Positive *Energy*

1996 Annual **Report**

Public Service Company of New Mexico

PNM.

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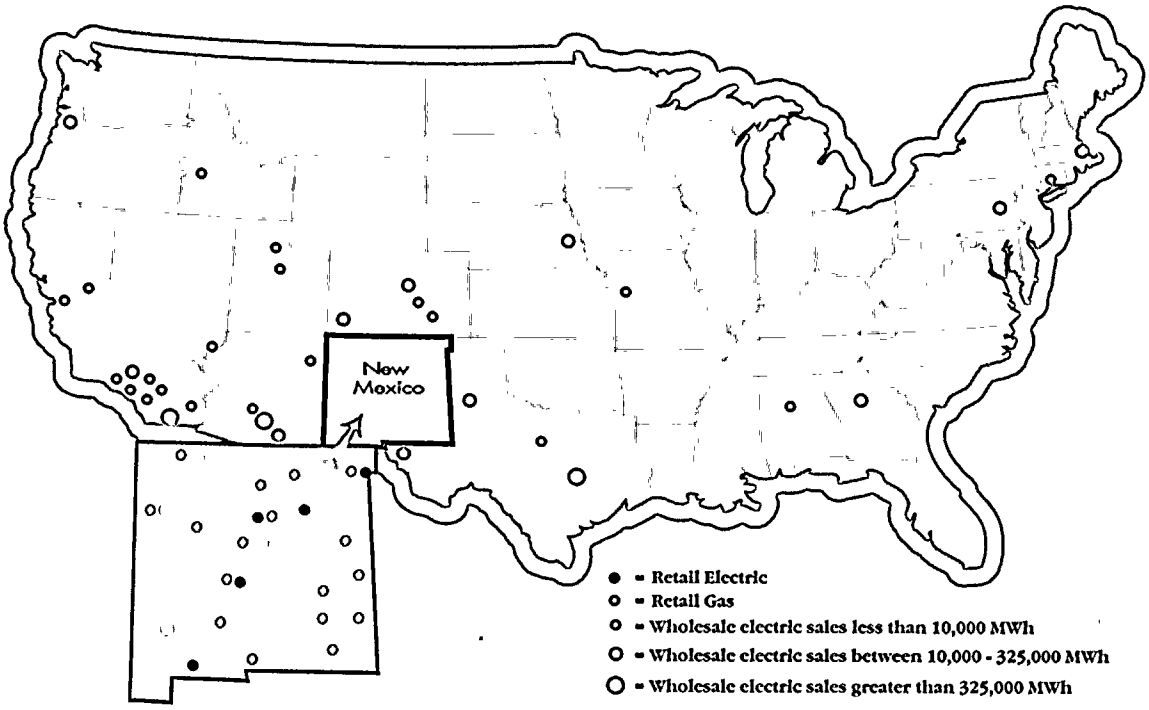
About Our Company

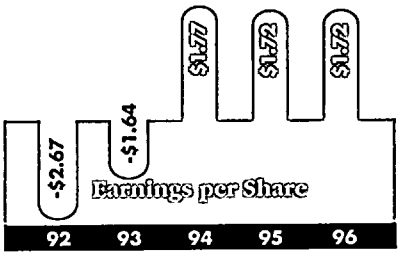
PNM is an integrated energy company that provides electric and natural gas service to more than 1.3 million people in the state of New Mexico, markets power to wholesale customers throughout the U.S., and offers a comprehensive range of energy and water management services to municipalities, government agencies and other institutional clients.

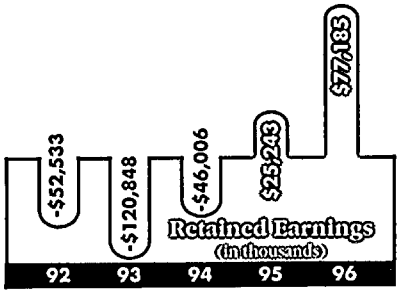
Service Area

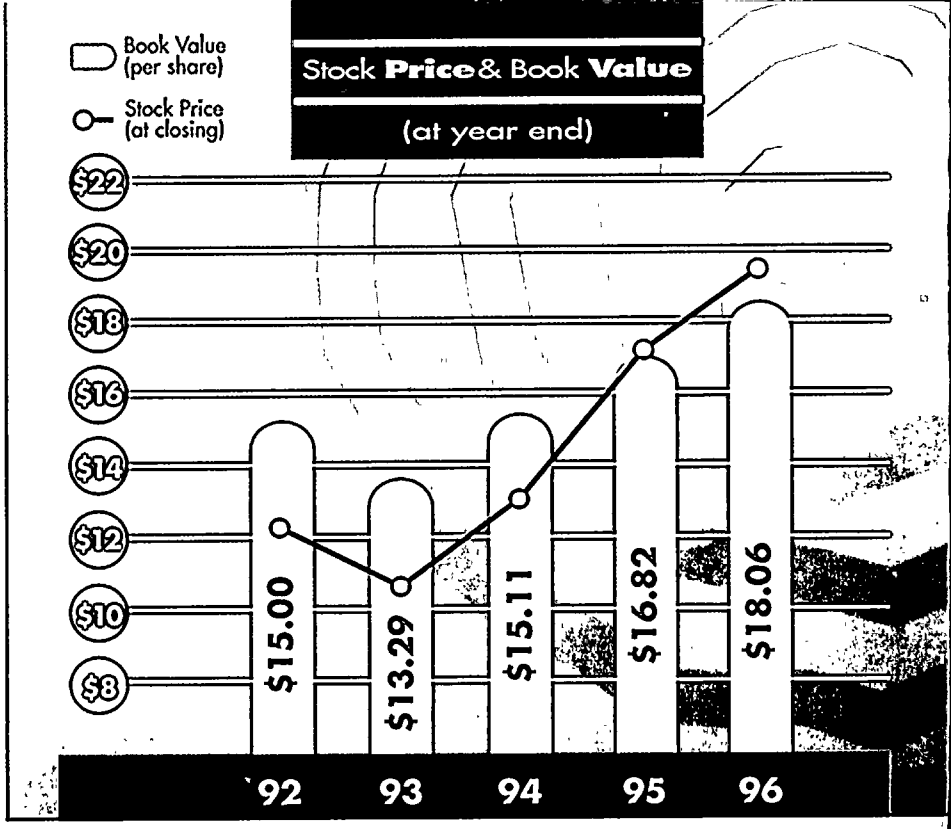


On the Cover

On the front cover and in the following pages are pictured a few of the 2,739 men and women of PNM, whose hard work and dedication have made our company's success possible.







Investor Highlights

(Dollars in thousands, except per share amounts)

		1996	1995	Percent Change ('95-'96)	5-Year Annual Growth Rate
Financial Data	Operating Revenues	$ 883,386	$ 808,465	9.3 %	0.6 %
	Operating Expenses	$ 757,367	$ 695,077	9.0 %	(0.7) %
	Operating Income	$ 126,019	$ 113,388	11.1 %	5.3 %
	Net Income	$ 72,580	$ 75,562	(3.9) %	25.9 %
	Retained Earnings	$ 77,185	$ 25,243	205.8 %	5.1 %
	Return on Average Common Equity	9.8 %	10.7 %	(8.4) %	40.3 %
Operating Data	Customers Served (at year-end)				
	Electric	342,255	333,220	2.7 %	2.9 %
	Gas	401,413	392,744	2.2 %	2.6 %
	Electric (Megawatt-hour sales)				
	Retail sales	6,406,296	6,029,365	6.3 %	4.5 %
	Wholesale sales	4,575,220	2,590,513	76.6 %	8.2 %
	Total Megawatt-hour sales	10,981,516	8,619,878	27.4 %	5.9 %
	Gas (Decatherms in thousands)	100,096	109,594	(8.7) %	(1.9) %
	System Peak (Megawatts)	1,217	1,247	(2.4) %	3.6 %
	Regular Employees	2,739	2,626	4.3 %	(2.8) %
Common Share Data	Earnings	$ 1.72	$ 1.72	—	40.0 %
	Closing Price	$ 19.63	$ 17.63	11.3 %	15.0 %
	Average Shares Outstanding	41,774,083	41,774,083	—	—
	Book Value	$ 18.06	$ 16.82	7.4 %	0.4 %

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The positive energy flowing through PNM today is a vitality solidly grounded in a recognition of our accomplishments of recent years and clearly focused on a shared vision of our company's future.

In 1996, PNM once again outperformed expectations. Although net income was down slightly compared to the previous year, and earnings were unchanged at $1.72 per share, a comparison of earnings net of non-recurring items shows a substantial improvement in ongoing profitability.

Earnings from ongoing operations increased 47 cents per share, from $1.35 in 1995 to $1.82 in 1996. This 35 percent increase was primarily due to continued strong growth in our service territory, coupled with effective cost containment and the positive impact of past financing decisions. Operating revenues rose 9.3 percent in 1996, retail electric sales increased 6.3 percent, and our aggressive marketing efforts in PNM Bulk Power Services resulted in a 76.6 percent increase in wholesale sales.

TO OUR SHAREHOLDERS

All these successes contributed to PNM's single most significant achievement of 1996: the restoration of our common stock dividend. During the course of the year, we also made substantial progress toward our second, closely related goal of regaining an investment grade credit rating.

In 1997, we continue to seek ways to further reduce our long-term debt, trim interest expense, and build the financial strength your company needs to take advantage of the many new opportunities opening up in our industry.

Our goal is to enter the next century as a growing, competitive, independent, financially strong energy services company. We plan to achieve this, first, by maintaining an unwavering commitment to our core business, constantly seeking ways to further lower our costs, improve service, and earn the trust and loyalty of our customers. The second key element of our strategic plan calls for an aggressive effort to expand into carefully targeted niche markets in the emerging energy services business.

Our strategy builds on PNM's primary competitive advantage: the experience and reputation we have earned in more than three-quarters of a century of service to the people of New Mexico.

Substantial challenges remain in our path toward realizing our vision of PNM as a successful competitor in the new energy marketplace. Here in New Mexico and all across the nation, our industry is changing rapidly. In helping to shape this change, PNM is committed to ensuring

Benjamin F. Montoya, President and Chief Executive Officer; John T. Ackerman, Chairman of the Board

"Our goal is to enter the next century as a growing, competitive, independent, financially strong, energy services company."

equitable treatment of our investors while bringing the benefits of a competitive marketplace to all of our customers. Based on the experience of other states and on the balanced approach New Mexico's Legislature is taking toward restructuring our electric industry, we continue to believe that we can arrive at a mutually beneficial resolution of issues which are so important to our investors and customers.

Despite the uncertainties surrounding industry restructuring, we continue to press forward with the execution of our strategic plan. Your Board of Directors has challenged the PNM management team to exceed industry norms in improving earnings through 1997 and beyond. While this standard of performance is high, our achievements of the last three years make us confident we can meet these expectations.

In 1996, for the third year in a row, PNM shareholders earned a total return on their investment superior to our peer group in the utility industry. In 1997, we intend to continue to provide an attractive total return to our shareholders by offering our customers the best value for their energy dollars.

Sincerely,

J. T. Ackerman

John T. Ackerman
Chairman of the Board

Ben Montoya

Benjamin F. Montoya
President and Chief Executive Officer

Our industry is evolving from the monopoly regulation of the past to the competitive market of the future. To succeed in that new, competitive environment, we are reshaping PNM from a traditional electric and gas utility into an integrated energy services company.

Building Financial Strength

In laying the groundwork for that success, it was first of all necessary to rebuild PNM's financial strength. We have pursued that primary financial objective through a consistent program of debt reduction, funded in part through the sale of assets not needed in the operation of our core businesses.

In 1996, the company continued to improve its financial condition with the repurchase of $200 million of long-term bonds and the refinancing of another $165 million of long-term debt. Standard & Poor's and Moody's Investors Services both recognized PNM's growing financial strength in 1996 by raising the rating on the company's securities to just one notch below investment grade.

We have been aided in our efforts by the rapid growth in our service area in recent years. That growth, combined with continuing cost control efforts throughout the company, has

POSITIVE ENERGY:

enhanced earnings and fueled a strong cash flow. In 1996, PNM total operating revenues increased 9.3 percent, while earnings from continuing operations increased 35 percent. Book value per share of common stock increased from $16.82 at the end of 1995 to $18.06 as of December 31, 1996.

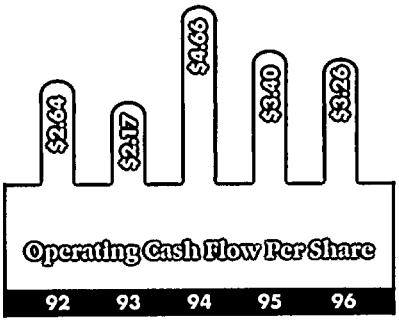
Based on our continuing strong financial performance, in May 1996 the PNM Board of Directors was able to reinstate the common stock dividend suspended in 1989. It is the Board's intention to manage dividend policy to continue to offer PNM shareholders a competitive total return on investment while retaining sufficient financial flexibility to take advantage of growth opportunities in our industry.

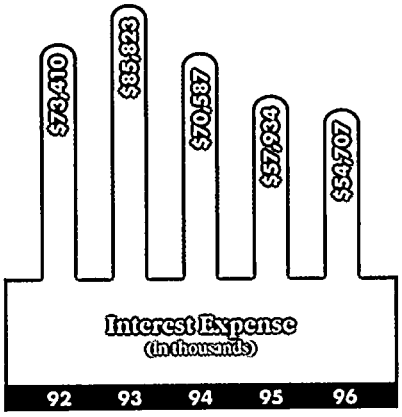
Focusing on Results

The PNM strategic plan recognizes that success in a competitive environment will require a new kind of company — an adaptive, flexible, results-driven organization, energized by a corporate culture that encourages innovation, rewards efficiency, and values superior performance.

Reorganizing PNM into four strategic business units, each focused on a particular segment of the company's market, was the first step toward creating that new energy company. In 1995, PNM continued that process by linking management compensation to stock performance,

POWERING CHANGE IN OUR COMPANY.





reinforcing the common interest of management and shareholders in the company's success.

In 1996, PNM continued to move away from a traditional wage structure toward a system linking each employee's compensation with the performance of the company as a whole. The emphasis is on achieving measurable results that provide immediate, tangible benefits to both shareholders and customers while advancing PNM toward its long-term strategic goals.

