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**Making  
the  
right  
moves.**



annual report

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**About Our Company**

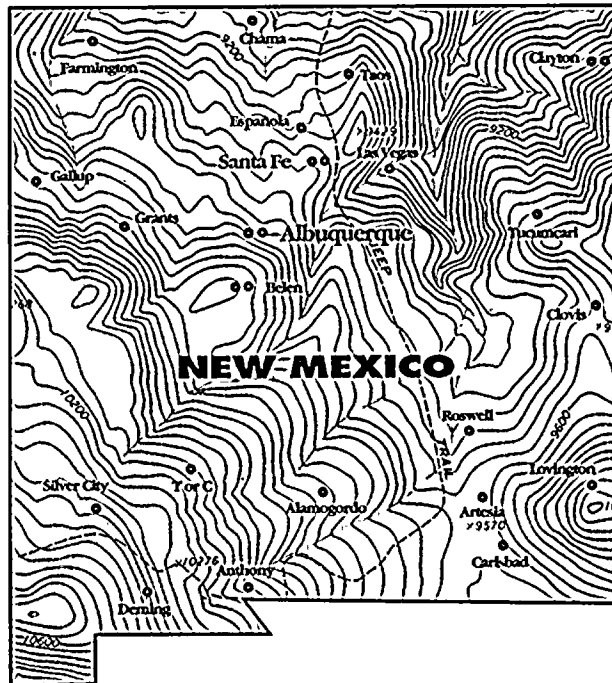
PNM, the Public Service Company of New Mexico, is a combined electric and gas utility serving 1.2 million people in more than 100 communities around the state. PNM is organized into four strategic business units, each focused on a particular segment of the company's core business. PNM Electric Services and PNM Gas Services provide retail service to 333,000 electric customers and 393,000 gas customers in New Mexico. PNM Bulk Power Services manages the company's transmission and generating system and sells power on the wholesale market. Through PNM Energy Services, the company also operates the Santa Fe municipal water system and offers water and waste water management, energy management, and energy conservation assistance to municipal and government agencies as well as to commercial and industrial customers.

**On the Cover**

Our new corporate logo, which now identifies all business units, combines the familiar PNM letters with an adaptation of the spiral "sun" motif which frequently appears in the Native American rock art of the Southwest.



**Service Area**



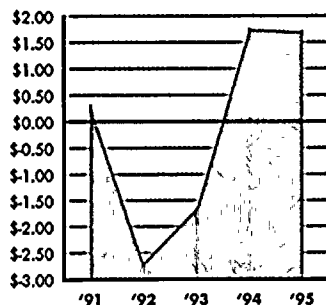
- Electric Service Areas
- Gas Service Areas

## Financial Highlights

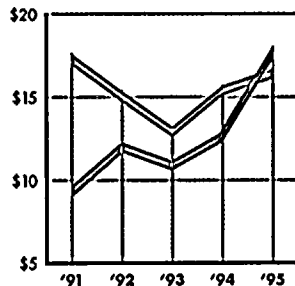
Public Service Company of New Mexico and Subsidiaries

	1995	1994	% Change favorable (unfavorable)
Operating revenues	\$ 808,465,000	\$ 904,711,000	(10.64)
Operating expenses	\$ 695,077,000	\$ 753,633,000	7.77
Net earnings	\$ 75,562,000	\$ 80,318,000	(5.92)
Return on average common equity	10.72%	12.40%	(13.55)
Earnings per common share	\$ 1.72	\$ 1.77	(2.82)
Book value per common share at year-end	\$ 16.82	\$ 15.11	11.32
<b>Electric:</b>			
Retail sales	6,029,365,000	5,953,151,000	1.28
Sales for resale	2,590,513,000	3,361,933,000	(22.95)
Total kilowatt-hour sales	8,619,878,000	9,315,084,000	(7.46)
<b>Gas:</b>			
Decatherm throughput	109,594,000	132,071,000	(17.02)

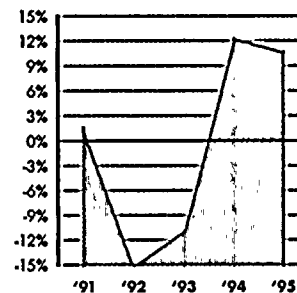
**Earnings Per Share**  
Available for common



**Market & Book Value**



**Return On Equity**



— Year end stock price  
- - - Year end book value



## To Our Shareholders:

Rock climbing may seem an unusual image for the cover of a utility company's annual report. Beyond its obvious association with the mountains and mesas of the Southwest, however, climbing offers a clear parallel with today's PNM.

Climbers set ambitious goals and chart a course toward those objectives. In 1993, we set our own ambitious goal – we resolved to become “the preferred provider of energy and related services in the Southwest.” We formulated a business plan that set clear, attainable objectives by which we could measure our progress toward that goal.

Over the past three years we have reached many of those objectives as we returned our company to profitability, cut prices and improved service to our customers.

Our financial results for 1995 exceeded our expectations, despite a 10.6 percent decline in total operating revenues compared to the previous year. Although the underlying growth rate in our service area continued at a healthy 3.3 percent last year, our revenues were reduced by the combined impact of the \$30 million electric rate reduction implemented at the end of 1994, a mild winter and lower prices in the electric wholesale market.

However, our aggressive, company-wide cost control efforts, together with lower interest costs and the gains on asset sales completed during the year, provided net earnings of \$75.6 million, or \$1.72 per share for 1995, compared to earnings of \$80.3 million, or \$1.77 per share in 1994.

### Dividend policy

As measured by criteria we set in last year's annual report to our stockholders, we made substantial progress toward restoring the company's financial health in 1995. The deficit in retained earnings was eliminated, ending the year at a positive \$25.2 million.

Cash flow from operations exceeded capital requirements for utility construction by \$40.4 million, or 38 percent, allowing us to continue our strategy of reducing debt to strengthen our balance sheet and cut our interest costs. Vigorous growth in New Mexico translated into rapid growth for PNM, while our program of debt retirement and our improved operating efficiency have boosted our capital ratios and credit quality. We anticipate continued improvement in all of these benchmark measurements in 1996.

Our achievements in 1995 set the stage for restoration of the common stock dividend. As part of our overall financial strategy, our dividend policy in 1996 will be aimed at maximizing the long-term value of your investment in PNM. We expect to announce details of our dividend plan sometime before the end of the second quarter.

PNM's stock appreciated 36.4 percent in 1995, outpacing the overall Dow Jones utility average for the second year in a row. Our superior stock performance, together with the steady increase in the market value of our debt, demonstrates the financial market's growing confidence in your company.

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*“Each of the steps we have taken has advanced PNM toward our strategic goals, while at the same time substantially improving returns for our shareholders.”*

**Benjamin Montoya**, President and CEO



## Strategic goals

To prepare our company to adapt to a new marketplace, we have adopted a business plan that sets three primary strategic goals:

- first, to strengthen the company's financial position;
- second, to take advantage of opportunities for growth in the evolving energy marketplace;
- third, to cooperate with all interested parties toward shaping the future of our industry in a way that will benefit all our customers and our investors.

Each of the steps we have taken has advanced PNM toward the achievement of those goals, while at the same time substantially improving returns for our shareholders.

*"We intend to have PNM counted among those utilities that will successfully grow into the new future of our industry."*

John Ackerman, Chairman

## Challenges ahead

While your company made significant progress in 1995, PNM continues to face formidable challenges in achieving its long-term strategic goals.

We are awaiting the New Mexico Public Utility Commission's decision on several cases that are important to our strategy of positioning PNM to succeed in a changing marketplace.

No one knows yet what shape the new marketplace will take. From California to Vermont, regulators and legislators continue to debate how best to introduce competition into an industry that has operated as a government-regulated monopoly for most of this century. Here in New Mexico, the legislative committee studying this issue announced its conclusions in November 1995. The New Mexico PUC has now taken up its own investigation.

PNM will continue to be active at both the state and federal levels in the public policy debate on the restructuring of the electric utility industry. By working with our customers, regulators and legislators we hope to arrive at an agreement that will protect the interest of our investors and offer benefits to all of our customers.

We believe our business plan contains sufficient flexibility to adapt successfully to the new marketplace, whatever its ultimate structure. We know that over the past three years, our management team has demonstrated the ability to respond effectively to new challenges as they arise.

Our world is changing and, as Abraham Lincoln wrote more than a century ago, "As our case is new, so we must think anew and act anew." Acting in that spirit, we intend to have PNM counted among those utilities that will successfully grow into the new future of our industry.



Benjamin F. Montoya  
President and Chief Executive Officer



John T. Ackerman  
Chairman of the Board



## Report From Management

### Making the Right Moves

Guided by the business plan adopted in 1993, we are confident that PNM is making the right moves to accomplish our strategic objectives and make a successful transition to a competitive marketplace.

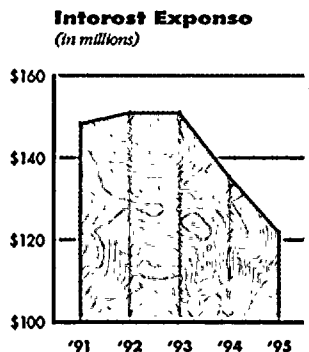
To better inform our shareholders about the significance of those moves and the context in which they are being made, in this year's annual report we have asked several outside observers to share their perspectives on our company and the economic and regulatory climate we face in New Mexico.

As we discuss the elements of PNM's strategic plan on the following pages, you will see comments from a distinguished Wall Street utilities analyst, a noted economist familiar with the regional economic outlook, a representative of one of PNM's largest customers, and the chairman of the New Mexico Public Utility Commission. We believe you will find their insights valuable in forming your own opinion of our company's prospects.

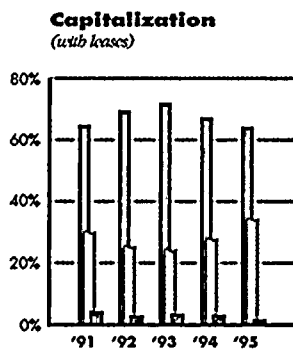
### Improving Our Financial Performance

PNM's financial strategy aims at regaining an investment-grade credit rating and paying an attractive, continuing return to our stockholders. These achievements will in turn lower our cost of capital, enhance cash flow, and enable the company to respond to the opportunities presented in a changing marketplace.

Over the last three years PNM has sold assets not needed to support our core business of supplying electric and gas services to the people of New Mexico. The cash raised from those sales has been primarily used to reduce the company's debt.



*Includes the interest expense associated with sale-leaseback lease obligations.*



Cumulative Preferred Stock  
 Common Stock Equity  
 Total Debt

### Reducing debt

In 1995, we retired \$190 million of our long-term debt, significantly improving our debt to capital ratio. Annual interest expense was about \$12.7 million less than 1994, a savings of about 18 cents per share.

In June and July, we completed the sale of our gas gathering and processing assets and our Santa Fe water utility. While the sale of these assets reduced operating income for the year by an estimated \$3.8 million, the two transactions provided an after-tax gain of \$19.2 million, or 46 cents per share.

In August, we used some of our available cash to retire \$64 million worth of preferred stock. While retiring equity rather than debt slightly raised the company's ratio of debt to capital, PNM took this step because the preferred stock represented the most expensive fixed obligations the company had outstanding. Eliminating the dividend paid on these three series of preferred stock will save our company another \$3.2 million, or 8 cents per share, in 1996.

### Seeking new investment opportunities

The strategy of debt retirement funded by asset sales has strengthened our balance sheet substantially over the last three years. The resulting liquidity, which allowed us to end 1995 with \$100 million in cash and short-term investments, gives us the flexibility to take advantage of opportunities for further savings or investment for growth.

PNM plans to retire additional debt over the next five years. The company has also asked regulators for permission to invest up to \$50 million in energy-related business activities over the next five years.

### An attractive turnaround story

*"We believe PNM is approaching the light at the end of the tunnel in the turnaround that began with the company's 1994 rate agreement.*

*Earnings gains in recent years have been driven by three main factors: a 3.5 percent to 4 percent annual sales growth (a scarcity in the utility industry), flat operation and maintenance costs, and the use of \$50 million to \$75 million of annual free cash flow to reduce debt, which has in turn produced interest cost savings.*

*This year, we believe PNM earnings will also benefit from continued operating improvements at Palo Verde Nuclear Generating Station, the renegotiation of coal contracts at the company's San Juan plant, and potential rate relief for PNM's gas business. The major factor offsetting these earnings benefits is price pressure in the wholesale power market, where PNM is a net seller.*

*PNM is probably still a couple of years away from an investment-grade bond rating, but we expect to see significant balance sheet improvements over the next few years driven by recent asset sales, high earnings retention and the continuing use of free cash flow to pay down debt. As a result, we project a reinstatement of the common stock dividend in mid-to-late 1996.*

*Overall, we believe that PNM will likely be the utility stock to own in 1996."*



**Steven I. Fleishman**  
Electric Utility Research  
Dean Witter Reynolds Inc.

## Serving Our Customers

Our goal is to keep the customers we have and grow our existing customer base. We will achieve that by giving customers what they want: reliable, high quality, reasonably priced products and services that meet their needs.

### Lowering prices, controlling costs

Recognizing that prices are a critical component in determining customer choice, PNM has vigorously attacked its cost structure over the last three years.

As a result, the company has been able to maintain operating and maintenance expenses at 1992 levels, even as the number of customers served has increased 8 percent. The number of PNM customers per employee – one key measure of a utility's efficiency – has grown from 207 in 1991 to 277 today.

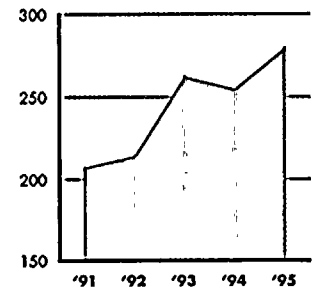
Our customers have benefited from these gains in productivity through lower prices. Our new rates, implemented at the end of 1994, make PNM's prices competitive with other investor-owned utilities in our region. In 1996, we are seeking permission from the New Mexico Public Utility Commission to offer our customers a more flexible rate structure that better meets their varying energy needs.

### Improving customer service

Price is only one element of the competitive equation, however. Value is not a function of price alone, and PNM is committed to providing the quality, reliability, and convenience our customers have come to expect from our company.

To meet those demands, in 1995 PNM Electric Services began installing a sophisticated computer system to help us better anticipate system faults and to respond more quickly when outages occur. This investment helped us to substantially reduce customer minutes interrupted and the number of outages per customer in 1995, significantly improving system reliability.

Customers Per Employee



### *They worked with us through the night*

*"When a fault in an aging cable shut down the power to Albuquerque High School on Saturday, October 30, 1995, the people at PNM offered their help.*

*After working on the problem through the weekend, at about 6 p.m. Sunday evening, we discovered that our 480-volt transformer needed to be replaced before we could restore service to the school. I called PNM Electric Services, and very shortly afterward they arrived with a PNM crew, a PNM crane, and their own transformer.*

*They worked with us through the night to install the new transformer and get the school fully operational.*

*I was really pleased with the effort put forth by PNM – their quick response and helpful attitude. They seemed to really care about getting the school back in operation, and 2,200 Albuquerque High students, teachers and district personnel back to school Monday morning."*

**Bill Koelm**

Director, Maintenance & Operations  
Albuquerque Public Schools



## Growing Our Business

The changes in our industry offer substantial opportunities for innovation and growth in coming years. As customers are offered more choice, we want them to rely on the expertise PNM has developed in almost 80 years in the energy business in helping them make those decisions.

### Value added products and services

PNM is now seeking regulatory approval to offer a range of new products and services to our residential and commercial customers. All are designed not just to generate additional revenues for PNM, but to reinforce our long-term relationship with our customers.

The one common theme these proposals share is that all are derived from the business we know best – providing reliable electric, gas, and water service to the people of New Mexico.

### Total energy and water solutions

PNM Energy Services, now in its first year of operating the Sangre de Cristo Water Company under contract to the City of Santa Fe, moved aggressively during 1995 to establish our company in the new and intensely competitive energy services marketplace.

We submitted our bid to manage and operate the University of New Mexico's utility systems under a long-term contract. The plan proposed by PNM Energy Services offers the university an opportunity to upgrade and modernize its system to meet present and future needs, while lowering overall energy costs by one-third.

In close cooperation with the Department of Energy, Federal Energy Management Program, the General Services Administration and other state and federal agencies, PNM Energy Services has launched a statewide initiative (the first of its kind in the nation) to provide similar energy management services to federal installations in New Mexico.

## Translating Growth into Shareholder Value

For the third year in a row, 1995 was a year of rapid growth for New Mexico and for PNM. Last year, New Mexico's economy ranked as the fourth fastest-growing in the nation, with an estimated 2.1 percent growth in population and a statewide employment growth double the national average.

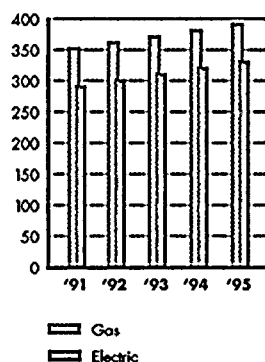
Growth in 1995 remained concentrated in the Albuquerque metro area, where the majority of PNM's electric and gas customers live and work. Led by an in-migration of high tech manufacturing and teleservices businesses, as well as a continuing boom in commercial and residential construction, Albuquerque's economy produced a 5.8 percent increase in employment and an 8.3 percent increase in personal income.

PNM benefited from the prospering local economy, adding 10,490 new electric and 10,425 new gas customers last year.

### Continued growth in '96

The challenge for PNM continues to be translating that growth into improved returns for our shareholders. To do that, we are constantly seeking new ways to control costs without compromising our commitment to the highest quality service for our customers.

