

PNM

Public Service Company of New Mexico

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RECORDS FACILITY BRANCH

1977 Annual Report

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The annual meeting of stockholders is scheduled to be held April 25, 1978. A proxy form and notice of the annual meeting will be mailed to all stockholders on March 23, 1978.

For further information and details pertaining to the information provided in this report contact D. E. Peckham, Secretary and Treasurer, Public Service Company of New Mexico, Post Office Box 2267, Albuquerque, New Mexico 87103.

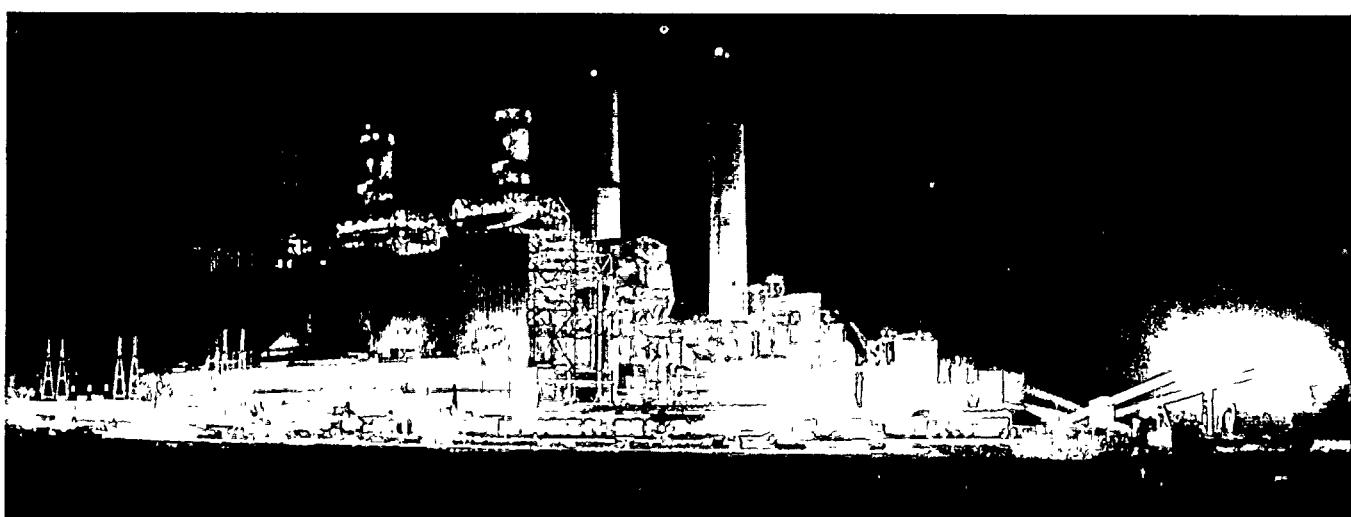
The Common Stock of this Company is traded on the New York Stock Exchange under the symbol PNM.

This Annual Report and the financial statements contained herein are submitted for the general information of the stockholders of the Company and are not intended for use in connection with any sale or purchase of, or any offer or solicitation of offers to buy or sell, any securities of the Company.

COVER PHOTO: Workers disassemble a steam turbine at the San Juan Generating Station as part of regularly scheduled maintenance procedures.

FINANCIAL HIGHLIGHTS

	<u>1977</u>	<u>1976</u>	<u>% Increase</u>
CONDENSED EARNINGS STATEMENT			
Total Operating Revenues	<u>\$138,635,951</u>	<u>\$ 99,523,146</u>	39.3
Operating Expenses:			
Operations and Maintenance	76,524,378	51,535,167	48.5
Depreciation and Amortization	11,463,823	9,548,173	20.1
Income Taxes	10,986,162	8,028,464	36.8
Other Taxes	<u>7,257,043</u>	<u>5,874,485</u>	23.5
Total Operating Expenses	<u>106,231,406</u>	<u>74,986,289</u>	41.7
Operating Income	<u>32,404,545</u>	<u>24,536,857</u>	32.1
Other Income and Deductions, Net	<u>7,653,033</u>	<u>4,797,724</u>	59.5
Income Before Interest Charges	<u>40,057,578</u>	<u>29,334,581</u>	36.6
Interest Charges	<u>15,136,962</u>	<u>11,977,418</u>	26.4
Net Earnings	<u>24,920,616</u>	<u>17,357,163</u>	43.6
Preferred Dividends	<u>6,284,825</u>	<u>4,194,268</u>	49.8
Earnings on Common Stock	<u>\$ 18,635,791</u>	<u>\$ 13,162,895</u>	41.6
Earnings per Common Share	<u>\$ 2.46</u>	<u>\$ 2.16</u>	13.9
Dividends per Common Share	<u>\$ 1.61</u>	<u>\$ 1.42</u>	13.4
Gross Investment in Property	<u>\$682,058,276</u>	<u>\$532,277,564</u>	28.1
Kilowatt-Hour Sales	<u>4,367,003,062</u>	<u>3,595,233,061</u>	21.5
Peak Load (Kilowatts)	<u>715,000</u>	<u>633,000</u>	13.0



The past year saw PNM make some amazing strides and encounter some tremendously frustrating problems. From a financial point of view, the year was better than most in recent history and this is encouraging. From an operational point of view, the job is clearly becoming more difficult.

The tremendous impact of inflation, fuel cost increases, environmental controls, and rapid capital expansion that people in the business have been all too aware of for the past several years is being translated into increased power costs. Our customers are becoming conscious of those things which business and government have been trying to bring to their attention for the past several years.

Perhaps the story hasn't been told often enough, but that is doubtful. The fact is that rising prices get more attention than all the studies, projections and prophecies that have been made. We now find the same people who brand themselves as dedicated consumer advocates and who have had a hand in producing the climate of distrust and intervention that has contributed to the rising costs, disassociating themselves from responsibility and accusing the productive sector of failing in its stewardship by conspiring to cheat customers through increased prices.

Add to this astounding intellectual ambivalence the puzzling tendency of some critics to decry burgeoning governmental bureaucracy while advocating governmental ownership of all public utilities and the conclusion comes to mind that Lewis Carroll is writing letters to editors.

The question that all businesses must come to grips with is whether the public will see this Mad Hatter's Tea Party for what it is or whether the tendency to substitute opinion for fact will become the rule of thumb in years to come.

Waiting for the solution to evolve may be a fatal mistake. If producers are fettered by various forces claiming to be acting in the public interest to the point where production is severely inhibited, the consuming public will probably conclude that

the producers don't know how to do their jobs and demand that changes be made. There can be no better scenario to study than the nuclear power industry. Every conceivable obstacle has been thrown in the path of nuclear electric power generation. The incredible tangle of regulatory procedures has pushed the cost in time and dollars to the point where the critics' claims that nuclear power is not economical are on the verge of becoming self-fulfilling prophecies. Who benefits? Not the people who repeatedly tell us that they want low-cost energy.

There may be no good solution, but those who believe that the market system of determining the range and availability of goods and services is a reasonably self-correcting mechanism which works in the interest of the consumer might do well to go out into the fray and confront their adversaries. The American public is clearly the best educated mass of people on earth. The communications system in this country makes Americans the best informed people who have ever lived. The decisions the public is being asked to make regarding the future of their country must be made based on as thorough an understanding of the issues as possible. The nature of our country is to continually seek what de Tocqueville called, "The American belief in the perfectability of man."

To provide accurate information is the key. People who are more aware of the workings of the economic system, from managers to employees to stockholders, should commit themselves to insisting that the information we all receive is accurate.

The day-to-day problems of running a company such as PNM are vexations that can be analyzed and dealt with. The philosophical shifts in attitude which dictate the manner in which the economic system operates in this country are much more profound and are not problems that can be addressed by management alone.

Coping with these interrelated changes is developing into the most pressing challenge we all face in the future; and while we are



J. D. Geist

confident the task can be managed, the sooner it is perceived as a societal problem, the sooner we can get on with developing the solutions. We are confident that the people of this country will make the best decisions in their own interest once the entire scope of the problem is brought to their attention. The time of awareness is rapidly approaching.

J. D. Geist

J. D. Geist
President

G. A. Schreiber
G. A. Schreiber
Chairman of the Board

Coming In

Operating revenues topped the \$100,000,000 mark for the first time in PNM's history. The year's total revenues of \$138,635,951 eclipsed the 1976 revenues of \$99,523,146 by 39.3 percent. However, a substantial portion of this increase went directly to fuel suppliers as it was collected under the fuel adjustment clause. While this pass-through of increased fuel costs increases the gross revenues, it does not increase net earnings. The adjustment is doing the job it was designed for as the cost of fuels, particularly natural gas and oil, continues to increase rapidly.

The increase in operating revenues also reflects a 21.5 percent increase in the amount of energy delivered to customers over the 1976 total. These figures tell the real story of changes in New Mexico and PNM's efforts to improve operations.

Although rising prices and the conservation ethic are certainly making consumers aware of how they use energy, the demand continues to grow. The per customer increase in residential sector usage was only 0.2 percent over 1976 consumption levels. This indicates that people are slowing the rate at which their personal use of electric energy is increasing. However, PNM personnel installed an average of thirty-five new services per day during the year. That's 9,000 new meters, an increase of 5.1 percent on the PNM system. This additional load put the increase in sales to the residential sector up 4.4 percent during the year.

Then there is the industrial load growth. As one of the nation's leading repositories of energy resources, New Mexico is experiencing a boom in mining activity. With reserves of oil, gas, uranium and various grades of coal, the state is being called on to provide energy for use in other parts of the country as well as for its own growing population. This industrialization, in a place where little has ever existed, is creating new demands for electrical energy. As much of the uranium ore near the earth's surface has already been mined,

the newer claims are extending shafts far into the earth to get at ore bodies. The power required to pump water from these deep mines is one of the largest new demands facing PNM. Last year the amount of kWhr delivered in the industrial area jumped 13.4 percent over 1976 levels.

With the new people and the new jobs come the corresponding increases in commercial activity to serve the community. Commercial demand, in terms of delivered kWhr, increased 3.4 percent even though commercial customers engaged in noticeable conservation efforts, often assisted by PNM representatives.

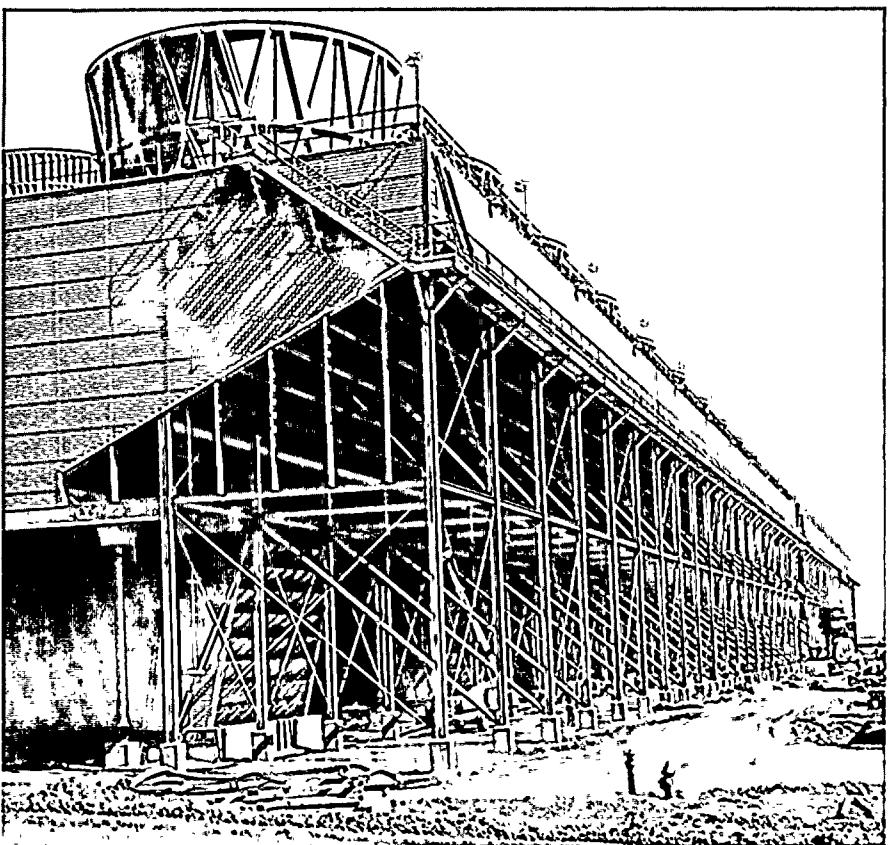
Going Out

Serving this increased energy demand means that operating costs are going to rise. New employees, new equipment, new generators and new methods all take money. Although construction costs will be covered separately, it is interesting to note that operating expenses plus

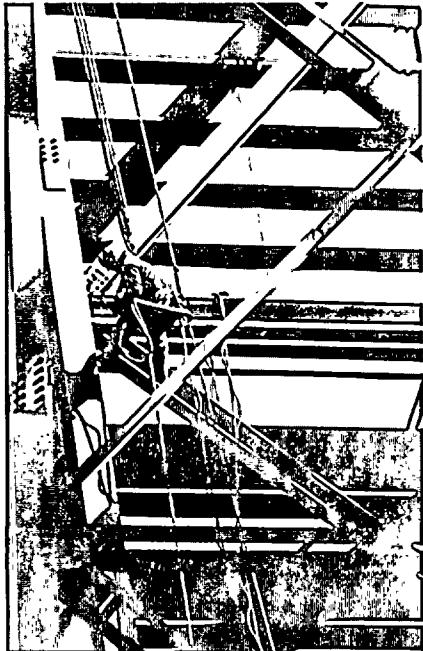
funds expended for utility plant additions during 1977 came to \$251,421,222.

Operating costs reached \$106,231,406, an all-time high. As previously noted, fuel played an unusually strong part in the cost picture. Because of the temporary loss of the San Juan coal-fired unit in July (See 'Explosion Shuts Down San Juan Unit 2', page 5), the need for additional gas-fired generation and purchased power further exacerbated fuel costs.

Over 270 new employees were added during the year to enable PNM to continue providing the service our customers have come to expect. Needless to say, maintenance, general inflation and taxes all contributed to the increase in operating expenses. Efforts made to hold down operating costs included budgeting procedure revisions, a management audit by a professional management evaluation firm and the development of more comprehensive project management activities.



