458	0.82

14. Supplementary Information to Disclose the Effects of Changing Prices (Unaudited).

The following supplementary information is furnished pursuant to Statement No. 33 of the Financial Accounting Standards Board for the purpose of illustrating the effects of changing prices in an inflationary environment. It offers some perspectives of approximated effects of inflation, and is not intended as precise measurements of those effects.

The Company and other public utilities similarly situated are subject to rate-making procedures which, by law and practice, in large part utilize the historical cost of utility plant in the determination of the allowed recovery (through depreciation) of the investment therein and return thereon. This precludes or restricts a rate-making response to the effects of realizing such recovery and return in inflated dollars, compared to those in which the investment was made. The first table below presents two approximate measurements of those effects from the perspective of that portion of the investment, restated on alternative bases to reflect intervening cost escalation, which was not reflected in 1982 depreciation or in the Company's return, and which is therefore not "recoverable."

For these presentations, "constant dollar" and "current cost" amounts were calculated by applying certain indices (or ratios derived therefrom) to certain historical or other amounts. In the case of constant dollars, the index was the Consumer Price Index for All Urban Consumers, which approximates the upward trend of prices in general during the indicated periods. In the case of current costs, the primary index was the Handy Whitman Index of Public Utility Construction Costs (an estimate of which was used for the last half of 1982), although the Consumer Price Index was used for construction work in progress. The Company believes that the Handy Whitman Index is the more accurate of the two in estimating the prices it would incur to duplicate at various times its utility plant in service at the indicated dates. Over the period up to 1979 which is relevant to the information presented below, that index rose faster than the Consumer Price Index, but the reverse occurred in 1979 through 1982.

Depreciation expense for 1982 was recalculated by applying the Company's composite depreciation rate to depreciable base determined by indexing the historical cost of the Company's utility plant (or, in the case of the Current Cost presentation, certain appraised values thereof in 1969) from the times of construction (or appraisal). The amount by which the expense so recalculated exceeds that shown on the Company's 1982 Statement of Income appears as an adjustment to income from operations. The Current Cost adjustment is the larger of the two because the accumulated Handy Whitman rise through 1982 exceeded the rise in the Consumer Price Index in the same period, thus producing a greater depreciable base (referred to in the discussion below as "Utility Plant at Current Cost").

The sum of the depreciation adjustment in the Constant Dollar column and the figure shown lower in that column as the "reduction to net recoverable cost" was derived through application of 1982 increases in the Consumer Price Index to historical costs of the Company's utility plant. The comparable sum in the Current Cost column, again consisting of the depreciation adjustment plus the "reduction to net recoverable cost," reflects the larger depreciation adjustment referred to above, which is more than offset by the difference between the two measurements of cost (or price) escalation in 1982 which are described in the next paragraph.

The first such measurement is that of a hypothetical increase in the dollar value of the Company's utility plant, and was derived by applying 1982 index rises (primarily in the Handy Whitman Index) to the Utility Plant at Current Cost, and subtracting the depreciation adjustment shown in the column. The second measurement is that of an assumed, unrecoverable dollar amount computed by applying the 1982 rise in the Consumer Price Index (which exceeded the corresponding rise in the Handy Whitman Index) to the Utility Plant at Current Cost.

In neither measurement did the Company make any adjustments to asset values, or related income statement amounts, other than those discussed above in regard to utility plant and depreciation thereon. Fuel inventories and fuel and purchased gas expenses are, in effect, monetary items, due to applicable rate-making procedures which include adjustment clauses. In accordance with Statement No. 33, income taxes were not adjusted.

As contrasted to the assumed net value losses which, in the presentation below, are associated with the holding of assets committed to a regulated business, there is an assumed "holding gain" associated with borrowings that will be repaid with inflated dollars. The 1982 decline in the purchasing power of net amounts owed by the Company (measured by the Consumer Price Index) appears in both columns, to result in a "net" difference between the assumed holding losses and gain.

Inferences which, in the case of some industries, may be drawn from information in the nature of that presented below as to the adequacy of future cash flows in relation to future plant replacement requirements are believed by the Company to be less valid in the case of public utilities which, like itself, should be able to establish rates to cover increased costs of new plant. However, the information may provide some indication of the expanded capital structure that will be required for making plant replacements and additions with inflated dollars.