Number Of Customers  
(in thousands)



In May 1995, we received permission from our regulators to combine electric and gas customer services, a move that saves PNM \$1.4 million in operating expenses and offers improved convenience for our customers.

PNM Electric and Gas Services achieved additional savings by revising the procedures for connecting new customers last year. Improved job-site reporting and contracting procedures, coupled with coordinated trenching for gas, electric, telephone and cable TV services, reduced PNM's cost to connect new residential customers by 10 percent in 1995.

To allow us to earn a fair return on your investment in PNM's gas system, in August 1995 PNM Gas Services filed the company's first gas rate case since 1990.



### *New Mexico: slower but still solid growth in '96*

*"The New Mexico economy, one of the most dynamic in the nation, once again led the seven states in the Federal Reserve's Tenth District in 1995. New Mexico's employment gain of nearly 4 percent and income gain of 5 percent outpaced both other district states and national averages.*

*New Mexico's growth was again fueled by its thriving high-tech manufacturing industry, which accounted for much of the state's 3.2 percent gain in manufacturing employment last year.*

*Albuquerque has also become a center for such service businesses as telemarketing, back-office accounting operations, and airline reservation centers. The solid gains in manufacturing and services, in turn, sustained a construction boom which began nearly four years ago.*

*Most indicators suggest New Mexico's economic boom has reached a plateau, pointing to slower but still solid growth in 1996."*

**Alan D. Barkema**

Assistant Vice President & Economist  
Federal Reserve Bank of Kansas City

### **Adapting to New Conditions**

Nowhere has the pace of change in our industry been more rapid than in the wholesale power market, where weather conditions and the entrance of new competitors put significant downward pressure on prices and margins last year.

While the activity of energy brokers and marketers still accounts for only a very small proportion of transactions, the evolution of a spot market in electricity has had an important effect on the wholesale market over the past two years. Not only are prices down, but long-term, firm requirements contracts are becoming less common as buyers instead rely on short-term contracts or the spot market for their energy needs.

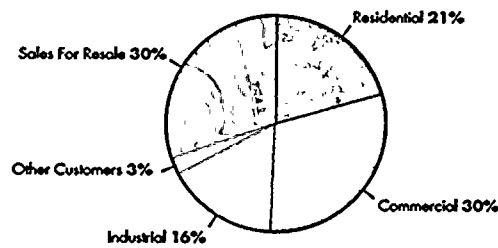
### Lower generating costs

To meet that competitive challenge, PNM Bulk Power Services is moving aggressively to lower fuel costs and streamline operations at San Juan Generating Station, which remains PNM's single most important generating resource.

An interim agreement with our San Juan coal supplier substantially lowered incremental fuel costs in 1995. A second agreement, in September 1995, offers longer term savings at the plant. We are confident that further adjustments to the coal contract, together with the improved operating efficiency at the plant, will make San Juan one of the most competitive sources of power in the regional market.

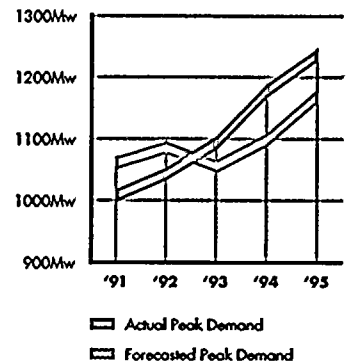
Our operating partner in Palo Verde Nuclear Generating Station also reported substantial progress in 1995 in improving that plant's efficiency and availability. The plant's superior performance last year, together with the rapid growth in the Southwest and in our own local service area, were among the factors that persuaded your board of directors to end our efforts to sell PNM's share in Palo Verde.

1995 Electric Sales



*While PNM has a smaller proportion of industrial sales than the average utility, the company depends on the wholesale market for about one-third of its total kWh sales.*

Electric Peak Demand



### Insuring system reliability

After a mild spring and early summer, unseasonably hot and dry weather in July and August boosted power demand in PNM's service area to new highs last year. At 1,247 megawatts, our 1995 peak was nearly 5 percent above the previous year's record. To meet the growing demand for power in its own service area, PNM continues to work toward finding ways to bolster the capacity and reliability of our transmission system.

In November, the New Mexico Public Utility Commission rejected our proposal to build the 345 kilovolt Ojo Line Extension (OLE) in northern New Mexico. While we are disappointed by the PUC's decision in that case, PNM continues to seek ways to improve our system to insure reliable service to our customers.

Transmission constraints and growing load during our peak summer cooling season require additional generation assets to meet demand. Accordingly, PNM has requested proposals for up to 200 Megawatts of additional peaking capacity.

## Shaping the Future of Our Industry

PNM has made significant progress in recent years toward positioning your company to succeed in a new, competitive marketplace. A strategy of debt retirement funded by asset sales has strengthened the company's financial structure while an intensive focus on customer satisfaction, accompanied by a vigorous cost control effort, have lowered prices and improved service.

Even with these efforts, PNM's success over the next few years also depends on decisions made by regulators and legislators at both the state and the federal level. Recognizing the importance of those decisions to our company's future, PNM is working with our legislators, our regulators, and our customers to help guide change in the electric utility industry.

### A cautious and deliberate approach

PNM's strategic business plan recognizes that technological and political changes now under way will result in substantial restructuring of the electric industry in coming years.

A special committee of the New Mexico Legislature issued its report in November 1995, recommending a cautious and deliberate approach to restructuring, balancing the interests of all classes of customers with the need to maintain the financial viability of the utilities in the state.

The committee's findings emphasized that small residential and commercial customers should share the economic benefits obtained through increased competition. The cost of those existing investments rendered uneconomic by a competitive market should also be shared by all who benefit from the transition to a more open market, according to the committee's report.

The committee also urged an approach to restructuring that will assure that the new markets operate efficiently across state lines. The full Legislature endorsed the committee's recommendation in February 1996.

### *It is those companies that recognize change and prepare for it that ultimately succeed.*

*"PNM's recent improvements in financial performance reflect a long struggle to deal with its excess capacity problems and its large investment in Palo Verde Nuclear Generating Station. From a regulator's perspective, this improvement is welcomed, not just because it strengthens a New Mexico-based company, but because it should enhance PNM's ability to deal with the rapidly changing market environment that all electric utilities face.*

*The New Mexico Public Utility Commission, in response to the rapid development of competitive pressures at the retail level nationwide, has initiated a Notice of Inquiry into possible restructuring of the electric industry in New Mexico. The Commission has not yet formulated a proposed rule or structure for retail competition and remains committed to protecting utility customers from unintended cost-shifting that might otherwise result from the transition to competition and, if possible, not unduly impacting the financial stability of the industry. Nonetheless, it is apparent that changes in the nature of regulation of electric utilities are coming. Indeed, PNM has publicly recognized that the industry faces substantial restructuring.*

*As is the case in any industry facing major shifts in its operating paradigm, it is those companies that recognize change and prepare for it that ultimately will succeed. This is the challenge facing PNM and New Mexico's other utilities in the coming year."*

**Wayne Shirley**

Chairman

New Mexico Public Utility Commission

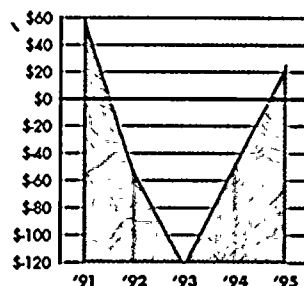
## A cooperative process

The New Mexico Public Utility Commission has now undertaken its own study. PNM fully supports this effort, and will continue to be actively involved in representing the interests of its investors in the commission's deliberations.

The important financial and environmental issues involved, together with the necessity of maintaining the reliability of the national electric grid, require a well-conceived plan to successfully guide the transition from the existing regulatory structure to a future of greater market competition. We are confident that New Mexico and the rest of the nation can form and implement such a plan if the process continues to be marked by the high degree of cooperation among legislators, regulators, and we in the industry that we have seen so far.

### Retained Earnings

Balance, December 31  
(in thousands)



## Redefining Our Identity

PNM is creating a more flexible, productive, innovative organization to respond to a changing marketplace. Restructuring our company into four strategic business units, each targeted on a particular segment of our market, has allowed us to move authority and responsibility downward, producing results for our shareholders by responding quickly and effectively to the needs of our customers.

### Results-based compensation

Another important element of that change has been in revising the PNM compensation structure. In 1993, our shareholders approved a performance stock plan for the company's top managers that tied their total compensation to the returns achieved for our investors.

In 1995, PNM took another significant step in the long-term shift toward results-based compensation by linking a portion of employees' annual pay to performance goals set for each business unit and for the company as a whole.

In future years, it is our goal to tie an increasing proportion of the PNM total compensation package to corporate results. PNM believes this strategy will produce superior returns for both employees and stockholders by recognizing the common interest of investors and workers in promoting the company's success.

## A familiar name with a new image

As we began combining customer service operations in 1995, PNM launched an extensive marketing effort to introduce our new corporate symbol and name to the public, strengthening our identity as New Mexico's premier energy company.

Our new corporate logo carries forward the familiar initials by which we have been known to many of our New Mexico customers for generations. At the same time, the distinctive new logo appearing on all PNM vehicles and facilities, as well as in our advertising and customer information literature, emphasizes the exciting changes taking place at today's PNM.

As previously regulated markets are opened to competition, customer confusion over which provider to choose is certain to mount. Facing a bewildering array of new options, consumers will increasingly come to rely on familiar, established brands to guide them in making their energy choices. In this changing world, we believe the people of the Southwest will look to the PNM brand as a familiar, reliable certificate of quality and reliability.

## Officers of the Company

**Benjamin F. Montoya**  
President and CEO

**M. Phyllis Bourque**  
Senior Vice President, Energy Services

**Marc D. Christensen**  
Senior Vice President, Customer Service and Public Affairs

**Roger J. Flynn**  
Senior Vice President, Electric Services

**Max H. Maerki**  
Senior Vice President and Chief Financial Officer

**Patrick T. Ortiz**  
Senior Vice President, General Counsel and Secretary

**William J. Real**  
Senior Vice President, Gas Services

**Jeffrey E. Sterba**  
Senior Vice President, Bulk Power Services

**Judith A. Zanotti**  
Senior Vice President, Human Resources

**Patrick J. Goodman**  
Vice President, Power Production

**Edwin A. Kraft**  
Vice President, Customer Service

**Alfonso R. Lujan**  
Vice President, Electric Transmission and Distribution Services

**Lawrence D. Ratliff**  
Vice President, Engineering and Technical Services

**Terry D. Rister**  
Vice President, Gas Transmission and Distribution Services

**Donna M. Burnett**  
Corporate Controller and Chief Accounting Officer

**Mitchell J. Marzec**  
Treasurer

*John Renner and Michael C. Slota were both retired as of 1/26/96.*

## Board of Directors and Committees of the Board

**John T. Ackerman**  
Chairman of the Board of PNM since August 1993,  
Mr. Ackerman has been a director since 1990.

**Robert G. Armstrong**  
Mr. Armstrong is President of Armstrong Energy Corporation and has served as a PNM director since 1991.

**Joyce A. Godwin**  
Prior to her retirement in 1993, Ms. Godwin was Vice President and Secretary of Presbyterian Healthcare Services. She has served as a PNM director since 1989.

**Laurence H. Lattman**  
Prior to his retirement in 1993, Dr. Lattman served as President of the New Mexico Institute of Mining and Technology from 1983-1993. He has been a PNM director since May 1993.

**Manuel Lujan, Jr.**  
Mr. Lujan has been with Manuel Lujan Insurance Inc., since 1948, a consultant on U.S. governmental matters since 1993, and served as U.S. Secretary of the Interior from 1989-1993. He became a PNM director in April 1994.

**Benjamin F. Montoya**  
Mr. Montoya has been President and Chief Executive Officer as well as a director of PNM since 1993.

**Roynaldo ("Reynie") U. Ortiz**  
Mr. Ortiz has been Chief Executive Officer of Jones Education Networks, Inc. since March 1994. He was elected to the PNM Board in April 1992.

**Robert M. Price**  
Since 1990, Mr. Price has been President of PSV, Inc., a technology consulting business. He became a PNM director in July 1992.

**Paul F. Roth**  
Mr. Roth served as the President of the Greater Dallas Chamber of Commerce from 1991-1992 and became a PNM director in May 1991.

The Audit Committee reviews the financial statements of PNM and meets with and receives reports and other communications from its internal and outside independent auditors. *Members: Mr. Armstrong, Chair; Dr. Lattman; Mr. Lujan; Mr. Ortiz.*

The Corporate and Public Responsibility Committee reviews, implements and monitors policies that deal with PNM's responsibility to the communities in which it does business and determines the standards which govern business transactions. *Members: Ms. Godwin, Chair; Dr. Lattman; Mr. Lujan; Mr. Ortiz.*

The Executive Committee exercises the power of the Board of Directors in the management of the business affairs and property of PNM during intervals between the meetings of the Board. *Members: Mr. Ackerman, Chair; Mr. Armstrong; Ms. Godwin; Mr. Price; Mr. Roth.*

The Finance Committee reviews and recommends to the Board the capital structure and financial strategy for PNM, including dividend policy. It has overview of PNM's financial performance, investment procedures and policies, pension fund performance and funding level, and risk management strategies and policies. *Members: Mr. Price, Chair; Mr. Montoya; Mr. Roth.*

The Management Development and Compensation Committee reviews the compensation policies and benefit programs of PNM and how they relate to the attainment of goals. *Members: Mr. Roth, Chair; Mr. Armstrong; Ms. Godwin; Mr. Price.*

The Nominating Committee makes recommendations to the Board with respect to nominees to be designated by the Board for election as directors, as well as recommendations concerning the effectiveness, structure, size and composition of the Board, including committee assignments and candidates for election as Chairman of the Board. *Members: Ms. Godwin, Chair; Dr. Lattman; Mr. Roth.*



**FINANCIAL SECTION**

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**SELECTED FINANCIAL DATA**

	1995	1994	1993	1992	1991
	(In thousands except per share amounts and ratios)				
Total Operating Revenues*	\$ 808,465	\$ 904,711	\$ 873,878	\$ 851,953	\$ 857,168
Net Earnings (Loss)	\$ 75,562	\$ 80,318	\$ (61,486)**	\$ (104,255)***	\$ 22,960
Earnings (Loss)					
per Common Share	\$ 1.72	\$ 1.77	\$ (1.64)**	\$ (2.67)***	\$ 0.32
Total Assets	\$2,035,669	\$2,203,265	\$2,212,189	\$2,375,582	\$2,344,332
Preferred Stock with Mandatory Redemption Requirements	—	\$ 17,975	\$ 24,386	\$ 25,700	\$ 26,982
Long-Term Debt, less Current Maturities	\$ 728,843	\$ 752,063	\$ 957,622	\$ 911,252	\$ 786,279
Common Stock Data:					
Market price per common share at year end	\$ 17.625	\$ 13.00	\$ 11.25	\$ 12.375	\$ 9.75
Book value per common share at year end	\$ 16.82	\$ 15.11	\$ 13.29	\$ 15.00	\$ 17.69
Average number of common shares outstanding	41,774	41,774	41,774	41,774	41,774
Return on Average Common Equity	10.7%	12.4%	(10.7)%	(15.0)%	1.8%
Capitalization:					
Common stock equity	48.6%	43.2%	34.8 %	38.6 %	45.8%
Preferred stock:					
Without mandatory redemption requirements	0.9	4.1	3.7	3.6	3.7
With mandatory redemption requirements	—	1.2	1.5	1.6	1.7
Long-term debt, less current maturities	50.5	51.5	60.0	56.2	48.8
	100.0%	100.0%	100.0%	100.0 %	100.0%

- \* The Company changed its method of accounting for unbilled revenues in 1992.
- \*\* Includes the write-down of the 22% beneficial interests in the PVNGS Units 1 and 2 leases purchased by the Company, the write-off of certain regulatory assets and other deferred costs and the write-off of certain PVNGS Units 1 and 2 common costs, aggregating \$108.2 million, net of taxes (\$2.59 per share).
- \*\*\* Includes the write-down of the Company's investment in PVNGS Unit 3 and the provision for loss associated with the M-S-R power purchase contract, aggregating \$126.2 million, net of taxes (\$3.02 per share).

The selected financial data should be read in conjunction with the consolidated financial statements, the notes to consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.



## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is management's assessment of the Company's financial condition and the significant factors affecting the results of operations. This discussion should be read in conjunction with the Company's consolidated financial statements.

### OVERVIEW

#### Competitive Electric Market

The electric utility industry is currently undergoing a period of fundamental change intended to promote a competitive environment in the retail and wholesale energy marketplaces. Legislators and regulators at both the state and Federal level are considering whether, and how, to promote competition among suppliers of electricity and how to provide customers with choice among suppliers.