This hybrid cooling tower, combining both wet and dry techniques, will use 80% less water than a conventional wet system. Such systems are more expensive but represent an important step in water conservation so important to the arid Southwest.



A steelworker continues his work seemingly at home in the iron anthill of construction activity at the San Juan plant.

Financing

At present, PNM has over \$3,000 in plant investment for every customer served. That is about \$5 in equipment for every dollar of revenue realized in 1977. This points out very graphically what people mean when they state that an electric utility is a "capital intensive" business. Few other businesses require the investment in facilities to provide a product that electric utilities face. With capital investment commitments of this size in comparison to revenues, it becomes clear that significant financing is required.

As New Mexico continues to grow in population and new uses for electricity come about, this need for capital will also increase. The five-year construction budget, which was approved by the PNM Board of Directors in late 1977, authorized expenditures of over

\$1.2 billion through the year 1982.

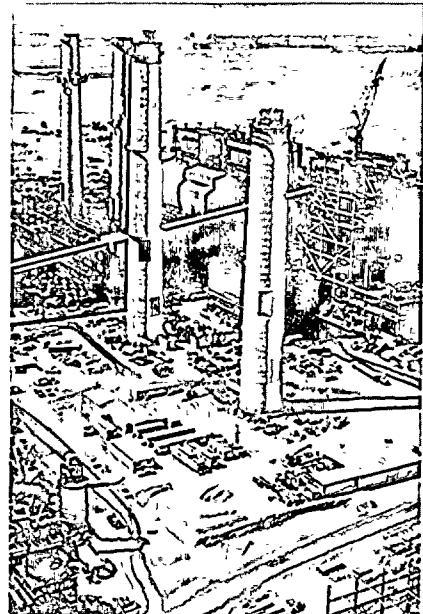
This projected need for capital coupled with the realization that the country is in a prolonged period of inflation prompted the development of PNM's Cost of Service Indexing for adjusting electric rates. (For more on Cost of Service Indexing, see 'Rates and Regulation' section on page 10.)

During 1977, PNM issued 1,526,238 shares of common stock and 200,000 shares of preferred stock, acquired \$30 million through the issuance of first mortgage bonds and utilized proceeds of approximately \$36 million from pollution control bonds. The total capital acquired during the year amounted to \$118,244,362. These funds were used primarily to finance the construction programs at San Juan Generating Station, including pollution control equipment, and Palo Verde Nuclear Generating Station.

OPERATIONS

Peak Leaps—13%

Despite periodic allegations that electric utilities are building unneeded generators—"excess capacity" is the usual term—PNM's 1977 peak was up 13 percent over the 1976 mark. The "excess capacity" claim is based on the premise that demand for electricity has leveled out due to conservation activities.



New units continue to take shape adjacent to the operational units at the San Juan plant.

Although it is true that our customers are practicing conservation to the extent that residential per customer use went up less than .2 percent in 1977, the additional customers added to the system, the increased industrial load and the substitution of electricity for other energy forms all played a role in the new peak demand.

The substitution effect is something that many people have apparently overlooked when forming opinions about the need for additional electric generating capacity. As other forms of energy become less available and more costly, the users will make a decision to find a replacement. We see solar energy entering the home and water heating market for just these reasons. However, for various tasks from making steel to cooking food at restaurants, electricity is being substituted for other energy forms. Should electric vehicles begin to be accepted, further demands for generation equipment will result.

Load Factor at All-Time High

One of the critical problems facing electric utilities and their customers is that the extremely costly machines used to convert fuel to electricity are not used to capacity.

This is the result of the inability to store large amounts of electricity and the need to have generation equipment on hand to meet peak demands. If demands were level, fewer generators would be needed and they would be used more economically. The ratio of how much an electric system is capable of producing as opposed to how much it actually is used is called the load factor.

PNM managed an annual load factor of 72.5 percent during 1977, which is considerably higher than the industry average, and the results can be attributed to a great extent to time-of-day rates in effect with several large wholesale customers. There are times of the day when these customers can buy power from PNM more cheaply than they can produce it themselves or acquire it elsewhere. These times occur when PNM's regular customers are not using the capacity which was installed for their use. If PNM can sell energy during these off-peak hours, the resulting revenues hold down the rates that our regular customers must pay for the facilities.

One of the major efforts PNM will be making during coming years is the development of load manage-

ment techniques to maintain and perhaps improve this load factor. Such a plan will assure investors and customers that the investments we are making are put to the best use possible.

Construction Pace Continues

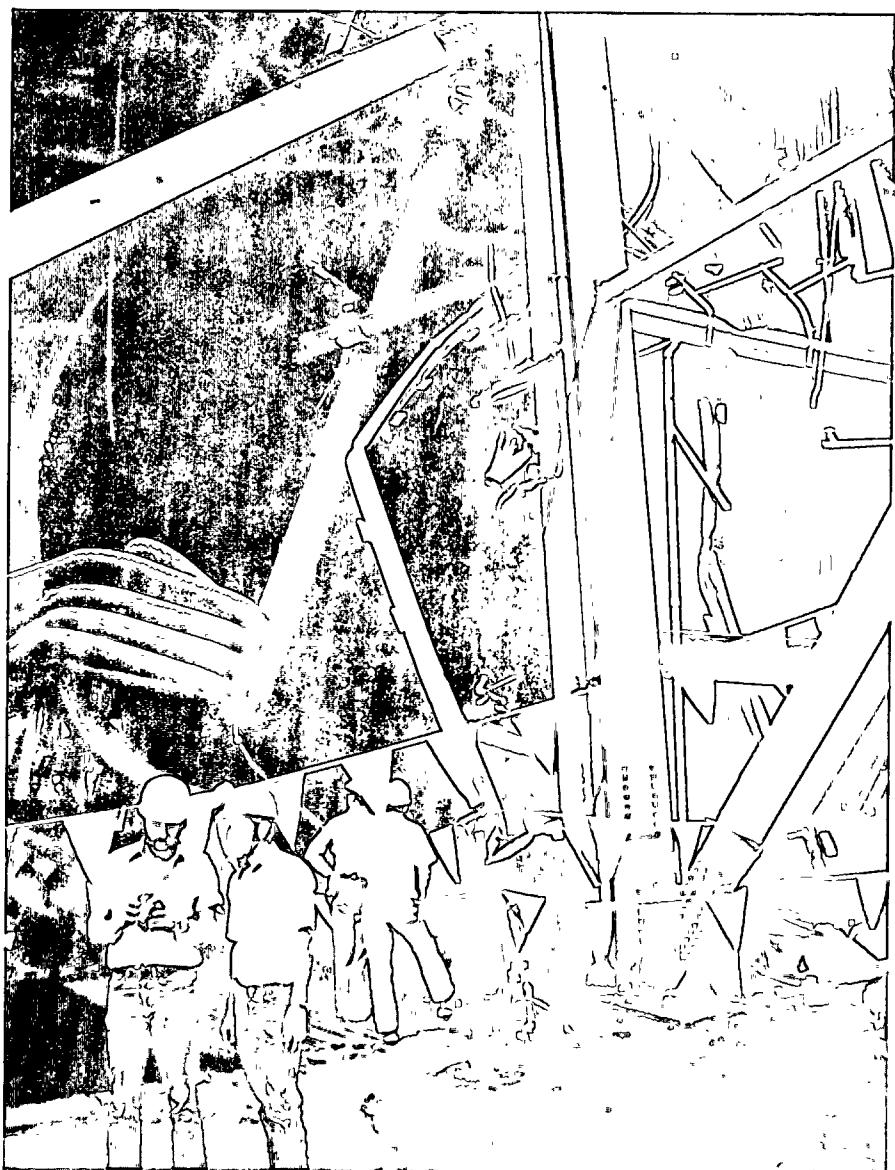
Construction at the San Juan Generating Station, jointly owned by PNM and Tucson Gas and Electric Company, continued throughout 1977 at a rapid pace. The repair to Unit 2 brought hundreds of additional workers onto the site in a determined effort to get the unit back on line as quickly as possible.

Unit 3, rated at 468 megawatts, scheduled for service in mid-1979, is 50 percent finished. The stack and turbine deck foundations for Unit 4 are in place. Unit 4, rated at 472 megawatts, will be completed in 1981, and will bring the total PNM system capacity based on coal to 77 percent.

The other major effort at San Juan during 1977 was the construction of the sulfur dioxide removal system for Units 1 and 2, which



The security guard is camped at the railhead at Prewitt, New Mexico, where he watches over an immense steam vessel. A special semi-tractor and trailer must be constructed to haul it overland 90 miles to the San Juan plant as roads and bridges simply aren't capable of bearing its weight.



Workers examine the wreckage following the boiler explosion which twisted metal fittings in San Juan Unit 2 like a child's tin toy.

will be complete in April 1978 at an approximate cost of \$120 million. The system represents the state of the art of sulfur dioxide control and is the largest installation of its type in the world. Not only is it designed to remove up to 90 percent of the SO₂ resulting from combustion of low sulfur coal in the boiler, but the process concentrates the SO₂ from the flue gas stream and reduces it to elemental sulfur.

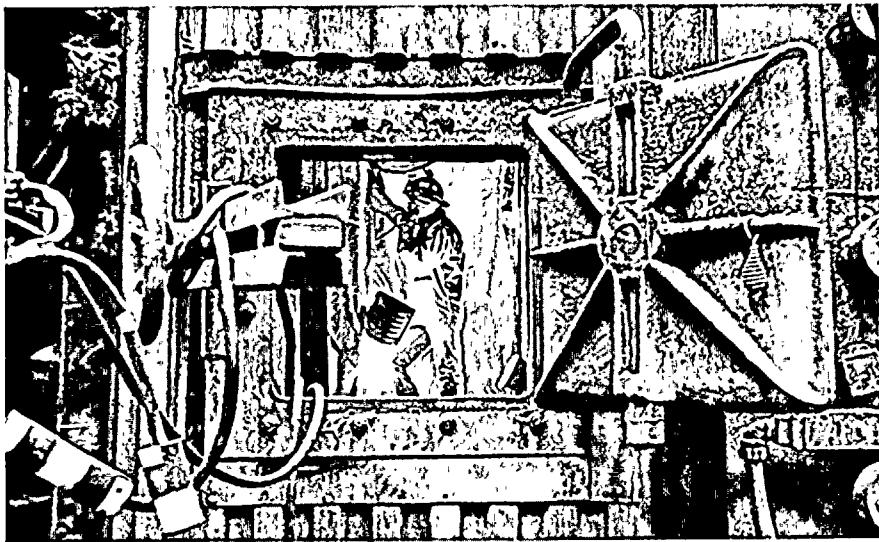
In Arizona, construction on the Palo Verde Nuclear Generating Station is well underway. Workers are busy excavating, setting thousands of tons of steel reinforcement bars in thousands of cubic yards of concrete as the first unit begins to take shape. This \$3 billion project, in which PNM is a 10.2 percent participant, consists of three units. The

first is scheduled for service in 1982. The second and third are planned for 1984 and 1986. Each unit consists of a 1270-megawatt turbine generator powered by a pressurized water reactor.

Explosion Shuts Down San Juan Unit 2

In the early morning of July 7, 1977, a tremendous explosion occurred in the boiler of Unit 2 at San Juan. The force of the blast ripped the twenty-two story boiler from bottom to top, pushing steel I-beams up to three feet off-center and blowing insulation and metal hundreds of feet.

The concussion was severe enough to trip the adjacent Unit 1 off line at the same time, and PNM went from a position of



When the work on Unit 2 is complete, a 1000° F Inferno will rage in the boiler where this workman is standing.

exporting several hundred megawatts to importing several hundred within seconds. However, the interconnections did their job and customers were completely unaware of the problem as service was not interrupted in the least. Unit 1 returned to service shortly thereafter.

Fortunately, a shift change was in progress and no workers were killed, although two suffered minor injuries. Crews on duty responded quickly and correctly to the accident and prevented subsequent injuries.

As soon as the metal began cooling, PNM engineers and representatives of the construction contractor, boiler manufacturer and insuror were probing the wreckage trying to determine the cause of the blast. To date, no specific cause has been identified.

New Mexico, the 47th state, is the fifth largest in the Union. However, because of climatic conditions unfavorable to agriculture and comparatively undeveloped transportation systems, the state remained one of the least populated. Until recently, that is. Since the end of World War II, a rather short period as history goes, the population of the state has increased by 98 percent.

The greatest part of this growth has occurred in the urban areas, precisely the areas PNM serves. As the economy, the nation's weather and people's perceptions of the

No similar incident has occurred in the history of the United States electric utility industry. The explosion occurred as the unit was being operated for the fourth consecutive day at full load. No changes in operating settings were being made and the unit was performing quite normally.

The most disconcerting problem resulting from the blast as far as PNM customers were concerned was the fact that the power produced by the unit would now have to come from gas-fired generators or through purchases from other utilities. Both of these options are considerably more expensive than the coal-fired kilowatts that San Juan produces. Since the damaged unit was unable to provide power, personnel at PNM's gas- and oil-fired plants coaxed every available kilowatt from their generators

so that the need to purchase power from other utilities would be as limited as possible. The unit was 17.5 percent of PNM's entire system capacity and was base loaded at all times so that more expensive-to-operate gas units could be held in reserve for peaking. The unit was adequately insured, and its repair is estimated to be complete by June 1978.

Water

When PNM was being formed, two of the utilities that were acquired included municipal water operations along with the electric businesses. Today, water service to the cities of Santa Fe and Las Vegas is still provided by PNM.

Those early water systems, consisting of reservoirs and gravity-fed distribution networks, have been upgraded over the years in order to meet growing demands for water. Millions of dollars have been spent in both communities on the PNM water systems. The newer installations include deep wells, pumping stations, massive storage tanks, treatment plants and computerized control systems. As communities across the nation struggle to upgrade their water systems to conform to the 1974 Safe Drinking Water Act, Santa Fe's system will be a much studied model of how to do the job.

Higher rates in effect in both communities resulted in a noticeable decrease in consumption during 1977. Conservation, particularly in the Santa Fe area, resulted in a decrease of 7.8 percent from 1976 consumption levels.