An ambitious earnings per share target encourages workers to constantly seek improvements in efficiency and productivity. At the same time, non-monetary objectives measured in terms of improved service and increased customer satisfaction reinforce a company-wide commitment to the people we serve.

While results-based pay represents a radical departure from the compensation philosophy which guided the company in past years, PNM employees have responded positively to the change. Other changes to our total compensation package, including health benefits and retirement plan, were also initiated in 1996 to position PNM for the future.

Today's energy company must be able to move rapidly to identify and develop new markets. In 1995, PNM recognized the opportunity offered in providing a total energy solution tailored to the needs of the many federal installations and smaller municipalities in the Southwest.

PNM Energy Services, which also operates the City of Santa Fe's municipal water system, has identified another potential market in managing utility systems for others in New Mexico and throughout the Southwest.

Entering New Markets

In 1996, PNM entered into its first agreements in these new markets, with White Sands Missile Range and with Santa Ana Pueblo in New Mexico. We believe these two agreements will serve as models for similar, future compacts with other clients in New Mexico and throughout the Southwest.

PNM is also actively engaged in Mexico, where the government is now privatizing that country's natural gas distribution system and opening the electric generation sector to

limited competition and private investment. The company has bid on several electric and gas projects in Mexico and continues to explore opportunities for cross-border cooperation.

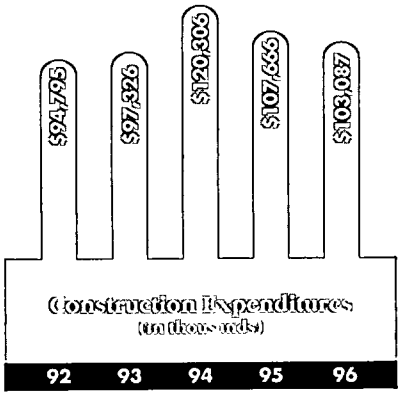
Adapting to Competition

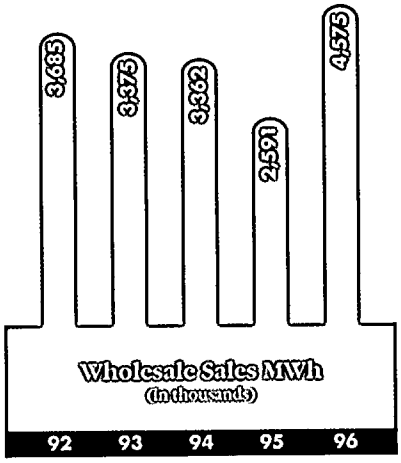
Successful energy companies must also learn to adapt to the demands of a fiercely competitive marketplace. Over the last two years, as federal regulators have set new open access rules for the interstate transmission system, the wholesale power business has become such a marketplace. PNM Bulk Power Services has met this challenge with a two-pronged strategy aimed at, first, reducing PNM's cost of energy, and second, aggressively marketing energy beyond our retail service territory.

To lower costs, PNM has streamlined operations and reduced fuel costs at our primary generating resource, San Juan Generating Station in northwestern New Mexico. In 1996, PNM and the other owners of San Juan approved an upgrade of the plant's emission control system which will provide additional cost savings beginning in 1999.

The operator of Palo Verde Nuclear Generating Station, in which PNM holds a 10.2 percent interest, has achieved similar success in lowering generating costs and improving the performance of that plant. Palo Verde operated at a record 89.1 percent of maximum capacity in 1996, up from 83.6 percent in 1995. Generating costs (operating and maintenance

POWERING CHANGE IN OUR BUSINESS.





plus fuel costs) at Palo Verde fell from 1.61 cents per kWh in 1995 to 1.45 cents per kWh in 1996, a decrease of almost 10%.

At the same time PNM has been bringing down its generating costs, the company's expanded wholesale trading desk has dramatically increased energy sales in the face of intense competition. Our power marketing strategy draws on both PNM's own generating resources and power purchases to expand our share of this dynamic market.

Wholesale sales were up 76.6 percent in 1996 compared to the previous year. Margins also improved somewhat on these large-volume sales last year, but still remain relatively thin compared to the retail electric market. However, with our strategically located connections to the Western grid and our years of experience in serving this market, we believe that PNM will continue to grow this business in 1997.

Today's energy company must be a customer-driven organization, responsive to consumer demand and constantly striving to offer the best value to its customers. To meet this standard, PNM Electric Services and PNM Gas Services continue to improve upon what they do best: providing reliable, efficient utility services to the people who live and work in our home state of New Mexico.

In 1996, for the fourth year in a row, rapid growth in the New Mexico economy resulted in corresponding growth in PNM's retail electric and gas sales. The total number of retail electric customers increased 3 percent and gas customers increased 2 percent, while retail kWh sales were up 6.3 percent.

To serve this steadily growing customer base, in 1996 PNM negotiated an agreement to purchase power from a proposed 100-megawatt power plant to be built near Albuquerque. To more efficiently manage the growing load on the PNM system, we have also asked regulators to approve rates that would allow commercial and industrial customers to reduce their costs by limiting their power consumption during peak periods.

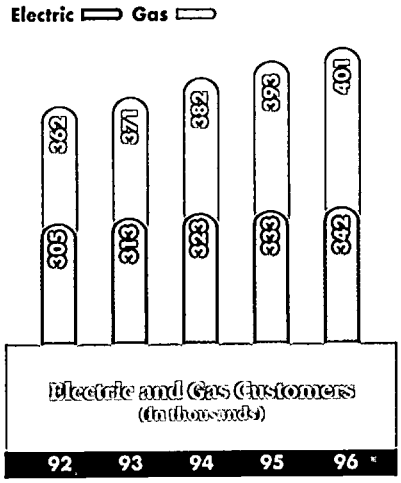
POSITIVE ENERGY:

Two widespread outages in the western U.S. in the summer of 1996 focused public attention on the reliability of the interstate electric transmission grid. This past winter, an unprecedented spike in natural gas prices burdened many of our customers with unusually high heating bills. Both these incidents underscore the critical role our services play in the lives of our customers. PNM is pledged to justify the confidence they place in us by meeting their demand for affordable, reliable electric and gas service.

In PNM Electric Services, bolstering system reliability remains a top priority for our company, and we continue to invest in upgrading our transmission and distribution system. To speed the restoration of service in the event of unavoidable interruptions, PNM's new, computerized emergency response system makes it possible to more quickly identify and locate faults and dispatch repair crews. In PNM Gas Services, we have revised our billing practices and are reassessing our gas supply strategy to ensure they serve the best interests of our customers.

We have heard what our customers are telling us. Customers want clear price signals so that they know in advance how much they are spending; they want expanded control over the price they pay; and they want choices in their energy supply portfolio so that they can select the option that best suits their needs. PNM is committed to working toward offering those energy solutions.

POWERING CHANGE FOR OUR CUSTOMERS.



Throughout our business, we are applying the latest technology to streamline business efficiency and improve service. In 1997, the company will invest about $20 million in a new customer service system to provide more flexible billing and information capabilities. In our phone center, a new interactive voice response system will make it easier for customers to access account information, schedule service calls, and report local outages.

Strengthening Customer Relationships

A clear focus on customer satisfaction is the key to success in a competitive marketplace. In a concerted effort to build solid, long-term relationships with our customers, PNM is seeking the regulatory flexibility to offer our retail customers a range of products and services tailored to meet their energy needs. We believe this strategy will not only help us retain market share in an increasingly competitive environment, but will also allow us to grow revenues and earnings by strengthening PNM's brand identity as a trusted energy ally, our customers' energy provider of choice.

The transition from a regulated to a competitive energy marketplace is already well under way in the wholesale power market as well as in the natural gas business. In California, in Rhode Island, and in other states, competition is being introduced to the retail electric market.

In our home state of New Mexico, the Legislature has endorsed a deliberate approach to change. Because few other products or services exercise such a pervasive influence on our daily lives, the question of how best to restructure our industry is of vital interest not just to PNM and its investors, but to every resident of our state. Only through a fair and carefully planned transition will our customers be able to enjoy the advantages of a free marketplace without losing the highly reliable, affordable, universally available electric service we now take for granted.

In February 1997, the New Mexico Public Utility Commission issued a final order in the gas rate case we have had pending since August 1995. At the same time, the commission ordered PNM to file both an electric rate case and a new gas rate case later this year. We believe these

proceedings may also serve to further the discussion over industry restructuring here in New Mexico. We continue to work at both the state and federal levels to support change that ensures a continuing flow of investment into our industry and extends the benefits of a competitive marketplace to all our customers.

Planning for the Future

Four years ago, Public Service Company of New Mexico was one of the first utilities in the nation to recognize that a fundamental restructuring of our industry was under way. To successfully transition from a monopoly to a competitive market, PNM adopted a business plan setting three primary goals:

- first, to strengthen the company's financial position;
- second, to build a flexible, efficient organization capable of responding quickly to new opportunities; and,
- third, to cooperate with all interested parties in shaping our industry to the mutual benefit of all our customers and our investors.

As PNM has succeeded in translating key elements of this business plan into reality, our stock has consistently outperformed our peer group in the utility industry.

POWERING CHANGE IN OUR INDUSTRY.

Key Principles of Electric Restructuring

High quality, reliable service must be maintained.

All customers should benefit from increased competition.

Past regulatory commitments must be honored and transition costs recovered.

All competitors should stand on an equal footing.

Lower rates should be brought about through efficiency and innovation, not through cost-shifting among customer classes.

Growth in our New Mexico service territory is expected to slow somewhat in 1997, although the state's economy is likely to continue to outperform most of the rest of the nation. Growing competition in the wholesale power market, in energy services, and in our retail markets will continue to exert pressure on earnings. Considerable regulatory and political uncertainty surrounding the pace and terms of the transition to a competitive marketplace continues to cloud the near-term horizon.

Whether in a regulated or a competitive environment, ultimately our success is entirely dependent upon our customers. Only by delivering the best service at the lowest price will we be able to continue to provide our shareholders with an attractive return on their investment. For the men and women of PNM, the challenge in 1997 and beyond is to demonstrate our whole-hearted, unwavering commitment to the people we serve.

Board of Directors

(age*) (year elected as PNM board member*)

1. **John T. Ackerman** *(55)* (1990)
   Chairman of the Board of PNM. E
2. **Robert G. Armstrong** *(50)* (1991)
   President of Armstrong Energy Corporation. A, E, H
3. **Joyce A. Godwin** *(53)* (1989)
   Retired as the Vice President and Secretary of Presbyterian Healthcare Services. C, E, H, N
4. **Laurence H. Lattman** *(73)* (1993)
   Retired as the President of the New Mexico Institute of Mining and Technology. A, C, N
5. **Manuel Lujan, Jr.** *(68)* (1994)
   Previously served as U.S. Secretary of the Interior, consults on U.S. governmental matters and is an insurance agent with Manual Lujan Insurance, Inc. A, C
6. **Benjamin F. Montoya** *(61)* (1993)
   President and Chief Executive Officer of PNM. F
7. **Reynaldo ("Reynie") U. Ortiz** *(50)* (1992)
   President and Chief Executive Officer of Sophia Communications, Inc., a startup wireless communications company. A, C
8. **Robert M. Price** *(66)* (1992)
   President of PSV, Inc., a technology consulting business. E, F, H
9. **Paul F. Roth** *(64)* (1991)
   Retired as the President of the Texas Division of Southwestern Bell Telephone Company. E, H, N

A – Members of the Audit Committee
C – Members of the Customer and Public Policy Committee
E – Members of the Executive Committee
F – Members of the Finance Committee
H – Members of the Compensation and Human Resources Committee
N – Members of the Nominating and Governance Committee

Officers of the Company

(age*) (years of service*)

Benjamin F. Montoya *(61)* (3)
President and CEO

Jeffry E. Sterba *(41)* (19)
Executive Vice President and COO

Marc D. Christensen *(48)* (5)
Senior Vice President,
Customer Service and Public Affairs

Roger J. Flynn *(54)* (2)
Senior Vice President, Electric Services

Max H. Maerki *(57)* (13)
Senior Vice President and
Chief Financial Officer

Patrick T. Ortiz *(47)* (5)
Senior Vice President,
General Counsel and Secretary

William J. Real *(48)* (18)
Senior Vice President, Gas Services

Raymond B. Ridgeway *(38)* (16)
Senior Vice President, Energy Services

Judith A. Zanotti *(58)* (11)
Senior Vice President, Human Resources

Barbara L. Barsky *(52)* (11)
Vice President,
Strategy, Analysis and Investor Relations

Melvin Christopher *(36)* (14)
Vice President,
Metro Gas Operations and Chief Engineer

Patrick J. Goodman *(47)* (24)
Vice President, Power Production

James P. Kovalcik *(50)* (1)
Vice President, Energy Partners

Alfonso R. Lujan *(48)* (24)
Vice President, Electric Transmission and
Distribution Services

Edward Padilla, Jr. *(43)* (20)
Vice President,
Bulk Power Marketing and Development

Lawrence D. Ratliff *(50)* (22)
Vice President,
Engineering and Technical Support

Terry D. Rister *(45)* (25)
Vice President, Customer Service

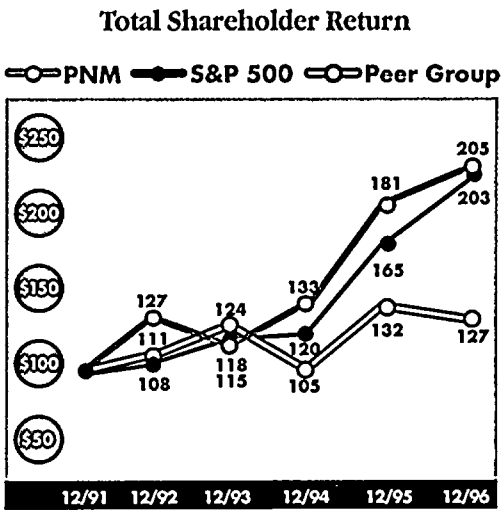
Donna M. Burnett *(43)* (17)
Corporate Controller and
Chief Accounting Officer