At the Federal level, the FERC promulgated a Notice of Proposed Rule Making ("Mega-NOPR") in March 1995, which proposes to require utilities to unbundle their generation and transmission services and to provide open access transmission. The Mega-NOPR also supplemented a prior NOPR concerning the appropriate treatment of stranded asset costs associated with the transition. Specifically, the FERC stated that recovery of legitimate and verifiable stranded asset costs is critical to the successful transition of the electric utility industry from a tightly regulated cost-of-service industry to an open transmission access, competitively priced industry. The Company in its response to the Mega-NOPR supported the FERC initiative toward open access transmission, but requested that all transmission asset owners, including municipal and Federal, be subject to the same requirements in order to establish a level playing field for all participants in the electric utility industry. The Company also agreed with the FERC regarding the proposed recovery of stranded asset costs. A final decision on the Mega-NOPR is expected in the middle of 1996. On January 22, 1996, a U.S. Senate bill, "Electricity Competition Act of 1996" was introduced, providing a national framework for a competitive electric industry by no later than the year 2010. The bill provides for recovery of stranded asset costs. On February 14, 1996, the Council of Economic Advisors issued an economic report to Congress in which it cautioned that electric industry competition should ensure competitive benefits to all power buyers and should not aggravate pollution or cause supply cuts to the poor. The report favors recovery of stranded asset costs borne by all parties on whose behalf the stranded costs were incurred, including customers that switch to other suppliers. Representative Dan Schaeffer, Chairman of the Energy Subcommittee of the House of Commerce Committee, has announced that he plans to conduct hearings on electric industry restructuring, possibly beginning this summer. The Company does not expect Congressional legislation to pass this year, but does expect Congressional interest to continue next year.

In November 1995, after three years of study, the Integrated Water and Resource Planning Committee of the New Mexico State Legislature (the "IWRPC") issued a resolution reporting its findings on the advantages and disadvantages of retail wheeling and alternative restructuring schemes applicable to the electric power industry in New Mexico. The IWRPC's recommendation stated that any proposed restructuring (i) must benefit all ratepayers in the state, (ii) must maintain and possibly encourage the financial health and economic viability of each of the state's utilities, (iii) must provide for appropriate protection from unfair or advantaged competition from utilities or others from outside the state, and (iv) must share equitably any costs, including stranded asset costs, among the varied interests benefited. The IWRPC also recommended that the NMPUC, under legislative direction and guidance, should monitor and evaluate the electric power industry and applicable market influences and factors and report its findings, conclusions and recommendations to the New Mexico State Legislature for legislative approval and action, as necessary, before any proposed restructuring may be implemented. The resolution further indicated that this continuing evaluation was necessary because of continuing changes even though restructuring and retail wheeling are not justified or in the public interest at this time. The IWRPC resolution was presented to the full Legislature as a Senate Joint Memorial. It was unanimously passed by the Senate and the House.

In November 1995, the NMPUC issued a Notice of Inquiry regarding the restructuring of regulation of the electric utility industry in New Mexico. The NMPUC is seeking input on a variety of questions related to competition, retail wheeling and state vs. Federal jurisdiction. The Company in its February 15, 1996 response stated that it believes that: (i) competition and customer choice may be beneficial to all affected interests in New Mexico if done appropriately and (ii) in order to achieve restructuring, there must be cooperative state and Federal action to avoid prolonged uncertainty and litigation, as well as to avert inconsistent state actions that would inhibit the development of competitive markets and restrict the benefits that they may provide. The Company proposed a five-year period to accomplish the

transition to a workable competitive market. The Company also stated that it supports action by the United States Congress to clarify boundaries between state and Federal jurisdiction over the electric utility industry, and to ensure that retail wheeling can be implemented in a manner that ensures fair competition and provides utilities the opportunity to recover all stranded asset costs.

Although it is uncertain as to the ultimate outcome of possible open access or retail wheeling initiatives, the Company will continue to be active at both the state and Federal levels in the public policy debate on the restructuring of the electric utility industry. By working with customers, regulators and legislators, the Company believes that an agreement will be reached that will protect the interests of stockholders as well as offer the potential benefits of a competitive marketplace to all customers.

### **Uncertainties**

The future structure of the industry, the form and timing of competition and the method of regulation in a competitive environment remain uncertain. If retail wheeling is implemented, it is possible that, based on other deregulated industries' experiences, retail energy prices could drop significantly. Should that be the case, the value of a utility's assets could be affected significantly in the transition to a more competitive market from a traditional rate regulated environment. Currently, the Company's generation costs are above those of neighboring utilities to the north and east of the Company's service territory.

The Company believes that the 1994 electric retail rate reduction improved its competitive position, but recognizes that lower cost producers may have an advantage if the regulatory framework changes significantly towards retail wheeling. The Company's owned nuclear capacity is currently valued at approximately \$900 per KW. If the Company were required to value its leased nuclear capacity at the same level as its owned nuclear capacity, it would be valued at approximately \$180 million versus approximately \$560 million. If there were no provision for the recovery of stranded asset costs, the Company would be required to charge against earnings approximately \$380 million.

### **Preparation for the Changes**

In order to mitigate the exposures associated with a competitive electric market and transition into this changing environment, the Company established the following strategic plan in 1995: (i) secure financial flexibility by retiring debt, (ii) control operation and maintenance costs, (iii) focus on maximizing shareholder value for the nuclear generation assets, and (iv) develop new business opportunities in the energy and utility related area. As part of this plan, the Company restructured its operation into four distinctive business units, each targeted at a specific segment of its customer base with emphasis on being more customer oriented and responsive to the changing competitive environment. The four business units are as follows: (i) Electric Services, (ii) Gas Services, (iii) Bulk Power Services and (iv) Energy Services.

In order to maximize value of the nuclear generation assets, the Company's board of directors (the "Board"), at its December 5, 1995 meeting, confirmed that it is in the best interest of the Company at this time to focus its efforts and resources on maximizing shareholder value from PVNGS as an asset (leased and owned) of the Company rather than disposing of it. Growth in the region, rapid growth in the Company's own local service territory and the continuous improvement in the operating performance of the plant were all factors in the change of approach. The Board stated that the Company no longer considers it to be a goal to dispose of its interests in PVNGS.

In conjunction with the development of new business opportunities, the Company focused on three energy and utility related activities under its Energy Services Unit. These activities will provide energy marketing, alternative fuel vehicle services and energy management services focused on residential and small customers, management services for water and wastewater systems and utility related management and operation services for Federal installations and other large commercial institutions. The Company believes that successful operation of these ventures will better position the Company in an increasingly competitive utility environment. The Company is currently seeking NMPUC approval for investment in energy and utility related subsidiaries under the Company's general diversification plan. The NMPUC Staff filed a motion in September 1995 to have the case dismissed. On January 31, 1996, the hearing examiner assigned to the case recommended that the NMPUC deny the Staff's motion. On February 5, 1996, the Staff filed a motion seeking to have the Company file an immediate report on its non-regulated activities being conducted without prior NMPUC approval; explain why NMPUC approval is not required; and explain why sanctions should not be considered if approval is required. On February 19, 1996, the Company filed its response describing its non-utility (energy and utility

related) activities and presenting the legal authority demonstrating that prior NMPUC approval is not required. The Company currently cannot predict the ultimate outcome of this proceeding but intends to vigorously defend against any allegation that it is in violation of any legal requirements.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Capital Requirements**

Total capital requirements include construction expenditures as well as other major capital requirements, including retirement of long-term debt, preferred stock and long-term debt sinking funds and preferred stock dividend requirements. The main focus of the construction program is upgrading generating systems, upgrading and expanding the electric and gas transmission and distribution systems, and purchasing nuclear fuel. Total capital requirements for 1995 and projections for 1996-2000 are \$367.4 million and \$676.8 million, respectively. These estimates are under continuing review and subject to on-going adjustment.

The Company currently anticipates that internal cash generation will be sufficient to meet capital requirements during 1996 through 2000. To cover the difference in the amounts and timing of cash generation and cash requirements, the Company intends to utilize short-term borrowings under its liquidity arrangements.

### **Liquidity and Financing**

The Company's construction expenditures for 1995 were entirely funded through cash generated from operations. In addition to cash flow from operations, the Company received approximately \$206.5 million from the sale of gas gathering and processing assets and the Company's water division. During 1995, the Company retired approximately \$133 million of PVNGS LOBs, redeemed, at par, \$64 million of the Company's cumulative preferred stock and retired approximately \$58 million of other long-term debt. At the end of 1995, the Company had \$96 million of temporary investments and no short-term borrowings. In addition, at year-end 1995, the Company had available liquidity arrangements of \$151 million, consisting of a \$100 million secured revolving credit facility ("Facility"), \$40 million credit facility collateralized by the Company's electric customer accounts receivable (the "Accounts Receivable Facility") and \$11 million in local lines of credit. On January 30, 1996, the Company requested NMPUC approval to increase the capacity of the Accounts Receivable Facility up to \$100 million by including in the collateral pool the Company's gas accounts receivable and certain amounts being recovered from gas customers relating to certain gas contract settlements. The Facility will expire in June 1998 and includes a maximum allowed debt to capitalization ratio of 70%. As of December 31, 1995, such ratio was 65%.

The Company's ability to finance its construction program at a reasonable cost and to provide for other capital needs is largely dependent upon its ability to earn a fair return on equity, results of operations, credit ratings, regulatory approvals and financial market conditions. Financing flexibility is enhanced by providing a high percentage of total capital requirements from internal sources and having the ability, if necessary, to issue long-term securities, and to obtain short-term credit. All of the Company's securities are rated below investment grade by Standard & Poor's Corp., Moody's Investors Service and Fitch Investors Service, Inc., which may result in limited credit markets being available and/or higher financing costs to the Company. Duff & Phelps Credit Rating Co. maintains an investment grade rating for the Company's first mortgage bonds, but continues to rate all other of the Company's securities below investment grade.

### **Financing Capability and Dividend Restrictions**

One impact of the Company's current ratings, together with covenants in the Company's PVNGS Units 1 and 2 lease agreements (see PART I, ITEM 2. "PROPERTIES Nuclear Plant"), is to limit the Company's ability, without consent of the owner participants and bondholders in the lease transactions, (i) to enter into any merger or consolidation, or (ii) except in connection with normal dividend policy, to convey, transfer, lease or dividend more than 5% of its assets in any single transaction or series of related transactions. The Facility and a reimbursement agreement associated with the letter of credit supporting \$37.3 million of pollution control revenue bonds impose similar restrictions irrespective of credit ratings.

The issuance of first mortgage bonds by the Company is subject to earnings coverage and bondable property provisions of the Company's first mortgage indenture. The Company also has the capability under the mortgage indenture, without regard to the earnings test but subject to other conditions, to issue first mortgage bonds on the basis

of certain previously retired bonds. At December 31, 1995, based on the earnings test, the Company could have issued approximately \$124 million of additional first mortgage bonds, assuming an annual interest rate of 9.25 percent. The Company's restated articles of incorporation limit the amount of preferred stock which may be issued. Assuming a preferred stock dividend rate of 9.75 percent, the Company could have issued \$381 million of preferred stock as of year-end.

The Company currently has no requirements for long-term financing during the period of 1996 through 2000. However, during this period, the Company could enter into long-term financings for the purpose of strengthening its balance sheet and reducing its cost of capital. The Company continues to evaluate its investment and debt retirement options to optimize its financing strategy and earnings potential. The Company currently plans to retire approximately \$90 million of long-term debt in 1996.

The Company has not declared dividends on its common stock since January 1989 and anticipates announcing a dividend plan sometime before the end of the second quarter of 1996. The Company's board of directors reviews the Company's dividend policy on a continuing basis. The resumption of common dividends is dependent upon a number of factors including earnings and financial condition of the Company and market conditions. The deficit in retained earnings was eliminated during 1995.

### Capital Structure:

The Company's capitalization, including short-term debt, at December 31 is shown below:

	1995	1994	1993
Common Equity .....	48.6%	39.2%	34.4%
Preferred Stock .....	0.9	4.8	5.2
Long-term Debt (including current maturities) .....	50.5	56.0	60.4
Total Capitalization* .....	100.0%	100.0%	100.0%

\* Total capitalization does not include the present value of the Company's lease obligations for PVNGS Units 1 and 2 and EIP as debt but does include, for 1994 and 1993, the debt associated with the beneficial interests in certain PVNGS Units 1 and 2 leases purchased by the Company, which were retired in March 1995.

### RESULTS OF OPERATIONS

Net earnings per common share in 1995 were \$1.72, compared to net earnings of \$1.77 per common share in 1994 and a loss of \$1.64 per common share in 1993. The loss experienced in 1993 was due to the Company recording an after-tax charge of \$108.2 million to earnings resulting from the write-down in connection with the Company's \$30 million retail electric rate reduction.

The financial performance of the excluded resources has been improved by the PVNGS Unit 3 write-down and the provision for loss associated with the M-S-R power purchase contract recorded in 1992. The gains from the sale of generating facilities to Anaheim recorded in August 1993 and to UAMPS recorded in June 1994 have also improved the financial performance of the excluded resources.

A number of items contributed to the \$3.5 million decrease in net earnings of the excluded resources as compared with 1994 results. The most significant item was the UAMPS gain recorded in June 1994. Operating results for the excluded resources for all these periods reflect the allocation of interest charges based on the average investment in excluded net utility plant as a percent of total utility plant for the period.

Selected financial information for the excluded resources for 1995, 1994 and 1993 is shown below:

	1995	1994	1993
		(In thousands)	
Operating revenues .....	\$ 35,317	\$ 39,227	\$ 42,517
Operating income .....	\$ 2,372	\$ 2,358	\$ 2,034
Net earnings (loss) .....	\$ (1,710)	\$ 1,838	\$ (2,099)
Net utility plant at year-end .....	\$133,757	\$133,697	\$159,387

The following discussion highlights other significant items which affected the results of operations in 1995, 1994 and 1993, and certain items expected to impact future earnings.

Electric gross margin (electric operating revenues less fuel and purchased power expense) decreased \$37.9 million in 1995 due to the retail rate reduction implemented in late 1994, reduced off-system sales as a result of the expiration of three sales contracts and generally poor wholesale power market conditions. Partially offsetting such decreases was the increase in retail revenues resulting from retail sales growth.

Electric gross margin increased \$32.3 million in 1994 compared to 1993, \$23.2 million of which was due to an increase in jurisdictional energy sales. This increase was partially due to warmer weather and a difference of \$6.7 million between the estimated unbilled revenues reported in 1993 and actual unbilled revenues in 1994.

Gas gross margin (gas operating revenues less gas purchased for resale) decreased \$16.4 million from a year ago due to a decrease of \$5.5 million in gas deliveries resulting from warmer than normal weather in 1995 and reduced margin of \$11.7 as a result of the gas gathering and processing assets sale in June 1995. Gas gross margin decreased \$5.1 million in 1994 from 1993. Principal factors were the write-off of certain deferred charges relating to costs of gas and a decrease in gas deliveries resulting from a warmer than normal winter in 1994.

Other operation and maintenance expenses ("O&M") decreased \$12.3 million in 1995 due to the following: (i) a \$2.1 million decrease in PVNGS O&M expense as a result of a reduction in scheduled maintenance outage hours and lower property taxes in the current period, (ii) decreased Four Corners O&M expenses of \$2.0 million resulting from a maintenance outage of Unit 4 in 1994, (iii) decreased SJGS O&M expenses of \$1.7 million resulting from lower maintenance outage hours in 1995, (iv) a decrease in gas production and products extraction expense of \$6.2 million resulting from the gas assets sale in June 1995, (v) a decrease in injuries and damages expense of \$4.5 million as a result of the recording of workers' compensation liability in 1994, (vi) lower office supplies and expenses of \$3.0 million as a result of a decrease in temporary office labor and postage expense and (vii) a decrease in water O&M expense of \$2.1 million resulting from the sale of the Company's water division in July 1995. Such decreases were partially offset by (i) higher administrative and general labor expense of \$4.7 million, (ii) higher employee benefit expense of \$2.7 million caused by the retroactive deferral of the gas operation's retirees health care costs for regulatory purposes recorded in 1994 and (iii) higher production O&M expenses for the gas and oil-fired plants of \$1.7 million resulting from the maintenance outages in 1995.

Other O&M expenses decreased \$5.1 million in 1994 from 1993 due to the following: (i) a \$10.6 million decrease as a result of the Company's 1993 severance program, (ii) a deferral of gas operation's retirees health care costs of \$2.8 million for regulatory purposes and (iii) lower electric regulatory commission expense of \$2.1 million. Offsetting such decrease was the following: (i) increased pension and retirees health care cost of \$3.0 million, (ii) increased electric distribution expense of \$3.6 million due to weather-related outages and increased tree trimming activity, (iii) increased generating station maintenance expense of \$2.4 million and (iv) increased workers' compensation liability of \$2.2 million.

Depreciation and amortization expenses increased \$6.7 million from a year ago as a result of the implementation of new depreciation rates approved by the NMPUC in November 1994.

Other, under the caption Other Income and Deductions, increased \$44.2 million from a year ago and increased \$9.3 million in 1994 from 1993. Significant 1995 items, net of taxes, included the following: (i) the gain of \$12.8 million recognized from the sale of the gas gathering and processing assets, (ii) the gain of \$6.4 million recognized from the sale of the Company's water division, (iii) an after-tax accrual of \$2.6 million of income pertaining to the carrying costs related to gas take-or-pay settlement amounts, (iv) income of \$1.9 million for insurance recovery and (v) income of \$1.4 million related to adjusting reclamation reserves for certain mining operations. Partially offsetting such increases were: (i) additional regulatory reserves of \$4.8 million and (ii) write-downs of \$1.8 million for various non-utility properties.

Significant 1994 items, net of taxes, included the following: (i) the write-off of \$3.0 million relating to gas take-or-pay settlement payments which are not recoverable through rates, (ii) additional provisions for legal expense of \$3.6 million and (iii) a gain and associated tax benefits of \$6.1 million from the sale of generating facilities to UAMPS.

Significant 1993 items, net of taxes, included the following: (i) the gain of \$7.5 million recognized from the sale of an investment, (ii) the gain and associated tax benefits of \$7.6 million from the sale of generating facilities to Anaheim and (iii) tax benefits of \$3.2 million from the Federal income tax rate change which allows the Company to utilize its

net operating loss at a higher tax rate. Partially offsetting such increases were: (i) additional provisions for legal and litigation expenses of \$5.7 million, (ii) a write-off of \$4.6 million of other deferred costs, (iii) PVNGS decommissioning fund adjustment of \$2.8 million and (iv) a write-off of \$2.1 million resulting from costs associated with refunding certain pollution control and EIP bonds, which represents the amount related to FERC firm-requirement wholesale customers and resources excluded from New Mexico jurisdictional rates.