SERVICE AREA

good life change, it appears that New Mexico will continue to grow for some time. Many newcomers, when asked why they chose New Mexico, respond, "It's the last place left." It may well be.

This voluntary migration toward the Southwest is creating impacts that are destined to change the very things that many people seek in coming here. Managing this growth is one of the state's most pressing problems and one of PNM's most interesting challenges.

Albuquerque, the largest metropolitan area in New Mexico, is the base for PNM operations. Over

376,000 people live in greater Albuquerque, and of the 9,000 new services connected to the PNM system in 1977, more than 7,000 were in Albuquerque. New residents and new jobs are raising the standard of living in Albuquerque and the changes will require much more energy in coming years.

Santa Fe, the capital, also is experiencing sharp growing pains as people who discover the oldest capital city in the United States continue to adopt it as their home. State and Federal government agencies, with their tendency to expand, are spurring a great deal of the



Archbishop Lamy of Santa Fe, immortalized in Willa Cather's *DEATH COMES TO THE ARCHBISHOP*, was a leading figure in territorial New Mexico's religious and political life. An able administrator, he was responsible for building numerous churches and schools throughout his diocese in the late 1880's, including the Cathedral of Santa Fe, shown here.

growth in Santa Fe.

Las Vegas, on the high plains at the foot of the eastern slopes of the Sangre de Cristo Mountains in north-central New Mexico, was originally a ranching town founded by Spanish settlers. Las Vegas became a booming railroad town during the years of western expansion of the United States. Easterners followed the railroad and became captivated by the clear mountain air and open spaces. They stayed and the present-day Las Vegas is a mixture of Spanish colonial architecture, turn of the century railroad Victorian styles, and more modern, if less aesthetically interesting, architecture.

The Montezuma Hotel, designed by Burnham and Root, two of Chicago's most noteworthy architects of the post-Great Fire Renaissance, still stands on the outskirts of town, waiting for someone to find a use appropriate to its grandeur.

Deming, only 30 miles from the Mexican border, is the lowest spot in PNM's service area, only 4,301 feet above sea level. This farming

community is similar to Phoenix, Arizona in its climate and geography. Deming sits astride the major southern transportation route linking the East and West coasts. Its location and climate will bring new people to Deming, particularly in light of recent eastern winters.

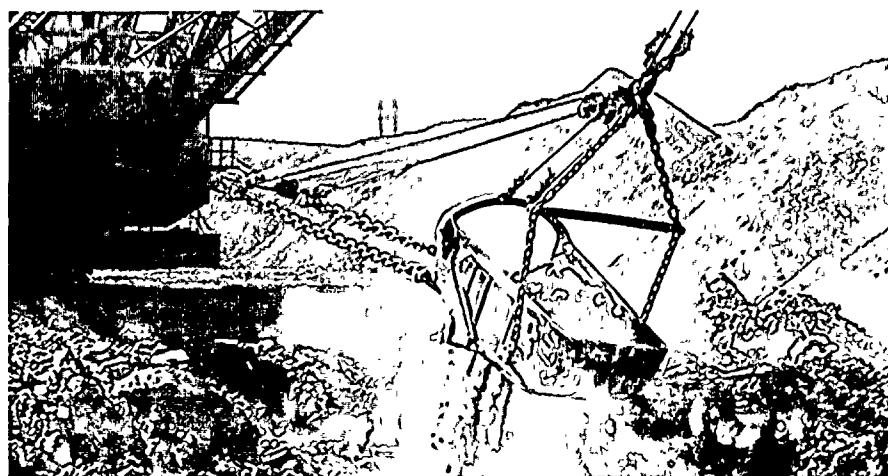
Small towns and Indian pueblos along the Rio Grande north and south of Albuquerque are also served by PNM. To the north, the Bernalillo Division serves Bernalillo—one of the oldest European cities in North America—and several villages and Indian pueblos.

The Belen Division serves the communities immediately south of Albuquerque along with the Isleta Indian Pueblo. The gains in population which New Mexico is experiencing are largely concentrated near Albuquerque. However, with mountains due east, Indian land north and south of the City and essentially barren mesa land to the west, many newcomers are settling in these smaller communities north and south of Albuquerque along the Rio Grande.

SUBSIDIARIES

Public Service Company has interest in two subsidiaries, the wholly owned Public Service Land Company and the jointly owned Western Coal Co. The Land Company provides an agency which acquires land and water rights for various utility expansion projects. The work entailed requires a full-time operation as land and water are costly, much sought after commodities.

Western Coal Co. manages fuel operations at the San Juan Generating Station and holds coal leases. It is owned in equal partnership with Tucson Gas and Electric Company.



Only a few yards of rock cover the coal at the San Juan mine. But it takes giant draglines to quickly remove this overburden so the coal can be mined.

RD&D—RESEARCH, DEVELOPMENT AND DEMONSTRATION

The thought persists in many quarters that utilities are bending their every effort to encourage growth in their service areas in spite of the fact that utilities nationwide are facing extremely difficult times adding new capacity. Few

places offer a better example than New Mexico. The growth here is roughly twice the national average, and PNM is developing conventional generation resources at an incredible pace. Ten years ago the entire value of the Company's

50-year accumulation of property and equipment was \$170 million. In five years the figure will be well over \$1.5 billion.

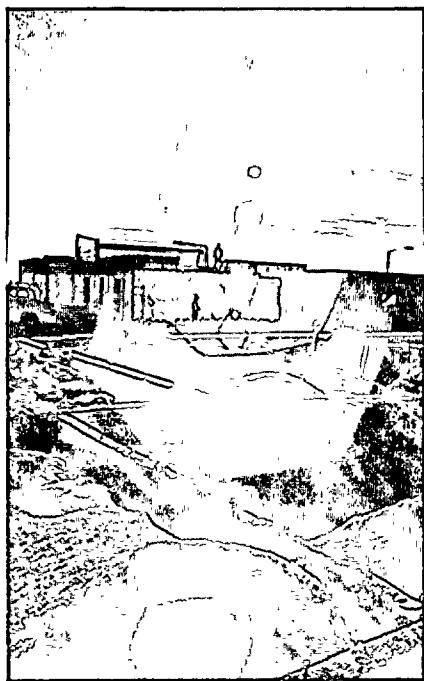
Even with the development of conventional generation there is still a need to look into new sources

of power in the face of such growth. Although fossil fuels offer well understood technology and comparatively predictable prices these days, they have a problem with which even elementary school children are becoming quite familiar—their days are numbered. Although nuclear fuels can provide power through known technology, problems, both practical and philosophical, presently cloud the future of this potent resource.

Consequently, PNM has undertaken numerous studies to look into ways of using energy sources that have not yet been put into large-scale use. Solar, of course, is the most often thought of energy resource when the idea of "alternative energy" is brought up. Of course, PNM feels that the word alternative is quite misleading and that "supplementary" is far better, semantically.

Engineers in PNM's resource analysis section are currently involved in at least a dozen solar energy projects, geothermal energy studies, a pumped storage facility design and numerous more esoteric studies dealing with improving the efficiency of existing and future power plants.

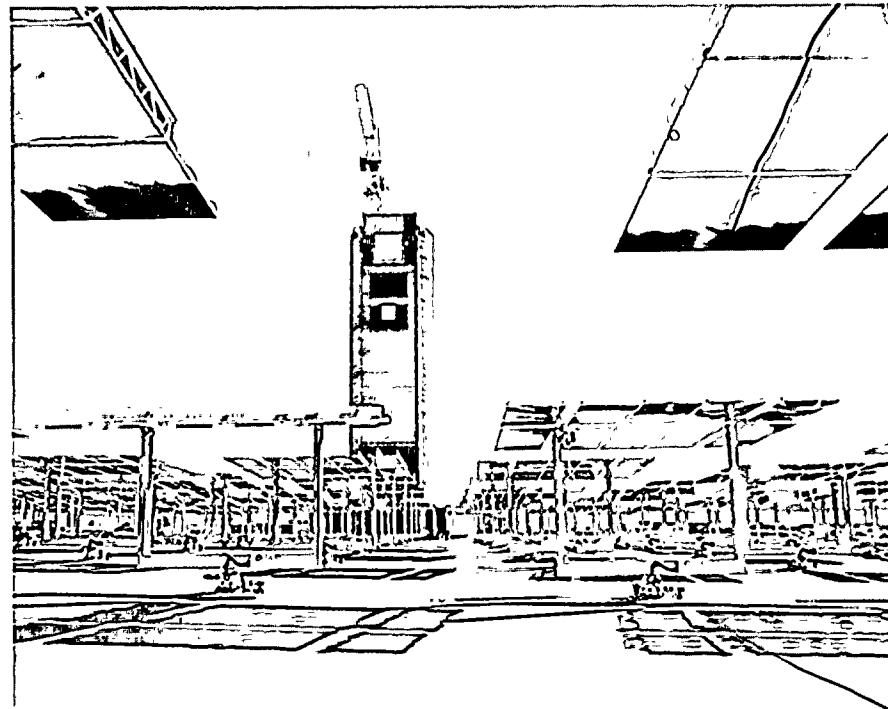
One of the most promising



Five solar homes are under construction in Albuquerque as part of an Electric Power Research Institute project. PNM is a sponsor in the project which seeks to develop solar systems appropriate to the New Mexico climate. At the same time the project will help planners assess the impact of solar energy use on the utility generation needs.

projects, from a general point of view, is the "Solar Hybrid Repowering Project." Several years ago PNM engineers who were looking at the various proposals to build solar thermal electric plants began

Southwest. PNM is negotiating with the Department of Energy for the construction of the first demonstration project, with the help of DOE funding, in the Company's service area.



The "power tower" at Sandia Laboratories near Albuquerque has already shown that it is possible to use solar energy to heat water to boiler-level temperatures. PNM engineers are studying the feasibility of retrofitting an existing gas-fired power plant with similar solar hardware.

wondering if the solar thermal concept could simply be added to an existing fossil fuel plant. In this way, the sun's energy could run the plant during the day, through peak periods, and if the plant's capacity was needed at night, the fossil fuel boiler could be fired-up.

Most of the plants which could be repowered with solar are older gas-fired plants, which, if not repowered, will have to be retired before the turn of the century due to fuel problems; but the generators, condensers, switchyards and all associated equipment will have a much longer life span if this plan is successful.

The repowering concept proved to be such an intriguing idea that the Department of Energy awarded PNM a \$700,000 grant to produce a definitive study of the concept.

So far the survey portion of the study has identified 10,000 megawatts of potential solar capacity in the Southwest. Because of this immense capacity, the Department of Energy (DOE) is now planning two solar repowering projects in the

Throughout his efforts to establish a national energy policy, President Carter has emphasized near-term solar concepts. The solar repowering idea is much more a near-term project than stand-alone solar plants.

Other interesting solar projects underway include PNM's part of a million dollar Electric Power Research Institute experiment on residential solar heating. Although the concept of using solar heat for residential space and water heating is certainly well understood and gaining wider acceptance every day, very few thorough studies designed to accurately measure system performance of various designs have been conducted under controlled conditions.

This project is centered on ten homes. Five are being built in Albuquerque and the other five on Long Island, New York. Each home will have a different solar heating system. The systems will be monitored and over 100 functions constantly compared. At the end of the test there will be hard evidence as to which is the most effective.

Management Audit

During 1976, the management consulting firm of Theodore Barry and Associates was retained by PNM to conduct an audit of Company management practices. The purpose was to locate weak points as well as strengths so that mid-course corrections could be made during the current period of rapid expansion without unnecessarily slowing down the various processes within the Company.

The study was completed in 1977 and the results were, for the most part, favorable. Several areas for improvement were cited and adjustments were being made even before the study was entirely complete to take advantage of potential savings.

The report was submitted to the New Mexico Public Service Commission in June 1977. The Barry firm has conducted similar studies for a number of electric utilities, often at the insistence of the local regulatory body.

Fuels

The ability to provide electricity to our customers at the lowest reasonable cost is intimately tied to using the lowest-priced fuels. In the past this meant using natural gas. But today, with the cost of natural gas escalating sharply and even the availability of gas supplies in doubt, PNM, like other utilities around the country, is turning to other fuels.

Ten years ago PNM used natural gas exclusively, with oil as a standby fuel, but today coal dominates the fuel mix. Last year about 60 per-

cent of PNM's generation came from coal. Using coal as a fuel is not without its problems. Fuel handling and emission controls all push the cost per kilowatt for plant installation beyond that needed for gas plants. Nevertheless, the decision to go with coal has proven a wise one because of the price and supply questions associated with natural gas.

In addition to coal generation, your Company is also participating in the Palo Verde Nuclear Generating Station near Phoenix, Arizona. The three units of the project, with an eventual total output of 3,810 megawatts, are scheduled to begin commercial service in 1982, 1984, and 1986. PNM's 10.2 percent interest in the project will amount to a total of 390 megawatts for customers in New Mexico.

Other sources are also entering PNM's fuel mix. A pumped storage project is now in its planning stages and will eventually produce 600 megawatts as a peaking and intermediate type of generating facility. Located near Seboyeta, New Mexico, this facility will use off-peak base load energy to pump water to an upper reservoir. During the day, when demand for electricity is high, the cycle is reversed and water flowing down to a lower reservoir will generate electricity by passing through turbines. This project is expected to come on line in 1985.

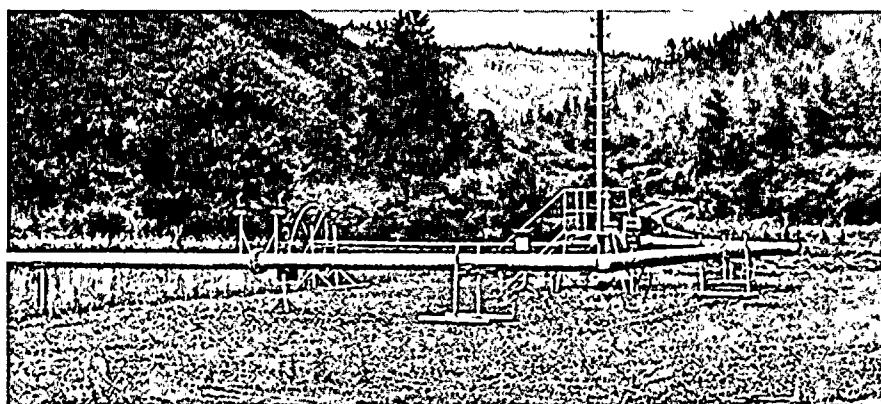
In cooperation with Union Oil Company, PNM is exploring the possible use of geothermal energy in the Jemez Mountains of New Mexico. Using a massive reservoir of hot water lying thousands of

feet below the surface, this facility would generate electricity through a system called "flash-steam." Hot water and steam are pumped to the surface. The water and steam are separated in flash tanks, the water reinjected into the reservoir and the steam used to run turbine generators. A proposal is now before the federal Department of Energy for partial funding of this pioneering project. If funding is approved, this geothermal source could be providing needed electricity by the mid-1980's.

