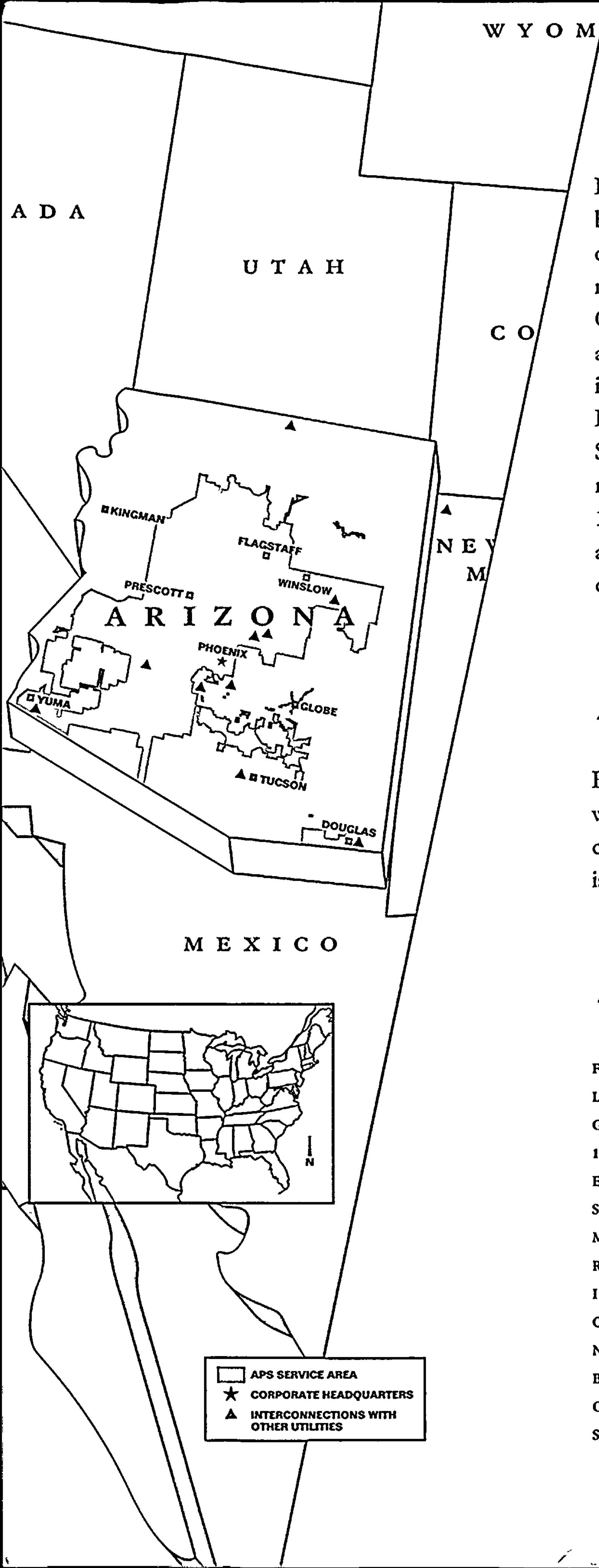
Views and Perspectives

Pinnacle West Capital Corporation 1993 An



About the Company

Pinnacle West Capital Corporation, a Phoenix-based holding company, has consolidated assets of approximately $7 billion. Pinnacle West's major subsidiary is Arizona Public Service Company, the state's largest electric utility serving approximately 654,000 customers in an area that includes all or part of 11 of Arizona's 15 counties. Pinnacle West's other two subsidiaries are SunCor Development Company, developer of residential and commercial projects on some 12,000 acres in the metropolitan Phoenix area, and El Dorado Investment Company, a venture capital firm with a diversified portfolio.

About This Annual Report

For this 1993 Annual Report to Shareholders, we asked a number of individuals across the country for their views and perspectives on issues of importance to the company.

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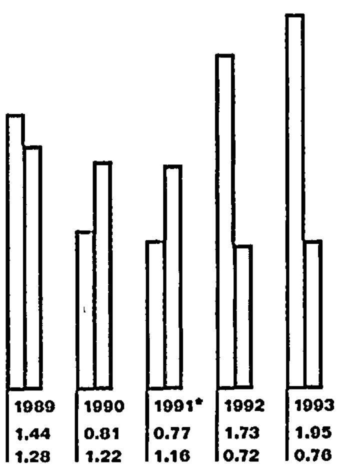
Financial Overview

PINNACLE WEST CAPITAL CORPORATION

(In Thousands, Except Per Share Amounts)	*1993*	*1992*
Operating Revenues	$ 1,718,538	$ 1,689,638
Income From Continuing Operations	$ 169,978	$ 150,440
Earnings From Continuing Operations Per Average Common Share Outstanding	$ 1.95	$ 1.73
Average Common Shares Outstanding	87,242	87,044
Book Value Per Share - Year-End	$ 18.87	$ 17.00

PINNACLE WEST
EARNINGS PER SHARE
(CONTINUING OPERATIONS) AND
NON-CASH INCOME PER SHARE
**Earnings exclude $407 million after-tax write-offs related to rate case settlement*