Net interest charges decreased \$12.7 million in 1995 as a result of the retirement of \$130 million of PVNGS LOBs in March 1995 and the retirement of \$45 million of first mortgage bonds in April 1994. In 1994, net interest charges decreased \$15.2 million compared to 1993. Major factors were: (i) lower short-term borrowings in 1994, (ii) the refinancing of \$182 million of pollution control revenue bonds in January (\$46 million) and September (\$136 million) of 1993 and (iii) the retirement of \$45 million of first mortgage bonds in April 1994.

Preferred stock dividend requirements decreased \$2.7 million in 1995 as a result of the retirement of \$64 million of preferred stock in August 1995.

## **OTHER ISSUES FACING THE COMPANY**

### **TRANSMISSION ISSUES**

#### *OLE Transmission Project*

OLE, a proposed 345 Kv transmission line connecting the existing Ojo 345 Kv line to the Norton Station in northern New Mexico, was designed to provide a needed improvement to the northern New Mexico transmission system and to allow greater delivery of power into the Company's two largest service territories, the greater Albuquerque area and the Santa Fe/Las Vegas area. OLE has faced considerable opposition by persons concerned primarily about the environmental impacts of the project.

The Company filed in 1991 for NMPUC approval for construction of OLE. On November 20, 1995, the NMPUC issued a final order disapproving the project. On December 20, 1995, the Company filed a limited Motion for Rehearing, accepting the NMPUC's determination that the OLE routing should not be pursued but seeking reconsideration of various parts of the final order which discuss system planning and reliability matters. The NMPUC took no action on the Company's request which in effect deemed it denied. The Company has elected not to appeal the NMPUC order or denial of rehearing. The Company has incurred approximately \$17 million for the OLE project and has established accounting reserves as deemed appropriate. The Company intends to seek recovery of these costs as legitimate and prudent costs in future appropriate proceedings.

#### *Transmission Right-of-Way*

The Company has easements for right-of-way with the Navajo Nation for portions of several transmission lines that deliver the Company's generation resources to the Albuquerque metropolitan area. One grant of easement for approximately 4.2 miles of right-of-way for two parallel 345 Kv transmission lines expired in 1993. Prior to the expiration, the Company had numerous unsuccessful negotiation meetings with the Navajo Nation for the renewal of the long-term grant. In 1994, the Navajo Nation adopted a Civil Trespass Statute providing for civil penalties, damages and other remedies, including removal, to be imposed for unconsented or unauthorized use of Navajo Nation lands. During 1995, the Company reached a tentative agreement with the Navajo Nation for a twenty-year renewal of the transmission easement and a resolution of all other transmission right-of-way issues. Prior to the execution of the agreement, another agency of the Navajo Nation notified the Company that it was contesting certain water rights at the SJGS, which has delayed resolution of the transmission right-of-way issues. The Company continues to work with the Navajo Nation to resolve this conflict.

The Company continues to assess its options but is not pursuing other alternatives unless it receives indications that settlement cannot be reached in a satisfactory manner. The Company currently cannot predict the outcome of the negotiations or the costs resulting therefrom; however, the Company believes that resolution of this issue will not have a material adverse impact on the Company's financial condition or results of operations.

### *Transmission Disputes*

The Company receives approximately \$14.0 million annually for the provision of firm transmission service to several customers. Most of these customers, through various actions, have initiated formal FERC investigations into the transmission service billing units and transmission rates charged by the Company. If these various allegations and requested rate reductions are approved by the FERC, the Company's revenues for transmission services could be reduced by as much as \$9 million annually. The Company has responded to these allegations and has requested that the FERC dismiss the complaints. The Company is currently awaiting the FERC decision. In a related FERC filing, the Company committed to file, on or before April 1, 1996, a rate change for all firm, point-to-point and network service transmission customers, including those customers that have filed the pending complaints. Although the Company anticipates a reduction in rates resulting from the filing, the Company does not anticipate any material adverse impact on the Company's financial condition or results of operations.

### **SALE OF GAS GATHERING AND PROCESSING ASSETS**

As part of the Company's announced action plan in 1993 to focus on its core utility business, the Company, in 1994, entered into an agreement with Williams for the sale of substantially all of the assets of Gathering Company and Processing Company and for the sale of Northwest and Southeast gas gathering and processing facilities of the Company.

The sales transaction provides for three 10-year contracts, each with an option to renew for an additional 5-year term, with Williams for competitively priced gathering and processing services. The purchase and sale agreement contains contractual requirements for the Company to address various environmental deficiencies identified as retained liabilities. It also contains environmental representations and warranties and indemnification provisions whereby the Company indemnifies Williams for a five-year period after closing for breaches of the environmental representations and warranties and against third party claims to a maximum of \$10.6 million. After the \$10.6 million cap has been reached, or after the expiration of the five-year post-closing indemnification period, whichever comes first, Williams indemnifies the Company against further environmental expenditures related to the properties sold. On June 30, 1995, following NMPUC approval, the Company and Williams closed the sale of the assets. As a result, the Company and its gas subsidiaries received \$154 million from Williams and recognized an after-tax gain of \$12.8 million, or 31 cents per share. Under the NMPUC approval, the Company recorded a liability of approximately \$35 million, representing an estimate of a portion of the gain resulting from the sale, which will be credited to the Company's gas customers' bills over five years. After completion of the fifth year, the amount of the gain will be recalculated to reflect actual expenses associated with the transaction which were appropriately and legitimately incurred. Such amount should include amounts expended to indemnify Williams as described above. Any resulting differences will be refunded or billed to customers over a one year period.

As a result of the gas assets sales, the operations of the Company's two wholly-owned gas subsidiaries, Gathering Company and Processing Company, have been substantially discontinued, effective June 30, 1995.

### **ENVIRONMENTAL ISSUES**

The Company is committed to complying with all applicable environmental regulations in a responsible manner. Environmental issues have presented and will continue to present a challenge to the Company. The Company has evaluated the potential impacts of the following environmental issues and believes, after consideration of established reserves, that the ultimate outcome of these environmental issues will not have a material adverse effect on the Company's financial condition or results of operations.

#### **Electric Operations**

##### *Person Station*

The Company, in compliance with the New Mexico Environment Department Corrective Action Directive, determined that groundwater contamination exists in the deep and shallow water aquifers. The Company is required to delineate the extent of the contamination and remediate the contaminants in the groundwater. The extent of the contaminated plume in the deep water aquifer has been assessed and results have been reported to the NMED. The Company has also proposed revised remedial options to the NMED. The Company is awaiting a final response from

the NMED. The Company's current estimate to decommission its retired fossil-fueled plants includes approximately \$10.9 million to complete the groundwater remediation program at Person Station. As part of the financial assurance requirement of the Person Station Hazardous Waste Permit, the Company posted a \$5.1 million performance bond with a trustee. The remediation program continues on schedule.

#### *Santa Fe Station*

The NMED has been conducting an investigation of the groundwater contamination detected beneath the Santa Fe Station site to determine the source of the contamination. The Company has been and is continuing to cooperate with the NMED site investigation pursuant to a settlement agreement between the Company and the NMED. In May 1995, the Company received a letter from the NMED indicating that the NMED had made a determination that Santa Fe Station was the source of gasoline-contaminated groundwater at the site and vicinity. The Company contested the NMED's determination and believes insufficient data exists to definitely identify the sources of groundwater contamination. A minimum site assessment ("MSA") of the two former underground storage tank sites at the Santa Fe Station site was conducted by the Company under the settlement agreement. The MSA report indicated that the Santa Fe Station site does not appear to have been a source of gasoline contamination. The MSA report has been submitted to the NMED and is currently pending NMED review.

#### *Albuquerque Electric Service Center*

Trenching work at the electric service center revealed oil contaminated soil in an area of the service center where used oil in drums were stored. The trenched area bisects a small portion of the storage area, indicating that potentially the area could be underlain with contaminated soil. The Company requested a laboratory analysis on the soil to determine the type of contamination. The Company may be required to assess soil and groundwater for contamination as well as remediate extensive volumes of soil in the area. The Company currently cannot predict the outcome of the analysis, to what extent the soil was contaminated or the costs of the remediation, if any.

In addition, leaking underground fuel lines, which have been replaced, caused soil and groundwater contamination in the vicinity of the leak. The Company proposed a quarterly sampling plan to the NMED for the site. The NMED has expressed concerns regarding the placement of monitoring wells and the relatively high levels of residual contamination remaining in the soil at the site. Based on the recent analysis of the groundwater sampling, the contaminated soil does not appear to be a continual recharge source to the groundwater contamination. The NMED may require additional monitoring wells and soil remediation work at the site.

### **Gas Operations**

#### *Air Permits*

In 1994, following an environmental audit performed in conjunction with the Company's sale of certain gas assets, which audit brought to light certain discrepancies regarding required air permits associated with certain natural gas facilities, the Company met with the NMED to discuss the nature of the permit discrepancies and to propose methods and schedules to resolve the discrepancies.

The Company submitted in 1994 its permit modification application for the Lybrook Gas Processing Plant ("Lybrook"). The Lybrook permit has now been issued to Williams, the purchaser of the gas assets.

The Company submitted an air permit modification application for the Kutz Canyon Gas Processing Plant ("Kutz") in the first quarter of 1995. In October 1995, the Company received a Notice of Violation ("NOV") from the NMED with specified corrective actions on the permit discrepancies in the Kutz air permit. In January 1996, the Company accepted a settlement offer for the NOV from the NMED in the amount of \$15,000. The Company cannot predict when the final permit will be issued by the NMED or whether additional requirements will be imposed by the NMED as conditions for issuance of the permit.

#### *Gas Wellhead Pit Remediation*

The New Mexico Oil Conservation Commission ("NMOCC") issued an order, effective on January 14, 1993, that affects the gas gathering facilities, which were sold to Williams, located in the San Juan Basin in northwestern New Mexico. The order prohibits the further discharge of fluids associated with the production of natural gas into unlined



earthen pits in certain specified areas of the San Juan Basin. The order also required the submission of closure plans for the closure of pits in which production fluids were previously discharged. The BLM has issued a similar ruling. The Company has complied with such rulings and submitted and received approval of the pit closure plans from the OCD, the Energy Minerals and Natural Resources Department, as well as the BLM.

The Company has received letters and directives from the OCD directing the Company to determine if certain unlined discharge pits have contributed to the groundwater contamination plumes that were identified at those sites. The Company is currently assessing the sites in accordance with the OCD directive. The Company continues to assess unlined pits in accordance with the OCD directive and is addressing potential groundwater contamination issues as they arise during the assessment process.

On March 3, 1995, the Jicarilla Apache Tribe ("Jicarilla") enacted an ordinance directing that unlined surface impoundments located within environmentally sensitive areas be remediated and closed by December 1996, and that all other unlined surface impoundments on Jicarilla's lands be remediated and closed by December 1998. The Company has received a claim for indemnification by Williams for the environmental work required to comply with the Jicarilla ordinance. The Company has submitted a closure/remediation plan to the Jicarilla, which has been approved, and the Company anticipates initiating the remediation process in the spring of 1996. The costs of remediation will be charged against the \$10.6 million indemnification cap contained in the purchase and sale agreement between the Company and Williams. The Company does not anticipate that the claim for indemnification will have any material impact on the Company's financial condition or results of operations.

### **GAS RATE CASE**

On August 28, 1995, the Company filed a request for a \$13.3 million increase in its retail natural gas sales and transportation rates. NMPUC Staff and intervenors in the case filed their testimony on January 16, 1996. The Staff recommended a \$2.5 million rate decrease and the AG recommended a \$14.7 million rate decrease. The major issues in the case center around the Company's request to recover certain costs associated with reservation fees, discounts given to large and industrial transportation customers and losses incurred to reacquire debt. The Company anticipates that it will have deferred as regulatory assets approximately \$22 million related to these items through July 1, 1996, the date when rates are anticipated to go into effect. The Company will file its rebuttal testimony on February 23, 1996 and hearings will begin on March 4, 1996. Although the Company cannot predict the ultimate outcome of this case, the Company believes that it has meritorious claims and will vigorously pursue the recovery of these assets.

### **ALBUQUERQUE FRANCHISE ISSUES**

The Company's non-exclusive electric service franchise with the City of Albuquerque (the "City") expired in 1992. The franchise agreement provided for the Company's use of City rights-of-way for placement of electric service facilities. The Company provides service to the area which contributed 46% of the Company's total 1995 electric operating revenues. The absence of a franchise does not change the Company's right and obligation to serve those customers under state law.

In 1991, the NMPUC issued an order concluding, among other things, that the City could bid for services to its own facilities (Albuquerque municipal loads generated approximately \$16.6 million in annual revenue for 1995), but not for service to other customers. However, the New Mexico Supreme Court ("Court") ruled that a city can negotiate rates for its citizens in addition to its own facility uses. The Court also ruled that any contracts with utilities for electric rates are a matter of statewide concern and subject to approval, disapproval or modification by the NMPUC. In addition, the Court reaffirmed the NMPUC's exclusive power to designate providers of utility service within a municipality and confirmed that municipal franchises are not licenses to serve but rather provide access to public rights-of-way.

During 1992, representatives of the Company and the City had numerous meetings in attempts to resolve the franchise renewal issue. Since that time, no meetings have been held. The City continues to maintain its options by advocating industry restructuring and monitoring the municipalization activities of the City of Las Cruces. A measure designed to start municipalization activities in Albuquerque was defeated by the City Council. The Company continues to collect and pay franchise fees to the City.

## PVNGS NUCLEAR DECOMMISSIONING

### *Decommissioning Costs and Trust Funds*

The Company has a program for funding its share of decommissioning costs for PVNGS. Under this program, the Company makes a series of annual deposits to an external trust fund over the estimated useful life of each unit with the trust funds being invested under a plan which allows the accumulation of funds largely on a tax-deferred basis through the use of life insurance policies on certain current and former employees. The results of the 1995 decommissioning study indicate that the Company's share of the PVNGS decommissioning costs will be approximately \$145.6 million, a decrease from \$157.8 million based on the previous 1992 study (both amounts are stated in 1995 dollars).

The Company has determined that a supplemental investment program will be needed as a result of both cost increases identified in the 1992 study and the lower than anticipated performance of the existing program. On September 29, 1995, the Company filed a request for permission from the NMPUC to establish a qualified tax advantaged trust for PVNGS Units 1 and 2. Due to Internal Revenue Service ("IRS") regulations, PVNGS Unit 3 will remain in a non-qualified trust.

The Company, on February 7, 1996, filed a motion for interim relief for establishment of a qualified trust pending final NMPUC action. The interim request was necessary in order to meet the March 15 deadline under IRS requirements for the qualified trust to be effective for the current year. On February 19, 1996, the NMPUC granted this request.

The market value of the existing trust at the end of 1995 was approximately \$12.4 million, which includes the cash surrender value of the current insurance policies.

### *Decommissioning Costs of Nuclear Power Plants*

In February 1996, the Financial Accounting Standards Board ("FASB") issued an Exposure Draft on the accounting for closure and removal costs, including decommissioning, of nuclear power plants. If current electric utility industry accounting practices for nuclear power plant decommissioning are changed, the annual provision for decommissioning could increase relative to 1995, and estimated costs for decommissioning could be recorded as a liability (rather than as accumulated depreciation), with recognition of an increase in the cost of related nuclear power plants. The Company is unable to predict the ultimate outcome of this project.

## PVNGS PROPERTY TAXES

On June 29, 1990, an Arizona state tax law was enacted, effective as of December 31, 1989, which adversely impacted the Company's earnings in the years of 1990 through 1995 by approximately \$5 million per year, before income taxes. On December 20, 1990, the PVNGS participants, including the Company, filed a lawsuit in the Arizona Tax Court, a division of the Maricopa County Superior Court, against the Arizona Department of Revenue, the Treasurer of the State of Arizona, and various Arizona counties, claiming, among other things, that portions of the new tax law are unconstitutional. In December 1992, the court granted summary judgment to the taxing authorities, holding that the law is constitutional. The PVNGS participants appealed this decision to the Arizona Court of Appeals. On November 21, 1995, the Arizona Court of Appeals ruled in favor of the PVNGS participants. Due to the significance of this decision, it is anticipated that the case will be further pursued through the courts. The Company cannot currently predict the ultimate outcome of this matter.

## EL PASO

El Paso, one of the joint owners of PVNGS and Four Corners, has been operating under Chapter 11 of the Bankruptcy Code since 1992. After the failed merger transaction with Central and South West Corporation, in September 1995, El Paso filed with the bankruptcy court a revised plan whereby, among other things, certain issues would be resolved, including its assumption of the joint facilities operating agreements. The revised plan, as amended, was confirmed by order of the Bankruptcy Court on January 9, 1996. The order approves an amended Assumption and Cure Agreement between El Paso and all participants at PVNGS. As a part of its plan, El Paso also assumed agreements at Four Corners and paid all sums outstanding under the agreements. In addition, El Paso assumed various transmission agreements with the Company. Currently, there are no remaining claims by the Company to be resolved in connection with the bankruptcy. El Paso emerged from bankruptcy on February 12, 1996.