Income from Operations Adjusted for Changing Prices for the Year Ended December 31, 1982

	Constant Dollar Average 1982 Dollars	Current Cost Average 1982 Dollars
	(Thousands of Dollars, Except Per Share Amounts)	
Net Income, as reported in Consolidated Statements of Income	$231,043	$231,043
Adjustment to restate depreciation expense	(74,309)	(84,016)
Income from operations (excluding reduction to net recoverable cost)	$156,734 (a)	$147,027
Income per common share (after preferred stock dividend requirements and excluding reduction to net recoverable cost)	$2.05	$1.88
Increase in specific prices (current cost) of utility plant held during the year (b)	$ —	$187,490
Reduction to net recoverable cost	(49,790)	(18,452)
Effect of increase in general price level	—	(209,121)
Excess of increase in general price level over increase in specific prices after reduction to net recoverable cost	—	(40,083)
Gain from decline in purchasing power of net amounts owed	71,500	71,500
Net	$ 21,710	$ 31,417

(a) Including the reduction to recoverable net cost, operations on a constant dollar basis would have resulted in a gain of $106,944,000 for 1982.

(b) At December 31, 1982 Utility Plant at Current Cost was $5,845,734,000 while historical cost, or net cost recoverable through depreciation, was $3,551,949,000.

Five-Year Comparison of Selected Supplementary Financial Data Adjusted for Effect of Changing Prices

	Year Ended December 31,				
	1982	1981	1980	1979	1978
	(Average 1982 Dollars in Thousands, Except for Per Share Amounts)				
Operating revenues	$1,064,453	$ 936,236	$ 897,007	$ 883,554	$ 831,816
Historical cost information adjusted for general inflation (1)					
Income from operations (excluding reduction to net recoverable cost)	$ 156,734	$ 142,179	$ 108,522	$ 110,241	—
Income per common share (after dividend requirements on preferred stock and excluding reduction to net recoverable cost)	$ 2.05	$ 2.18	$ 1.84	$ 2.36	—
Net assets at year-end at net recoverable cost (2)	$1,593,016	$1,431,824	$1,308,123	$1,241,428	—
Reduction to net recoverable cost	$ 49,790	$ 194,334	$ 279,751	$ 294,972	—
Current cost information (1)					
Income from operations (excluding reduction to net recoverable cost)	$ 147,027	$ 132,020	$ 94,730	$ 92,601	—
Income per common share (after dividend requirements on preferred stock and excluding reduction to net recoverable cost)	$ 1.88	$ 1.98	$ 1.52	$ 1.85	—
Excess of increase in general price level over increase in specific prices after reduction to net recoverable cost	$ (40,083)	$ (184,175)	$ (265,960)	$ (277,332)	—
Net assets at year-end at net recoverable cost (2)	$1,593,016	$1,431,824	$1,308,123	$1,241,428	—
Reduction to net recoverable cost	$ 18,452	$ 133,557	$ 161,086	$ 100,884	—
General Information					
Gain from decline in purchasing power of net amounts owed (1)	$ 71,500	$ 153,480	$ 199,786	$ 203,665	—
Cash dividends declared per common share	$ 2.40	$ 2.33	$ 2.41	$ 2.58	$ 2.56
Market price per common share at year-end	$ 24.10	$ 19.90	$ 19.72	$ 21.69	$ 29.03
Average consumer price index	289.1	272.4	246.8	217.4	195.4

(1) Not required for years prior to 1979.
(2) Consisting of common stock equity and non-redeemable preferred stock.

BOARD OF DIRECTORS

†Joe Acosta, 59, president Acosta, Cordova & Pittman, C.P.A.s, P.A., Phoenix, Arizona

Dino DeConcini, 49, attorney at law of counsel to DeConcini McDonald Brammer Yetwin & Lacy, P.C., Phoenix, Arizona

*O. Mark De Michele, 49, president and chief operating officer of the company, Phoenix, Arizona

*Karl Eller, 54, president The Karl Eller Company (media consultant), Phoenix, Arizona

*William T. Garland, 66, chairman of the board, Garland-Rhuart Development Corporation (land development), Sedona, Arizona

†Pamela Grant Korf, 44, chairman & chief executive officer, Goldwaters, Division of Associated Dry Goods (General Mercantile), Scottsdale, Arizona

†Jack M. Morgan, 59, attorney at law and state senator, Farmington, New Mexico

Marvin R. Morrison, 59, farmer, cattle feeder and dairyman, Morrison Brothers Ranch, Higley, Arizona

John J. Rhodes, 66, former member of the U.S. House of Representatives and attorney at law, Mesa, Arizona

Henry B. Sargent, Jr., 48, executive vice president and chief financial officer of the company, Phoenix, Arizona

Wilma W. Schwada, 56, civic leader and homemaker, Mesa, Arizona

James P. Simmons, 58, chairman of the board, United Bank of Arizona, Phoenix, Arizona

Richard Snell, 52, chairman of the board and president, Ramada Inns, Inc., Phoenix, Arizona

*Donald N. Soldwedel, 58, publisher and general manager, Yuma Daily Sun, Yuma, Arizona

*Maurice Tanner, 61, chairman of the board and chief executive officer, The Tanner Companies (construction and materials supply), Phoenix, Arizona

*Keith L. Turley, 59, chairman and chief executive officer of the company, Phoenix, Arizona