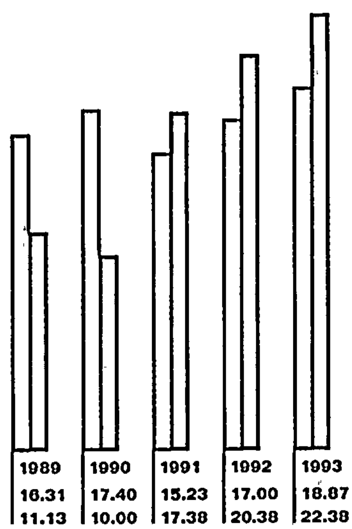


(In Dollars)

EPS (CONTINUING OPERATIONS)
NON-CASH INCOME PER SHARE

Earnings have increased in quantity and quality.

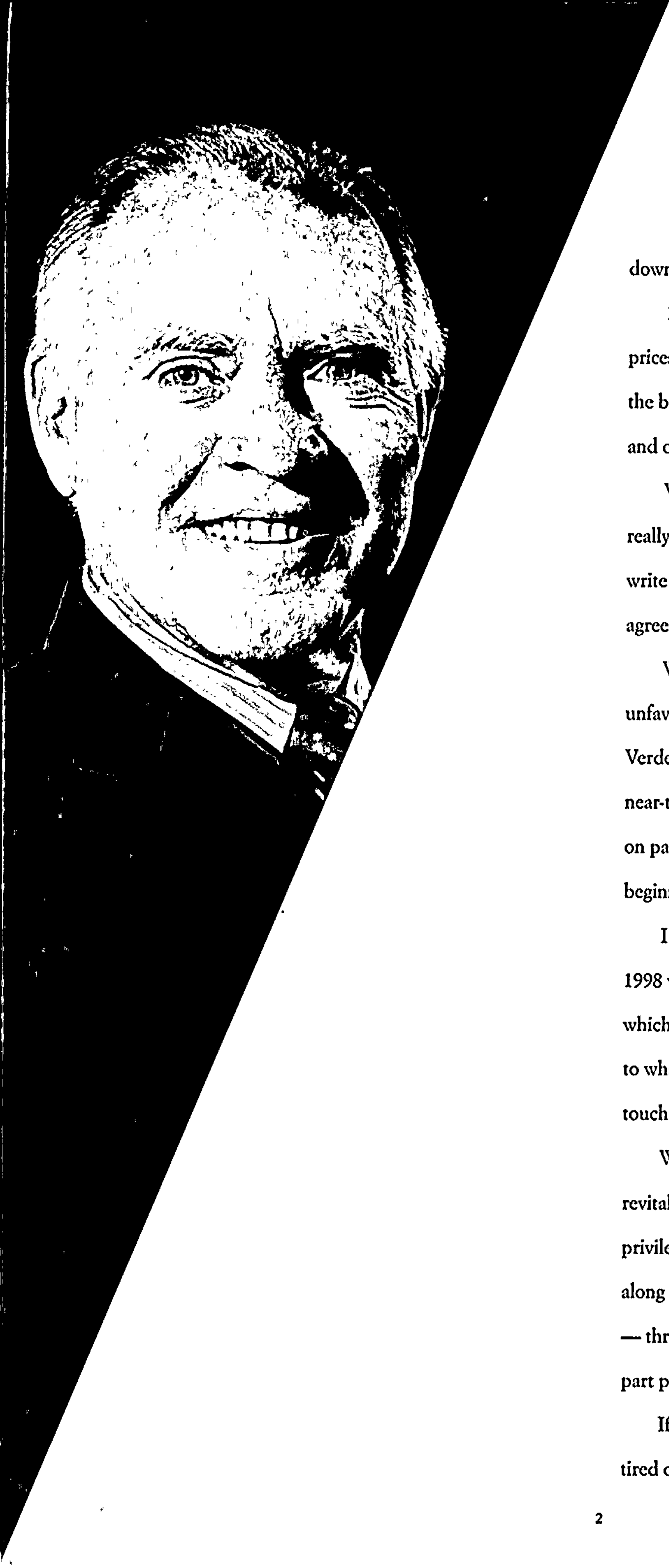
PINNACLE WEST
BOOK VALUE AND MARKET VALUE
PER SHARE AT YEAR-END



(In Dollars)

BOOK VALUE
MARKET VALUE

The stock valuation has improved relative to the underlying book value.



1993 was a good year. We made money. We paid down debt. We restored the dividend. We grew.

1993 was also a bad year. From August on, utility stock prices dropped like a rock because of nervousness about the bond market and future prospects for the industry, and our own stock price was no exception.

When all things are considered, I believe the year was really a good one, and some of the people who agreed to write guest commentaries in this annual report seem to agree we are on the right track.

We posted some good numbers in 1993 even with unfavorable weather and mechanical problems at Palo Verde. For a more complete discussion of our results and near-term challenges, please read our discussion beginning on page 14 and Management's Discussion and Analysis beginning on page 20.

I want to concentrate on the five-year period through 1998 which is within our detailed planning horizon, and which I will refer to as the "transition period" in deference to what we see happening in our industry. I will also be touching on the years beyond.