## ACCOUNTING STANDARDS

### *SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*

In March 1995, the FASB issued Statement of Financial Accounting Standard ("SFAS") No. 121. This statement requires companies to review their long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. SFAS No. 121 also requires all regulatory assets, which must have a high probability of recovery to be initially established, must continue to meet that high probability standard to avoid being written off. However, if written off, a regulatory asset can be restored if, through regulatory actions, it again becomes probable of recovery. The adoption of SFAS No. 121 had no impact on the Company's financial condition or results of operations.

## PVNGS - STEAM GENERATOR TUBES

APS, as the operating agent of PVNGS, has encountered tube cracking in the steam generators and has taken, and will continue to take, remedial actions that it believes have slowed further tube degradation. The steam generator tubes in each unit continue to be inspected in conjunction with their respective outages. APS currently believes that the PVNGS steam generators in Units 1 and 3 are capable of operating for their designed life of forty years, although, at some point, long-term economic considerations may warrant examination of possible steam generator replacement. APS's ongoing analyses indicate that it will be economically desirable for APS to replace the Unit 2 steam generators, which have been most affected by tube cracking, in five to ten years. APS expects that the steam generator replacement can be accomplished within financial parameters established before replacement was a consideration. Based on APS's analyses, the Company believes that its share of the replacement costs (in 1995 dollars and including installation and replacement power costs) would be between \$10.5 million and \$17.5 million, most of which would be incurred after the year 2000. APS expects that the replacement would be performed in conjunction with a normal refueling outage in order to limit additional incremental outage time to approximately 50 days. APS believes that replacement of the Unit 2 steam generators within five to ten years will be economically desirable. The Company is evaluating this and other options in regards to this issue.

All of the PVNGS units were operating at full power at December 31, 1995 and are expected to continue operating at full power, except for scheduled (mid-cycle or refueling) outages. Last year, PVNGS had three refueling outages, one for each of the three units.

## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The management of Public Service Company of New Mexico is responsible for the preparation and presentation of the accompanying consolidated financial statements. The consolidated financial statements have been prepared in conformity with generally accepted accounting principles and include amounts that are based on informed estimates and judgments of management. Management maintains a system of internal accounting controls which it believes is adequate to provide reasonable assurance that assets are safeguarded, transactions are executed in accordance with management authorization and the financial records are reliable for preparing the consolidated financial statements. The system of internal accounting controls is supported by written policies and procedures, by a staff of internal auditors who conduct comprehensive internal audits and by the selection and training of qualified personnel. The board of directors, through its audit committee comprised entirely of outside directors, meets periodically with management, internal auditors and the Company's independent auditors to discuss auditing, internal control and financial reporting matters. To ensure their independence, both the internal auditors and independent auditors have full and free access to the audit committee. The independent auditors, Arthur Andersen LLP, are engaged to audit the Company's consolidated financial statements in accordance with generally accepted auditing standards.

## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders of  
Public Service Company of New Mexico:

We have audited the accompanying consolidated balance sheets and statements of capitalization of Public Service Company of New Mexico (a New Mexico corporation) and subsidiaries as of December 31, 1995 and 1994, and the related consolidated statements of earnings (loss), retained earnings (deficit), and cash flows for each of the three years in the period ended December 31, 1995. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Public Service Company of New Mexico and subsidiaries as of December 31, 1995 and 1994, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1995 in conformity with generally accepted accounting principles.

As explained in notes 1 and 7 to the financial statements, effective January 1, 1993, the Company adopted Statement of Financial Accounting Standards No. 106, *Employer's Accounting for Postretirement Benefits Other Than Pensions*, and No. 109, *Accounting for Income Taxes*.

ARTHUR ANDERSEN LLP

Albuquerque, New Mexico  
February 13, 1996

**CONSOLIDATED STATEMENTS OF EARNINGS (LOSS)**

	Year Ended December 31,		
	1995	1994	1993
	(In thousands except per share amounts)		
Operating Revenues:			
Electric .....	\$584,284	\$621,794	\$589,728
Gas .....	217,985	269,510	271,087
Water .....	6,196	13,407	13,063
Total operating revenues .....	<u>808,465</u>	<u>904,711</u>	<u>873,878</u>
Operating Expenses:			
Fuel and purchased power .....	140,752	140,411	140,674
Gas purchased for resale .....	94,299	129,381	125,940
Other operation expenses .....	257,627	264,391	274,023
Maintenance and repairs .....	55,809	61,386	56,821
Depreciation and amortization .....	80,865	74,137	77,326
Taxes, other than income taxes .....	35,531	39,717	40,089
Income taxes .....	30,194	44,210	25,721
Total operating expenses .....	<u>695,077</u>	<u>753,633</u>	<u>740,594</u>
Operating income .....	<u>113,388</u>	<u>151,078</u>	<u>133,284</u>
Other Income and Deductions, net of taxes .....	20,108	(173)	(108,947)
Income before interest charges .....	133,496	150,905	24,337
Interest Charges, net .....	57,934	70,587	85,823
Net Earnings (Loss) .....	75,562	80,318	(61,486)
Preferred Stock Dividend Requirements .....	3,714	6,433	6,829
Net Earnings (Loss) Available for Common Stock .....	<u>\$ 71,848</u>	<u>\$ 73,885</u>	<u>\$ (68,315)</u>
Average Number of Common Shares Outstanding .....	41,774	41,774	41,774
Net Earnings (Loss) per Share of Common Stock .....	<u>\$ 1.72</u>	<u>\$ 1.77</u>	<u>\$ (1.64)</u>
Dividends Paid per Share of Common Stock .....	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

**CONSOLIDATED STATEMENTS OF RETAINED EARNINGS (DEFICIT)**

	Year Ended December 31,		
	1995	1994	1993
	(In thousands)		
Balance at Beginning of Year .....	\$(46,006)	\$(120,848)	\$ (52,533)
Net earnings (loss) .....	75,562	80,318	(61,486)
Redemption of cumulative preferred stock .....	(599)	957	-
Cumulative preferred stock dividends .....	(3,714)	(6,433)	(6,829)
Balance at End of Year .....	<u>\$ 25,243</u>	<u>\$ (46,006)</u>	<u>\$ (120,848)</u>

The accompanying notes are an integral part of these financial statements.

**CONSOLIDATED BALANCE SHEETS**

	December 31,	
	1995	1994
	(In thousands)	
<b>ASSETS</b>		
Utility Plant, at original cost except PVNGS:		
Electric plant in service . . . . .	\$1,871,897	\$1,783,962
Gas plant in service . . . . .	421,607	537,762
Water plant in service . . . . .	-	63,048
Common plant in service . . . . .	35,222	49,049
Plant held for future use . . . . .	639	894
	<u>2,329,365</u>	<u>2,434,715</u>
Less accumulated depreciation and amortization . . . . .	892,727	890,905
	<u>1,436,638</u>	<u>1,543,810</u>
Construction work in progress . . . . .	106,892	119,308
Nuclear fuel, net of accumulated depreciation of \$26,395 and \$35,333. . . . .	30,904	33,569
Net utility plant . . . . .	<u>1,574,434</u>	<u>1,696,687</u>
Other Property and Investments:		
Non-utility property, net of accumulated depreciation of \$1,547 and \$1,328. . . . .	4,063	5,752
Other investments . . . . .	29,370	28,771
Total other property and investments . . . . .	<u>33,433</u>	<u>34,523</u>
Current Assets:		
Cash . . . . .	4,228	21,029
Temporary investments, at cost . . . . .	95,972	74,521
Receivables . . . . .	127,642	129,048
Income taxes receivable . . . . .	4,792	4,182
Fuel, materials and supplies, at average cost . . . . .	44,660	51,068
Gas in underground storage, at average cost . . . . .	5,431	8,744
Other current assets . . . . .	7,186	9,549
Total current assets . . . . .	<u>289,911</u>	<u>298,141</u>
Deferred charges . . . . .	137,891	173,914
	<u>\$2,035,669</u>	<u>\$2,203,265</u>
<b>CAPITALIZATION AND LIABILITIES</b>		
Capitalization:		
Common stock equity:		
Common stock outstanding - 41,774,083 shares . . . . .	\$ 208,870	\$ 208,870
Additional paid-in capital . . . . .	470,358	469,648
Excess pension liability, net of tax . . . . .	(1,623)	(1,106)
Retained earnings (deficit) since January 1, 1989 . . . . .	25,243	(46,006)
Total common stock equity . . . . .	<u>702,848</u>	<u>631,406</u>
Cumulative preferred stock without mandatory redemption requirements . . . . .	12,800	59,000
Cumulative preferred stock with mandatory redemption requirements . . . . .	-	17,975
Long-term debt, less current maturities . . . . .	728,843	752,063
Total capitalization . . . . .	<u>1,444,491</u>	<u>1,460,444</u>
Current Liabilities:		
Short-term debt . . . . .	-	-
Accounts payable . . . . .	93,666	105,213
Current maturities of long-term debt . . . . .	146	148,532
Accrued interest and taxes . . . . .	26,856	28,073
Other current liabilities . . . . .	44,699	43,662
Total current liabilities . . . . .	<u>165,367</u>	<u>325,480</u>
Deferred Credits:		
Accumulated deferred investment tax credits . . . . .	66,734	71,564
Accumulated deferred income taxes . . . . .	78,829	77,207
Other deferred credits . . . . .	280,248	268,570
Total deferred credits . . . . .	<u>425,811</u>	<u>417,341</u>
Commitments and Contingencies (notes 2 through 12)		
	<u>\$2,035,669</u>	<u>\$2,203,265</u>

The accompanying notes are an integral part of these financial statements.

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Year Ended December 31,		
	1995	1994	1993
	(In thousands)		
<b>Cash Flows From Operating Activities:</b>			
Net earnings (loss) . . . . .	\$75,562	\$80,318	\$(61,486)
Adjustments to reconcile net earnings (loss) to net cash flows from operating activities:			
Depreciation and amortization . . . . .	93,125	90,656	95,415
Accumulated deferred investment tax credit . . . . .	(4,830)	(6,898)	(8,321)
Accumulated deferred income taxes . . . . .	1,622	23,069	(63,393)
Gain on sale of utility property . . . . .	(39,050)	(6,576)	(7,350)
Gain on sale of other property and investments . . . . .	-	-	(12,394)
Write-down of the PVNGS Units 1 & 2 leases, regulatory assets and other deferred costs . . . . .	-	-	178,954
Changes in certain assets and liabilities:			
Receivables . . . . .	795	23,868	(12,551)
Fuel, materials and supplies . . . . .	(26,505)	(3,126)	3,222
Deferred charges . . . . .	6,731	8,427	20,936
Accounts payable . . . . .	(11,527)	(11,893)	(53,973)
Accrued interest and taxes . . . . .	(1,218)	(1,919)	631
Deferred credits . . . . .	29,185	(5,418)	(7,137)
Other . . . . .	7,090	(3,604)	10,571
Other, net . . . . .	16,095	14,160	14,181
Net cash flows from operating activities . . . . .	147,075	201,064	97,305
<b>Cash Flows From Investing Activities:</b>			
Utility plant additions . . . . .	(106,627)	(119,284)	(100,784)
Utility plant sales . . . . .	206,482	39,562	49,302
Other property additions . . . . .	(801)	(1,307)	(2,554)
Other property sales . . . . .	-	-	19,912
Temporary investments, net . . . . .	(21,451)	(26,671)	(47,665)
Net cash flows from investing activities . . . . .	77,603	(107,700)	(81,789)
<b>Cash Flows From Financing Activities:</b>			
Redemptions of PVNGS lease obligation bonds . . . . .	(132,663)	-	-
Redemptions and repurchases of preferred stock . . . . .	(64,175)	(7,711)	(600)
Redemption of first mortgage bonds . . . . .	-	(45,000)	-
Bond refinancing costs . . . . .	-	-	(8,960)
Bond redemption premium and costs . . . . .	(505)	(2,732)	-
Proceeds from asset securitization . . . . .	18,758	-	60,475
Repayments of long-term debt . . . . .	(57,768)	(31,002)	(8,842)
Net decrease in short-term debt . . . . .	-	-	(51,550)
Dividends paid . . . . .	(5,126)	(6,400)	(6,609)
Net cash flows from financing activities . . . . .	(241,479)	(92,845)	(16,086)
Increase (Decrease) in Cash . . . . .	(16,801)	519	(570)
Cash at Beginning of Year . . . . .	21,029	20,510	21,080
Cash at End of Year . . . . .	\$ 4,228	\$21,029	\$20,510
<b>Supplemental cash flow disclosures:</b>			
Interest paid . . . . .	\$63,366	\$70,720	\$83,248
Income taxes paid . . . . .	\$52,405	\$20,000	\$13,978

Cash consists of currency on hand and demand deposits.

The accompanying notes are an integral part of these financial statements.

**CONSOLIDATED STATEMENTS OF CAPITALIZATION**

	December 31,	
	1995	1994
(In thousands)		
<b>Common Stock Equity:</b>		
Common Stock, par value \$5 per share	\$ 208,870	\$ 208,870
Additional paid-in capital	470,358	469,648
Excess pension liability, net of tax	(1,623)	(1,106)
Retained earnings (deficit) since January 1, 1989	25,243	(46,006)
<b>Total common stock equity</b>	<b>702,848</b>	<b>631,406</b>

	Stated Value	Shares		Current Redemption Price	
		Outstanding at December 31, 1995			
<b>Cumulative Preferred Stock:</b>					
Without mandatory redemption requirements:					
1965 Series, 4.58%	\$100	128,000	\$102.00	12,800	13,000
8.48% Series	100	-	-	-	20,000
8.80% Series	100	-	-	-	26,000
		<u>128,000</u>		<u>12,800</u>	<u>59,000</u>
With mandatory redemption requirements:					
8.75% Series	100	-	-	-	17,975
Redeemable within one year		-	-	-	<u>17,975</u>

Issue and Final Maturity	Interest Rates		
<b>Long-Term Debt:</b>			
First mortgage bonds:			
1997	57/8%	14,650	14,650
1999 through 2002	71/4% to 81/8%	43,063	43,272
2004 through 2007	81/8% to 91/8%	43,421	43,421
2008	9%	54,374	54,374
Pollution control revenue bonds:			
2008 through 2023	5.9% to 73/4%	537,045	537,045
2022	Variable rate	37,300	37,300
Total first mortgage bonds		<u>729,853</u>	<u>730,062</u>
Lease obligation bonds of First PV Funding Corporation:			
1996 through 2016	8.95% to 10.3%	-	132,663
Asset securitization		-	38,805
Other, including unamortized premium and (discount), net		(864)	(935)
Total long-term debt		<u>728,989</u>	<u>900,595</u>
Less current maturities		146	148,532
Long-term debt, less current maturities		<u>728,843</u>	<u>752,063</u>
<b>Total Capitalization</b>		<b>\$ 1,444,491</b>	<b>\$ 1,460,444</b>

The accompanying notes are an integral part of these financial statements.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1995, 1994 and 1993

### (1) Summary of Significant Accounting Policies

#### *Systems of Accounts*

The Company maintains its accounts for utility operations primarily in accordance with the uniform systems of accounts prescribed by the Federal Energy Regulatory Commission ("FERC") and the National Association of Regulatory Utility Commissioners ("NARUC"), and adopted by the New Mexico Public Utility Commission ("NMPUC").

#### *Organization*

Public Service Company of New Mexico (the "Company") is an investor-owned utility company engaged in the generation, transmission, distribution and sale of electricity. The Company provides retail electric service to a large area of north central New Mexico, including the cities of Albuquerque, Santa Fe, Rio Rancho, Las Vegas, Belen and Bernalillo. The Company provides service to customers in the City of Albuquerque without a franchise agreement, which contributes approximately one-half of the Company's total electric operating revenues. The absence of a franchise does not change the Company's right and obligation to serve these customers under state law. The Company also provides retail electric service to Deming in southwestern New Mexico and to Clayton in northeastern New Mexico. The Company is also engaged in the transmission, distribution and sale of natural gas within the State of New Mexico. The Company distributes natural gas to most of the major communities in New Mexico, including Albuquerque and Santa Fe.

#### *Principles of Consolidation*

The consolidated financial statements include the accounts of the Company and subsidiaries in which it owns a majority voting interest. All significant intercompany transactions and balances have been eliminated.

#### *Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual recorded amounts could differ from those estimated.

#### *Utility Plant*

Utility plant, with the exception of Palo Verde Nuclear Generating Station ("PVNGS") Unit 3 and the Company's purchased 22% beneficial interests in the PVNGS Units 1 and 2 leases, is stated at original cost, which includes capitalized payroll-related costs such as taxes, pension and other fringe benefits, administrative costs and an allowance for funds used during construction ("AFUDC"). Utility plant includes certain electric assets not subject to NMPUC regulation. The results of operations of such electric assets are included in operating income.

PVNGS Unit 3 and the Company's purchased 22% beneficial interests in the PVNGS Units 1 and 2 leases were written down in 1992 and 1993, respectively, to their net realizable value to reflect a permanent impairment to their original costs.

It is Company policy to charge repairs and minor replacements of property to maintenance expense and to charge major replacements to utility plant. Gains or losses resulting from retirements or other dispositions of operating property in the normal course of business are credited or charged to the accumulated provision for depreciation.

*Depreciation and Amortization*

Provision for depreciation and amortization of utility plant is made at annual straight-line rates approved by the NMPUC. The average rates used are as follows:

	1995	1994	1993
Electric plant .....	3.32%	3.01%	2.98%
Gas plant .....	3.21%	3.15%	3.12%
Water plant (1) .....	-	2.68%	2.62%
Common plant (2) .....	-	4.94%	4.90%

(1) Water plant was sold in July 1995 (see note 12).

(2) As a result of the water plant sale, common plant was transferred to electric plant.