Mitchell J. Marzec *(49)* (21)
Treasurer

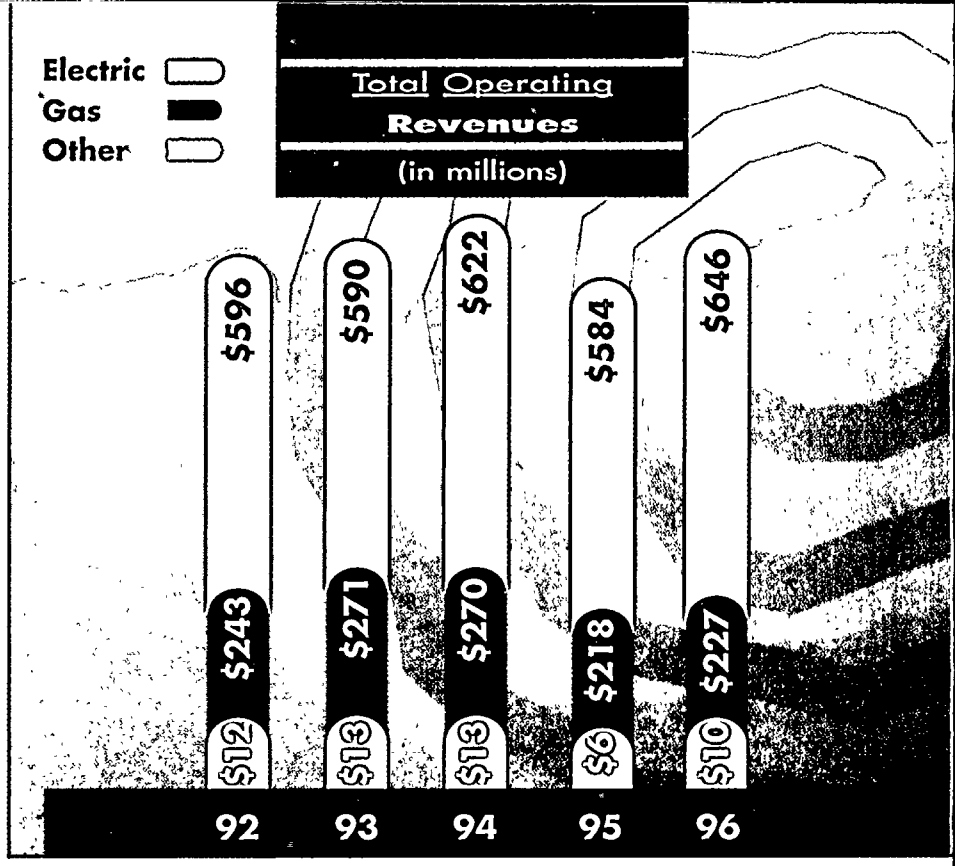
*as of March 11, 1997

PNM.

FINANCIAL SECTION



For the third year in a row, PNM shareholders earned a total return on their investment superior to our peer group in the utility industry.



Implementation of a $30 million rate reduction and the sale of the gas gathering and processing assets and the Santa Fe water operations reduced total operating revenues in 1995.

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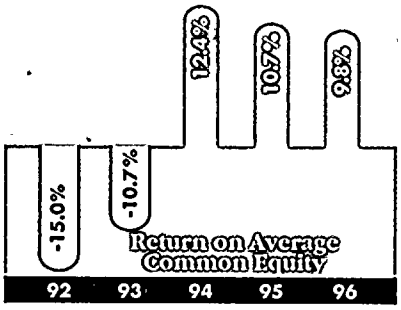
SELECTED FINANCIAL DATA

	1996	1995	1994	1993	1992
	(In thousands except per share amounts and ratios)				
Total Operating Revenues	$ 883,386	$ 808,465	$ 904,711	$ 873,878	$ 851,953
Net Earnings (Loss)	$ 72,580	$ 75,562	$ 80,318	$ (61,486)*	$ (104,255)**
Earnings (Loss) per Common Share	$ 1.72	$ 1.72	$ 1.77	$ (1.64)*	$ (2.67)**
Total Assets	$ 2,230,314	$ 2,035,669	$ 2,203,265	$ 2,212,189	$ 2,375,582
Preferred Stock with Mandatory Redemption Requirements	—	—	$ 17,975	$ 24,386	$ 25,700
Long-Term Debt, less Current Maturities	$ 713,919	$ 728,843	$ 752,063	$ 957,622	$ 911,252
Common Stock Data:					
Market price per common share at year end	$ 19.625	$ 17.625	$ 13.00	$ 11.25	$ 12.375
Book value per common share at year end	$ 18.06	$ 16.82	$ 15.11	$ 13.29	$ 15.00
Average number of common shares outstanding	41,774	41,774	41,774	41,774	41,774
Cash dividend declared per common share	$ 0.48	—	—	—	—
Return on Average Common Equity	9.8%	10.7%	12.4%	(10.7)%	(15.0)%
Capitalization:					
Common stock equity	50.9	48.6	43.2	34.8	38.6
Preferred stock:					
Without mandatory redemption requirements	0.9	0.9	4.1	3.7	3.6
With mandatory redemption requirements	—	—	1.2	1.5	1.6
Long-term debt, less current maturities	48.2	50.5	51.5	60	56.2
	100%	100%	100%	100%	100%

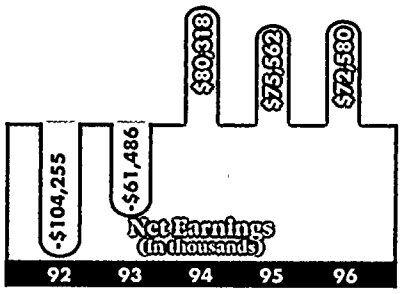
* Includes the write-down of the 22% beneficial interests in the PVNGS Units 1 and 2 leases purchased by the Company, the write-off of certain regulatory assets and other deferred costs and the write-off of certain PVNGS Units 1 and 2 common costs, aggregating $108.2 million, net of taxes ($2.59 per 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.



PNM's ROE was negative in 1992 and 1993 as a result of the write-off of certain regulatory assets and deferred costs and the write-down of the value of its investment in PVNGS.



In 1994, PNM's net earnings turned positive. In its third year of profitable operations, PNM reinstated its common stock dividend in 1996.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Restructuring the Electric Utility Industry

The electric utility industry continues to be in 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 levels continue to consider how to promote competition among suppliers of electricity and how to provide customers with choice among suppliers.

At the state level, the Integrated Water and Resource Planning Committee of the New Mexico State Legislature (the "IWRPC") held hearings during 1996 which focused on the issues related to restructuring of the electric industry in New Mexico. The Company participated extensively in these hearings and, at the invitation of the IWRPC, submitted draft legislation to be used as a starting point for the various parties to consider regarding the electric industry restructuring. The draft legislation would allow an electric utility to recover all of its prudently incurred stranded costs, and also provide a path for business flexibility. The New Mexico Attorney General ("AG") testified that retail competition should not be introduced at this time but, if it is, there should be independent ownership of generation, transmission and distribution facilities, due to market power concerns. At its November 1996 meeting, the IWRPC voted not to recommend restructuring legislation in the 1997 session but instead to recommend continuation of the IWRPC and a study of the tax effects of restructuring. The IWRPC also sent a letter to the New Mexico Public Utility Commission ("NMPUC") calling for no restructuring to be undertaken by the NMPUC without legislative approval. The New Mexico legislative session is currently in progress and the Company will closely monitor any legislative action regarding restructuring of the electric utility industry.

During 1996, the NMPUC conducted a series of workshop meetings in its "Investigation of Restructuring of Regulation of the Electric Industry in New Mexico". The Company actively participated in these workshops and presented the Company's position on various matters related to industry restructuring. The Company provided data and analysis in the areas of market structure, measurement and collection of stranded costs, market power, potential changes in Company structure and issues related to the transition phase. In conjunction with the work shop meetings, the NMPUC ordered all utilities under its jurisdiction to file their estimates of stranded costs, absent any recovery method being adopted, based on the Texas Public Utility Commission Economic Cost Over Market ("ECOM") model. The Company, in its filing, presented two methodologies: (i) using the ECOM model, the Company's stranded cost estimates run from $657 million for a 1998 full retail access case to $119 million for a 2002 full retail access case, and (ii) using a second methodology, based upon the difference between the Company's costs of existing generation and the costs of new combined cycle and combustion turbine units to serve the same load, the Company's costs above the level of new gas units were estimated at $748 million for a 1998 full retail access case to $327 million for a 2002 full retail access case. The Company advised the NMPUC that the results of the ECOM model are highly sensitive to various assumptions, primarily projections of future gas prices. To date, the NMPUC has not acted on the requested information.

At the Federal level, two orders and a Notice of Proposed Rulemaking ("NOPR") related to the provision of transmission service by public utilities were issued in 1996. FERC Order 888, effective July 9, 1996, addresses, among other things, numerous subjects related to the terms and conditions under which public utilities are required to provide access to transmission services, to purchase transmission service on comparable terms for their own wholesale marketing activities, to recover stranded costs from departing wholesale customers and to conform existing power pool agreements to the open access provision of the order. All public utilities were required to have filed, by the effective date, an Open Access Transmission Tariff based on the provisions of the order. In July 1996, the Company filed its compliance Open Access Transmission Tariff under Order 888.

FERC Order 889, effective January 3, 1997, requires public utilities to install and operate an Open Access Same-time Information System and comply with certain standards of conduct among employees in transmission operations and wholesale power marketing, designed to prevent employees of a public utility or its affiliates engaged in wholesale marketing functions from obtaining preferential access to transmission-related information or from engaging in unduly discriminatory business practices regarding access to transmission service. On January 2, 1997, the Company filed with the FERC its Standards of Conduct report in compliance with provisions of Order 889.

A NOPR relating to transmission capacity reservation proposed the elimination of the provision of separate "network" and "point-to-point" service as provided in Order 888, providing all open access service under a capacity reservation tariff. Industry comments were submitted to the FERC on October 1, 1996. The FERC has provided no indication of any future activity on the proposed rulemaking. The Company continues to assess the impact of both the rules and the potential impact of the proposed rulemaking.

In July 1996, legislation was introduced in the United States Congress to allow retail competition by the year 2000. Since then, a number of bills have been drafted for potential introduction in Congress. It is anticipated that these bills will be heavily lobbied by utilities, industrials, power marketers, generators, environmental groups, consumer groups and state regulators.

Although it is currently unable to predict the ultimate outcome of possible retail wheeling initiatives, the Company has been and will continue to be active at both the state and Federal levels in the public policy debates on the restructuring of the electric utility industry. The Company will continue to work with customers, regulators and legislators and other interested parties to find solutions that bring competitive benefits while recognizing past commitments.

Competitive Strategy

The Company's strategy for dealing with competition in changing market places includes ongoing cost reductions, increased productivity, pursuit of growth opportunities, seeking to improve credit ratings to investment grade and strengthening of customer relations. To accomplish these objectives, the Company continues to maintain the focus on its core business and is aggressively pursuing its efforts to expand its energy related business into carefully targeted markets for new business opportunities.

In pursuing new business opportunities, the Company is focusing on energy and utility related activities under its Energy Services Business Unit. These activities will provide energy marketing 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 in the Southwest. The Energy Services Business Unit is also pursuing business opportunities in Mexico.

In June 1995, the Company filed an application with the NMPUC for authorization for the creation of three wholly-owned non-utility subsidiaries as part of the Energy Services Business Unit. 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. In March 1996, the NMPUC issued an order adopting the hearing examiner's recommendation and denied NMPUC staff's motion to dismiss the case. On July 8, 1996, hearings in the case began and were concluded on July 19, 1996. The NMPUC staff alleged that certain activities undertaken by the Company, that would be transferred to the subsidiaries if approval is granted, required prior approval thus leaving the Company subject to sanctions. The Company currently cannot predict the ultimate outcome of this proceeding but has and intends to continue to vigorously defend against any allegation that it is in violation of any legal requirements.

In December 1996, the Company filed an application for certain variances and authorization to invest up to $7.5 million of equity capital in a partially-owned subsidiary company to be incorporated under the laws of the United Mexican States, and to provide guarantees, as necessary, of up to $10 million that may be required in connection with the forming of a subsidiary in Mexico. The Company jointly with Triturados Basalticos y Derivados, S.A. ("Tribasa"), one of the largest construction companies in Mexico, submitted a bid to develop, design, construct, manage and operate natural gas distribution systems in the cities of Chihuahua, Cuauhtemoc-Anahuac and Delicias in the State of Chihuahua, Mexico. If the Company and Tribasa, and possibly a third entity, were to be awarded the permit jointly,

these companies would be required, under Mexican law, to form and capitalize a Mexican corporation to comply with permit requirements. In such event, the Company would serve as technical participant and would be required to maintain a certain equity ownership interest. On January 17, 1997, the NMPUC gave the Company conditional approval to proceed. On February 3, 1997, the Company made its compliance filing pursuant to the NMPUC's conditional approval. The Company is currently unable to predict the outcome of the bid.

The Company believes that successful operation of the Energy Services Business Unit activities will better position the Company in an increasingly competitive utility environment. The Company is currently awaiting NMPUC action on the formation of the energy and non-utility related subsidiaries under the Company's general diversification plan discussed above.

LIQUIDITY AND CAPITAL RESOURCES

Capital Requirements and Liquidity

Total capital requirements include construction expenditures as well as other major capital requirements, including retirement of long-term debt, long-term debt sinking funds and cash dividend requirements for both common and preferred stock. The main focus of the Company's construction program is upgrading generating systems, upgrading and expanding the electric and gas transmission and distribution systems and purchasing nuclear fuel. Total capital requirements and construction expenditures for 1996 were $321.0 million and $103.1 million, respectively. Projections for total capital requirements and construction expenditures for years 1997-2001 are $914.7 million and $563.7 million, respectively. These estimates are under continuing review and subject to on-going adjustment. In conjunction with upgrading generating systems, the Company has begun a retrofit environmental project at the San Juan Generating Station ("SJGS") which will cost the Company approximately $40 million during the next two years.

The Company's construction expenditures for 1996 were entirely funded through cash generated from operations. The Company currently anticipates that internal cash generation will be sufficient to meet capital requirements during 1997 through 2001. 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.