The proposed National Energy Act, currently under consideration by a joint Senate-House conference committee, contains provisions requiring electric utilities to convert from gas and oil as a boiler fuel to coal or other fuels. PNM's present construction program provides for coal burning facilities which are scheduled to replace its gas- and oil-fired plants. Under these guidelines, PNM is planning the construction of a nominal 2,000 megawatt generating plant. This plant will be a mine-mouth operation located in the Bisti area about 35 miles south of Farmington. Called "New Mexico Station," the first unit is scheduled to be installed in 1983. The final ownership in the first unit has not been determined.

In addition, PNM is currently engaged in the initial stages of an early site review process for possible nuclear generating facilities in New Mexico. This study is aimed at gathering a data bank of information on hydrology, geology, seismology and economics at potentially superior sites throughout the state. The early site review is a necessary step should PNM decide to exercise the nuclear option for electrical generation in the 1990's and beyond.

These various projects are being undertaken to provide the stability to electric service that comes from fuel diversification as well as to maintain that service at the lowest reasonable cost. The future will, no doubt, see your Company exploring yet other ways to provide electric service, other ways that today seem exotic but tomorrow will be essential.



New Mexico may have its first geothermal power plant if the Department of Energy approves PNM's proposal to build in the Jemez Mountains. Shown here is one of eleven producing wells on the Baca location.

Franchises

Public Service Company has long-term franchises for electric service in all of its divisions. The Albuquerque franchise will be in effect until 1992; Santa Fe until 1999; Las Vegas until 1996; Belen until 1990; Deming until 1993; and Bernalillo until 1988.

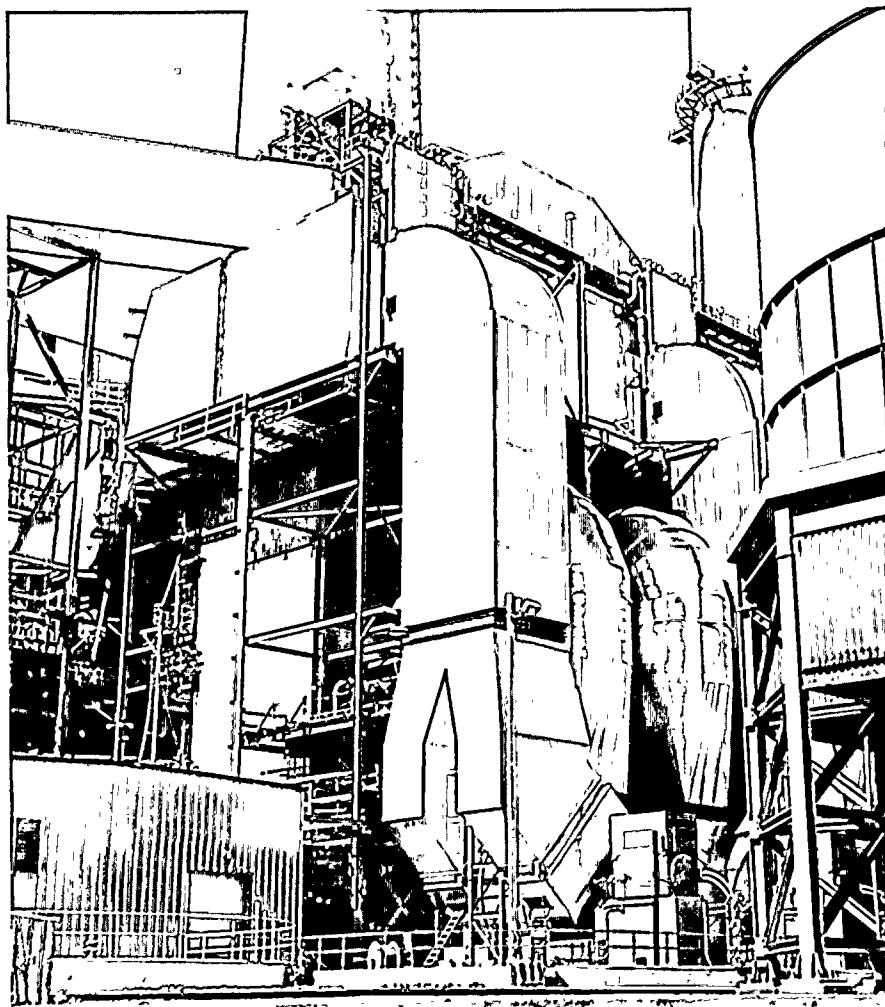
Water operation franchises in Santa Fe and Las Vegas will be in effect until 1979 and 1996, respectively. A 25-year franchise was granted for Santa Fe water service in November 1977, but was rejected by the City's voters.

Five-Year Forecast

During 1977, the growth rate in New Mexico and the rest of the Southwest continued as new residents, businesses, and energy-related industries moved to this area of the "Sunbelt."

Reflecting this growth, the Company's five-year construction budget climbed to a record \$1.2 billion. With an annual growth rate in peak demand of 8 percent, more than twice the national average for utilities, PNM is one of the fastest growing utilities in the country.

During the next five years, \$690 million in generation-related construction is planned, with an additional \$248 million going for environmental control systems. This money is earmarked for continued construction on Units 3 and 4 at San Juan Generating Station, a large pumped storage project, the



Sulfur dioxide scrubbers presently being constructed at the San Juan plant represent state-of-the-art equipment and are designed to remove 90% of the SO₂ from stack emissions.

Palo Verde Nuclear Generating Station in Arizona, New Mexico Generating Station and PNM's interest in Four Corners Generating Station. The balance of the \$1.2

billion will be spent over the next five years on transmission and distribution systems plus additional operating facilities for both electric and water customers.

RATES AND REGULATION

The Company is subject to the jurisdiction of the New Mexico Public Service Commission (the Commission) with respect to most of its rates, service, accounting, issuance of securities, construction of new generating and transmission facilities and other matters. The Federal Energy Regulatory Commission (FERC), formerly the Federal Power Commission, has jurisdiction with respect to rates for electric energy sold for resale.

The Company is currently applying a Cost of Service Index adjustment (Indexing) to all electric billings subject to the jurisdiction of the Commission.

In July 1977, the Public Service

Commission held an open meeting to invite comments from the public and the Company to determine the best way to review the Indexing. As a result of that meeting, the Commission indicated that a series of hearings would be held to review the performance of Indexing as well as the Company's basic rate designs, the Company's request for full tax normalization and full inclusion of construction work in progress in the rate base.

In January 1978, the Commission denied the Company's request for full tax normalization and issued an order beginning a year-long inquiry into the operation of Indexing and the rate treatment of

construction work in progress.

Public Service Company has fuel adjustment clauses covering all kWh sales. Heretofore, street lighting was the only service for which no adjustment was applicable. As of July, new rates were approved which include a fuel adjustment clause applicable to street lighting.

In June, the Company filed for a \$5 million annual increase in rates, based on a future test year, for certain FERC customers. These customers include Community Public Service Company, Plains Electric Generation and Transmission Cooperative and the Department of Energy at Los Alamos. This rate

was permitted to become effective in October, subject to refund pending final approval.

In addition, the City of Farmington signed a contract in August for electric service under time-of-day rates similar to the Company's other FERC customers.

The Company filed a revised electric rate tariff in 1975 which would increase electric revenues

from the City of Gallup by about \$850,000 per year. Hearings before an Administrative Law Judge were completed in late 1976 and an increase of \$544,000 was allowed pending final approval by the FERC.

In February 1977, the Commission approved a rate increase for Santa Fe water service. The original rate case was filed in 1976. This increase represents annual revenues

of about \$2,200,000. The new rates designed to generate this amount went into effect on May 31.

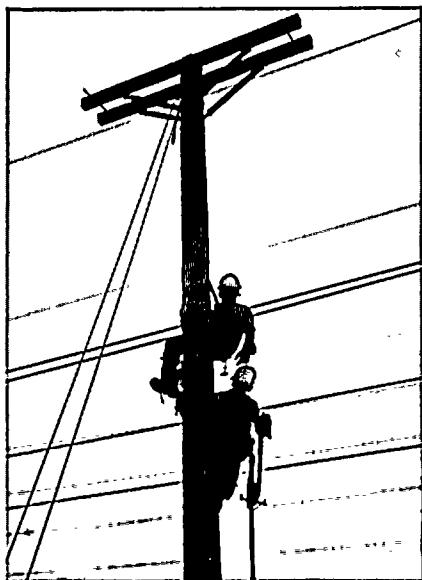
Last year the Commission also approved the Company's request for rate relief for PNM's water operations in Las Vegas. The Commission's order in September granted the Company an annual increase of approximately \$330,000 over 1975 test year revenues.

PNM—PEOPLE AND PROGRAMS

Over recent years, Public Service Company of New Mexico has had the enviable record of attracting highly skilled and talented people of various occupations. Their ability is the key to your Company's success. The many different and even unique projects and activities of PNM are testimony to their energy and skill. There are now more than 1,750 employees working together to provide our customers with reliable and economic electric and water service, both now and for the future.

A. E. Rhodes, president of Western Coal Co., retired recently, having served PNM since 1958. R. B. Rountree, PNM Senior Vice President, has replaced Rhodes as the head of Western Coal Co.

In June 1977, A. J. Robison was promoted from Manager of Rates to the position of Assistant Treasurer.



PNM'S rapidly expanding system demands constant training of new personnel. These apprentice linemen are practicing the pole top rescues that they all hope will never be necessary.

Employee Relations

Keeping talented employees is as important as attracting them in the first place. To help do this, PNM maintains a wide range of benefit programs including medical, dental, life insurance, stock purchase and pension plans. Such programs are a part of modern corporate life, of course, but their high quality here at PNM also reflects the commitment of the Company's management to the employees who make success possible.

Public Information

In 1977 energy remained in the national and local spotlight. Rising prices for utility services, efforts to establish a national energy policy, environmental concerns, conservation, freezing winter weather—all these and more—have captured the attention of the nation.

These public concerns about energy also voice a need for information. Responding to this need from our customers, PNM has increased its efforts to tell the public what we are doing and why and how it affects their lives. This is an important process because our customers, like their fellow citizens across the country, are faced with major decisions about energy that can determine the future of the nation. Without accurate information, such decisions cannot be responsibly made.

Conservation has been the other main topic of interest to our customers. Through paid advertising, bill stuffers and numerous public appearances, your Company has given information to its customers on ways to conserve and make efficient use of the energy they buy. The SMART Home concept, for



G. A. Schreiber, former PNM President and now Chairman of the Board, presides over last year's annual meeting of stockholders.

instance, has become more accepted as a way to efficient residential energy use.

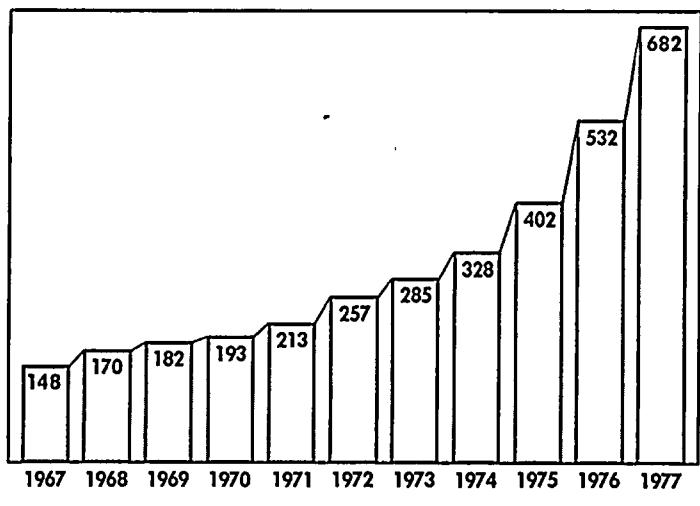
Communicating with our customers is done in other ways as well, through the Speakers Bureau, which addresses community groups on many energy-related topics. Demonstrations on energy use plus explanations of economics designed for students are regularly offered by PNM's Consumer Education and Educational Resources Departments. Plant tours for media personnel and public groups have been conducted and exhibits for energy-related museum shows and energy fairs have been prepared.

The Company also has added a video production studio as another tool to communicate with the public and employees as well. This facility has also been used as a support for community activities.