Effective January 1, 1995, depreciation rates were revised and include a provision for the recovery of fossil-fueled plant decommissioning costs approved by the NMPUC in 1994 (see note 11).

The provision for depreciation of certain equipment is charged to clearing accounts and subsequently allocated to operating expenses or construction projects based on the use of the equipment. Depreciation of non-utility property is computed on the straight-line method. Amortization of nuclear fuel is computed based on the units of production method.

*Nuclear Decommissioning*

The Company accounts for nuclear decommissioning costs on a straight-line basis over the estimated useful life of the facilities. Such amounts are based on the net present value of expenditures estimated to be required to decommission the plant.

*Fuel and Purchased Power Adjustment Clause ("FPPCAC")*

The Company's FPPCAC for its retail customers was eliminated in November 1994. A base fuel cost was incorporated with the overall rates approved by the NMPUC. The Company uses the deferral method of accounting for fuel and purchased power costs for its firm-requirements wholesale customers. Such amounts are reflected in subsequent periods under a FPPCAC approved by the FERC.

*Purchased Gas Adjustment Clause ("PGAC")*

The Company uses the deferral method of accounting for gas purchase costs which are settled in subsequent periods under gas adjustment clauses. Future recovery of these costs is subject to approval by the NMPUC.

*Amortization of Debt Discount, Premium and Expense*

Discount, premium and expense related to the issuance of long-term debt are amortized over the lives of the respective issues. In connection with the retirement of long-term debt, such amounts associated with resources subject to NMPUC regulation are amortized over the lives of the respective issues. Amounts associated with the Company's firm-requirements wholesale customers and its excluded resources are recognized immediately as expense or income as they are incurred.

### *Income Taxes*

The Company reports income tax expense in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, *Accounting for Income Taxes*. SFAS No. 109 requires deferred income taxes for temporary differences between book and tax to be recorded using the liability method. Deferred income taxes are computed using the statutory tax rates scheduled to be in effect when the temporary differences reverse. Current NMPUC jurisdictional rates include the tax effects of the majority of these temporary differences (normalization). Recovery of reversing temporary differences previously accounted for under the flow-through method is also included in rates charged to customers. For regulated operations, any changes in tax rates applied to accumulated deferred income taxes may not be immediately recognized because of ratemaking and tax accounting provisions contained in the Tax Reform Act of 1986. For items accorded flow-through treatment under NMPUC orders, deferred income taxes and the future ratemaking effects of such taxes, as well as corresponding regulatory assets and liabilities, are recorded in the financial statements.

### *Accounting for Stock-Based Compensation*

The Company has a stock option plan for certain selected key employees. The Company accounts for this plan under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, under which no compensation cost has been recognized (see note 7).

### *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*

In March 1995, the FASB issued SFAS No. 121. This statement requires companies to review their long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. SFAS No. 121 also requires all regulatory assets, which must have a high probability of recovery to be initially established, must continue to meet that high probability standard to avoid being written off. However, if written off, a regulatory asset can be restored if, through regulatory actions, it again becomes probable of recovery. The adoption of SFAS No. 121 had no impact on the Company's financial condition or results of operations.

## **(2) Risks and Uncertainties**

### *Competitive Electric Market*

The electric utility industry is currently undergoing a period of fundamental change intended to promote a competitive environment in the retail and wholesale energy marketplaces. Legislators and regulators at both the state and Federal level are considering whether, and how, to promote competition among suppliers of electricity and how to provide customers with choice among suppliers.

At the Federal level, the FERC promulgated a Notice of Proposed Rule Making ("Mega-NOPR") in March 1995, which proposes to require utilities to unbundle their generation and transmission services and to provide open access transmission. The Mega-NOPR also supplemented a prior NOPR concerning the appropriate treatment of stranded asset costs associated with the transition. Specifically, the FERC stated that recovery of legitimate and verifiable stranded asset costs is critical to the successful transition of the electric utility industry from a tightly regulated cost-of-service industry to an open transmission access, competitively priced industry. The Company in its response to the Mega-NOPR supported the FERC initiative toward open access transmission, but requested that all transmission asset owners, including municipal and Federal, be subject to the same requirements in order to establish a level playing field for all participants in the electric utility industry. The Company also agreed with the FERC regarding the proposed recovery of stranded asset costs. A final decision on the Mega-NOPR is expected in the middle of 1996. On January 22, 1996, a U.S. Senate bill, "Electricity Competition Act of 1996", was introduced, providing a national framework for a competitive electric industry by no later than the year 2010. The bill provides for recovery of stranded asset costs. On February 14, 1996, the Council of Economic Advisors issued an economic report to Congress in which it cautioned that electric industry competition should ensure competitive benefits to all power buyers and should not aggravate pollution or cause supply cuts to the poor. The report favors recovery of stranded asset costs borne by all parties on whose behalf the stranded costs were incurred, including customers that switch to other suppliers. Representative Dan Schaeffer, Chairman of the Energy Subcommittee of the House of Commerce Committee, has announced that he plans to conduct hearings on electric industry restructuring, possibly beginning this summer. The Company does not expect Congressional legislation to pass this year, but does expect Congressional interest to continue next year.

In November 1995, after three years of study, the Integrated Water and Resource Planning Committee of the New Mexico State Legislature (the "IWRPC") issued a resolution reporting its findings on the advantages and disadvantages of retail wheeling and alternative restructuring schemes applicable to the electric power industry in New Mexico. The IWRPC's recommendation stated that any proposed restructuring (i) must benefit all ratepayers in the state, (ii) must maintain and possibly encourage the financial health and economic viability of each of the state's utilities, (iii) must provide for appropriate protection from unfair or advantaged competition from utilities or others from outside the state, and (iv) must share equitably any costs, including stranded asset costs, among the varied interests benefitted. The IWRPC also recommended that the NMPUC, under legislative direction and guidance, should monitor and evaluate the electric power industry and applicable market influences and factors and report its findings, conclusions and recommendations to the New Mexico State Legislature for legislative approval and action, as necessary, before any proposed restructuring may be implemented. The resolution further indicated that this continuing evaluation was necessary because of continuing changes even though restructuring and retail wheeling are not justified or in the public interest at this time. The Committee resolution was presented to the full Legislature as a Senate Joint Memorial. It was unanimously passed by the Senate and the House.

In November 1995, the NMPUC issued a Notice of Inquiry regarding the restructuring of regulation of the electric utility industry in New Mexico. The NMPUC is seeking input on a variety of questions related to competition, retail wheeling and state vs. Federal jurisdiction. The Company in its February 15, 1996 response stated that it believes that: (i) competition and customer choice may be beneficial to all affected interests in New Mexico if done appropriately and (ii) in order to achieve restructuring, there must be cooperative state and Federal action to avoid prolonged uncertainty and litigation, as well as to avert inconsistent state actions that would inhibit the development of competitive markets and restrict the benefits that they may provide. The Company proposed a five-year period to accomplish the transition to a workable competitive market. The Company also stated that it supports action by the United States Congress to clarify boundaries between state and Federal jurisdiction over the electric utility industry, and to ensure that retail wheeling can be implemented in a manner that ensures fair competition and provide utilities the opportunity to recover all stranded asset costs.

Although it is uncertain as to the ultimate outcome of possible open access or retail wheeling initiatives, the Company will continue to be active at both the state and Federal levels in the public policy debate on the restructuring of the electric utility industry. By working with customers, regulators and legislators, the Company believes that an agreement will be reached that will protect the interests of stockholders as well as offer the potential benefits of a competitive marketplace to all customers.

### *Uncertainties*

The future structure of the industry, the form and timing of competition and the method of regulation in a competitive environment remain uncertain. If retail wheeling is implemented, it is possible that, based on other deregulated industries' experiences, retail energy prices could drop significantly. Should that be the case, the value of a utility's assets could be affected significantly in the transition to a more competitive market from a traditional rate regulated environment. Currently, the Company's generation costs are above those of neighboring utilities to the north and east of the Company's service territory.

The Company believes that the 1994 electric retail rate reduction improved its competitive position, but recognizes that lower cost producers may have an advantage if the regulatory framework changes significantly towards retail wheeling. The Company's owned nuclear capacity is currently valued at approximately \$900 per KW. If the Company were required to value its leased nuclear capacity at the same level as its owned nuclear capacity, it would be valued at approximately \$180 million versus approximately \$560 million. If there were no provision for the recovery of stranded asset costs, the Company would be required to charge against earnings approximately \$380 million.

### *Preparation for the Changes*

In order to mitigate the exposures associated with a competitive electric market and transition into this changing environment, the Company established the following strategic plan in 1995: (i) secure financial flexibility by retiring debt, (ii) control operation and maintenance costs, (iii) focus on maximizing shareholder value for the nuclear generation assets, and (iv) develop new business opportunities in the energy and utility related area. As part of this plan, the Company restructured its operation into four distinctive business units, each targeted at a specific segment of its customer base with emphasis on being more customer oriented and responsive to the changing competitive environment. The four business units are as follows: (i) Electric Services, (ii) Gas Services, (iii) Bulk Power Services and (iv) Energy Services.

In order to maximize value of the nuclear generation assets, the Company's board of directors (the "Board"), at its December 5, 1995 meeting, confirmed that it is in the best interest of the Company at this time to focus its efforts and resources on maximizing shareholder value from PVNGS as an asset (leased and owned) of the Company rather than disposing of it. Growth in the region, rapid growth in the Company's own local service territory and the continuous improvement in the operating performance of the plant this year were all factors in the change of approach. The Board stated that the Company no longer considers it to be a goal to dispose of its interests in PVNGS.

On December 30, 1994, the Company filed a petition for declaratory order with the NMPUC. In the petition, the Company requested, among other things, a declaratory order that its corporate reorganization into four main business units was in compliance with NMPUC regulations and previous orders and otherwise lawful. Subsequently, on June 23, 1995, the Company filed an application for authorization for the creation of three wholly-owned subsidiaries to: (i) manage and operate water and wastewater systems, (ii) pursue energy marketing, alternative fuel vehicle services and energy management services; and (iii) pursue utility management services and related energy management services for federal installations and large commercial customers. The Company sought approval to invest a maximum of \$50 million in the three subsidiaries over time and to enter into reciprocal loan agreements for up to \$30 million with these subsidiaries. The NMPUC Staff filed a motion on September 20, 1995 to have the case dismissed. On January 31, 1996, the hearing examiner assigned to the case recommended that the NMPUC deny the Staff's motion. On February 5, 1996, the Staff filed a motion seeking to have the Company file an immediate report on its non-regulated activities being conducted without prior NMPUC approval; explain why NMPUC approval is not required; and explain why sanctions should not be considered if approval is required. On February 19, 1996, the Company filed its response describing its non-utility (energy and utility related) activities and presenting the legal authority demonstrating that prior NMPUC approval is not required. The Company currently cannot predict the ultimate outcome of this proceeding but intends to vigorously defend against any allegation that it is in violation of any legal requirements.

### **(3) Regulatory Assets and Liabilities**

The Company is subject to the provisions of SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation" on operations regulated by the NMPUC. Regulatory assets represent probable future revenue to the Company associated with certain costs which will be recovered from customers through the ratemaking process. Regulatory liabilities represent probable future reductions in revenues associated with amounts that are to be credited to customers through the ratemaking process. Regulatory assets and liabilities reflected in the Consolidated Balance Sheets as of December 31, relate to the following:

	1995	1994
	(in thousands)	
Deferred Income Taxes .....	\$ 71,094	\$ 77,020
Gas Take-or-Pay Costs .....	50,870	64,858
Gas Imputed Revenues .....	8,113	4,529
Loss on Reacquired Debt .....	6,377	7,360
Gas Reservation Fees .....	5,622	2,805
Gas Retirees' Health Care Costs .....	4,437	2,776
Gas Rate Case Costs .....	1,100	-
Purchased Gas Adjustment Clause .....	931	2,868
Fuel and Purchased Power Cost Adjustment Clause .....	121	1,224
Subtotal .....	<u>148,665</u>	<u>163,440</u>
Deferred Income Taxes .....	(60,815)	(64,877)
Customer Gain on Gas Assets Sale .....	(31,559)	-
PVNGS Prudence Audit .....	(7,313)	(7,688)
Settlement Due Customers .....	(4,101)	(5,049)
Gain on Reacquired Debt .....	(669)	(842)
Revenue Subject to Refund .....	(382)	-
Subtotal .....	<u>(104,839)</u>	<u>(78,456)</u>
Net Regulatory Assets .....	<u>\$ 43,826</u>	<u>\$ 84,984</u>

If a portion of the Company's operations under the NMPUC jurisdiction becomes no longer subject to the provisions of SFAS No. 71, a write off of related regulatory assets and liabilities would be required, unless some form of transition cost recovery (refund) continues through rates established and collected for the Company's remaining regulated operations.

#### (4) Capitalization

Changes in common stock, additional paid-in capital and cumulative preferred stock are as follows:

	Cumulative Preferred Stock						
	Common Stock			Without Mandatory Redemption Requirements	With Mandatory Redemption Requirements		
	Number of Shares	Aggregate Par Value	Additional Paid-In Capital	Number of Shares	Aggregate Stated Value	Number of Shares	Aggregate Stated Value
(Dollars in thousands)							
Balance at December 31, 1993 ..	41,774,083	\$208,870	\$470,149	590,000	\$59,000	243,861	\$24,386
Redemption of preferred stock .....	-	-	(501)	-	-	(64,111)	(6,411)
Balance at December 31, 1994 ..	41,774,083	208,870	469,648	590,000	59,000	179,750	17,975
Redemption of preferred stock .....	-	-	710	(462,000)	(46,200)	(179,750)	(17,975)
Balance at December 31, 1995 ..	41,774,083	\$208,870	\$470,358	128,000	\$12,800	-	-

*Common Stock*

The number of authorized shares of common stock with par value of \$5 per share is 80 million shares.

The Company has not declared dividends on its common stock since January 1989 and anticipates announcing a dividend plan sometime before the end of the second quarter of 1996. The Company's board of directors reviews the Company's dividend policy on a continuing basis. The resumption of common dividends is dependent upon a number of factors including earnings and financial condition of the Company and market conditions. The deficit in retained earnings was eliminated during 1995.

*Cumulative Preferred Stock*

The number of authorized shares of cumulative preferred stock is 10 million shares. The Company's restated articles of incorporation limit the amount of preferred stock which may be issued. The earnings test in the Company's restated articles of incorporation currently allows for the issuance of preferred stock.

On August 7, 1995, the Company redeemed, at par, all of its 8.48% Series, 8.80% Series and 8.75% Series of cumulative preferred stock outstanding as of July 6, 1995. The redemption price of \$64 million included accrued dividends through the redemption date.

*Long-Term Debt*

Substantially all utility plant is pledged to secure the Company's first mortgage bonds. A portion of certain series of long-term debt will be redeemed serially prior to their due dates. The issuance of first mortgage bonds by the Company is subject to earnings coverage and bondable property provisions of the Company's first mortgage indenture. The Company also has the capability under the mortgage indenture to issue first mortgage bonds on the basis of certain previously retired bonds and earnings.

On March 8, 1995, \$121 million of PVNGS Lease Obligation Bonds ("LOBs") were retired. The retired LOBs consisted of \$58 million of 10.30% LOBs due 2014 retired at a price of 100% of par and \$63 million of 10.15% LOBs due 2016 retired at a price of 97.8% of par. Additionally, \$4.4 million and \$4.8 million of LOBs due 1996 and 1997 at interest rates of 9.125% and 8.95%, respectively, were retired at par on March 22, 1995. In conjunction with these retirements, the Company wrote off \$1.5 million of net costs related to these transactions. The retirement of the LOBs, which were the Company's highest cost debt, will save the Company approximately \$11 million annually in interest expense over a five year period.

The aggregate amounts (in thousands) of maturities for 1996 through 2000 on long-term debt outstanding at December 31, 1995 are as follows:

1996.....	\$ 146
1997.....	\$16,470
1998.....	\$ 4,275
1999.....	\$16,185
2000.....	\$ 5,460

*Fair Value of Financial Instruments*

The estimated fair value of the Company's financial instruments (including current maturities) at December 31, is as follows:

	1995		1994	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In thousands)			
Long-Term Debt	\$728,989	\$730,337	\$900,595	\$805,000
Redeemable Preferred Stock	-	-	\$ 17,975	\$ 15,638

Estimates are based on market quotes provided by the Company's investment bankers.

**(5) Revolving Credit Facility and Other Credit Facilities**

The carrying amounts reflected on the consolidated balance sheets approximate fair value for cash, temporary investments, and receivables and payables due to the short period of maturity.

At December 31, 1995, the Company had a \$100 million secured revolving credit facility (the "Facility") with an expiration date of June 30, 1998. The Company must pay commitment fees of 3/8% per year on the total amount of the Facility. The Company also has a \$40 million credit facility, collateralized by the Company's electric customer accounts receivable (the "Accounts Receivable Facility") with an expiration date of December 20, 1998. On January 30, 1996, the Company requested NMPUC approval to increase the capacity of the Accounts Receivable Facility up to \$100 million by including in the collateral pool the Company's gas accounts receivable and certain amounts being recovered from gas customers relating to certain gas contract settlements. This would increase the Company's liquidity arrangements up to \$211 million from \$151 million, including local lines of credit of \$11 million. As of December 31, 1995, there were no borrowings outstanding under the Facility, the Accounts Receivable Facility or any of the local lines of credit.