In September 1996, the NMPUC granted the Company's request for the purchase of up to $300 million of Palo Verde Nuclear Generating Station ("PVNGS"), Lease Obligation Bonds ("LOBs") and Eastern Interconnection Project ("EIP") secured facility bonds over the next three years. In October 1996, the Company purchased $200 million of PVNGS LOBs at a premium with accrued interest. In purchasing the LOBs, the Company borrowed $100 million against the credit facility collateralized by the Company's utility customer accounts receivable and certain amounts being recovered from gas customers relating to certain gas contract settlements and utilized $118 million of its cash. Although the PVNGS LOBs are off-balance sheet debt, these outstanding bonds have been included in the calculation of the Company's debt to capitalization ratio as well as various financial coverage ratios by the major rating agencies. The purchase of the LOBs will not only improve these ratios, but will also increase earnings in the form of interest income. At the end of 1996, the Company had $20.3 million in cash and temporary investments and $100.4 million in short-term borrowings.

In addition, at year-end 1996 the Company had $110.6 million of available liquidity arrangements, consisting of $100 million from the revolving credit facility ("Facility") and $10.6 million in local lines of credit. The Facility will expire in June 1998 and includes a maximum allowed debt to capitalization ratio of 70%. As of December 31, 1996, such ratio was 61.7 %, including the PVNGS and EIP leases as debt. The Company expects to renew the Facility before its expiration date.

Financing Capability and Dividend Restrictions

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. In September 1996, Standard & Poor's Corp. and Moody's Investors Service, Inc. upgraded the Company's credit ratings to one

level below investment grade. Duff & Phelps Credit Rating Co. maintains an investment grade rating for the Company's first mortgage bonds, but continues to rate all other securities of the Company below investment grade. The Company may face limited credit markets and higher financing costs as a result of its securities being rated below investment grade.

One impact of the Company's current ratings, together with covenants in the Company's PVNGS Units 1 and 2 lease agreements 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 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, 1996, based on the earnings test, the Company could have issued approximately $254 million of additional first mortgage bonds, assuming an annual interest rate of 8.65 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 9.40 percent, the Company could have issued $379 million of preferred stock as of year-end.

In December 1996, the Company refinanced $23 million 1984 Series A Pollution Control Revenue Bonds, $77.045 million 1977 Series Pollution Control Revenue Bonds and $65 million 1978 Series A Pollution Control Revenue Bonds with fixed rates of 6.3%, 6.3% and 5.7%, respectively. The maturity dates for these new bonds are December 2026, December 2016 and December 2016, respectively. In addition, the Company is currently in the process of refinancing an additional $190 million of pollution control revenue bonds. On January 21, 1997, the Company received NMPUC approval for the refinancing of such bonds, and closing is anticipated for late February 1997. The remaining $60 million of the 1978 Series A Pollution Control Revenue Bonds and $40 million of the Company's 1979 Series A Pollution Control Revenue Bonds will be refinanced as variable rate bonds in the weekly mode. The initial variable rate will be determined prior to closing. The remaining $90 million of the 1979 Series A Pollution Control Revenue Bonds will be refinanced with a fixed rate of 6.375%. The total of the $190 million bonds will mature in April 2022.

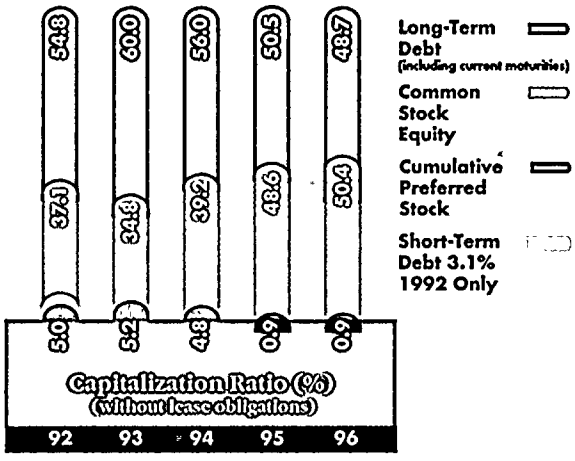
The Company currently has no requirements for long-term financing during the period of 1997 through 2001. However, during this period, the Company could enter into long-term financing for the purpose of strengthening its balance sheet and reducing its cost of capital. The Company continues to evaluate its investment and debt retirement options to optimize its financing strategy and earnings potential.

The Company resumed the payment of cash dividends on common stock starting in May 1996 and continued a quarterly cash dividend of 12 cents per common share during 1996. The Company's board of directors reviews the Company's dividend policy on a continuing basis. The declaration of common dividends is dependent upon a number of factors including earnings and financial condition of the Company and market conditions.

Bond Ratings

Security Class	Standard & Poor's	Moody's	Duff & Phelps
Senior Secured Debt	BB+	Ba1	BBB-
EIP Funding Corp. Secured Lease Obligation Bonds (SLOBs)	BB+	Ba2	BB+
First PV Funding Corp. Lease Obligation Bonds (LOBs)	BB+	Ba3	BB+
Preferred Stock	BB+	"b1"	B+

PNM targets investment grade for all of its securities. Currently Standard & Poor's and Moody's Investors Services rate PNM's senior secured debt one step below investment grade.



PNM retired $64 million in preferred stock and $190 million of long-term debt in 1995.

Capital Structure

The Company's capitalization, including current maturities of long-term debt, at December 31 is shown below:

	1996	1995	1994
Common Equity	50.4%	48.6%	39.2%
Preferred Stock	0.9	0.9	4.8
Long-term Debt (including current maturities)	48.7	50.5	56.0
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, 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

Earnings per share of common stock were $1.72, $1.72 and $1.77 for 1996, 1995 and 1994, respectively. The sales of the gathering and processing assets and the Company's water division in 1995 had a significant positive earnings effect in 1995 and impacted 1996 earnings by reducing operating margin, reducing operating expenses, reducing interest charges and increasing investment income.

Electric gross margin (operating revenues less fuel and purchased power expense) increased $23.3 million in 1996 as a result of retail load growth and warmer than normal weather and increased off-system sales margin as a result of improved wholesale power market conditions.

Electric gross margin decreased $37.9 million in 1995 from 1994 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. An offset to such decreases was the increase in revenues resulting from retail load growth.

Gas gross margin (operating revenues less gas purchased for resale) was unchanged from 1995. Higher off-system sales margin and higher retail sales margin as a result of cooler than normal weather in 1996 were offset by the absence of the gas gathering and processing margin in 1996 due to the sale of the gas assets in 1995.

Gas gross margin decreased $16.4 million in 1995 from 1994 due to decreased gas deliveries resulting from warmer than normal weather in 1995 and reduced margin as a result of the sale of the gas assets in 1995.

Other operation and maintenance expenses ("O&M") decreased $.3 million in 1996 from 1995 due to the following: (i) lower production O&M expenses of $7.9 million as a result of reduced scheduled maintenance outages in 1996, decreased down time in 1996 for refueling outages and lower property taxes in 1996, (ii) a decrease of $6.3 million in gas production and products extraction expense resulting from the gas assets sale in June 1995, (iii) lower pension and benefit costs of $4.2 million as a result of an adjustment to the retiree's health care costs and (iv) a decrease in water O&M expense of $3.0 million resulting from the sale of the Company's water division in July 1995. Such decreases were offset by higher administrative and general ("A&G") expense of $21.0 million due to increased labor, increased office supplies and expense and higher outside services.

Other O&M expenses decreased $12.3 million in 1995 from 1994 due to the following: (i) a decrease of A&G expense of $7.5 million due to decreased injuries and damages as a result of the recording of worker's compensation liability in 1994 and a decrease in temporary office labor and postage expense, (ii) a decrease in gas production and products extraction expense of $6.2 million resulting from the gas assets sale in 1995, (iii) a $4.1 million decrease in production O&M expenses as a result of a reduction in scheduled maintenance outage hours and (iv) a decrease in water O&M expense of $2.1 million resulting from the sale of the Company's water division in 1995. Such decreases were offset by (i) higher A&G labor expense of $4.7 million and (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.

Depreciation and amortization expenses decreased $2.7 million from a year ago as a result of the sale of the Company's water division and gas assets in 1995 and an adjustment recorded in 1996 for the over amortization of certain intangible utility plant. Depreciation and amortization expenses for 1995 increased $6.7 million from 1994 as a result of the implementation of new depreciation rates approved by the NMPUC in November 1994.

Net other income and deductions decreased $18.8 million from a year ago and increased $20.3 million in 1995 from 1994. Significant 1996 items, net of taxes, included the following: (i) a regulatory liability of $10.1 million, (ii) a $1.7 million write-down of certain assets related to the Company's natural gas vehicle program and (iii) an additional accrual of $1.0 million for environmental liabilities associated with the 1995 gas assets sale. Offsetting such decreases was a curtailment gain of $8.0 million related to the change of the Company's defined benefit pension plan and higher interest income of $7.6 million as a result of increased temporary investments in 1996 and the purchase of the PVNGS LOBs.

Significant 1995 items, net of taxes, included the following: (i) a gain of $12.8 million recognized from the gas assets sale, (ii) a gain of $6.4 million recognized from the sale of the Company's water division, (iii) a $2.6 million adjustment to the carrying costs related to gas take-or-pay settlement amounts, (iv) a $1.9 million insurance recovery and (v) the $1.4 million related to adjusting reclamation reserves for certain mining operations. 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) a write-off of $3.0 million relating to gas take-or-pay settlement payments which were not recoverable through rates, (ii) an additional provision for legal expenses of $3.6 million and (iii) a gain and associated tax benefits of $6.1 million from the sale of generating facilities to Utah Associated Municipal Power Systems ("UAMPS").

Net interest charges decreased $3.2 million and $12.7 million in 1996 and 1995, respectively, as a result of the retirement of $132.7 million of PVNGS LOBs in March 1995. An offset to the 1996 decrease was higher short-term interest charges resulting from short-term borrowings for the purchase of the PVNGS LOBs and an interest assessment from the IRS. In addition, the 1995 decrease included the effect of the retirement of $45 million of first mortgage bonds in April 1994.

Preferred stock dividend requirements decreased $3.1 million and $2.7 million in 1996 and 1995, respectively, as a result of the retirement of $64 million of preferred stock in August 1995.

OTHER ISSUES FACING THE COMPANY

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 $13.2 million rate decrease. On February 13, 1997, the NMPUC issued a final order in the gas rate case, ordering a rate decrease of $7.0 million. In ordering the rate decrease, among other things, the NMPUC disallowed the recovery of certain regulatory assets. The Company strongly disagrees with the NMPUC's final order and filed an appeal with the New Mexico Supreme Court on February 17, 1997. The Company has evaluated the impacts of the rate reduction and has established appropriate reserves in its 1996 financial statements, pending the outcome of the appeal.

NMPUC ORDER—THE COMPANY'S JANUARY 1997 PGAC FACTOR VARIANCE REQUEST; ORDER TO FILE NEW RETAIL ELECTRIC AND GAS RATE CASES

Due to rapidly rising gas supply costs in December 1996, Public Service Company of New Mexico Gas Services, a division of the company ("PNMGS") requested a variance, on December 18, 1996, from the NMPUC to increase its gas cost factor by more than 10% without a prior mandatory hearing. Pursuant to NMPUC rules, PNMGS implemented the new gas cost factor with its January billing cycle. This increase in gas cost along with increased gas consumption and longer billing periods for some customers resulted in a substantial increase to customers bills. The NMPUC denied PNMGS variance to increase the factor more than 10% without a hearing and held public hearings to receive public comment and testimony. These hearings began on January 22 and concluded on January 30, 1997. The Company provided testimony regarding the higher gas costs.

The NMPUC issued a final order in this case on February 13, 1997. In the order, the NMPUC imposed, but suspended, a fine of $2.2 million to the Company due to an allegedly incorrect cost factor (too low) that was filed in

November 1996. In addition, the NMPUC disallowed collection of $1.6 million of gas costs and ordered an independent audit to be conducted to review the Company's Purchased Gas Adjustment Clause ("PGAC") factor calculations for the period of December 1995 through January 1997. The NMPUC also ordered the docketing of two new investigations. The first, which requires a Company filing by March 15, 1997, will investigate whether or not the Company should exit the merchant function in providing gas supplies to customers. The second, will investigate the prudence of the Company's portfolio strategies and purchase practices. In addition, the NMPUC ordered the Company to file a new gas rate case by August 1, 1997, and also ordered the Company to file an electric retail rate case by May 1, 1997.

In the order, the NMPUC accused the Company of intentionally filing an inaccurate factor to avoid a hearing, thus, impairing the NMPUC's ability to investigate rising gas prices. The Company strongly disagrees with the NMPUC's final order and is evaluating its options, including rehearing and a possible appeal to the New Mexico Supreme Court.

TRANSMISSION ISSUES

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. In 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 continued to work with the Navajo Nation in 1996 to resolve this conflict.

The Company continues to assess its options but will not pursue 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.

FERC Transmission Issues

In April 1996, the Company filed a notice of change in rates for firm and non-firm transmission services. The Company also filed two transmission service tariffs and a market-based generation tariff. The Company requested that the rate change filings, as well as the transmission and generation tariff filings, be consolidated with four Section 206 complaint proceedings of four affected customers, as well as a rate change proceeding related to the Company's provision of firm transmission service to El Paso Electric Company ("El Paso"). Seven dockets (the "consolidated dockets") were consolidated for purposes of determining appropriate transmission service rates.

In addition, two wholesale customers separately filed requests for transmission service under Section 211 of the Federal Power Act in 1996. One of these customers notified the Company of its intention to terminate certain transmission service agreements and the Company filed notice of termination of this transmission service agreement with the FERC.

Prior to the scheduled hearings in the case, the parties were able to reach a negotiated settlement of the consolidated dockets, the transmission service requests and the Company's market-based generation rate tariff. Certain provisions of the Company's Open Access Transmission Tariff ("the Tariff") were also incorporated into the settlement, leaving portions of the Tariff subject to further FERC review. A stipulation on the settlement reached by the parties was filed with the FERC on December 16, 1996. In accordance with the stipulated agreement, the Company will refund approximately $3.7 million of revenues it collected from the customers during the time their Section 206 complaints were pending. In addition, the Company's firm wholesale transmission service revenues will

be reduced by approximately $1.6 million annually. The stipulation was certified by the Administrative Law Judge to the FERC on January 22, 1997. The Company anticipates that the FERC will take action on the stipulation before the end of the second quarter of 1997. The Company does not anticipate any material adverse impact on the Company's financial condition or results of operations from the settlement agreement.