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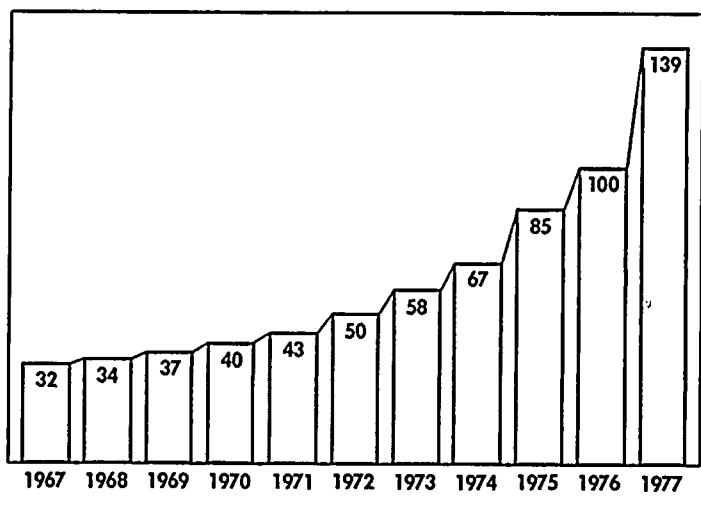
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GROWTH GRAPHS



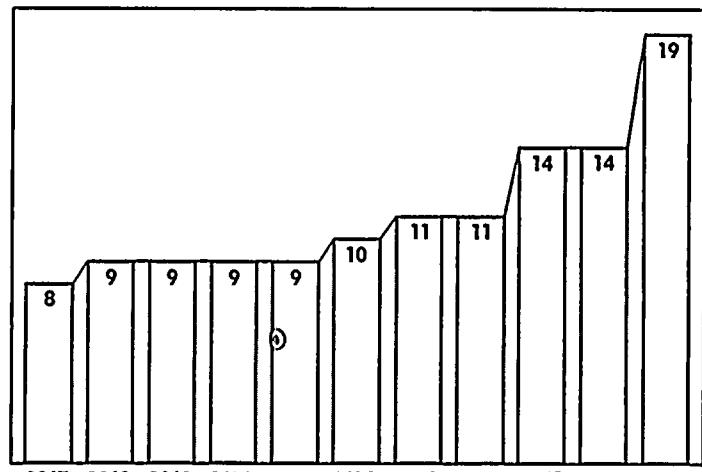
**Gross Plant
Investment**

MILLIONS OF DOLLARS



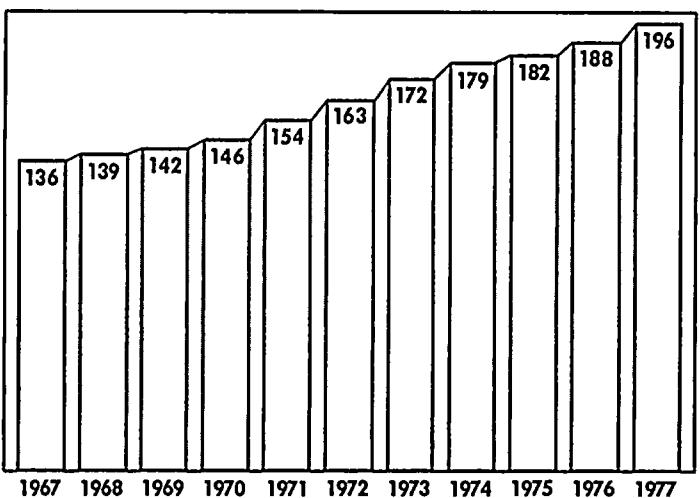
**Total Operating
Revenues**

MILLIONS OF DOLLARS



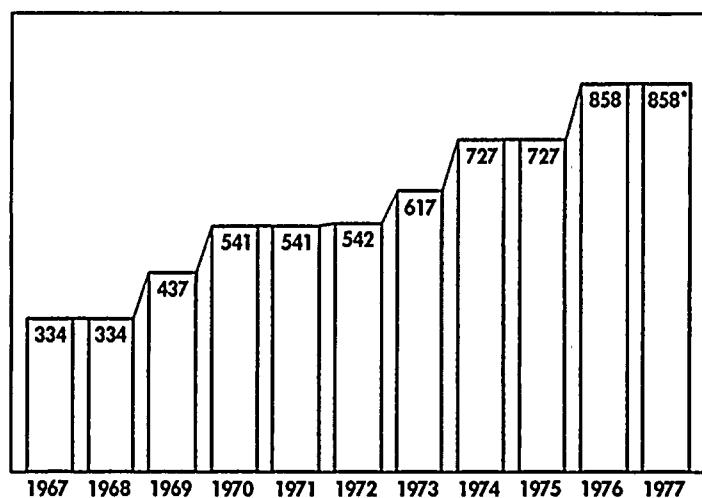
**Federal, State, Local
and General Taxes**

MILLIONS OF DOLLARS



**Average Number of Customers
Electric and Water**

THOUSANDS OF CUSTOMERS



**Net Generating
Capability**

THOUSANDS OF KILOWATTS

* San Juan Unit 2, the Company's share of which is 161,000 kW, is presently out of service.

COMPARATIVE OPERATING STATISTICS

	<u>1977</u>	<u>1976</u>	<u>1975</u>	<u>1974</u>
ELECTRIC SERVICE				
ENERGY SALES—kWhr (Thousands)				
Residential	957,390	916,748	875,361	828,243
Commercial	1,320,651	1,277,025	1,177,953	1,128,576
Industrial	686,845	605,559	530,188	549,622
Other Ultimate Customers	160,922	157,694	136,136	137,843
Total Sales to Ultimate Customers	3,125,808	2,957,026	2,719,638	2,644,284
Sales for Resale	1,241,195	638,207	578,037	250,901
Total Energy Sales	<u>4,367,003</u>	<u>3,595,233</u>	<u>3,297,675</u>	<u>2,895,185</u>
ELECTRIC REVENUES (Thousands)				
Residential	\$ 39,547	\$ 32,423	\$ 28,912	\$ 23,314
Commercial	45,520	36,198	30,851	25,403
Industrial	18,918	13,070	9,993	8,349
Other Ultimate Customers	5,215	4,168	3,361	3,004
Total Revenue from Ultimate Customers	109,200	85,859	73,117	60,070
Sales for Resale	23,219	9,340	8,241	2,782
Total Revenue from Energy Sales	132,419	95,199	81,358	62,852
Miscellaneous Electric Revenues	2,605	1,935	1,412	2,406
Total Electric Revenue	<u>\$ 135,024</u>	<u>\$ 97,134</u>	<u>\$ 82,770</u>	<u>\$ 65,258</u>
CUSTOMERS AT YEAR END				
Residential	164,803	156,116	151,111	147,516
Commercial	18,374	17,483	16,738 (2)	16,469
Industrial	493	489	515 (2)	298
Other	265	250	246	231
Total Ultimate Customers	183,935	174,338	168,610	164,514
Sales for Resale	5	5	4	4
Total Customers	<u>183,940</u>	<u>174,343</u>	<u>168,614</u>	<u>164,518</u>
Reliable net capability — kW	858,000	858,000	727,000	727,000
Coincidental peak demand — kW	715,000	633,000	586,000	583,400
Average Fuel Cost per million BTU	92.74¢	61.83¢	47.23¢	39.49¢
BTU per kWhr of net generation	11,004	11,084	10,848	11,054
WATER SERVICE				
SALES — Gallons (Thousands)				
Customer sales	2,726,059	2,959,209	2,859,783	3,013,508
Interdepartmental sales	5,742	4,014	9,195	12,568
Total water sales	<u>2,731,801</u>	<u>2,963,223</u>	<u>2,868,978</u>	<u>3,026,076</u>
REVENUES				
Customer sales	\$3,605,984	\$2,386,222	\$2,204,967	\$2,103,169
Interdepartmental sales	5,642	2,580	2,721	5,970
Total water sales	<u>\$3,611,626</u>	<u>\$2,388,802</u>	<u>\$2,207,688</u>	<u>\$2,109,139</u>
Customers at year end	<u>17,427</u>	<u>16,838</u>	<u>16,437</u>	<u>16,158</u>

(1) Reclassified Against Expense

(2) Certain customers were reclassified from commercial to industrial during 1975. The reclassification accounted for a change of 220 customers in both categories.

<u>1973</u>	<u>1972</u>	<u>1971</u>	<u>1970</u>	<u>1969</u>	<u>1968</u>
786,108	706,973	648,626	583,136	532,200	486,468
1,110,147	985,431	885,782	792,376	732,807	659,836
616,405	653,761	618,695	552,118	524,180	479,883
128,171	123,568	116,202	107,598	97,762	89,835
<u>2,640,831</u>	<u>2,469,733</u>	<u>2,269,305</u>	<u>2,035,228</u>	<u>1,886,949</u>	<u>1,716,022</u>
122,656	114,333	106,000	98,026	91,890	86,765
<u>2,763,487</u>	<u>2,584,066</u>	<u>2,375,305</u>	<u>2,133,254</u>	<u>1,978,839</u>	<u>1,802,787</u>
\$ 20,552	\$ 17,760	\$ 15,295	\$ 13,910	\$ 12,861	\$ 11,955
22,283	19,421	16,309	14,784	13,719	12,489
7,210	7,229	6,549	5,963	5,662	5,187
2,613	2,204	1,994	2,056	1,889	1,751
52,658	46,614	40,147	36,713	34,131	31,382
1,074	937	857	778	659	557
53,732	47,551	41,004	37,491	34,790	31,939
2,803	795	670	621	654	640
<u>\$ 56,535</u>	<u>\$ 48,346</u>	<u>\$ 41,674</u>	<u>\$ 38,112</u>	<u>\$ 35,444</u>	<u>\$ 32,579</u>
143,201	136,515	127,911	120,865	115,595	112,765
16,241	15,754	14,775	13,908	13,395	13,084
295	303	308	300	290	296
229	221	205	201	199	187
159,966	152,793	143,199	135,274	129,479	126,332
3	3	3	3	2	2
<u>159,969</u>	<u>152,796</u>	<u>143,202</u>	<u>135,277</u>	<u>129,481</u>	<u>126,334</u>
617,000	542,000	540,700	540,700	437,400	334,000
533,000	491,700	458,700	400,600	372,300	347,800
26.16¢	24.47¢	23.55¢	23.04¢	24.48¢	24.26¢
11,017	10,841	10,870	11,058	11,552	11,550
<u>2,855,673</u>	<u>2,781,854</u>	<u>2,563,745</u>	<u>2,564,580</u>	<u>2,397,078</u>	<u>2,356,690</u>
10,710	3,638	1,707	1,782	1,609	1,132
<u>2,866,383</u>	<u>2,785,492</u>	<u>2,565,452</u>	<u>2,566,362</u>	<u>2,398,687</u>	<u>2,357,822</u>
\$1,566,730	\$1,530,012	\$1,434,685	\$1,417,697	\$1,209,617	\$1,172,831
3,585	(1)	813	899	780	659
<u>\$1,570,315</u>	<u>\$1,530,012</u>	<u>\$1,435,498</u>	<u>\$1,418,596</u>	<u>\$1,210,397</u>	<u>\$1,173,490</u>
<u>15,848</u>	<u>15,454</u>	<u>15,024</u>	<u>14,495</u>	<u>14,216</u>	<u>14,092</u>

SUMMARY OF OPERATIONS

	<u>1977</u>	<u>1976</u>	<u>1975</u>	<u>1974</u>	<u>1973</u>
Operating revenues	<u>\$138,635,951</u>	<u>\$99,523,146</u>	<u>\$84,977,929</u>	<u>\$67,367,044</u>	<u>\$58,105,583</u>
Operating expenses:					
Operations and maintenance	76,524,378	51,535,167	39,784,697	30,836,104	22,984,163
Depreciation and amortization	11,463,823	9,548,173	8,649,772	7,974,988	6,210,576
Taxes, other than income taxes	7,257,043	5,874,485	5,114,600	4,451,727	3,643,430
Income taxes	10,986,162	8,028,464	8,626,084	6,638,499	7,734,730
Total operating expenses	<u>106,231,406</u>	<u>74,986,289</u>	<u>62,175,153</u>	<u>49,901,318</u>	<u>40,572,899</u>
Operating income	<u>32,404,545</u>	<u>24,536,857</u>	<u>22,802,776</u>	<u>17,465,726</u>	<u>17,532,684</u>
Allowance for equity funds used during construction	6,218,281	4,109,043	1,582,648	431,792	1,970,459
Other income and deductions, net	1,434,752	688,681	530,404	454,396	46,220
Income before interest charges	<u>40,057,578</u>	<u>29,334,581</u>	<u>24,915,828</u>	<u>18,351,914</u>	<u>19,549,363</u>
Interest charges	15,136,962	11,977,418	10,699,656	8,059,394	6,793,566
Net earnings	<u>24,920,616</u>	<u>17,357,163</u>	<u>14,216,172</u>	<u>10,292,520</u>	<u>12,755,797</u>
Preferred stock dividends	6,284,825	4,194,268	2,952,133	1,768,400	595,400
Net earnings applicable to common stock	<u>\$ 18,635,791</u>	<u>\$13,162,895</u>	<u>\$11,264,039</u>	<u>\$ 8,524,120</u>	<u>\$12,160,397</u>
Average common shares outstanding	<u>7,569,131</u>	<u>6,106,015</u>	<u>4,608,773</u>	<u>4,370,919</u>	<u>4,321,113</u>
Per share amounts —					
Net earnings	\$2.46	\$2.16	\$2.44	\$1.95	\$2.81
Dividends	\$1.61	\$1.42	\$1.26	\$1.20	\$1.14

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE SUMMARY OF OPERATIONS

The following factors, which may not be indicative of future operations or earnings, have had a significant effect upon the Company's results of operations during the years 1976 and 1977.

Electric revenues increased \$14.4 million in 1976 and \$37.9 million in 1977. The principal factors causing these increases were:

(a) Fuel cost adjustment—natural gas fuel costs have accelerated rapidly, and the shutdown of the first unit of the San Juan Generating Station described below has resulted in a larger portion of the Company's system requirements being met through generation at gas-fired plants and through purchases from other utilities. Generally, such costs are passed on to customers, and revenue from the fuel cost adjustment increased \$5.3 million in 1976 and \$12.1 million in 1977.

(b) Rate increases—in August 1975, the Company implemented rate increases for certain industrial customers. Also in August 1975, the Company began billing most customers under a Cost of Service Index order which provides for quarterly adjustments to rates based upon the jurisdictional return on common equity. The Company had revenues of \$5.9 million in 1976 and \$16.8 million in 1977 from Index adjustments. The Company has periodically negotiated higher rates with certain customers whose rates are subject to the jurisdiction of the FERC. In 1977, new rates for time-of-day customers were filed with the FERC and accounted for \$1.7 million of revenues which are subject to refund pending a determination by the FERC.

(c) kWh sales—although the effect of conservation of electricity by the Company's customers was experienced to a minor extent, both the number of customers and the average use per customer increased in each period. Wholesale customers provided increased base revenues of \$.6 million in 1976 and \$10.3 million in 1977. Increases in kWh sales were 9.0% in 1976 and 21.5% in 1977.

Water revenues increased \$1.2 million in 1977, as a result of rate increases allowed by the New Mexico Public Service Commission.