**(6) Income Taxes**

Income taxes consist of the following components:

	1995	1994	1993
	(In thousands)		
Current Federal income tax . . . . .	\$45,940	\$24,243	\$ 12,502
Current State income tax . . . . .	5,864	-	-
Deferred Federal income tax . . . . .	(3,212)	15,449	(52,827)
Deferred State income tax . . . . .	7,031	8,077	(8,433)
Amortization of accumulated investment tax credits . . . . .	(4,442)	(4,701)	(5,036)
Recognition of accumulated deferred investment tax credits relating to sales of utility property . . . . .	(388)	(2,197)	(3,284)
<b>Total income taxes . . . . .</b>	<b>\$50,793</b>	<b>\$40,871</b>	<b>\$ (57,078)</b>
Charged to operating expenses . . . . .	\$30,194	\$44,210	\$ 25,721
Charged (credited) to other income and deductions . . . . .	20,599	(3,339)	(82,799)
<b>Total income taxes . . . . .</b>	<b>\$50,793</b>	<b>\$40,871</b>	<b>\$ (57,078)</b>

The Company's provision for income taxes differed from the Federal income tax computed at the statutory rate for each of the years shown. The differences are attributable to the following factors:

	1995	1994	1993
	(In thousands)		
Federal income tax at statutory rates . . . . .	\$44,224	\$42,417	\$(41,497)
Investment tax credits . . . . .	(4,442)	(4,701)	(5,036)
Depreciation of flow-through items . . . . .	723	1,112	1,719
Gains on the sale and leaseback of PVNGS			
Units 1 and 2 . . . . .	(527)	(527)	(514)
State income tax . . . . .	7,146	5,222	(5,585)
Gains on sale of utility property . . . . .	3,090	(2,139)	(3,169)
Federal income tax rate change to 35% . . . . .	-	-	(2,527)
Other . . . . .	579	(513)	(469)
<b>Total income taxes . . . . .</b>	<b>\$50,793</b>	<b>\$40,871</b>	<b>\$ (57,078)</b>



Deferred income taxes result from certain differences between the recognition of income and expense for tax and financial reporting purposes, as described in note 1. The major sources of these differences for which deferred taxes have been provided and the tax effects of each are as follows:

	1995	1994	1993
		(In thousands)	
Deferred fuel costs . . . . .	\$(3,990)	\$(1,945)	\$ 4,549
Depreciation and cost recovery . . . . .	12,730	22,118	17,668
Loss provision for the M-S-R power purchase contract . . . . .	3,497	5,632	6,335
Contributions in aid of construction . . . . .	(4,308)	(5,055)	(4,491)
Alternative minimum tax in excess of regular tax . . . . .	(26,002)	(24,100)	(13,808)
Net operating losses utilized . . . . .	55,217	35,077	15,067
PVNGS decommissioning . . . . .	(2,321)	(2,445)	(3,962)
Write-down of interests in PVNGS Units 1 and 2 . . . . .	-	-	(51,585)
Hedge loss write-off . . . . .	-	-	(3,908)
Loss on reacquired debt write-off . . . . .	-	-	(5,561)
Gains on sale of utility property . . . . .	(29,868)	(8,421)	(11,321)
Contribution to 401(h) plan . . . . .	(885)	1,204	(3,226)
Reserve for litigation . . . . .	-	-	(1,979)
OLE Transmission Project . . . . .	(3,177)	(792)	(929)
Other . . . . .	2,926	2,253	(4,109)
Net deferred taxes provided . . . . .	<u>\$ 3,819</u>	<u>\$23,526</u>	<u>\$(61,260)</u>

The components of the net accumulated deferred income tax liability were:

	1995	1994
		(In thousands)
Deferred Tax Assets:		
Net operating losses . . . . .	\$ -	\$ 51,199
Alternative minimum tax credit carryforward . . . . .	66,628	40,626
Nuclear decommissioning . . . . .	14,023	11,703
Regulatory liabilities . . . . .	60,070	64,877
Other . . . . .	45,403	41,446
Total deferred tax assets . . . . .	<u>\$186,124</u>	<u>\$209,851</u>
Deferred Tax Liabilities:		
Depreciation . . . . .	\$168,562	\$175,068
Investment tax credit . . . . .	66,734	71,564
Fuel costs . . . . .	24,804	28,794
Regulatory assets . . . . .	70,348	77,020
Other . . . . .	1,239	6,176
Total deferred tax liabilities . . . . .	<u>331,687</u>	<u>358,622</u>
Accumulated deferred income taxes, net . . . . .	<u>\$145,563</u>	<u>\$148,771</u>

The Company has no net operating loss carryforwards as of December 31, 1995.

The Company defers investment tax credits related to utility assets and amortizes them over the estimated useful lives of those assets. Investment tax credits related to non-utility assets have been flowed through in earlier years.

**(7) Employee and Post-Employment Benefits***Pension Plan*

The Company and its subsidiaries have a pension plan covering substantially all of their employees, including officers. The plan is non-contributory and provides for benefits to be paid to eligible employees at retirement based primarily upon years of service with the Company and the average of their highest annual base salary for three consecutive years. The Company's policy is to fund actuarially-determined contributions. Contributions to the plan reflect benefits attributed to employees' years of service to date and also for services expected to be provided in the future. Plan assets primarily consist of common stock, fixed income securities, cash equivalents and real estate. The components of pension cost (in thousands) are as follows:

	1995	1994	1993
Service cost .....	\$ 6,770	\$ 8,121	\$ 7,263
Interest cost .....	18,332	17,589	16,849
Actual loss (return) on plan assets .....	(42,148)	1,079	(18,148)
Net amortization and deferral .....	23,295	(18,731)	(878)
Net periodic pension cost .....	6,249	8,058	5,086
Curtailment loss .....	-	-	1,657
Total pension expense .....	<u>\$ 6,249</u>	<u>\$ 8,058</u>	<u>\$ 6,743</u>

The following sets forth the plan's funded status and amounts (in thousands) at December 31:

	1995	1994
Vested benefits .....	\$222,501	\$183,364
Non-vested benefits .....	10,556	8,071
Accumulated benefit obligation .....	233,057	191,435
Effect of future compensation levels .....	46,889	36,581
Projected benefit obligation .....	279,946	228,016
Fair value of plan assets .....	246,670	208,751
Projected benefit obligation in excess of assets .....	33,276	19,265
Unrecognized prior service cost .....	(214)	(248)
Net unrecognized loss from past experience different from assumed and the effects of changes in assumptions .....	(41,185)	(27,183)
Unamortized asset at transition, being amortized through the year 2002 .....	6,978	8,142
Accrued pension asset .....	<u>\$ (1,145)</u>	<u>\$ (24)</u>

The weighted average discount rate used to measure the projected benefit obligation was 7.50% and 8.25% for 1995 and 1994, respectively, and the expected long-term rate of return on plan assets was 8.75% for 1995 and 1994. The rate of increase in future compensation levels based on age-related scales was 4.1% for 1995 and 1994.

*Other Postretirement Benefits*

The Company provides medical and dental benefits to eligible retirees. Currently, retirees are offered the same benefits as active employees after reflecting Medicare coordination. The components of postretirement benefit cost (in thousands) are as follows:

	1995	1994	1993
Service cost .....	\$ 1,869	\$ 1,389	\$ 1,175
Interest cost .....	4,962	3,250	2,974
Actual loss (return) on plan assets .....	(2,726)	100	(56)
Transition obligation amortization .....	1,817	1,817	1,857
Net amortization and deferral .....	2,498	(295)	-
Net periodic postretirement benefit cost .....	8,420	6,261	5,950
Curtailment loss .....	-	-	4,295
Total postretirement benefit expense .....	<u>\$ 8,420</u>	<u>\$ 6,261</u>	<u>\$ 10,245</u>

The following sets forth the plan's funded status and amounts (in thousands) at December 31:

	1995	1994
Accumulated benefit obligations for:		
Retirees . . . . .	\$ 29,088	\$ 32,085
Fully eligible employees . . . . .	7,144	1,848
Active employees . . . . .	<u>39,854</u>	<u>27,387</u>
Accumulated benefit obligation . . . . .	76,086	61,320
Fair value of plan assets . . . . .	<u>15,600</u>	<u>8,559</u>
Funded status . . . . .	(60,486)	(52,761)
Net unrecognized loss . . . . .	22,196	15,310
Unrecognized transition obligation (being amortized through the year 2012) . . . . .	<u>30,891</u>	<u>32,708</u>
Accrued postretirement liability . . . . .	<u>\$ (7,399)</u>	<u>\$ (4,743)</u>

Plan assets consist primarily of domestic common stock, fixed income securities and cash equivalents.

The weighted average discount rate used to measure the projected benefit obligation was 7.5% and 8.25% for 1995 and 1994, respectively, and the expected long-term rate of return on plan assets was 8.75% for 1995 and 1994. The health care cost trend rate was 8.0%, 7.5% and 6.0% for 1995, 1994 and 1993, respectively. The effect of a 1% increase in the health care trend rate assumption would increase the accumulated postretirement benefit obligation as of December 31, 1995 by approximately \$11.8 million and the aggregate service and interest cost components of net periodic postretirement benefit cost for 1995 by approximately \$1.2 million. The health care cost trend rate was expected to decrease to 6.0% by 2010 and to remain at that level thereafter.

The Company received NMPUC approval in 1994 for the recovery of the full accrual amount of Electric Business Unit's retirees' health care costs expense. The Company currently defers the benefit costs in excess of the pay-as-you-go basis for PNMGS (\$4.4 million deferred as of December 31, 1995) and has addressed the recovery of this amount as well as the full accrual amount of retirees' health care costs related to PNMGS in its general rate case which was filed in August 1995.

#### *Performance Stock Plan*

In 1993, the Company adopted a nonqualified stock option plan covering a group of management employees. Options are granted at the fair market value of the shares on the date of grant. Options granted through December 31, 1995, vest on June 30, 1996, and have a purchase term of up to 10 years.

The Performance Stock Plan activity for 1993, 1994 and 1995 is summarized as follows:

	Shares Subject to Option	Range of Exercise Prices Per Share
Balance at December 31, 1993 . . . . .	370,000	\$13.75
Options Granted . . . . .	817,135	\$11.50 - \$13.00
Options Cancelled . . . . .	(13,593)	
Balance at December 31, 1994 . . . . .	1,173,542	\$11.50 - \$13.75
Options Granted . . . . .	507,238	\$17.625
Options Cancelled . . . . .	(16,280)	
Balance at December 31, 1995 . . . . .	1,664,500	\$11.50 - \$17.625

Options may be exercised following vesting as described in the plan. The aggregate maximum number of options granted under the current plan during its five-year time frame is two million shares, subject to certain adjustments. As proposed under an amended plan, all subsequent awards granted after December 31, 1995, shall vest three years from the grant date of the award and the maximum number of options would be increased to five million shares through December 31, 2000. This amended plan is subject to shareholder approval at the next annual meeting in April 1996.

### *Executive Retirement Program*

The Company has an executive retirement program for a group of management employees. The program was intended to attract, motivate and retain key management employees. The Company's projected benefit obligation for this program, as of December 31, 1995, was \$18.5 million, of which the accumulated and vested benefit obligation was \$17.6 million. As of December 31, 1995, the Company has recognized an additional liability of \$1.6 million for the amount of unfunded accumulated benefits in excess of accrued pension costs. The net periodic pension cost for 1995, 1994 and 1993 was \$2.0 million, \$2.2 million and \$2.1 million, respectively. In 1989, the Company established an irrevocable grantor trust in connection with the executive retirement program. Under the terms of the trust, the Company may, but is not obligated to, provide funds to the trust, which was established with an independent trustee, to aid it in meeting its obligations under such program. Funds in the amount of approximately \$10.5 million (fair market value of \$13.0 million) are presently in trust. No additional funds have been provided to the trust since 1989.

### **(8) Construction Program and Jointly-Owned Plants**

It is estimated that the Company's construction expenditures for 1996 will be approximately \$123 million, including expenditures on jointly-owned projects. The Company's proportionate share of expenses for the jointly-owned plants is included in operating expenses in the consolidated statements of earnings.

At December 31, 1995, the Company's interests and investments in jointly-owned generating facilities are:

Station (Fuel Type)	Plant in Service	Construction Accumulated Depreciation	Work in Progress	Composite Interest
(In thousands)				
San Juan Generating Station (Coal) . . . . .	\$729,516	\$308,656	\$ 5,653	46.3%
Palo Verde Nuclear Generating Station (Nuclear)* . . . . .	\$189,504	\$ 38,301	\$15,743	10.2%
Four Corners Power Plant Units 4 and 5 (Coal) . . . . .	\$115,729	\$ 42,179	\$ 4,316	13.0%

- \* Includes the Company's interest in PVNGS Unit 3, the Company's interest in common facilities for all PVNGS units and the 22% beneficial interests in the PVNGS Units 1 and 2 leases.

#### *San Juan Generating Station ("SJGS")*

The Company operates and jointly owns SJGS. At December 31, 1995, SJGS Units 1 and 2 are owned on a 50% shared basis with Tucson Electric Power Company, Unit 3 is owned 50% by the Company, 41.8% by Southern California Public Power Authority and 8.2% by Century Power Corporation ("Century"). Century sold its remaining 8.2% interest to Tri-State Generation and Transmission Association, Inc. Unit 4 is owned 38.457% by the Company, 8.475% by the City of Farmington, 28.8% by M-S-R Public Power Agency, a California public power agency ("M-S-R"), 7.2% by the County of Los Alamos, 10.04% by the City of Anaheim, California and 7.028% by Utah Associated Municipal Power Systems.

#### *Palo Verde Nuclear Generating Station*

The Company has a 10.2% interest in PVNGS. Commercial operation commenced in 1986 for Unit 1 and Unit 2 and 1988 for Unit 3. In 1985 and 1986, the Company completed sale and leaseback transactions for its undivided interests in Units 1 and 2 and certain related common facilities.

In 1992, the Company purchased approximately 22% of the beneficial interests in PVNGS Units 1 and 2 leases for approximately \$17.5 million, recording \$158.3 million as utility plant and \$140.8 million as long-term debt. In 1993, such utility plant was written down to \$46.7 million in conjunction with the electric retail rate reduction.

The PVNGS participants have insurance for public liability payments resulting from nuclear energy hazards to the full limit of liability under Federal law. This potential liability is covered by primary liability insurance provided by commercial insurance carriers in the amount of \$200 million and the balance by an industry wide retrospective assessment program. The maximum assessment per reactor under the retrospective rating program for each nuclear incident occurring at any nuclear power plant in the United States is approximately \$79.3 million, subject to an annual limit of \$10 million per incident. Based upon the Company's 10.2% interest in the three PVNGS units, the Company's maximum potential assessment per incident is approximately \$24.3 million, with an annual payment limitation of \$3 million. The insureds under this liability insurance include the PVNGS participants and "any other person or organization with respect to his legal responsibility for damage caused by the nuclear energy hazard".

The PVNGS participants maintain "all-risk" (including nuclear hazards) insurance for nuclear property damage to, and decontamination of, property at PVNGS in the aggregate amount of approximately \$2.75 billion as of January 1, 1996, a substantial portion of which must first be applied to stabilization and decontamination. The Company has also secured insurance against a portion of the increased cost of generation or purchased power resulting from certain accidental outages of any of the three PVNGS units if such outage exceeds 21 weeks.

The Company has a program for funding its share of decommissioning costs for PVNGS. Under this program, the Company makes a series of annual deposits to an external trust over the estimated useful life of each unit with the trust funds being invested under a plan which allows the accumulation of funds largely on a tax-deferred basis through the use of life insurance policies on certain current and former employees. The results of the 1995 decommissioning study indicate that the Company's share of the PVNGS decommissioning costs will be approximately \$145.6 million, a decrease from \$157.8 million based on the previous 1992 study (both amounts are stated in 1995 dollars).

The Company has determined that a supplemental investment program will be needed as a result of both cost increases identified in the 1992 study and the lower than anticipated performance of the existing program. On September 29, 1995, the Company filed a request for permission from the NMPUC to establish a qualified tax advantaged trust for PVNGS Units 1 and 2. Due to Internal Revenue Service ("IRS") regulations, PVNGS Unit 3 will remain in a non-qualified trust.

The Company, on February 7, 1996, filed a motion for interim relief for establishment of a qualified trust pending final NMPUC action. The interim request was necessary in order to meet the March 15 deadline under IRS requirements for the qualified trust to be effective for the current year. On February 19, 1996, the NMPUC granted this request.

The market value of the existing trust at the end of 1995 was approximately \$12.4 million, which includes the cash surrender value of the current insurance policies.

## **(9) Long-Term Power Contracts and Franchises**

The Company had two long-term contracts for the purchase of electric power. Under a contract with M-S-R, which expired in early 1995, the Company was obligated to pay certain minimum amounts and a variable component representing the expenses associated with the energy purchased and debt service costs associated with capital improvements. Total payments under this contract amounted to approximately \$14 million for 1995 and \$42 million in each year for 1994 and 1993.

The Company has a long-term contract with Southwestern Public Service Company ("SPS") for up to 200 MW of interruptible power from May 1995 through May 2011. Total payments under this contract amounted to approximately \$12.1 million in 1995. Minimum payments under the contract amount to approximately \$14.0 million for 1996 and 1997. In addition, the Company will be required to pay for any energy purchased under the contract. The amount of minimum payments for future years will depend on whether the Company exercises its option to reduce its purchase obligations under the contract. The Company provided such notice in 1995 to reduce the purchase by 25 MW in 1999.