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

Santa Fe Station

The Company and the New Mexico Environmental Department ("NMED") have conducted investigations of the groundwater contamination detected beneath the former Santa Fe Generating Station site to determine the source of the contamination. The Company has been and is continuing to cooperate with the NMED regarding site investigations and remedial planning pursuant to a settlement agreement between the Company and the NMED. In June 1996, the Company received a letter from the NMED, indicating that the NMED believes the Company is the source of gasoline contamination in a municipal well supplying the City of Santa Fe and groundwater underlying the Santa Fe Station. Further, the NMED letter stated that the Company was required to proceed with interim remediation of the contamination pursuant to the New Mexico Water Quality Control Commission ("NMWQCC") regulations.

In July 1996, the Company filed an appeal with the NMWQCC protesting the determination and directives contained in the NMED's June 1996 letter. Subsequently, negotiation meetings were conducted between the Company and the NMED for a resolution of the groundwater contamination issue.

On October 3, 1996, the Company and the NMED signed an Amendment to the Settlement Agreement concerning the groundwater contamination. As part of the Amendment, the Company agreed to spend approximately $1.2 million ("Settlement Amount") for certain costs related to sampling, monitoring, and development and implementation of a remediation plan. The remediation plan is to be developed jointly by the Company and the NMED. Since the contamination affects a municipal well supplying the City of Santa Fe, the cooperation of the City of Santa Fe will also be sought in the development of the plan. The amended Settlement Agreement does not, however, provide the Company with a full and complete release from potential further liability for remediation of the groundwater contamination. After the Company has expended the Settlement Amount, if the NMED can establish through binding arbitration that the Santa Fe Station is the source of the contamination, the Company could be required to perform further remediation that is determined to be necessary. The Company continues to dispute any contention that the Santa Fe Station is the source of the groundwater contamination and believes that insufficient data exists to identify the sources of groundwater contamination. The Company has completed an aquifer characterization report and a groundwater quality report associated with the 40 day reactivation of the adjacent Santa Fe supply well in July and August of 1996. These reports strongly suggest the groundwater contamination does not originate from the Santa Fe Station site and has been drawn under the site by the pumping of the Santa Fe supply well. In addition, other urban wells in Santa Fe are likely vulnerable to contamination from off-site sources. The Company is working to provide a remedial approach plan by April 1997 in accordance with the amended Settlement Agreement.

Person Station

The Company, in compliance with the NMED's 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 was assessed and results were reported to the NMED. The Company 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 Permit, the Company posted a $5.1 million performance bond with a trustee. The remediation program continues on schedule.

Gas Operations

Gas Wellhead Pit Remediation

The New Mexico Oil Conservation Commission issued an order, effective on January 14, 1993, that affects the gas gathering facilities located in the San Juan Basin in northwestern New Mexico. The Bureau of Land Management ("BLM") has issued a similar order. The order prohibits the further discharge of fluids associated with the production of natural gas into unlined earthen pits in specified areas (designated as "vulnerable areas") in the San Juan Basin. The order also required the submission of closure plans for the pits where further discharge was prohibited. The Company has complied with the orders and has submitted and received approval for pit closures from the New Mexico Oil Conservation Division ("OCD") and the BLM.

These gas gathering facilities were sold to Williams Gas Processing Blanco, Inc., a Subsidiary of the Williams Field Services Group, Inc., of Tulsa Oklahoma ("Williams") on June 30, 1995. As a part of the sale agreement, the Company agreed to cease discharge to unlined earthen pits in designated vulnerable areas and to retain the responsibility for pit closures for a stated period of time and to a stated dollar amount. The Company has assessed the pits in accordance with OCD/BLM directives, and is now in the process of closing pits and remediating them, if necessary, at wellhead locations within the designated vulnerable areas. The Company has submitted a groundwater management plan to the OCD and has received approval of the plan, and is proceeding with delineation of groundwater contamination and, as necessary, cleanup, in accordance with the approved plan. The Company will address groundwater contamination within the dollar and time limitations imposed by the sale agreement with Williams, and in accordance with the requirements of the OCD.

In March 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. In 1995, the Company received a claim for indemnification by Williams, the purchaser of the Company's gas gathering and processing assets, for the environmental work required to comply with the Jicarilla ordinance. The Company submitted a closure/remediation plan to the Jicarilla, which was approved. The Company's remediation work pursuant to the plan commenced in mid-1996, and the costs of remediation are being charged against the $10.6 million indemnification cap contained in the purchase and sale agreement between the Company and Williams. The Company met the requirement for closing and remediating pits within the environmentally sensitive area by December 1996, and anticipates closing and remediating all other pits associated with the gas gathering and processing assets by the December 1998 deadline specified in the ordinance.

COAL FUEL SUPPLY

In July 1996, the Company was notified by BHP Minerals International, Inc., ("BHP"), fuel supplier to the SJGS, that the Navajo Nation has proposed to select certain properties within the San Juan and La Plata Mines (the "mining properties") pursuant to the Navajo-Hopi Land Settlement Act of 1974 (the "Act"). The mining properties are operated by BHP under leases from the BLM and comprise a portion of the fuel supply for SJGS. An administrative appeal by BHP is pending. In the appeal, BHP expressed concern that transfer of the mining properties to the Navajo Nation may subject the mining operations to taxation and additional regulation by the Navajo Nation, both of which could increase the price of coal that might potentially be passed on to SJGS through the existing Coal Sale Agreement. A stay of all actions by the BLM has been ordered by the Interior Board of Land Appeals pending resolution of the issues on appeal. The Company is monitoring closely the appeal and other developments on this issue and will continue to assess potential impacts to SJGS and the Company's operations. Currently, the Company is unable to predict the ultimate outcome of this matter but does not believe it will have a material adverse effect on the Company's financial condition or results of operations.

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 facilities. The Company provides service to the area which contributed 43.0% of the Company's total 1996 electric operating revenues. The absence of a franchise does not change the Company's right and obligation to serve those customers under state law. The Company continues to collect and pay franchise fees to the City.

In 1991, 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.

In October 1996, a local news media reported that the Mayor of the City had met with two NMPUC Commissioners about his concern that state efforts regarding retail wheeling were proceeding too slowly and that he was evaluating the City's option to implement Article XV of the City Charter requiring competitive bids for electric franchises. The Company has taken the position that the NMPUC does not have authority to order retail wheeling. (See "OVERVIEW-*Restructuring the Electric Utility Industry*".)

Although a measure designed to start municipalization activities in Albuquerque was defeated by the City Council, the City continues to maintain its options by advocating industry restructuring and monitoring the municipalization activities of the City of Las Cruces. In September 1996, the Court agreed to decide the question. In August 1996, in an action brought seeking condemnation, the Federal Magistrate Court ruled that the City of Las Cruces had failed to prove that condemnation would not materially impair service by El Paso to customers outside Las Cruces and certified the question of whether state law allows condemnation of an electric utility to the Court.

The Company filed a "friend of the Court" brief in support of El Paso. The Court heard oral argument on February 11, 1997, and took the case under advisement. The Company is currently unable to predict the outcome of these matters, but does not anticipate any material impact on the Company's financial condition or results of operation.

ACCOUNTING FOR THE EFFECTS OF CERTAIN TYPES OF REGULATION

As described in note 3 to the consolidated financial statements, the Company complies with the provisions of Statement of Financial Accounting Standards ("SFAS") No. 71, *Accounting for the Effects of Certain Types of Regulation.* In the event the Company determines that it no longer meets the criteria for following SFAS No. 71, the accounting impact would be an extraordinary, non-cash charge to operations of an amount that could be material. Criteria that may give rise to the discontinuance of SFAS No. 71 include (1) increasing competition that restricts the Company's ability to establish prices to recover specific costs and (2) a significant change in the manner in which rates are set by regulators from cost-based regulation to another form of regulation. The Company periodically reviews these criteria to ensure that the continuing application of SFAS No. 71 is appropriate. Based on a current evaluation of the various factors and conditions that are expected to impact future cost recovery, the Company believes that its regulatory assets (net of related regulatory liabilities), including those related to generation, are probable of future recovery.

PVNGS—STEAM GENERATOR TUBES

Arizona Public Service Company ("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 1996 dollars and including installation and replacement power costs) would be approximately $15.3 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. However, a formal decision as to when to replace the steam generators has not been made by the PVNGS participants.

ACCOUNTING STANDARDS

Environmental Remediation Liabilities. Effective January 1, 1997, the Company will adopt the provisions for Statement of Position ("SOP") 96-1, *Environmental Remediation Liabilities.* This Statement provides authoritative guidance for recognition, measurement, display and disclosure of environmental remediation liabilities in financial statements. The Company previously recorded environmental liabilities of $24.0 million for its retired fossil-fueled plants. Approximately $13.7 million of the $24.0 million has been expended through December 31, 1996. The Company does not expect that the adoption of SOP 96-1 will have a material impact on the Company's financial position or results of operations.

Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities. In June 1996, Financial Accounting Standards Board ("FASB") issued SFAS No. 125. This Statement establishes, among other things, new criteria for determining whether a transfer of financial assets should be accounted for as a sale or as a pledge of collateral in a secured borrowing. SFAS No. 125 also establishes new accounting requirements for pledged collateral. SFAS No. 125 is effective for all transfers and servicing of financial assets and extinguishments of liabilities occurring after December 31, 1996, and is to be applied prospectively, and earlier or retroactive application is not permitted.

Nuclear Plant Decommissioning. The staff of the SEC has questioned certain of the current accounting practices of the electric utility industry regarding the recognition, measurement and classification of decommissioning costs for nuclear generating stations in financial statements of electric utilities. In response to these questions, the FASB has added a project to its agenda to review 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 1996, and the estimated cost for decommissioning could be recorded as a liability (rather than as accumulated depreciation), with recognition of an increase in the cost of the related nuclear power plant. The Company does not believe that such changes, if required, would have a material adverse effect on results of operations due to the fact that decommissioning costs related to its two leased nuclear units are currently being recovered in rates.

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 (the "Act") provides a "safe harbor" for forward-looking statements to encourage companies to provide prospective information about their companies without fear of litigation so long as those statements are identified as forward-looking and are accompanied by meaningful, cautionary statements identifying important factors that could cause actual results to differ materially from those projected in the statement. Accordingly, the Company hereby identifies the following important factors which could cause the Company's actual financial results to differ materially from any such results which might be projected, forecasted, estimated or budgeted by the Company in forward-looking statements: (i) adverse actions of utility regulatory commissions, (ii) utility industry restructuring, (iii) failure to recover stranded assets, (iv) failure to obtain new customers or retain existing customers, (v) inability to carry out marketing and sales plans, (vi) adverse impacts resulting from environmental regulations, (vii) loss of favorable fuel supply contracts, (viii) failure to obtain water rights and rights-of-way, (ix) operational and environmental problems at generating stations and (x) failure to maintain adequate transmission capacity.

Many of the foregoing factors discussed have been addressed in the Company's previous filings with the SEC pursuant to the Securities Exchange Act of 1934. The foregoing review of factors pursuant to the Act should not be construed as exhaustive or as any admission regarding the adequacy of disclosures made by the Company prior to the effective date of the Act.

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The management of Public Service Company of New Mexico (the "Company") 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, 1996 and 1995, and the related consolidated statements of earnings, retained earnings (deficit), and cash flows for each of the three years in the period ended December 31, 1996. 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, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996 in conformity with generally accepted accounting principles.

Arthur Andersen LLP

Albuquerque, New Mexico
February 13, 1997

CONSOLIDATED STATEMENTS OF EARNINGS

	Year Ended December 31,		
	1996	1995	1994
	(In thousands except per share amounts)		
Operating Revenues:			
Electric	$ 645,639	$ 584,284	$ 621,794
Gas	227,301	217,985	269,510
Energy Services	10,446	—	—
Water	—	6,196	13,407
Total operating revenues	883,386	808,465	904,711
Operating Expenses:			
Fuel and purchased power	178,807	140,752	140,411
Gas purchased for resale	113,059	94,299	129,381
Other operation expenses	263,432	257,627	264,391
Maintenance and repairs	49,694	55,809	61,386
Depreciation and amortization	78,116	80,865	74,137
Taxes, other than income taxes	34,864	35,531	39,717
Income taxes	39,395	30,194	44,210
Total operating expenses	757,367	695,077	753,633
Operating income	126,019	113,388	151,078
Other Income and Deductions:			
Other	2,367	40,707	(3,512)
Income tax benefit (expense)	(1,099)	(20,599)	3,339
Net other income and deductions	1,268	20,108	(173)
Income before interest charges	127,287	133,496	150,905
Interest Charges:			
Interest on long-term debt	49,009	52,637	65,511
Other interest charges	5,698	5,297	5,341
Allowance for borrowed funds used during construction	—	—	(265)
Net interest charges	54,707	57,934	70,587
Net Earnings	72,580	75,562	80,318
Preferred Stock Dividend Requirements	586	3,714	6,433
Net Earnings Available for Common Stock	$ 71,994	$ 71,848	$ 73,885
Average Number of Common Shares Outstanding	41,774	41,774	41,774
Net Earnings per Share of Common Stock	$ 1.72	$ 1.72	$ 1.77
Dividends Paid per Share of Common Stock	$ 0.36	$ —	$ —

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS (DEFICIT)

	Year Ended December 31,		
	1996	1995	1994
	(In thousands)		
Balance at Beginning of Year	$ 25,243	$ (46,006)	$ (120,848)
Net earnings	72,580	75,562	80,318
Redemption of cumulative preferred stock	—	(599)	957
Dividends:			
Cumulative preferred stock dividends	(586)	(3,714)	(6,433)
Common stock dividends	(20,052)	—	—
Balance at End of Year	$ 77,185	$ 25,243	$ (46,006)