Operating and general expenses increased by \$10.3 million in 1976 and \$23.0 million in 1977. Principal causes were:

- (a) Production of energy from the Company's own generating units decreased by 4.6% in 1976, due primarily to a scheduled major overhaul of the first San Juan generating unit during the first quarter of 1976. The growth in kWhr sales, coupled with the decline in generation, was made up through purchase and interchange agreements. The Company was a net purchaser of 313 million kWhr in 1976 while in 1975 the Company sold 199 million kWhr through interchange agreements. The second San Juan generating unit was declared operational in December 1976, and the production of energy from the Company's own generating units increased 26.2% during 1977. The growth in kWhr sales and the boiler explosion causing the shutdown of the first unit at the San Juan generating plant in July 1977 resulted in the Company being a net purchaser of 51 million kWhr for 1977. Increased fuel and purchased power expenses resulting from the boiler explosion are estimated at \$4.5 million and are being passed on to customers through fuel adjustment clauses by approval of the New Mexico Public Service Commission. The Commission has ruled that charges for such increased cost are subject to refund if it is determined that the Company was responsible for the explosion. Total increased costs, based upon a formula proposed to the Commission, are expected to be approximately \$10.9 million through May 1978.
- (b) Rapidly accelerating fuel costs.
- (c) Amendments to the Company's pension plan necessitated by the Employee Retirement Income Security Act of 1974 and revision of health benefit plans.
- (d) Higher costs of labor due to escalating wage rates and an increase in the number of employees necessary to operate the expanded electric generating and water treatment facilities.
- (e) General inflationary factors.

Maintenance and repair expenses increased by \$1.5 million in 1976 and \$2.0 million in 1977. Overhauls and inspections at the San Juan plant in 1976 and at the Four Corners plant, the San Juan plant and the Las Vegas turbine in 1977 accounted for increased costs of \$1.1 million in 1976 and \$1.7 million in 1977.

The Company's gross utility plant increased by approximately 32% in 1976 and 28% in 1977 as a result of expanded operations, the need to maintain reliable service and increasing environmental protection requirements. The increase in utility plant and the Company's construction program have been the primary causes of increases experienced in the following areas of operations:

- (a) Depreciation and amortization.
- (b) Taxes, other than income taxes—increases in ad valorem taxes resulted from increased plant.
- (c) Allowance for funds used during construction—increased construction at the San Juan plant and the Palo Verde Nuclear Generating Station resulted in an increase in AFUDC in 1976 and in 1977. The New Mexico Public Service Commission ordered, effective April 22, 1975, that AFUDC be limited to generating plant construction.
- (d) Interest charges and preferred dividends—from 1975 through 1977, the Company issued \$55 million principal amount of first mortgage bonds, utilized \$80 million of proceeds of pollution control revenue bonds and issued \$50 million of Preferred Stock, generally at higher interest and dividend rates than previous issues, and had up to \$56.1 million principal amount of short-term debt outstanding.

Other income and deductions, net of taxes increased by \$.7 million in 1977, primarily because the Company's wholly owned subsidiary completed a transaction for the sale of certain real estate and for reimbursement of certain operating expenses.

As a result of items detailed above, earnings before income taxes and net earnings increased in 1976 and 1977. In 1976 income taxes decreased due to tax benefits associated with increased AFUDC and increased tax depreciation resulting from guideline depreciation provisions on the generating unit placed in service in December 1976. Both of these tax benefits are accounted for by the flow-through method. In 1977 income taxes increased due to higher earnings before income taxes. The increase in net earnings in 1976 did not result in a corresponding increase in earnings per share because of the increase in average common shares outstanding resulting from the issuance of 675,000 shares in September 1975, 1,000,000 shares in February 1976, and 1,200,000 shares in November 1976.

CONSOLIDATED BALANCE SHEET

December 31, 1977 and 1976

Assets

	<u>1977</u>	<u>1976</u>
Utility plant, at original cost (note 3):		
Electric plant in service	\$379,811,692	\$353,407,866
Water plant in service	28,218,610	25,945,445
Common plant in service	12,190,902	9,612,883
	<u>420,221,204</u>	<u>388,966,194</u>
Less accumulated depreciation and amortization	88,284,054	77,225,159
	<u>331,937,150</u>	<u>311,741,035</u>
Construction work in progress	261,837,072	143,311,370
Net utility plant	<u>593,774,222</u>	<u>455,052,405</u>
 Other property and investments:		
Non-utility property, at cost, net of accumulated depreciation of \$353,204 in 1977 and \$208,744 in 1976	9,683,394	3,464,971
Investment in fifty-percent-owned company	2,273,077	1,746,666
Other, at cost	2,745,568	511,331
Total other property and investments	<u>14,702,039</u>	<u>5,722,968</u>
 Current assets:		
Cash (note 4)	5,637,329	3,055,958
Receivables:		
Customers	14,867,486	7,813,645
Income tax refunds	264,589	5,649,579
Other	6,845,312	3,562,726
Allowance for doubtful receivables	(158,340)	(178,839)
Fuel, materials and supplies, at average cost	14,214,636	9,164,552
Prepaid expenses	1,231,591	788,210
Deferred fuel costs	7,128,200	4,534,721
Total current assets	<u>50,030,803</u>	<u>34,390,552</u>
 Deferred charges:		
Unamortized debt expense	3,213,726	2,743,600
Other deferred charges	2,727,924	1,038,166
Total deferred charges	<u>5,941,650</u>	<u>3,781,766</u>
	<u><u>\$664,448,714</u></u>	<u><u>\$498,947,691</u></u>

See accompanying notes to consolidated financial statements.

Stockholders' Equity and Liabilities

	<u>1977</u>	<u>1976</u>
Stockholders' equity (note 2):		
Cumulative preferred stock. Authorized 5,000,000 shares; outstanding 600,000 shares of \$100 stated value in 1977 and 400,000 shares in 1976 and 800,000 shares of \$25 stated value in 1977 and 1976	\$ 80,000,000	\$ 60,000,000
Common stock of \$5 par value. Authorized 20,000,000 shares; outstanding 8,857,390 shares in 1977 and 7,331,152 shares in 1976	44,286,950	36,655,760
Additional paid-in capital	90,947,569	68,238,436
Retained earnings	56,212,750	49,476,949
Total stockholders' equity	<u>271,447,269</u>	<u>214,371,145</u>
 Long-term debt, less maturities and sinking fund payments due within one year (note 3)	 <u>244,720,992</u>	 <u>178,432,864</u>
 Current liabilities:		
Short-term debt (note 4)	50,000,000	30,592,000
Accounts payable	33,195,095	21,477,929
Preferred dividends declared	1,421,850	997,849
Sinking fund requirements and maturities of long-term debt (note 3)	1,364,665	5,869,230
Accrued interest	3,591,742	2,026,900
Accrued taxes	4,156,580	2,575,314
Other current liabilities	4,900,941	2,773,348
Total current liabilities	<u>98,630,873</u>	<u>66,312,570</u>
 Deferred credits:		
Customer advances for construction	4,883,152	3,738,111
Accumulated deferred investment tax credits	25,845,594	15,455,168
Accumulated deferred income taxes (note 5)	16,830,639	18,737,820
Other deferred credits	2,090,195	1,900,013
Total deferred credits	<u>49,649,580</u>	<u>39,831,112</u>
Commitments and construction program (note 7)	<u>\$664,448,714</u>	<u>\$498,947,691</u>

CONSOLIDATED STATEMENT OF EARNINGS

Years ended December 31, 1977 and 1976

	<u>1977</u>	<u>1976</u>
Operating revenues:		
Electric (note 8)	\$135,024,325	\$ 97,134,344
Water	3,611,626	2,388,802
Total operating revenues	<u>138,635,951</u>	<u>99,523,146</u>
 Operating expenses:		
Operating and general expenses	66,403,791	43,381,261
Maintenance and repairs	10,120,587	8,153,906
Provision for depreciation and amortization	11,463,823	9,548,173
Taxes, other than income taxes	7,257,043	5,874,485
Income taxes (note 5)	10,986,162	8,028,464
Total operating expenses	<u>106,231,406</u>	<u>74,986,289</u>
Operating income	<u>32,404,545</u>	<u>24,536,857</u>
 Other income and deductions:		
Allowance for equity funds used during construction	6,218,281	4,109,043
Equity in earnings of fifty-percent-owned company, net of taxes (note 5)	486,551	409,375
Other, net of taxes (note 5)	948,201	279,306
Net other income and deductions	<u>7,653,033</u>	<u>4,797,724</u>
Income before interest charges	<u>40,057,578</u>	<u>29,334,581</u>
 Interest charges:		
Interest on long-term debt	15,294,803	11,683,381
Amortization of debt discount, expense and premium	239,371	205,205
Other interest charges	2,161,477	1,781,064
Allowance for borrowed funds used during construction	(2,558,689)	(1,692,232)
Total interest charges	<u>15,136,962</u>	<u>11,977,418</u>
Net earnings	<u>24,920,616</u>	<u>17,357,163</u>
Preferred stock dividend requirements	<u>6,284,825</u>	<u>4,194,268</u>
Net earnings applicable to common stock	<u>\$ 18,635,791</u>	<u>\$ 13,162,895</u>
Average number of shares outstanding	<u>7,569,131</u>	<u>6,106,015</u>
 Per share amounts:		
Net earnings	<u>\$ 2.46</u>	<u>\$ 2.16</u>
Dividends	<u>\$ 1.61</u>	<u>\$ 1.42</u>

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

Years ended December 31, 1977 and 1976

	<u>1977</u>	<u>1976</u>
Cumulative preferred stock:		
Balance at beginning of year	\$ 60,000,000	\$ 40,000,000
Issuance of preferred stock	20,000,000	20,000,000
Balance at end of year	<u>80,000,000</u>	<u>60,000,000</u>
Common stock:		
Balance at beginning of year	36,655,760	25,655,760
Issuance of common stock	7,631,190	11,000,000
Balance at end of year	<u>44,286,950</u>	<u>36,655,760</u>
Additional paid-in capital:		
Balance at beginning of year	68,238,436	36,364,940
Premium on common stock	24,195,102	34,375,000
Expenses of stock issuance	(1,485,969)	(2,501,504)
Balance at end of year	<u>90,947,569</u>	<u>68,238,436</u>
Retained earnings:		
Balance at beginning of year	49,476,949	44,680,290
Net earnings	24,920,616	17,357,163
	<u>74,397,565</u>	<u>62,037,453</u>
Cash dividends:		
Cumulative preferred stock	6,284,825	4,194,268
Common stock	11,899,990	8,366,236
	<u>18,184,815</u>	<u>12,560,504</u>
Balance at end of year	56,212,750	49,476,949
Total stockholders' equity at end of year	<u>\$271,447,269</u>	<u>\$214,371,145</u>
Number of shares issued:		
\$100 stated value preferred stock	200,000	—
\$25 stated value preferred stock	—	800,000
Common stock	<u>1,526,238</u>	<u>2,200,000</u>

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

Years ended December 31, 1977 and 1976

	<u>1977</u>	<u>1976</u>
Funds provided:		
Net earnings	\$ 24,920,616	\$ 17,357,163
Charges (credits) to earnings not requiring funds:		
Depreciation and amortization	12,231,798	10,171,832
Provision for non-current deferred income taxes, net	(1,907,181)	3,525,438
Investment tax credit, net	10,390,426	8,459,397
Allowance for equity funds used during construction	(6,218,281)	(4,109,043)
Undistributed earnings of fifty-percent-owned company	(526,411)	(442,912)
Funds derived from operations	<u>38,890,967</u>	<u>34,961,875</u>
Sale of first mortgage bonds	30,000,000	—
Sale of preferred stock	20,000,000	20,000,000
Proceeds from pollution control revenue bonds	36,418,069	36,653,858
Sale of common stock	31,826,293	45,375,000
Proceeds from other long-term debt	2,532,155	1,825,658
Proceeds from short-term debt	158,350,000	71,310,000
Utility plant retirements, net of removal costs	1,035,275	1,094,079
Customer advances for construction, net of refunds	1,145,041	339,842
Decrease in other deferred charges	—	566,168
Decrease in working capital other than short-term debt	—	9,191,859
Other	213,697	1,622,562
	<u>\$320,411,497</u>	<u>\$222,940,901</u>
Funds used:		
Cash dividends	\$ 18,184,815	\$ 12,560,504
Utility plant additions	145,189,816	127,855,859
Payment of short-term debt	138,942,000	72,593,000
Reduction of long-term debt	2,574,745	6,605,800
Bond discount and expense	820,362	485,097
Capital stock expense	1,485,970	2,501,504
Increase in other deferred charges	1,751,967	—
Additions to non-utility property	6,497,637	—
Increase in working capital other than short-term debt	2,729,948	—
Other	2,234,237	339,137
	<u>\$320,411,497</u>	<u>\$222,940,901</u>
Changes in working capital other than short-term debt:		
Increase (decrease) in current assets:		
Cash	\$ 2,581,371	\$ (1,483,598)
Receivables	4,971,936	6,641,082
Fuel, materials and supplies	5,050,084	(789,629)
Prepaid expenses	443,381	(96,047)
Deferred fuel costs	2,593,479	3,016,901
	<u>15,640,251</u>	<u>7,288,709</u>
Increase (decrease) in current liabilities other than short-term debt:		
Accounts payable	11,717,166	10,306,426
Preferred dividends declared	424,001	457,999
Sinking fund requirements and maturities of long-term debt	(4,504,565)	5,076,876
Accrued interest	1,564,842	(113,748)
Accrued taxes	1,581,266	150,407
Other current liabilities	2,127,593	602,608
	<u>12,910,303</u>	<u>16,480,568</u>
Increase (decrease) in working capital other than short-term debt	<u>\$ 2,729,948</u>	<u>\$ (9,191,859)</u>

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1977 and 1976

(1) Summary of Significant Accounting Policies

System of Accounts —

The Company maintains its accounting records in accordance with the uniform system of accounts prescribed by the Federal Energy Regulatory Commission (FERC) and adopted by the New Mexico Public Service Commission. As a result, the application of generally accepted accounting principles by the Company differs in certain respects from the application by nonregulated businesses. Such differences generally regard the time at which certain items enter into the determination of net earnings in order to follow the principle of matching costs and revenues.

Principles of Consolidation —

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Public Service Land Company. All significant intercompany transactions have been eliminated.

Utility Plant —

Utility plant is stated at original cost, which includes payroll-related costs such as taxes, pensions and other fringe benefits, administrative costs and an allowance for funds used during construction. Contributions received from customers to meet the customers' special construction requirements are credited to utility plant.