†Douglas J. Wall, 56, *member of the law firm of Mangum Wall Stoops & Warden, Flagstaff, Arizona

†Morrison F. Warren, 59, professor of education and director of the I.D. Payne Laboratory, Arizona State University, Tempe, Arizona

†Ben F. Williams, Jr., 53, mayor of the City of Douglas and attorney at law, Douglas, Arizona

Thomas G. Woods, Jr., 56, executive vice president of the company, Phoenix, Arizona

DIRECTOR EMERITUS

E. Ray Cowden, 91, cattle feeding and investments, Phoenix, Arizona


Joe Acosta


Dino DeConcini


O. Mark De Michele


Karl Eller


William T. Garland


Pamela Grant Korf


Jack M. Morgan


Marvin R. Morrison


John J. Rhodes


Henry B. Sargent, Jr.


Wilma W. Schwada


James P. Simmons


Richard Snell


Donald N. Soldwedel


Maurice Tanner


Keith L. Turley


Douglas J. Wall


Morrison F. Warren


Ben F. Williams, Jr.


Thomas G. Woods, Jr.


E. Ray Cowden

*Member of Executive Committee
†Member of Audit Review Committee

Officers Named

William J. Post was elected controller and Faye Widenmann was elected assistant secretary by the board of directors in December.

Post had been manager of accounting and control. Since joining the company in 1973, he has held supervisory and managerial positions in budgets and forecasts and sales and load forecasts.

Prior to her appointment, Widenmann had been general corporate services manager. She joined the company in 1978 as a public affairs representative after serving as office manager for the U.S. Senate energy and natural resource committee.

OFFICERS

G. Carl Andognini, 47, vice president, Nuclear Operations

D. Louis Broussard, 62, vice president, Research and Development

O. Mark DeMichele, 49, president and chief operating officer

Walter F. Ekstrom, 45, vice president, Electric Operations

Karl Eller, 54, chairman of executive committee

David W. Ellis, 44, vice president, Gas Operations

Joseph A. Gelinas, 38, vice president, Employee Relations

Gerald J. Griffin, 62, assistant secretary (Ret. 12/82)

B. Paul Hart, 59, vice president, Rates and Regulation

Russell D. Hulse, 55, vice president, Resources Planning

Jerry Human, 52, vice president, Customer Services

Charles D. Jarman, 47, vice president, Engineering and Construction

Jaron B. Norberg, 45, senior vice president and corporate counsel

John C. Ogden, 37, vice president, Customer and Administrative Services

William J. Post, 32, controller

Wm. T. Quinsler, 58, secretary and assistant treasurer

H. B. Sargent, Jr., 48, executive vice president and chief financial officer, Corporate Finance, Planning and Control

Keith L. Turley, 59, chairman and chief executive officer

E. E. Van Brunt, Jr., 51, vice president, Nuclear Project Management

Faye Widenmann, 34, assistant secretary

Paul A. Williams, 37, treasurer, Finance and Tax Accounting

T. G. Woods, Jr., 56, executive vice president, Arizona Nuclear Power Project

REGIONAL GENERAL MANAGERS

A. G. (Andy) Anderson, 51
Metro Region

Guy W. Lunt, 49
State Divisions Region

(Age on Annual Meeting date April 21, 1983)

SHAREHOLDER INFORMATION

STOCKLISTING
(Symbol: AZP)

Common stock of the company: The $10.70 cumulative preferred stock, Series I, and the $3.58 cumulative preferred stock, Series O, are listed for trading on the New York Stock Exchange. Common stock is also listed on the Pacific Stock Exchange.

TRANSFER AGENT

First Interstate Bank of Arizona, N.A.
Phoenix, Arizona
The First National Bank of Boston
Boston, MA (common stock only)

REGISTRARS

The Valley National Bank of Arizona
Phoenix, Arizona
The First National Bank of Boston
Boston, MA (common stock only)

GENERAL COUNSEL

Snell & Wilmer, Phoenix, Arizona

AUDITORS

Deloitte Haskins & Sells
Phoenix, Arizona

DIVIDEND REINVESTMENT AND STOCK PURCHASE PLAN

A Prospectus describing this plan for holders of the company's stock is available to shareholders upon request. Write: Office of the Secretary, Sta. 1892, at the address below.

FORM 10-K

A copy of our Annual Report to the Securities and Exchange Commission, Form 10-K, will be available after March 31, 1983, without charge, upon written request of shareholders. Write: Office of the Secretary, Sta. 1892, at the address below.

STATISTICAL REPORT

A detailed Statistical Report for Financial Analysis 1972–1982 will be available by mid-April on request. Write: Office of the Treasurer, Sta. 1820, at the address below.

MAILING ADDRESS

P. O. Box 21666
Phoenix, Arizona 85036