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

CONSOLIDATED BALANCE SHEETS

ASSETS

	As of December 31, 1996	1995
	(Dollars in thousands)	
Utility Plant, at original cost except PVNGS:		
Electric plant in service	$ 1,918,238	$ 1,871,897
Gas plant in service	424,827	419,346
Energy services plant in service	1,241	2,261
Common plant in service	40,005	35,222
Plant held for future use	639	639
	2,384,950	2,329,365
Less accumulated depreciation and amortization	937,228	892,727
	1,447,722	1,436,638
Construction work in progress	76,038	106,892
Nuclear fuel, net of accumulated amortization of $20,413 and $26,395	28,933	30,904
Net utility plant	1,552,693	1,574,434
Other Property and Investments:		
Non-utility property, net of accumulated depreciation of $1,774 and $1,547	3,434	4,063
Other investments, at cost	250,834	29,370
Total other property and investments	254,268	33,433
Current Assets:		
Cash	11,125	4,228
Temporary investments, at cost	9,128	95,972
Receivables, net of allowance for uncollectible accounts of $709 and $569	197,025	127,642
Income taxes receivable	18,825	4,792
Fuel, materials and supplies, at average cost	41,260	44,660
Gas in underground storage, at average cost	2,679	5,431
Other current assets	6,632	7,186
Total current assets	286,674	289,911
Deferred Charges	136,679	137,891
	$ 2,230,314	$ 2,035,669

CAPITALIZATION AND LIABILITIES

Capitalization:		
Common stock equity:		
Common stock outstanding—41,774,083 shares	$ 208,870	$ 208,870
Additional paid-in capital	470,358	470,358
Excess pension liability, net of tax	(2,102)	(1,623)
Retained earnings since January 1, 1989	77,185	25,243
Total common stock equity	754,311	702,848
Cumulative preferred stock without mandatory redemption requirements	12,800	12,800
Long-term debt, less current maturities	713,919	728,843
Total capitalization	1,481,030	1,444,491
Current Liabilities:		
Short-term debt	100,400	—
Accounts payable	130,661	93,666
Dividends payable	5,159	—
Current maturities of long-term debt	14,970	146
Accrued interest and taxes	23,356	26,856
Other current liabilities	25,477	44,699
Total current liabilities	300,023	165,367
Deferred Credits:		
Accumulated deferred investment tax credits	62,258	66,734
Accumulated deferred income taxes	110,266	78,829
Other deferred credits	276,737	280,248
Total deferred credits	449,261	425,811
Commitments and Contingencies (notes 2 through 12)		
	$ 2,230,314	$ 2,035,669

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	1996	1995	1994
		(In thousands)	
Cash Flows From Operating Activities:			
Net earnings	$ 72,580	$ 75,562	$ 80,318
Adjustments to reconcile net earnings to net cash flows from operating activities:			
Depreciation and amortization	91,340	93,125	90,656
Accumulated deferred investment tax credit	(4,476)	(4,830)	(6,898)
Accumulated deferred income taxes	31,436	1,622	23,069
Gain on sale of utility property	(309)	(39,050)	(6,576)
Write-down of natural gas vehicle program	2,810	1,445	—
Curtailment gain on defined benefit pension plan	(13,316)	—	—
Changes in certain assets and liabilities:			
Receivables	(83,416)	795	23,868
Fuel, materials and supplies	5,795	(26,505)	(3,126)
Deferred charges	5,190	6,731	8,427
Accounts payable	36,930	(11,527)	(11,893)
Accrued interest and taxes	(3,500)	(1,218)	(1,919)
Deferred credits	12,655	29,185	(5,418)
Other	(9,279)	5,645	(3,604)
Other, net	7,278	16,095	14,160
Net cash flows from operating activities	151,718	147,075	201,064
Cash Flows From Investing Activities:			
Utility plant additions	(88,904)	(106,627)	(119,284)
Utility plant sales	333	206,482	39,562
Other property sales	702	(801)	(1,307)
Net increase in other property and investments	(14,706)	—	—
Purchase of PVNGS lease obligation bonds	(208,446)	—	—
Decrease (increase) in temporary investments, net.	86,844	(21,451)	(26,671)
Net cash flows from investing activities	(224,177)	77,603	(107,700)
Cash Flows From Financing Activities:			
Redemptions of PVNGS lease obligation bonds	—	(132,663)	—
Redemptions and repurchases of preferred stock	—	(64,175)	(7,711)
Redemption of first mortgage bonds	—	—	(45,000)
Bond redemption premium and costs	(5,158)	(505)	(2,732)
Proceeds from asset securitization	100,400	18,758	—
Repayments of long-term debt	(326)	(57,768)	(31,002)
Dividends paid	(15,560)	(5,126)	(6,400)
Net cash flows from financing activities	79,356	(241,479)	(92,845)
Increase (Decrease) in Cash	6,897	(16,801)	519
Cash at Beginning of Year	4,228	21,029	20,510
Cash at End of Year	$ 11,125	$ 4,228	$ 21,029
Supplemental cash flow disclosures:			
Interest paid	$ 55,480	$ 63,366	$ 70,720
Income taxes paid	$ 31,617	$ 52,405	$ 20,000

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, 1996	December 31, 1995
	(In thousands)	
Common Stock Equity:		
Common Stock, par value $5 per share	$ 208,870	$ 208,870
Additional paid-in capital	470,358	470,358
Excess pension liability, net of tax	(2,102)	(1,623)
Retained earnings since January 1, 1989	77,185	25,243
Total common stock equity	754,311	702,848

	Stated Value	Shares Outstanding at December 31, 1996	Current Redemption Price	1996	1995
Cumulative Preferred Stock:					
Without mandatory redemption requirements:					
1965 Series, 4.58%	$100.00	128,000	$102.00	12,800	12,800

Long-Term Debt:			
Issue and Final Maturity	Interest Rates		
First mortgage bonds:			
1997	5 7/8%	14,650	14,650
1999 through 2002	7 1/4% to 8 1/8%	42,876	43,063
2004 through 2007	8 1/8% to 9 1/8%	43,276	43,421
2008	9 %	54,374	54,374
Pollution control revenue bonds:			
2007 through 2026	5.7% to 7 3/4%	537,045	537,045
2022	Variable rate	37,300	37,300
Total first mortgage bonds		729,521	729,853
Other, including unamortized premium and (discount), net.		(632)	(864)
Total long-term debt		728,889	728,989
Less current maturities		14,970	146
Long-term debt, less current maturities		713,919	728,843
Total Capitalization		$1,481,030	$1,444,491

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1996, 1995 and 1994

(1) Summary of Significant Accounting Policies

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. The Company is also engaged in the operation and management of the City of Santa Fe's Water System and is pursuing new business activities in the energy and utility related services area.

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").

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 reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. 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. Utility plant includes certain electric assets not subject to regulation. The results of operations of such electric assets are included in operating income.

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.

(1) Summary of Significant Accounting Policies (Continued)

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:

	1996	1995	1994
Electric plant	3.32%	3.32%	3.01%
Gas plant	3.27%	3.21%	3.15%
Water plant (1)	—	—	2.68%
Common plant (2)	—	—	4.94%

(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.

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 resources excluded from NMPUC retail rates 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.

Investments in Debt and Equity Securities

Certain of the Company's other investments are classified as Held-to-Maturities under the terms of SFAS No. 115, *"Accounting for Certain Investments in Debt and Equity Securities"*, and measured at amortized cost in the statement of financial position.

Accounting Standards

Environmental Remediation Liabilities. Effective January 1, 1997, the Company will adopt the provisions of Statement of Position ("SOP") 96-1, *Environmental Remediation Liabilities.* This Statement provides authoritative guidance for recognition, measurement, display and disclosure of environmental remediation liabilities in financial statements. The Company previously recorded environmental liabilities of $24.0 million for its retired fossil-fueled plants. Approximately $13.7 million of the $24.0 million has been expended as of December 31, 1996. The Company does not expect that the adoption of SOP 96-1 will have a material impact on the Company's financial position or results of operations.

Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities. In June 1996, the Financial Accounting Standards Board ("FASB") issued SFAS No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities.* This Statement establishes, among other things, new criteria for determining whether a transfer of financial assets should be accounted for as a sale or as a pledge of collateral in a secured borrowing. SFAS No. 125 also establishes new accounting requirements for pledged collateral. SFAS No. 125 is effective for all transfers and servicing of financial assets and extinguishments of liabilities occurring after December 31, 1996, and is to be applied prospectively, and earlier or retroactive application is not permitted.

Nuclear Plant Decommissioning. The staff of the Securities and Exchange Commission has questioned certain of the current accounting practices of the electric utility industry regarding the recognition, measurement and classification of decommissioning costs for nuclear generating stations in financial statements of electric utilities. In response to these questions, the FASB has added a project to its agenda to review 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 1996, and the estimated cost for decommissioning could be recorded as a liability (rather than as accumulated depreciation), with recognition of an increase in the cost of the related nuclear power plant. The Company does not believe that such changes, if required, would have a material adverse effect on results of operations due to the fact that decommissioning costs related to its two leased nuclear units are currently being recovered in rates.

(2) Risks and Uncertainties

The electric utility industry continues to be in 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 levels continue to consider how to promote competition among suppliers of electricity and how to provide customers with choice among suppliers.

At the state level, the Integrated Water and Resource Planning Committee of the New Mexico State Legislature (the "IWRPC") held hearings during 1996 which focused on the issues related to restructuring of the electric industry in New Mexico. The Company participated extensively in these hearings and, at the invitation of the IWRPC, submitted draft legislation to be used as a starting point for the various parties to consider regarding the electric industry restructuring. The draft legislation would allow an electric utility to recover all of its prudently incurred stranded costs and also provide a path for business flexibility. The AG testified that retail competition should not be introduced at this time but, if it is, there should be independent ownership of generation, transmission and distribution facilities, due to market power concerns. At its November 1996 meeting, the IWRPC voted not to

(2) Risks and Uncertainties (Continued)

recommend restructuring legislation in the 1997 session but instead to recommend continuation of the IWRPC and a study of the tax effects of restructuring. The IWRPC also sent a letter to the NMPUC calling for no restructuring to be undertaken by the NMPUC without legislative approval. The New Mexico legislative session is currently in progress and the Company will closely monitor any legislative action regarding restructuring of the electric utility industry.

During 1996, the NMPUC conducted a series of workshop meetings in its "Investigation of Restructuring of Regulation of the Electric Industry in New Mexico". The Company actively participated in these workshops and presented the Company's position on various matters related to industry restructuring. The Company provided data and analysis in the areas of market structure, measurement and collection of stranded costs, market power, potential changes in Company structure and issues related to the transition phase. In conjunction with the workshop meetings, the NMPUC ordered all utilities under its jurisdiction to file their estimates of stranded costs, absent any recovery method being adopted, based on the Texas Public Utility Commission Economic Cost Over Market ("ECOM") model. The Company, in its filing, presented two methodologies: (i) using the ECOM model, the Company's stranded cost estimates run from $657 million for a 1998 full retail access case to $119 million for a 2002 full retail access case, and (ii) using a second methodology, based upon the difference between the Company's costs of existing generation and the costs of new combined cycle and combustion turbine units to serve the same load, the Company's costs above the level of new gas units were estimated at $748 million for a 1998 full retail access case to $327 million for a 2002 full retail access case. The Company advised the NMPUC that the results of the ECOM model are highly sensitive to various assumptions, primarily projections of future gas prices. To date, the NMPUC has not acted on the requested information.

(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:

	1996	1995
	(In thousands)	
Deferred Income Taxes	$ 71,682	$ 71,094
Gas Take-or-Pay Costs	36,335	50,870
Purchased Gas Adjustment Clause	28,873	931
Gas Imputed Revenues	10,362	8,113
Loss on Reacquired Debt	7,850	6,377
Gas Reservation Fees	7,029	5,622
Deferred Customer Expense on Gas Assets Sale	5,260	2,755
Gas Retirees' Health Care Costs	4,437	4,437
Proposed Transmission Line Costs	3,111	—
Gas Rate Case Costs	1,571	1,100
Other	598	422
Subtotal	177,108	151,721
Deferred Income Taxes	(56,961)	(60,815)
Gas Regulatory Reserve	(24,614)	(7,328)
Customer Gain on Gas Assets Sale	(22,230)	(31,559)
PVNGS Prudence Audit	(6,937)	(7,313)
Settlement Due Customers	(4,072)	(4,101)
Revenue Subject to Refund	(3,594)	(382)
Gain on Reacquired Debt	(559)	(669)
Subtotal	(118,967)	(112,167)
Net Regulatory Assets	$ 58,141	$ 39,554

As of December 31, 1996, substantially all of the Company's regulatory assets and regulatory liabilities are being recovered in rates charged to customers or have been addressed in a regulatory proceeding. 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.

Effective January 1, 1996, the Company adopted SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of.* This statement imposes a stricter criterion for regulatory assets by requiring that such assets be probable of future recovery at each balance sheet date. Based on the current regulatory structure in which the Company operates, adoption of this standard did not have a material impact on the Company's financial position or results of operations. However, the Company's ability to meet the criterion may change in the future as competitive factors influence wholesale and retail pricing in this industry.

(4) Capitalization

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

	Common Stock			Cumulative Preferred 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, 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 and 1996	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.

On December 31, 1996, the Company's Board of Directors ("Board") declared a quarterly cash dividend of 12 cents per share of common stock payable February 21, 1997 to shareholders of record as of February 3, 1997. This will be the fourth quarterly dividend to the Company's common shareholders since the Company reinstated its common stock dividend in May 1996.

On September 16, 1996, the Company implemented a dividend reinvestment and stock purchase plan for investors, including customers and employees. The plan, called PNM Direct, also includes safekeeping services and automatic investment features. Initially, the Company's stock will be purchased in the open market to meet plan requirements.

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.

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.

(4) Capitalization (Continued)

The aggregate amounts (in thousands) of maturities for 1997 through 2001 on long-term debt outstanding at December 31, 1996 are as follows:

1997	$ 14,970
1998	$ 350
1999	$ 12,030
2000	$ 1,050
2001	$ 16,038

Revolving Credit Facility and Other Credit Facilities

At December 31, 1996, the Company has a $100 million revolving credit facility (the "Facility") with an expiration date of June 30, 1998. The Company must pay commitment fees of 3/10% per year on the total amount of the Facility. The Company expects to renew the Facility before its expiration date. The Company also has a $100 million credit facility, which expires on May 20, 2001, and is collateralized by the Company's electric and gas customer accounts receivable and certain amounts being recovered from gas customers relating to certain gas contract settlements. As of December 31, 1996, the Company has $110.6 million of available liquidity arrangements, consisting of $100 million from the Facility and $10.6 million from local lines of credit.