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.

Allowance for Funds Used During Construction (AFUDC) —

In accordance with the uniform system of accounts prescribed by the FERC, AFUDC, a noncash item, is charged to utility plant. The rate used for 1977 and 1976 was 6½% as approved by the New Mexico Public Service Commission. The Commission also ordered, effective April 22, 1975, that AFUDC be limited to generating plant construction. Effective January 1, 1977, the FERC has ordered that the allowance for equity funds used during construction be credited to other income and deductions and that the allowance for borrowed funds used during construction be credited to interest charges. The allowance for funds used during construction in 1976 has been reclassified accordingly in the accompanying consolidated statement of earnings. The allocation of AFUDC between borrowed funds, after taxes, and equity funds is based on the method required by the FERC.

Depreciation —

Provision for depreciation of utility plant is made at annual straight-line rates prescribed by the New Mexico Public Service Commission. The average depreciation rates used were as follows:

	<u>1977</u>	<u>1976</u>
Electric plant	3.09%	3.14%
Water plant	1.89%	1.87%
Common plant	<u>5.15%</u>	<u>4.74%</u>

The provision for depreciation and amortization of certain equipment, including amortization applicable to capital leases, is charged to clearing accounts along with other costs of operation and subsequently apportioned to operating expenses and property accounts based on the use of the equipment. Depreciation of non-utility property is computed on the straight-line method.

Investment in Fifty-Percent-Owned Company —

The Company's investment in a fifty-percent-owned company is stated at equity. The co-owner, Tucson Gas & Electric Company, is participating with the Company in the construction and operation of a steam turbo-electric generating plant described in note (7). The generating plant utilizes coal from properties of the fifty-percent-owned company as a source of fuel.

Deferred Fuel Costs —

The Company uses the deferred method of accounting for the portion of fuel costs which is recoverable in subsequent periods under fuel adjustment clauses.

Amortization of Debt Discount, Expense and Premium —

Discount, expense and premium incurred in the issuance of the presently outstanding debt are being amortized by charges to income over the lives of the respective issues on the debt outstanding method.

Investment Tax Credits —

The Company follows the practice of deferring investment tax credits and amortizes them over the estimated useful lives of the related properties. Investment tax credit carryforwards are recorded as a reduction of deferred federal income tax credits to the extent of credits originating in the current year and those which will reverse in the investment tax credit carryforward period.

Income Taxes —

For income tax purposes, the Company has availed itself of accelerated amortization of emergency facilities and liberalized depreciation methods allowed by the Internal Revenue Code. Amounts equal to the resulting tax reductions are charged to income and accumulated in the deferred income tax accounts to offset the increase in taxes which occurs when deductions are less than they are under the method used for accounting purposes (normalization method).

Generally, the Company uses guideline depreciation provisions for assets acquired prior to 1972 and the class life asset depreciation range system for assets acquired in 1972 and thereafter to compute depreciation for income tax purposes. The tax reductions related to guideline depreciation are recorded as a reduction in income tax expense in the current year (flow-through method). The reduction in income taxes attributable to asset class lives shorter than guideline lives is normalized by the method previously described.

For income tax purposes, the Company deducts the allowance for funds used during construction and certain employee benefits and taxes related to construction projects which are capitalized for accounting purposes. The income tax effects are recorded as a reduction of income taxes as incurred, except the tax effects of payroll taxes capitalized which are normalized.

Deferred fuel costs are deducted currently for income tax purposes. The Company accounts for the related tax benefits by the normalization method.

The Company deducted, for tax purposes, costs incurred in training employees in the operation of a new generating station. Such costs were capitalized for accounting purposes. The Company also deducted, for tax purposes, a loss from abandonment of property which is being deferred and amortized over five years for accounting purposes. The Company has adopted the normalization method of accounting for the related tax benefits.

Revenues —

Revenues are recognized based on cycle billings rendered to customers monthly. The Company does not accrue revenues in respect of energy sold but not billed at the end of a fiscal period.

Segment Information — Major Customers —

The Company's operations are primarily in the electric utility industry. Revenues derived from sales to domestic federal, state, county and municipal governmental agencies aggregated approximately \$27.6 million, or 19.9% of total operating revenues during 1977.

Pension Plan —

The Company's policy is to fund pension costs which are composed of normal costs and amortization of prior service costs over thirty years.

(2) Stockholders' Equity

The cumulative preferred stock may be redeemed by the Company, upon thirty days notice thereof, at redemption prices per share (plus accrued and unpaid dividends) as follows:

<u>Series</u>	<u>Shares Outstanding</u>	<u>Aggregate Stated Value</u>	<u>Redemption Price (a)</u>
1965 Series, 4.58%, \$100 stated value	130,000	\$13,000,000	\$103.032
1974 Series, 9.2%, \$100 stated value (b)	170,000	17,000,000	109.20
1975 Series, 10.12%, \$100 stated value (b)	100,000	10,000,000	110.12
9.16% Series, \$25 stated value (b)	800,000	20,000,000	27.29
8.48% Series, \$100 stated value (b)	<u>200,000</u>	<u>20,000,000</u>	<u>108.48</u>
	<u>1,400,000</u>	<u>\$80,000,000</u>	

(a) Redemption prices are at reduced premiums in future years.

(b) Redemption may not be made through certain refunding operations prior to April 15, 1979 for the 1974 series, or prior to March 15, 1980 for the 1975 series, or prior to June 1, 1981 for the 9.16% series, or prior to April 1, 1982 for the 8.48% series.

The Board of Directors has reserved 900,000 shares of unissued common stock for the dividend reinvestment program, the Employee Stock Purchase Plan and the Tax Reduction Act Stock Ownership Plan, of which 773,762 shares remained unissued at December 31, 1977.

Charter provisions relating to the preferred stock and the indenture securing the first mortgage bonds impose certain restrictions upon the payment of cash dividends on common stock of the Company. At December 31, 1977, there were no retained earnings restricted under such provisions.

(3) Long-Term Debt

The details of the Company's outstanding long-term debt including unamortized discount and premium, less sinking fund payments and maturities due within one year, are as follows:

First Mortgage Bonds:	<u>1977</u>	<u>1976</u>
3 % Series, due 1980	\$ 3,750,000	\$ 3,800,000
3½% Series, due 1982	3,040,000	3,080,000
3⅓% Series, due 1984	2,312,207	2,372,579
4⅓% Series, due 1988	8,792,000	8,910,000
4⅔% Series, due 1991	10,090,000	10,177,000
5⅓% Series, due 1997	18,768,962	18,979,660
7⅓% Series, due 1999	14,192,515	14,339,083
8⅓% Series, due 2001	19,363,624	19,561,562
7½% Series, due 2002	19,563,968	19,761,940
9⅓% Series, due 2005	25,000,000	25,000,000
8⅓% Series, due 2007	29,917,831	—
1976 Pollution Control Series, securing 6⅓% Pollution Control Revenue Bonds, Series 1976, due 2006 (\$20,000,000 principal amount less \$1,799,799 at December 31, 1977 and \$8,787,969 at December 31, 1976 held by trustee)	18,200,201	11,212,031
7.6% Pollution Control Revenue Bonds, Series 1974, due 1984 (\$55,000,000 principal amount less \$15,273,651 at December 31, 1976 held by trustee)	55,000,000	39,726,349
5% Pollution Control Revenue Bonds, 1977 Series A, due 1984 (\$22,000,000 principal amount less \$7,843,752 at December 31, 1977 held by trustee)	14,156,248	—
Other	<u>2,573,436</u>	<u>1,512,660</u>
	<u>\$244,720,992</u>	<u>\$178,432,864</u>

Substantially all utility plant is pledged to secure the first mortgage bonds.

Approximately 25 percent of the original principal amount of each series of first mortgage bonds will be redeemed through sinking fund requirements prior to the aforementioned due dates. The aggregate amounts of maturities and sinking fund requirements on long-term debt outstanding at December 31, 1977 are as follows:

1978	\$1,364,665
1979	1,539,067
1980	5,508,936
1981	1,751,426
1982	<u>4,796,204</u>

In August 1977 the City of Farmington, New Mexico issued and sold \$77,045,000 principal amount of its 5.9% Pollution Control Revenue Refunding Bonds, Series 1977, the proceeds of which are expected to be used to retire the Series 1974 Bonds and the 1977 Series A Bonds at their maturity in 1984. From and after such retirement, but not before, the Refunding Bonds will be payable out of revenues received by the City from the Company. Upon such retirement the Company will also guarantee the payment of the Series 1977 Bonds and secure its guaranty with an equal principal amount of its first mortgage bonds.

In March 1978 the City of Farmington expects to sell \$125,000,000 principal amount of its 6% Pollution Control Revenue Bonds, 1978 Series A, the proceeds of which will be utilized in the construction of pollution control facilities at the San Juan Plant. The Company will guarantee the 1978 Series A Bonds and secure its guaranty with an equal principal amount of its first mortgage bonds.

(4) Short-Term Debt and Compensating Balance Arrangements

The Company's interim financing requirements are met through issuance of unsecured notes payable to banks and commercial paper. The Company has agreed to maintain compensating balances with certain lending banks, generally equal to 20% of the outstanding indebtedness or 10% of the lines of credit at such banks, whichever is greater. Details of the Company's short-term debt at December 31, 1977 and December 31, 1976 and for the years then ended were as follows:

	<u>1977</u>	<u>1976</u>
Aggregate short-term debt outstanding:		
Notes payable to banks	\$19,050,000	\$ 9,592,000
Commercial paper	\$30,950,000	\$21,000,000
Average interest rate on outstanding debt:		
Notes payable to banks	7½%	6¾%
Commercial paper	6½%	4¾%
Maximum short-term debt outstanding during year	\$56,120,000	\$45,755,000
Average short-term debt outstanding during year	\$36,950,000	\$28,450,000
Weighted average interest rate on short-term debt outstanding during year, computed using daily outstanding balances:		
Stated interest rates	6 %	6¼ %
Effective rate considering the effect of compensating balances	6½%	6½%
Unused lines of credit (subject to cancellation at the banks' option)	\$31,525,000	\$29,678,000
Compensating balances at end of year	<u>\$ 676,000</u>	<u>\$ 1,125,000</u>

Compensating balances have been reduced by the average difference between collected bank balances and book balances.

(5) *Income Taxes*

Income taxes consist of the following components:

	<u>1977</u>	<u>1976</u>
Current Federal income tax	\$ 713,123	\$(4,772,252)
Current State income tax	647,462	316,911
Deferred Federal income tax	(2,314,593)	2,515,933
Deferred State income tax	503,587	486,588
Amount equivalent to current investment tax credit	12,356,854	9,560,207
Amortization of accumulated investment tax credit	(368,463)	(264,627)
Total income taxes	<u>\$11,537,970</u>	<u>\$ 7,842,760</u>
Charged to operating expenses	\$10,986,162	\$ 8,028,464
Charged to other income and deductions	551,808	(185,704)
Total income taxes	<u>\$11,537,970</u>	<u>\$ 7,842,760</u>

The Company has investment tax credit carryforwards which will expire in 1984 of approximately \$9,087,000.

Deferred income taxes result from timing differences in the recognition of income and expenses for tax and accounting purposes. The sources of these differences and the tax effects of each were as follows:

	<u>1977</u>	<u>1976</u>
Deferred fuel costs	\$ 1,309,188	\$ 1,523,083
Accelerated amortization of emergency facilities, liberalized depreciation methods and asset class lives shorter than guideline lives	3,557,809	3,115,135
Extraordinary property losses	93,803	(31,397)
Undistributed earnings of fifty-percent-owned company (included in other deductions)	39,860	33,538
Construction costs deducted for tax purposes and miscellaneous timing differences	229,310	408,162
Investment tax credit carryforward	<u>(7,040,976)</u>	<u>(2,046,000)</u>
	<u>\$1,811,006</u>	<u>\$ 3,002,521</u>

The current portion of deferred taxes (included in accrued taxes) results from timing differences on deferred fuel costs. Such balance amounted to \$339,302 as of December 31, 1977 and \$243,127 as of December 31, 1976 after reduction for investment tax credit carryforwards.

The Company's effective income tax rate was less than the Federal income tax statutory rate for each of the years shown. The differences are attributable to the following factors:

	<u>1977</u>	<u>1976</u>
Federal income tax statutory rate	48.0%	48.0%
Tax depreciation in excess of book depreciation caused by use of guideline depreciation provisions	(2.8%)	(4.7%)
Allowance for funds used during construction, net of depreciation adjustments	(11.0%)	(10.2%)
Certain employee benefits and taxes capitalized for financial statements, net of depreciation adjustments	(1.3%)	(2.0%)
State income taxes, net of Federal tax effect	1.6%	1.5%
Undistributed earnings of fifty-percent-owned company	(.6%)	(.7%)
Amortization of investment tax credits	(1.0%)	(1.0%)
Other miscellaneous items	<u>(1.3%)</u>	<u>.2%</u>
Company's effective income tax rate	<u>31.6%</u>	<u>31.1%</u>

(6) Pension Plan

The Company has a pension plan covering substantially all of its employees, including officers. The plan provides for monthly pension payments to participating employees upon their attaining the age of 65 or the age of 62 with 30 years service, the amount of such payments being dependent upon length of service and the average wage of the five most highly compensated consecutive years of employment. Early retirement is optional after age 55 or 30 years of service. Normal retirement benefits are the lesser of 2% of the participant's average annual base earnings rate times his years of credited service or 65% of the participant's average annual base earnings rate minus \$1,320. The Company made contributions to the employees' pension plan of \$2,091,000 in 1977 and \$1,753,700 in 1976 including normal costs and amortization of prior service costs. The actuarially computed value of vested benefits as of January 1, 1976, the most recent valuation date, exceeded the total of the pension fund assets by approximately \$290,000.

In addition, the employees contribute \$3 for the first \$400 of monthly base salary, plus 3 percent of that part of base salary in excess of \$400 during each month.

The estimated amount of the unfunded prior service liability at January 1, 1976 was approximately \$3,600,000.

(7) Commitments and Construction Program

The Company is participating with Tucson Gas & Electric Company in the construction of a steam turbo-electric generating station located in San Juan County, New Mexico. The Company will own an undivided fifty-percent interest therein. The first unit of the station was placed in service in 1973 and the second unit was placed in service in December 1976.