**(10) Lease Commitments**

The Company classifies its leases in accordance with generally accepted accounting principles. The Company leases Units 1 and 2 of PVNGS, transmission facilities, office buildings and other equipment under operating leases. The lease expense for PVNGS is \$66.3 million per year over base lease terms expiring in 2015 and 2016. Prior to 1992, the aggregate lease expense for the PVNGS leases was \$84.6 million per year over the base lease terms; however, this amount was reduced by the purchase of approximately 22% of the beneficial interests in the PVNGS Units 1 and 2 leases (see note 8). Each PVNGS lease contains renewal and fair market value purchase options at the end of the base lease term.

Future minimum operating lease payments (in thousands) at December 31, 1995 are:

1996.....	\$ 77,926
1997.....	77,674
1998.....	77,563
1999.....	77,268
2000.....	77,217
Later years.....	<u>1,102,754</u>
Total minimum lease payments.....	<u>\$1,490,402</u>

Operating lease expense, inclusive of PVNGS leases, was approximately \$80 million in 1995, \$79.1 million in 1994 and \$80.6 million in 1993. Aggregate minimum payments to be received in future periods under noncancelable subleases are approximately \$7.2 million.

**(11) Environmental Issues and Fossil-Fueled Plant Decommissioning Costs**

The Company is committed to complying with all applicable environmental regulations in a responsible manner. Environmental issues have presented and will continue to present a challenge to the Company. The Company has evaluated the potential impacts of the following environmental issues and believes, after consideration of established reserves, that the ultimate outcome of these environmental issues will not have a material adverse effect on the Company's financial condition or results of operations.

**Electric Operations***Person Station*

The Company, in compliance with the New Mexico Environment Department ("NMED") Corrective Action Directive, determined that groundwater contamination exists in the deep and shallow water aquifers. The Company is required to delineate the extent of the contamination and remediate the contaminants in the groundwater. The extent of the contaminated plume in the deep water aquifer has been assessed and results have been reported to the NMED. The Company has also proposed revised remedial options to the NMED. The Company is awaiting a final response from the NMED. The Company's current estimate to decommission its retired fossil-fueled plants includes approximately \$10.9 million to complete the groundwater remediation program at Person Station. As part of the financial assurance requirement of the Person Station Hazardous Waste Permit, the Company posted a \$5.1 million performance bond with a trustee. The remediation program continues on schedule.

*Santa Fe Station*

The NMED has been conducting an investigation of the groundwater contamination detected beneath the Santa Fe Station site to determine the source of the contamination. The Company has been and is continuing to cooperate with the NMED site investigation pursuant to a settlement agreement between the Company and the NMED. In May 1995, the Company received a letter from the NMED indicating that the NMED had made a determination that Santa Fe Station was the source of gasoline-contaminated groundwater at the site and vicinity. The Company contested the NMED's determination and believes insufficient data exists to definitely identify the sources of groundwater contamination. A minimum site assessment ("MSA") of the two former underground storage tank sites at the Santa Fe Station site was conducted by the Company under the settlement agreement. The MSA report indicated that the Santa Fe Station site does not appear to have been a source of gasoline contamination. The MSA report has been submitted to the NMED and is currently pending NMED review.

### *Albuquerque Electric Service Center*

Trenching work at the electric service center revealed oil contaminated soil in an area of the service center where used oil in drums were stored. The trenched area bisects a small portion of the storage area, indicating that potentially the entire area could be underlain with contaminated soil. The Company requested a laboratory analysis on the soil to determine the type of contamination. The Company may be required to assess soil and groundwater for contamination as well as remediate extensive volumes of soil in the area. The Company currently cannot predict the outcome of the analysis, to what extent the soil was contaminated or the costs of the remediation, if any.

In addition, leaking fuel lines, which have been replaced, caused soil and groundwater contamination in the vicinity of the leak. The Company proposed a quarterly sampling plan to the NMED for the site. The NMED has expressed concerns regarding the placement of monitoring wells and the relatively high levels of residual contamination remaining in the soil at the site. Based on the recent analysis of the groundwater sampling, the contaminated soil does not appear to be a continual recharge source to the groundwater contamination. The NMED may require additional monitoring wells and soil remediation work at the site.

## **Gas Operations**

### *Air Permits*

In 1994, following an environmental audit performed in conjunction with the Company's sale of certain gas assets, which audit brought to light certain discrepancies regarding required air permits associated with certain natural gas facilities, the Company met with the NMED to discuss the nature of the permit discrepancies and to propose methods and schedules to resolve the discrepancies.

The Company submitted in 1994 its permit modification application for the Lybrook Gas Processing Plant ("Lybrook"). The Lybrook permit has now been issued to Williams Gas Processing-Blanco, Inc. ("Williams"), the purchaser of the gas assets.

The Company submitted an air permit modification application for the Kutz Canyon Gas Processing Plant ("Kutz") in the first quarter of 1995. In October 1995, the Company received a Notice of Violation ("NOV") from the NMED with specified corrective actions on the permit discrepancies in the Kutz air permit. In January 1996, the Company accepted a settlement offer for the NOV from the NMED in the amount of \$15,000. The Company cannot predict when the final permit will be issued by the NMED or whether additional requirements will be imposed by the NMED as conditions for issuance of the permit.

### *Gas Wellhead Pit Remediation*

The New Mexico Oil Conservation Commission ("NMOCC") issued an order, effective on January 14, 1993, that affects the gas gathering facilities, which were sold to Williams, located in the San Juan Basin in northwestern New Mexico. The order prohibits the further discharge of fluids associated with the production of natural gas into unlined earthen pits in certain specified areas of the San Juan Basin. The order also required the submission of closure plans for the closure of pits in which production fluids were previously discharged. The Bureau of Land Management ("BLM") has issued a similar ruling. The Company has complied with such rulings and submitted and received approval of the pit closure plans from the New Mexico Oil Conservation Division ("OCD"), the Energy Minerals and Natural Resources Department, as well as the BLM.

The Company has received letters and directives from the OCD directing the Company to determine if certain unlined discharge pits have contributed to the groundwater contamination plumes that were identified at those sites. The Company is currently assessing the sites in accordance with the OCD directive. The Company continues to assess unlined pits in accordance with the OCD directive and is addressing potential groundwater contamination issues as they arise during the assessment process.

On March 3, 1995, the Jicarilla Apache Tribe ("Jicarilla") enacted an ordinance directing that unlined surface impoundments located within environmentally sensitive areas be remediated and closed by December 1996, and that all other unlined surface impoundments on Jicarilla's lands be remediated and closed by December 1998. The Company has received a claim for indemnification by Williams for the environmental work required to comply with the Jicarilla ordinance. The Company has submitted a closure/remediation plan to the Jicarilla, which has been approved, and the Company anticipates initiating the remediation process in the spring of 1996. The costs of remediation will be charged against the \$10.6 million indemnification cap contained in the purchase and sale agreement between the Company and Williams (see note 12). The Company does not anticipate that the claim for indemnification will have any material impact on the Company's financial condition or results of operations.

#### *Fossil-Fueled Plant Decommissioning Costs*

The Company's six owned or partially owned, in service and retired, fossil-fueled generating stations are expected to incur dismantling and reclamation costs as they are decommissioned. The Company's share of decommissioning costs for all of its fossil-fueled generating stations is projected to be approximately \$141 million stated in 1995 dollars, including approximately \$24.0 million (of which \$12.1 million has already been expended) for Person, Prager and Santa Fe Stations which have been retired.

The Company is currently recovering estimated decommissioning costs from NMPUC retail customers through its depreciation rates. Depreciation amounts for the retired generating units are not being recovered.

### **(12) Asset Sales**

#### *Sale of Sangre de Cristo Water Company*

In February 1994, the Company and the City of Santa Fe (the "City") executed a purchase and sale agreement for the Company's water division, subject to NMPUC approval. On May 22, 1995, the NMPUC issued a final order approving the sale. On July 3, 1995, the closing of the sale was finalized. As a result, the Company received \$51.2 million (exclusive of current assets netted against current liabilities) from the sale and recorded an after-tax gain of \$6.4 million, or 15 cents per share. Pursuant to the purchase and sale agreement, the Company, through its Energy Services Unit, will continue to operate the water utility up to four years for a fee under a contract with the City.

#### *Sale of Gas Gathering and Processing Assets*

As part of the Company's announced action plan in 1993 to focus on its core utility business, the Company, in 1994, entered into an agreement with Williams for the sale of substantially all of the assets of Gathering Company and Processing Company and for the sale of Northwest and Southeast gas gathering and processing facilities of the Company.

The sales transaction provides for three 10-year contracts, each with an option to renew for an additional 5-year term, with Williams for competitively priced gathering and processing services. The purchase and sale agreement contains contractual requirements for the Company to address various environmental deficiencies identified as retained liabilities. It also contains environmental representations and warranties and indemnification provisions whereby the Company indemnifies Williams for a five-year period after closing for breaches of the environmental representations and warranties and against third party claims to a maximum of \$10.6 million. After the \$10.6 million cap has been reached, or after the expiration of the five-year post-closing indemnification period, whichever comes first, Williams indemnifies the Company against further environmental expenditures related to the properties sold. On June 30, 1995, following NMPUC approval, the Company and Williams closed the sale of the assets. As a result, the Company and its gas subsidiaries received \$154 million from Williams and recognized an after-tax gain of \$12.8 million, or 31 cents per share. Under the NMPUC approval, the Company recorded a liability of approximately \$35 million, representing an estimate of a portion of the gain resulting from the sale, which will be credited to the Company's gas customers' bills over five years. After completion of the fifth year, the amount of the gain will be recalculated to reflect actual expenses associated with the transaction which were appropriately and legitimately incurred. Such amount should include amounts expended to indemnify Williams as described above. Any resulting differences will be refunded or billed to customers over a one year period.

As a result of the gas assets sales, the operations of the Company's two wholly-owned gas subsidiaries, Gathering Company and Processing Company, have been substantially discontinued, effective June 30, 1995.



**(13) Segment Information**

The financial information pertaining to the Company's electric, gas and other operations for the years ended December 31, 1995, 1994 and 1993 are as follows:

	Electric*	Gas	Other	Total
	(In thousands)			
<b>1995:</b>				
Operating revenues .....	\$ 584,284	\$217,985	\$ 6,196	\$ 808,465
Operating expenses excluding income taxes .....	470,824	190,128	3,931	664,883
Pre-tax operating income .....	113,460	27,857	2,265	143,582
Operating income tax .....	24,884	4,313	997	30,194
Operating income .....	\$ 88,576	\$ 23,544	\$ 1,268	\$ 113,388
Depreciation and amortization expense .....	\$ 63,047	\$ 17,248	\$ 570	\$80,865
Construction expenditures .....	\$ 76,610	\$ 26,315	\$ 4,741	\$ 107,666
Identifiable assets:				
Net utility plant .....	\$1,298,103	\$276,218	\$ 113	\$1,574,434
Other .....	327,547	125,387	8,301	461,235
Total assets .....	\$1,625,650	\$401,605	\$ 8,414	\$2,035,669
<b>1994:</b>				
Operating revenues .....	\$ 621,794	\$269,510	\$13,407	\$ 904,711
Operating expenses excluding income taxes .....	468,519	233,743	7,161	709,423
Pre-tax operating income .....	153,275	35,767	6,246	195,288
Operating income tax .....	32,998	9,158	2,054	44,210
Operating income .....	\$ 120,277	\$ 26,609	\$ 4,192	\$ 151,078
Depreciation and amortization expense .....	\$ 56,003	\$ 16,847	\$ 1,287	\$74,137
Construction expenditures .....	\$ 80,282	\$ 31,518	\$ 8,506	\$ 120,306
Identifiable assets:				
Net utility plant .....	\$1,302,467	\$341,232	\$52,988	\$1,696,687
Other .....	307,010	187,748	11,820	506,578
Total assets .....	\$1,609,477	\$528,980	\$64,808	\$2,203,265
<b>1993:</b>				
Operating revenues .....	\$ 589,728	\$271,087	\$13,063	\$ 873,878
Operating expenses excluding income taxes .....	467,659	239,859	7,355	714,873
Pre-tax operating income .....	122,069	31,228	5,708	159,005
Operating income tax .....	19,184	5,347	1,190	25,721
Operating income .....	\$ 102,885	\$ 25,881	\$ 4,518	\$ 133,284
Depreciation and amortization expense .....	\$ 59,298	\$ 16,859	\$ 1,169	\$ 77,326
Construction expenditures .....	\$ 67,886	\$ 26,593	\$ 2,847	\$ 97,326
Identifiable assets:				
Net utility plant .....	\$1,324,110	\$333,862	\$45,960	\$1,703,932
Other .....	257,153	240,908	10,196	508,257
Total assets .....	\$1,581,263	\$574,770	\$56,156	\$2,212,189

\* Includes the resources excluded from NMPUC regulation.

On June 30, 1995, the Company sold substantially all of the gas gathering and processing assets of the Company and its gas subsidiaries and on July 3, 1995, the Company sold its water division (see note 12).

**QUARTERLY OPERATING RESULTS**

The unaudited operating results by quarters for 1995 and 1994 are as follows:

	Quarter Ended			
	March 31	June 30	September 30	December 31
	(In thousands except per share amounts)			
<b>1995:</b>				
Operating Revenues.....	\$230,235	\$191,532	\$195,586	\$191,112
Operating Income .....	\$ 33,731	\$ 25,024	\$ 34,734	\$ 19,899
Net Earnings (1).....	\$ 18,184	\$ 23,419	\$ 28,969	\$ 4,990
Net Earnings per Share (1).....	\$ 0.40	\$ 0.52	\$ 0.68	\$ 0.12
<b>1994:</b>				
Operating Revenues.....	\$260,807	\$204,260	\$218,717	\$220,927
Operating Income .....	\$ 42,671	\$ 32,150	\$ 43,606	\$ 32,651
Net Earnings .....	\$ 24,103	\$ 19,248	\$ 21,789	\$ 15,178
Net Earnings per Share.....	\$ 0.54	\$ 0.42	\$ 0.48	\$ 0.33

In the opinion of management of the Company, all adjustments (consisting of normal recurring accruals) necessary for a fair statement of the results of operations for such periods have been included.

- (1) On June 30, 1995, the Company consummated the sale of substantially all of the gas gathering and processing assets of the Company and its gas subsidiaries to Williams. The Company recorded an after-tax gain of \$12.8 million, or 31 cents per share. On July 3, 1995, the Company consummated the sale of the Company's water division to the City of Santa Fe. The Company recorded an after-tax gain of \$6.4 million, or 15 cents per share.

## Annual Meeting of Shareholders

The 1996 Annual Meeting of Shareholders will be held at 9:30 a.m. (Mountain Daylight Time), April 30, 1996, at the UNM Continuing Education Center, 1634 University Boulevard NE, Albuquerque, New Mexico.

Notice of meeting, proxy statement and proxy will be mailed to shareholders with the annual report on or about March 25, 1996.

## Shareholder Services and Information Requests

Shareholders are invited to contact the company for assistance with:

### Matters regarding stock ownership:

Shareholder Services Department  
Public Service Company of New Mexico  
Alvarado Square - MS 0802  
Albuquerque, NM 87158  
(505) 241-2650 - Albuquerque  
(800) 545-4425 - Other than Albuquerque

### Requests for information:

Investor Relations Department  
Public Service Company of New Mexico  
Alvarado Square - MS 2720  
Albuquerque, NM 87158  
(505) 241-2477 - Albuquerque  
(800) 545-4425 - Other than Albuquerque

### Inquiries by security analysts and investors:

Barbara L. Barsky, Director  
Planning and Investor Relations  
(505) 241-2662 - Albuquerque

### Inquiries by the news media:

Rick Brinneman, Manager  
Regional Public Affairs  
(505) 241-2622 - Albuquerque

For the latest, earnings reports and financial statements, a daily stock quote, and other news of interest to PNM investors, call our toll-free Shareholder Information line at 1-800-840PNM (1-800-840-0766) or see the new PNM home page on the World Wide Web at <http://www.rt66.com/pnmhome/> Computer users can also e-mail PNM Investor Relations via our CompuServe ID 76325,151

## Quarterly High and Low Share Prices

	1995		1994	
	High	Low	High	Low
First Quarter	13 <sup>7</sup> / <sub>8</sub>	12 <sup>1</sup> / <sub>4</sub>	13 <sup>5</sup> / <sub>8</sub>	11
Second Quarter	14 <sup>1</sup> / <sub>4</sub>	12 <sup>3</sup> / <sub>8</sub>	13 <sup>3</sup> / <sub>8</sub>	11 <sup>3</sup> / <sub>8</sub>
Third Quarter	16 <sup>3</sup> / <sub>8</sub>	13 <sup>3</sup> / <sub>4</sub>	12 <sup>5</sup> / <sub>8</sub>	11 <sup>1</sup> / <sub>4</sub>
Fourth Quarter	18 <sup>1</sup> / <sub>4</sub>	16 <sup>1</sup> / <sub>8</sub>	13 <sup>1</sup> / <sub>2</sub>	11 <sup>5</sup> / <sub>8</sub>

## Stock Exchange Listing

The Public Service Company of New Mexico's common stock is primarily traded on the New York Stock Exchange under the ticker symbol PNM. The company is not aware of any active trading market for its cumulative preferred stock.

## Transfer Agent

The Public Service Company of New Mexico is the sole transfer agent and registrar for our common and preferred stock. As of December 31, 1995, there were 21,007 registered shareholders.

## Form 10-K

A copy of the company's 1995 10-K Annual Report, filed with the Securities and Exchange Commission, may be obtained by shareholders upon written request, without charge. Requests should be addressed to Barbara Barsky, Director, Planning and Investor Relations, MS 2720, Alvarado Square, Albuquerque, NM 87158.



Public Service Company of New Mexico  
Alvarado Square  
Albuquerque, New Mexico 87158

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