Off-Balance Sheet Items

Although the PVNGS LOBs are off-balance sheet debt, these bonds are included in the calculation of the Company's debt to equity ratio as well as various financial coverage ratios by the major rating agencies. The purchase of the PVNGS LOBs is treated by the rating agencies as a defeasance of the bonds thereby resulting in an improvement to these ratios. The purchase of the PVNGS LOBs has also increased earnings in the form of interest income.

(5) Fair Value of Financial Instruments

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

	1996		1995	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In thousands)			
Long-Term Debt	$728,889	$731,358	$728,989	$730,337
Investment in PVNGS LOBs	$212,979	$211,327	—	—

Fair value is based on market quotes provided by the Company's investment bankers.

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.

(6) Income Taxes

Income taxes consist of the following components:

	1996	1995	1994
		(In thousands)	
Current Federal income tax	$ 14,815	$ 45,940	$ 24,243
Current state income tax	2,847	5,864	—
Deferred Federal income tax	22,372	(3,212)	15,449
Deferred state income tax	4,936	7,031	8,077
Amortization of accumulated investment tax credits	(4,476)	(4,442)	(4,701)
Recognition of accumulated deferred investment tax credits relating to sales of utility property	—	(388)	(2,197)
Total income taxes	$ 40,494	$ 50,793	$ 40,871
Charged to operating expenses	$ 39,395	$ 30,194	$ 44,210
Charged (credited) to other income and deductions	1,099	20,599	(3,339)
Total income taxes	$ 40,494	$ 50,793	$ 40,871

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:

	1996	1995	1994
		(In thousands)	
Federal income tax at statutory rates	$ 39,576	$ 44,224	$ 42,417
Investment tax credits	(4,476)	(4,442)	(4,701)
Depreciation of flow-through items	519	723	1,112
Gains on the sale and leaseback of PVNGS Units 1 and 2	(527)	(527)	(527)
State income tax	5,192	7,146	5,222
Gains on sale of utility property	—	3,090	(2,139)
Other	210	579	(513)
Total income taxes	$ 40,494	$ 50,793	$ 40,871

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:

	1996	1995	1994
		(In thousands)	
Deferred fuel costs	$ 8,234	$ (3,990)	$ (1,945)
Depreciation and cost recovery	18,048	12,730	22,118
Loss provision for the M-S-R power purchase contract	—	3,497	5,632
Contributions in aid of construction	(4,053)	(4,308)	(5,055)
Alternative minimum tax in excess of regular tax	(1,052)	(26,002)	(24,100)
Net operating losses utilized	—	55,217	35,077
PVNGS decommissioning	537	(2,321)	(2,445)
Gains on sale of utility property	—	(29,868)	(8,421)
Contribution to 401(h) plan	(510)	(885)	1,204
Regulatory liability	(6,651)	—	—
Curtailment gain (pension plan)	5,272	—	—
Transmission project cost.	4,898	(3,177)	(792)
Other	2,585	2,926	2,253
Net deferred taxes provided	$ 27,308	$ 3,819	$ 23,526

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

	1996	1995
	(In thousands)	
Deferred Tax Assets:		
Alternative minimum tax credit carryforward	$ 67,681	$ 66,628
Nuclear decommissioning	16,303	14,023
Regulatory liabilities	54,430	60,070
Other	48,944	45,403
Total deferred tax assets	$187,358	$186,124
Deferred Tax Liabilities:		
Depreciation	$179,430	$ 168,562
Investment tax credit	62,258	66,734
Fuel costs	33,038	24,804
Regulatory assets	69,151	70,348
Other	16,005	1,239
Total deferred tax liabilities	359,882	331,687
Accumulated deferred income taxes, net	$172,524	$ 145,563

(6) Income Taxes (Continued)

The following table reconciles the change in the net accumulated deferred income tax liability to the deferred income tax expense included in the statement of earnings for the period:

Net change in deferred income tax liability per above table	$ 26,961
Change in tax effects of income tax related regulatory assets and liabilities	(4,443)
Tax effect of excess pension liability	314
Deferred income tax expense for the period	$ 22,832

The Company has no net operating loss carryforwards as of December 31, 1996.

(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:

	1996	1995	1994
Service cost	$ 8,540	$ 6,770	$ 8,121
Interest cost	20,546	18,332	17,589
Actual loss (return) on plan assets	(31,211)	(42,148)	1,079
Net amortization and deferral	9,577	23,295	(18,731)
Net periodic pension cost	7,452	6,249	8,058
Curtailment gain	(13,317)	—	—
Total pension expense (income)	$ (5,865)	$ 6,249	$ 8,058

In December 1996, the Company's board of directors approved changes to the Company's defined benefit pension plan and implementation of a defined contribution plan no later than January 1, 1998. As a result, the Company recorded a curtailment gain of approximately $13.3 million in the financial statements for the year ended December 31, 1996.

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

	1996	1995
Vested benefits	$ 233,687	$ 222,501
Non-vested benefits	13,470	10,556
Accumulated benefit obligation	247,157	233,057
Effect of future compensation levels	11,894	46,889
Projected benefit obligation	259,051	279,946
Fair value of plan assets	273,981	246,670
Projected benefit obligation in excess of (less than) assets	(14,930)	33,276
Unrecognized prior service cost	(180)	(214)
Net unrecognized loss from past experience different from assumed and the effects of changes in assumptions	(5,814)	(41,185)
Unamortized asset at transition, being amortized through the year 2002	5,814	6,978
Accrued pension asset	$ (15,110)	$ (1,145)

The weighted average discount rate used to measure the projected benefit obligation was 7.75% and 7.50% for 1996 and 1995, respectively, and the expected long-term rate of return on plan assets was 8.75% for 1996 and 1995. The rate of increase in future compensation levels based on age-related scales was 4.1% for 1996 and 1995.

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:

	1996	1995	1994
Service cost	$ 1,449	$ 1,869	$ 1,389
Interest cost	4,478	4,962	3,250
Actual loss (return) on plan assets	(1,208)	(2,726)	100
Transition obligation amortization	1,817	1,817	1,817
Net amortization and deferral	(159)	2,498	(295)
Total postretirement benefit expense	$ 6,377	$ 8,420	$ 6,261

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

	1996	1995
Accumulated benefit obligations for:		
Retirees	$ 25,237	$ 29,088
Fully eligible employees	15,375	7,144
Active employees	17,787	39,854
Accumulated benefit obligation	58,399	76,086
Fair value of plan assets	20,930	15,600
Funded status	(37,469)	(60,486)
Net unrecognized loss	2,416	22,196
Unrecognized transition obligation (being amortized through the year 2012)	29,074	30,891
Accrued postretirement liability	$ (5,979)	$ (7,399)

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 7.75% and 7.50% for 1996 and 1995, respectively, and the expected long-term rate of return on plan assets was 8.75% for 1996 and 1995. The health care cost trend rate was 8.0%, 8.0% and 7.5% for 1996, 1995 and 1994, 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, 1996 by approximately $10.4 million and the aggregate service and interest cost components of net periodic postretirement benefit cost for 1996 by approximately $1.1 million. The health care cost trend rate was expected to decrease to 6.0% by 2010 and to remain at that level thereafter.

(7) Employee and Post-Employment Benefits (Continued)

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, 1996, was $18.3 million, of which the accumulated and vested benefit obligation was $17.4 million. As of December 31, 1996, the Company has recognized an additional liability of $2.1 million for the amount of unfunded accumulated benefits in excess of accrued pension costs. The net periodic pension cost for 1996, 1995 and 1994 was $2.1 million, $2.0 million and $2.2 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 $10.1 million (fair market value of $13.9 million) are presently in trust. No additional funds have been provided to the trust since 1989.

Performance Stock Plan

The Company has a non-qualifying stock option plan, covering a group of management employees. Options are granted at the fair market value of the shares on the date of the grant. Options granted through December 31, 1995, vested on June 30, 1996, have an exercise term of up to 10 years. All subsequent awards granted after December 31, 1995, shall vest three years from the grant date of the awards and the maximum number of options are five million shares through December 31, 2000. In addition, the Company has a Director Restricted Stock Retainer Plan. The number of option shares granted in 1996 under the restricted stock retainer plan was 4,000 shares with an exercise price of $5.50. No options under the restricted stock retainer plan were exercised during 1996.

The option price of each option grant is determined on the date of grant using the Black-Scholes option-pricing model with the following average assumptions used for grants in 1995 and 1996, respectively: dividend yield of 2.7% and 2.4%; expected volatility of 20% and 18%; risk-free interest rates of 5.5% and 5.59%; and expected lives of four years.

The Company applies APB Opinion 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for its plan. Accordingly, no compensation cost has been recognized for its fixed stock option plan. Had compensation cost for the Company's stock based compensation plan been determined consistent with SFAS No. 123, *Accounting for Stock-Based Compensation*, the effect on the Company's pro forma net income and pro forma earnings per share would not be material.

A summary of the status of the Company's fixed stock option plan (Performance Stock Plan) at December 31, 1996 and 1995 and changes during the years then ended is presented below:

	1996		1995	
Fixed Options	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	508,986	$ 17.625	—	—
Granted	390,228	$ 19.480	508,986	$ 17.625
Exercised	52,427	—	—	—
Forfeited	—	—	—	—
Outstanding at end of year	846,787	$ 18.480	508,9866	$ 17.625
Options exercisable at year-end	456,559		—	
Weighted-average fair value of options granted during the year	$ 3.56		$ 3.49	

The following table summarizes information about fixed stock options outstanding at December 31, 1996:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at 12/31/96	Weighted Average Remaining Contractual Life	Weighted Average Exercise Prices	Number Exercisable at 12/31/96	Weighted Average Price
$ 5.50-$ 19.625	846,787	9.46 years	$18.547	456,559	$17.625

(8) Construction Program and Jointly-Owned Plants

It is estimated that the Company's construction expenditures for 1997 will be approximately $165 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, 1996, the Company's interests and investments in jointly-owned generating facilities are:

Station (Fuel Type)	Plant in Service	Accumulated Depreciation	Construction Work in Progress	Composite Interest
		(In thousands)		
San Juan Generating Station (Coal)	$ 724,525	$ 319,962	$ 3,755	46.3%
Palo Verde Nuclear Generating Station (Nuclear)*	$ 198,549	$ 43,052	$ 10,723	10.2%
Four Corners Power Plant Units 4 and 5 (Coal)	$ 117,884	$ 48,879	$ 3,613	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, 1996, 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 Tri-State Generation and Transmission Association, Inc. Unit 4 is owned 38.457% by the Company, 28.8% by M-S-R Public Power Agency, California public power agency ("M-S-R"), 10.04% by the City of Anaheim, California, 8.475% by the City of Farmington, 7.2% by the County of Los Alamos, and 7.028% by Utah Associated Municipal Power Systems.

Palo Verde Nuclear Generating Station

The Company has a 10.2% undivided 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 the 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.

(8) Construction Program and Jointly-Owned Plants (Continued)

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 for all three units is approximately $24.3 million, with an annual payment limitation of $3 million per incident. 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". If the funds provided by this retrospective assessment program prove to be insufficient, Congress could impose revenue raising measures on the nuclear industry to pay claims.

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, 1997, a substantial portion of which must be applied to stabilization and decontamination. The Company has also secured insurance against portions of the increased cost of generation or purchased power and business interruption resulting from certain accidental outages of any of the three PVNGS units if the outage exceeds 21 weeks. The Company is a member of two industry mutual insurers. These mutual insurers provide both the "all-risk" and increased cost of generation insurance to the Company. In the event of adverse losses experienced by these insurers, the Company is subject to an assessment. The Company's maximum share of any assessment is approximately $3.9 million per year.

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 $147.5 million, a decrease from $157.8 million based on the previous 1992 study (both amounts are stated in 1995 dollars).

The Company determined that a supplemental investment program will be needed as a result of both historical cost increases 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 regulations, PVNGS Unit 3 will remain in a non-qualified trust.

Pursuant to NMPUC approval the Company funded an additional $12.5 million into the qualified and non-qualified funds. The estimated market value of the trusts, including the current life insurance policies, at the end of 1996 was approximately $25.6 million.

(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 for 1994.

The Company has a power purchase contract with Southwestern Public Service Company ("SPS") for up to 200 MW, expiring in May 2011. The Company may reduce its purchases from SPS by 25 MW annually upon three years' notice. The Company provided such notice to reduce the purchase by 25 MW in 1999 and by an additional 25 MW in 2000. Also, the Company has 39 MW of contingent capacity obtained from El Paso Electric Company under a transmission capacity for generation capacity trade arrangement that increases to 70 MW from 1998 through 2003. In addition, the Company is interconnected with various utilities for economy interchanges and mutual assistance in emergencies.

The Company anticipates the need for approximately 100 to 200 MW of additional capacity in the 1998 through 2000 timeframe. To meet this need, on October 4, 1996, the Company entered into a long-term power purchase contract with the Cobisa-Person Limited Partnership ("PLP") to purchase approximately 100 MW of unit contingent peaking capacity from a gas turbine generating unit for a period of 20 years, with an option to renew for an additional five years. The gas turbine generating unit will be constructed and operated by PLP and will be located on the Company's retired Person Generating Station site located in Albuquerque, New Mexico. The site for the generating unit was chosen, in part, to provide needed benefits to the Company's constrained transmission system. Depending on the regulatory timing of NMPUC and FERC approvals and the securing of necessary permits, construction could start in August 1998 with commercial operation beginning by May 1999. The operational date was chosen to satisfy both resource and transmission needs for the Company's jurisdictional load. During October 1996, the Company filed a request for approval from the NMPUC and PLP filed its application for requisite state commission determinations from the NMPUC. These two applications were consolidated by the NMPUC. In December 1996, the NMPUC established a procedural schedule for the consolidated applications. The Company and PLP have requested a final order from the NMPUC by July 31, 1997. Thereafter, certain actions from the FERC will be required, including approval of PLP's status as an "exempt wholesale generator" under Section 32 of the Public Utility Holding Company Act.

In addition to the long-term power purchase contract with PLP, the Company is pursuing other options to ensure its additional capacity needs are met.