The Company is also participating with several other utilities in the construction of a nuclear generating station with the first unit scheduled for completion in 1982.

It is estimated that the Company's construction expenditures for 1978 will approximate \$215,000,000 including expenditures on the San Juan and nuclear projects. In connection therewith, substantial commitments have been made.

The Company leases data processing, communication and office equipment, utility poles (joint use), other equipment and real estate. Certain data processing equipment, communication equipment and real estate leases are capital leases. All other leases are operating leases.

Certain leases provide purchase options in the approximate amount of \$1,984,000 for data processing equipment, \$1,522,000 for construction equipment and \$33,000 for other equipment. Renewal options and contingent rental provisions were not significant.

Leased property under capital leases by major classes at December 31, 1977 and 1976 was as follows:

	<u>1977</u>	<u>1976</u>
Data processing equipment	\$1,653,195	\$1,647,781
Communication equipment	115,738	—
Real estate	94,800	93,600
	<u>1,863,733</u>	<u>1,741,381</u>
Less accumulated amortization	651,405	460,090
	<u>\$1,212,328</u>	<u>\$1,281,291</u>

Future minimum lease payments under capital leases at December 31, 1977 were:

1978	\$ 418,469
1979	419,909
1980	419,439
1981	418,026
1982	350,095
Later years	<u>250,440</u>
Total minimum lease payments	2,276,378
Less amount representing executory costs	<u>305,000</u>
Net minimum lease payments	1,971,378
Less amount representing interest	<u>604,350</u>
Present value of net minimum lease payments	<u>\$1,367,028</u>

Future minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of December 31, 1977 were:

1978	\$ 667,932
1979	459,787
1980	348,251
1981	195,629
1982	144,506
Later years	<u>611,182</u>
Total minimum payments required	<u>\$2,427,287</u>

Rents charged to operating and general expenses were \$969,919 in 1977 and \$852,256 in 1976. Such amounts exclude payments made on capital leases. Rents charged to utility plant were \$1,006,126 in 1977 and \$620,138 in 1976.

(8) *Revenues Subject to Refund*

On July 7, 1977, a boiler explosion caused the shutdown of Unit 2 at the San Juan generating plant. The Company's portion of the total cost of repairs is estimated to be approximately \$7 million. The management of the Company currently believes that substantially all of the costs of repair will be covered by insurance. The Company expects the unit to be back in operation in May 1978. The major part of increased costs for replacement energy required during the shutdown is, with the approval of the New Mexico Public Service Commission, being passed on to customers through fuel adjustment clauses; however, the Commission has ruled that charges for such increased costs are subject to refund if it is determined that the Company was responsible for the explosion. Such increased costs, based upon a formula proposed to the Commission, were \$4,487,000 through December 31, 1977 and are expected to total approximately \$10,900,000 through May 1978. The future effect on net earnings, if any, is not presently determinable.

In addition, wholesale rate increases have been implemented, providing revenues of \$1,705,000 which are subject to refund.

(9) *Quarterly Results of Operations (Unaudited)*

The results of operations by quarters for 1977 and 1976 were as follows:

<u>Quarter Ended</u>	<u>Total Operating Revenues</u>	<u>Operating Income</u>	<u>Net Earnings</u>	<u>Net Earnings per Share</u>
December 31, 1977	\$41,208,201	\$10,032,865	\$8,739,356	\$.87
September 30, 1977	\$36,566,841	\$ 8,910,264	\$6,647,733	\$.67
June 30, 1977	\$31,317,032	\$ 6,913,172	\$4,803,972	\$.42
March 31, 1977	\$29,543,877	\$ 6,548,244	\$4,729,555	\$.47
December 31, 1976	\$26,792,977	\$ 6,402,957	\$4,969,674	\$.56
September 30, 1976	\$24,707,277	\$ 6,670,488	\$4,976,042	\$.61
June 30, 1976	\$24,844,898	\$ 5,711,626	\$3,749,347	\$.46
March 31, 1976	\$23,177,994	\$ 5,751,786	\$3,662,100	\$.52

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

(10) *Utility Plant Replacement Cost (Unaudited)*

Replacing items of utility plant with assets having equivalent productive capacity generally requires a substantially greater capital investment than was required to purchase the assets which are being replaced. Such additional capital investment reflects the cumulative effect of inflation on the costs of these assets.

The Company's annual report on Form 10-K (a copy of which is available upon request) contains specific information with respect to replacement cost of utility plant in service as of December 31, 1977 and 1976 and the approximate effect which replacement cost would have had on the computation of depreciation expense for the years then ended.

ACCOUNTANTS' REPORT

PEAT, MARWICK, MITCHELL & CO.
CERTIFIED PUBLIC ACCOUNTANTS
P.O. BOX 1027
ALBUQUERQUE, NEW MEXICO 87103

The Board of Directors
Public Service Company of New Mexico:

We have examined the consolidated balance sheet of Public Service Company of New Mexico and subsidiary as of December 31, 1977 and 1976 and the related consolidated statements of earnings, stockholders' equity and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of Public Service Company of New Mexico and subsidiary at December 31, 1977 and 1976 and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Peat, Marwick, Mitchell & Co.

February 24, 1978

STOCK/DIVIDEND DATA

Range of sales prices of the Company's common stock, on the New York Stock Exchange (Symbol: PNM), and dividends paid on both common and preferred stock for fiscal 1977 and 1976, by quarters. (Unaudited)

COMMON STOCK

	<i>Range of Sales Prices</i>		<i>Dividends</i>
	<i>High</i>	<i>Low</i>	<i>Per Share</i>

Fourth Quarter, 1977	22½	20	\$0.42
Third Quarter, 1977	23½	21	0.40
Second Quarter, 1977	23¾	21½	0.40
First Quarter, 1977	24	21¾	0.39
Fiscal Year	24	20	<u>\$1.61</u>
Fourth Quarter, 1976	24¾	19½	\$0.38
Third Quarter, 1976	23¼	19	0.36
Second Quarter, 1976	19¾	17½	0.34
First Quarter, 1976	20¾	18½	0.34
Fiscal Year	24¾	17½	<u>\$1.42</u>

PREFERRED STOCK

1965 Series, 1974 Series, 1975 Series, 9.16 % Series 8.48 % Series

4.58% 9.2% 10.12%

(Dividends per share)

Fourth Quarter, 1977	\$1.145	\$2.30	\$ 2.53	\$0.5725	\$2.12
Third Quarter, 1977	1.145	2.30	2.53	0.5725	2.12
Second Quarter, 1977	1.145	2.30	2.53	0.5725	2.167
First Quarter, 1977	1.145	2.30	2.53	0.5725	
Fiscal Year	<u>\$4.58</u>	<u>\$9.20</u>	<u>\$10.12</u>	<u>\$2.2900</u>	<u>\$6.407</u>
Fourth Quarter, 1976	\$1.145	\$2.30	\$ 2.53	\$0.5725	
Third Quarter, 1976	1.145	2.30	2.53	0.1336	
Second Quarter, 1976	1.145	2.30	2.53		
First Quarter, 1976	1.145	2.30	2.53		
Fiscal Year	<u>\$4.58</u>	<u>\$9.20</u>	<u>\$10.12</u>	<u>\$0.7061</u>	

Note: While isolated sales of the Company's preferred stock have occurred in the past, the Company is not aware of any active trading market for its preferred stock.

OFFICERS AND DIRECTORS

Board of Directors

H. L. GALLES, JR.* — *Chairman of the Board, Galles Chevrolet Company — Albuquerque, New Mexico*
J. D. GEIST* — *President, Public Service Company of New Mexico*
C. E. LEYENDECKER† — *President, Mimbres Valley Bank — Deming, New Mexico*
R. F. MATHER — *President, Creamland Dairies, Inc. — Albuquerque, New Mexico*
D. W. REEVES* — *Chairman of the Executive Committee, Public Service Company of New Mexico*
R. R. REHDER — *Dean, Robert O. Anderson School of Business and Administrative Sciences, University of New Mexico — Albuquerque, New Mexico*
G. A. SCHREIBER* — *Chairman of the Board, Public Service Company of New Mexico*
R. H. STEPHENST — *President, Stephens-Irish Agency — Las Vegas, New Mexico*
E. R. WOOD† — *President, Santa Fe Motor Company — Santa Fe, New Mexico*

* Members of the Executive Committee

† Members of the Audit Committee

Officers

G. A. SCHREIBER — *Chairman of the Board*
J. D. GEIST — *President*
R. B. ROUNTREE — *Senior Vice President*
R. MULLINS — *Vice President, Engineering and Construction*
C. D. BEDFORD — *Vice President, Administration*
J. P. BUNDRAINT — *Vice President, Division Operations*
J. B. MULCOCK — *Vice President, Public Affairs*
R. F. MERSHON — *Vice President, Industrial Relations*
D. E. PECKHAM — *Secretary and Treasurer*
B. D. LACKY — *Controller*
P. J. ARCHIBECK — *Assistant Secretary and Assistant Treasurer*
A. J. ROBISON — *Assistant Treasurer*
B. P. LOPEZ — *Assistant Secretary*
H. L. HITCHINS, JR. — *Assistant Secretary and Assistant Treasurer*
W. A. BADSGARD — *Albuquerque Division Vice President*
F. E. GRAY — *Vice President, Water Operations*
E. L. FOGLEMAN — *Las Vegas Division Vice President*
P. R. GAMERTSFELDER — *Santa Fe Division Electric Vice President*
J. L. SMITH — *Belen Division Manager*
W. R. STONE — *Deming Division Manager*
T. P. WARNEKE — *San Juan Operations Manager*
L. C. EDWARDS — *Bernalillo Division Manager*
W. M. HICKS, JR. — *Western Division Manager*

Executive Offices

414 Silver Avenue SW, Albuquerque, New Mexico

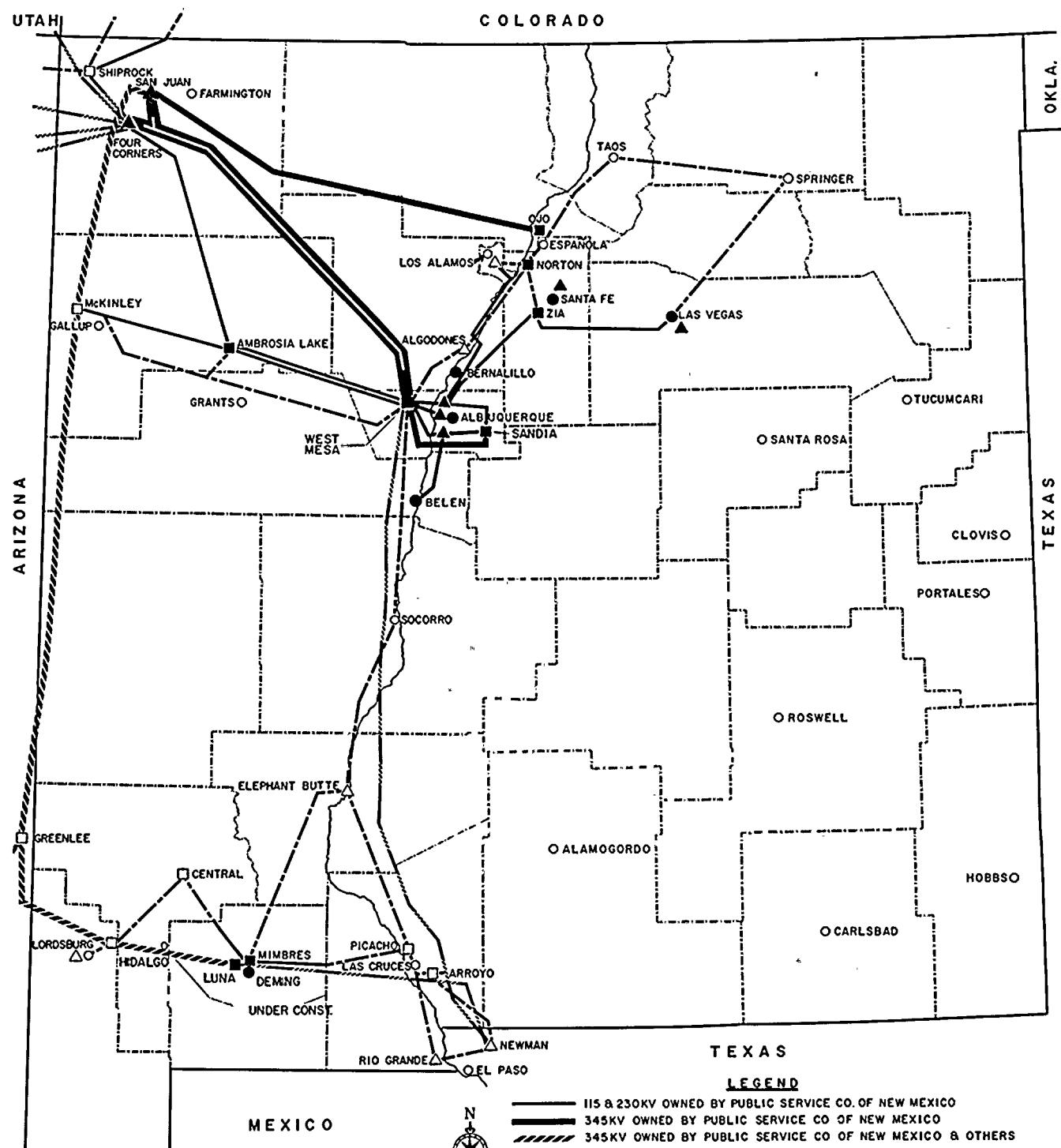
Transfer Agents

Albuquerque National Bank, Albuquerque, New Mexico
Chemical Bank, New York, New York
Irving Trust Company, New York, New York

Registrars

First National Bank in Albuquerque, Albuquerque, New Mexico
Chemical Bank, New York, New York
Irving Trust Company, New York, New York

SYSTEM MAP



SYSTEM MAP

PUBLIC SERVICE COMPANY OF NEW MEXICO

PNM

PUBLIC SERVICE COMPANY OF NEW MEXICO
POST OFFICE BOX 1047
ALBUQUERQUE, NEW MEXICO 87103

RETURN REQUESTED