(10) Lease Commitments

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. Covenants in the Company's PVNGS Units 1 and 2 lease agreements 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.

Future minimum operating lease payments (in thousands) at December 31, 1996 are:

1997	$ 79,028
1998	78,700
1999	78,333
2000	78,213
2001	78,100
Later years	1,026,864
Total minimum lease payments	$ 1,419,238

Operating lease expense, inclusive of PVNGS leases, was approximately $80.3 million in 1996, $80.0 million in 1995 and $79.1 million in 1994. Aggregate minimum payments to be received in future periods under noncancelable subleases are approximately $6.6 million.

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

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.

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

Electric Operations

Santa Fe Station

The Company and the New Mexico Environmental Department ("NMED") have conducted investigations of the groundwater contamination detected beneath the former Santa Fe Generating Station site to determine the source of the contamination. The Company has been and is continuing to cooperate with the NMED regarding site investigations and remedial planning pursuant to a settlement agreement between the Company and the NMED. In June 1996, the Company received a letter from the NMED, indicating that the NMED believes the Company is the source of gasoline contamination in a municipal well supplying the City of Santa Fe and groundwater underlying the Santa Fe Station. Further, the NMED letter stated that the Company was required to proceed with interim remediation of the contamination pursuant to the New Mexico Water Quality Control Commission ("NMWQCC") regulations.

In July 1996, the Company filed an appeal with the NMWQCC protesting the determination and directives contained in the NMED's June 1996 letter. Subsequently, negotiation meetings were conducted between the Company and the NMED for a resolution of the groundwater contamination issue.

On October 3, 1996, the Company and the NMED signed an Amendment to the Settlement Agreement concerning the groundwater contamination. As part of the Amendment, the Company agreed to spend approximately $1.2 million ("Settlement Amount") for certain costs related to sampling, monitoring, and development and implementation of a remediation plan. The remediation plan is to be developed jointly by the Company and the NMED. Since the contamination affects a municipal well supplying the City of Santa Fe, the cooperation of the City of Santa Fe will also be sought in the development of the plan. The amended Settlement Agreement does not, however, provide the Company with a full and complete release from potential further liability for remediation of the groundwater contamination. After the Company has expended the Settlement Amount, if the NMED can establish through binding arbitration that the Santa Fe Station is the source of the contamination, the Company could be required to perform further remediation that is determined to be necessary. The Company continues to dispute any contention that the Santa Fe Station is the source of the groundwater contamination and believes that insufficient data exists to identify the sources of groundwater contamination. The Company has completed an aquifer characterization report and a groundwater quality report associated with the 40 day reactivation of the adjacent Santa Fe supply well in July and August of 1996. These reports strongly suggest the groundwater contamination does not originate from the Santa Fe Station site and has been drawn under the site by the pumping of the Santa Fe supply well. In addition, other urban wells in Santa Fe are likely vulnerable to contamination from off-site sources. The Company is working to provide a remedial approach plan by April 1997 in accordance with the amended Settlement Agreement.

Person Station

The Company, in compliance with the NMED's 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 was assessed and results were reported to the NMED. The Company 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 Permit, the Company posted a $5.1 million performance bond with a trustee. The remediation program continues on schedule.

Gas Operations

Gas Wellhead Pit Remediation

The New Mexico Oil Conservation Commission issued an order, effective on January 14, 1993, that affects the gas gathering facilities located in the San Juan Basin in northwestern New Mexico. The Bureau of Land Management ("BLM") has issued a similar order. The order prohibits the further discharge of fluids associated with the production of natural gas into unlined earthen pits in specified areas (designated as "vulnerable areas") in the San Juan Basin. The order also required the submission of closure plans for the pits where further discharge was prohibited. The Company has complied with the orders and has submitted and received approval for pit closures from the New Mexico Oil Conservation Division ("OCD") and the BLM.

These gas gathering facilities were sold to Williams Gas Processing-Blanco Inc., a subsidiary of Williams Field Services Group, Inc., of Tulsa Oklahoma ("Williams") on June 30, 1995. As a part of the sale agreement, the Company agreed to cease discharge to unlined earthen pits in designated vulnerable areas and to retain the responsibility for pit closures for a stated period of time and to a stated dollar amount (see note 12). The Company has assessed the pits in accordance with OCD/BLM directives, and is now in the process of closing pits and remediating them, if necessary, at wellhead locations within the designated vulnerable areas. The Company has submitted a groundwater management plan to the OCD and has received approval of the plan, and is proceeding with delineation of groundwater contamination and, as necessary, cleanup, in accordance with the approved plan. The Company will address groundwater contamination within the dollar and time limitations imposed by the sale agreement with Williams, and in accordance with the requirements of the OCD.

In March 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. In 1995, the Company received a claim for indemnification by Williams, the purchaser of the Company's gas gathering and processing assets, for the environmental work required to comply with the Jicarilla ordinance. The Company submitted a closure/remediation plan to the Jicarilla, which was approved. The Company's remediation work pursuant to the plan commenced in mid-1996, and the costs of remediation are being charged against the $10.6 million indemnification cap contained in the purchase and sale agreement between the Company and Williams. The Company met the requirement for closing and remediating pits within the environmentally sensitive area by December 1996, and anticipates closing and remediating all other pits associated with the gas gathering and processing assets by December 1998 deadline specified in the ordinance.

(12) Asset Sales

In 1995, the Company and its subsidiaries sold certain non-strategic gas assets for approximately $154 million to Williams, recognizing an after-tax gain of $12.8 million. This gain was adjusted to $11.8 million in 1996 due to an accrual for additional gas environmental costs. Under the NMPUC order approving the sale, the Company is required to share approximately $35 million from the sale with customers, which will be credited to the customers bills over five years. After completion of the fifth year, the amount of gain will be recalculated to include actual expenses specified in the agreement, subject to NMPUC review. As of December 31, 1996, the Company has a remaining balance of $22.2 million for future years credit to the customers. In addition, the Company, in 1995, sold its water division to the City of Santa Fe for $51.2 million (exclusive of current assets netted against current liabilities), recognizing an after-tax gain of $6.4 million. Pursuant to the purchase and sale agreement, the Company, through its Energy Service Business Unit, will continue to operate the water utility up to four years from the closing date for a fee under a contract with the City of Santa Fe.

(13) Segment Information

The financial information pertaining to the Company's electric, gas and other operations for the years ended December 31, 1996, 1995 and 1994 are as follows:

	Electric*	Gas	Other	Total
		(In thousands)		
1996:				
Operating revenues	$ 645,639	$ 227,301	$ 10,446	$ 883,386
Operating expenses excluding income taxes	509,804	191,922	16,246	717,972
Pre-tax operating income (loss)	135,835	35;379	(5,800)	165,414
Operating income tax	32,422	8,927	(1,954)	39,395
Operating income (loss)	$ 103,413	$ 26,452	$ (3,846)	$ 126,019
Depreciation and amortization expense	$ 64,817	$ 13,122	$ 177	$ 78,116
Construction expenditures	$ 76,572	$ 26,497	$ 18	$ 103,087
Identifiable assets:				
Net utility plan	$ 1,270,141	$ 281,348	$ 1,204	$ 1,552,693
Other	449,478	202,725	25,418	677,621
Total assets	$ 1,719,619	$ 484,073	$ 26,622	$ 2,230,314
1995:				
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
1994:				
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

* Includes the resources excluded from NMPUC retail rates 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).

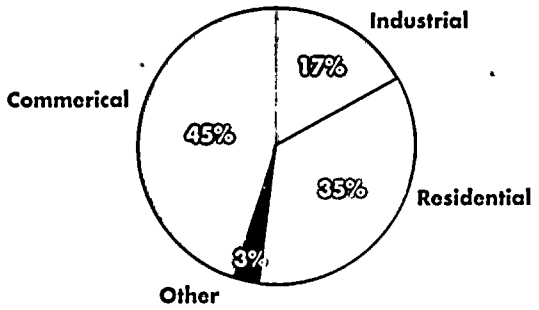
(14) Subsequent Events

On February 13, 1997, the NMPUC issued a final order in the gas rate case, ordering a rate decrease of $7.0 million. (See "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS—OTHER ISSUES FACING THE COMPANY—GAS RATE CASE and NMPUC ORDER—THE COMPANY'S JANUARY 1997 PGAC FACTOR VARIANCE REQUEST; ORDER TO FILE RETAIL ELECTRIC AND GAS RATE CASES" in this report.) In ordering the rate decrease, among other things, the NMPUC disallowed the recovery of certain regulatory assets. The Company strongly disagrees with the NMPUC s final order and filed an appeal with the New Mexico Supreme Court on February 17, 1997. The Company has evaluated the impacts of the rate reduction and has established appropriate reserves in its 1996 financial statements, pending the outcome of the appeal.

The NMPUC issued a final order in the Company's January 1997 PGAC Factor Variance Request on February 13, 1997. In the order, the NMPUC imposed, but suspended, a fine of $2.2 million to the Company due to an allegedly incorrect cost factor (too low) that was filed in November 1996. In addition, the NMPUC disallowed collection of $1.6 million of gas costs and ordered an independent audit to be conducted to review the Company's PGAC factor calculations for the period of December 1995 through January 1997. The NMPUC also ordered the docketing of two new investigations. The first, which requires a Company filing by March 15, 1997, will investigate whether or not the Company should exit the merchant function in providing gas supplies to customers. The second, will investigate the prudence of the Company's portfolio strategies and purchase practices. In addition, the NMPUC ordered the Company to file a new gas rate case by August 1, 1997, and also ordered the Company to file an electric retail rate case by May 1, 1997.

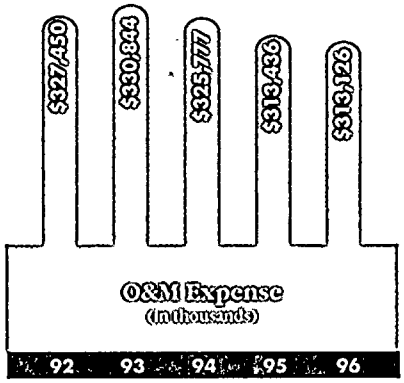
In the order, the NMPUC accused the Company of intentionally filing an inaccurate factor to avoid a hearing, thus, impairing the NMPUC's ability to investigate rising gas prices. The Company strongly disagrees with the NMPUC's final order and is evaluating its options, including rehearing and a possible appeal to the New Mexico Supreme Court.

1996 Electric Revenues by Customer Class



PNM's residential and commercial customers account for 80% of the company's electric revenues in 1996.

Operations and Maintenance Expense



Consistent decreases in operation and maintenance expenses are a result of strict cost management and productivity improvements.

QUARTERLY OPERATING RESULTS

The unaudited operating results by quarters for 1996 and 1995 are as follows:

	Quarter Ended			
	March 31	June 30	September 30	December 31
	(In thousands except per share amounts)			
1996:				
Operating Revenues	$ 241,904	$ 197,597	$ 210,757	$ 233,128
Operating Income	$ 38,475	$ 25,346	$ 32,412	$ 29,786
Net Earnings (1), (2)	$ 26,448	$ 13,542	$ 19,940	$ 12,650
Net Earnings per Share (1), (2)	$ 0.63	$ 0.32	$ 0.47	$ 0.30
1995:				
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

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. The gain amount was adjusted by $1.0 million or two cents per share in 1996 due to an accrual for additional gas environmental costs. 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 (see note 12).

(2) During the quarter ended December 31, 1996, the Company made a provision for loss of $10.0 million, net of tax ($.24 per common share), as a result of the gas rate order, pending the outcome of the appeal. In addition, the Company recorded an after-tax curtailment gain of $8.0 million ($.19 per common share) related to the change of the Company's defined benefit pension plan.

PNM considers this annual report to contain "forward-looking statements" under Federal securities law. It is published to assist shareholders in evaluating PNM and its securities. This report does not contain all of the information material to an evaluation and should be read in conjunction with the reports, proxy statements, and other information PNM files with the Securities and Exchange Commission. Please refer to page 25, *"Disclosure Regarding Forward-Looking Statements,"* for a listing of the factors which could cause the Company's actual financial results to differ materially from those forecasted by the Company in forward-looking statements.

INVESTOR INFORMATION

Common Stock Prices and Dividends

	1996 High	1996 Low	Dividends Paid per Share	1995* High	1995* Low
1st Quarter	18 3/4	17 3/8	$0.00	13 7/8	12 1/4
2nd Quarter	20 1/2	17 1/4	$0.12	14 1/4	12 3/8
3rd Quarter	20 3/8	19	$0.12	16 3/8	13 3/4
4th Quarter	19 7/8	18 1/8	$0.12	18 1/4	16 1/8

*No dividends were paid in 1995.

Form 10-K

PNM's Annual Report to the Securities and Exchange Commission on Form 10-K is available to shareholders upon written request, without charge. Write: Investor Relations at the address below.

Corporate Headquarters

Street address: 414 Silver SW, Albuquerque, NM 87102
Mailing address: Alvarado Square, Albuquerque, NM 87158
Main telephone number: (505) 241-2700

Annual Meeting

Tuesday, April 29, 1997, 9:30 a.m.
UNM Continuing Education Conference Center, 1634 University Boulevard NE, Albuquerque, NM

Stock Listing

Ticker symbol: PNM on the New York Stock Exchange
Newspaper financial listings: PSvNM

PNM Direct Plan

In 1996, PNM instituted the company's stock purchase and dividend reinvestment plan, PNM Direct. Any interested investor may now purchase PNM common stock through the PNM Direct Plan. Features of the Plan include certificate safekeeping, automatic monthly investment, reinvestment of dividends, direct deposit of cash dividends, and reduced brokerage commissions. A PNM Direct Plan prospectus and enrollment materials may be obtained by calling 1-800-545-4425.

Transfer Agent/Registrar and Shareholder Account Information

On January 31, 1997, there were 18,835 holders of record of the company's common stock.
PNM Shareholder Records Department
Alvarado Square - 1104, Albuquerque, NM 87158
Telephone: (800) 545-4425; Fax: (505) 241-4311
E-Mail: yjohnso@mail.pnm.com

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For the latest news, earnings reports and financial statements, a daily stock quote, and other news of interest, call 1-800-840-0766 or visit our web site on the World Wide Web at http://www.pnm.com

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