We enter the transition period after a time of revitalization following some very difficult times. I am privileged to have been involved in that revitalization— along with hundreds of other dedicated men and women — throughout which we have been guided by a seven - part plan I announced in 1990.

If you have been with us for a while, you are probably tired of hearing about that plan; you shouldn't be because

it has served us well. Rest easy, it is now history.

Instead, we have a new plan to guide us in the transition period. Unfortunately for the suffering reader, it also has seven components:

MANAGE OUR COSTS — repeating a basic tenet, but with new twists

OPTIMIZE OUR ASSETS — getting the most out of our power plants, real estate and other hard assets, but also recognizing employees and customers as huge parts of the asset base

WORK WITH OUR REGULATORS — recognizing that many of their goals are in line with our own

CHANNEL CASH FLOW — suggesting that debt reduction remains important, but is now joined by additional considerations of a financial nature

ANTICIPATE OUR CUSTOMERS — meaning the customers as they now exist, but more importantly as they may exist in the year 2000

CONTROL OUR COMMITMENTS — being careful with what we have now and what we obligate ourselves to in the future

CAPTURE THE FUTURE — identifying and seizing industry opportunity for long-term benefit

These are by no means exclusive. APS, for example, has clearly articulated specific and generic targets that direct its progress, reform its culture and measure its achievements. They are consistent with the plan I am speaking about.

Components of this plan interrelate. For instance:

SUCCESSFUL COST MANAGEMENT —
whereby we select and achieve results smarter,
not just more cheaply
plus
OPTIMIZATION OF OUR ASSETS —
through increased productivity of our investment
in plant and people
equals
lower costs per kilowatt-hour sold
which in turn equals
better WORKING RELATIONSHIPS WITH
OUR REGULATORS
and also
better ability to work with and ANTICIPATE THE
NEEDS OF OUR CUSTOMERS.

Simple enough. But in WORKING WITH OUR REGULATORS (as we did in the 1991 rate settlement and continue to do on a regular basis) and WITH OUR CUSTOMERS, we are thinking seriously about the REGULATORY RELATIONSHIP and the CUSTOMERS of the future.

We see that future as one in which our larger customers — and those of our competitors — may be fair game for all comers — including us — but also one in which smaller customers may still be receiving

perceived protection from the regulatory compact. Along the way we will need to redefine our "competitors." We also see changes in the definition of our utility product — for some customers it will no longer be just "electricity," but rather one or more associated services, some of which we have yet to identify.

Conversely, we may want to curtail or de-emphasize some of our existing services or functions in favor of others. When we look at our utility we recognize that its most distinguishing feature is its service territory. Until now, that territory has generally been characterized by its percentage growth, and by that measurement has been widely envied. That continues to be the case. Now, however, the base is getting pretty big, and the raw numbers of size and growth are getting pretty impressive, at least to me.

We will capitalize on the value inherent in that growth characteristic. If our plan priorities so indicate, we will take the appropriate steps. These could include combination with other territories having similar characteristics on the one hand, or moving away from asset concentration in generating capacity on the other.

This gets into two plan components that have the potential for conflict: *CONTROLLING OUR COMMITMENTS*; and *CAPTURING THE FUTURE*

With the growth inherent in our service territory and with our rather unique ability to increase our common stock dividend by significant increments well over the industry average, we are under no compulsion to do anything dramatic to enhance shareholder value. We are not, for example, venturing into somebody else's territory with capital investment in generating plant and are certainly not doing that offshore. Our commitments to utility, real estate and other assets will be carefully controlled.

Yet, while one can debate the timing, secular change is coming to the utility industry. I think this creates opportunity for our shareholders which is too important to miss. Success in grasping that opportunity will require willingness to transcend industry norms, freedom from distraction, and agility.

A preview of this occurred in 1990, when we had candid discussions with PacifiCorp about our company, couldn't agree upon value, and then struck a large deal with them that will produce substantial benefits into the future. Consolidation within the utility industry will no doubt occur in a number of forms, and we will participate under the right circumstances.

In the foreseeable future we will continue to position the company through *COST MANAGEMENT, WORKING WITH OUR REGULATORS* and other programs that are solidly in place and being further improved upon. In the process we will aim to strengthen the company financially and to achieve earnings and dividend growth over time.

Our dividend policy, incidentally, plays a key role in our intent to *CHANNEL CASH FLOW* judiciously. That role, and the fact that debt prepayment is getting expensive for Pinnacle because of the premiums it is now

encountering, plus other financial considerations, combine to require more sophistication in our cash planning than before. The debt reduction goals through 1995 we have previously announced pretty much remain intact, but our plans now extend beyond those goals.

Most of the foregoing comments are focused on our plan for APS because so much of our future lies with it, and also because we need to clearly delineate our own course amidst the clutter and confusion now surrounding the electric utility industry. But the same plan applies to SunCor, with obvious adaptations. Where, for instance, you infer rate and nuclear regulators for APS, infer instead city and other zoning and permitting authorities for SunCor; environmental regulation applies to both of them.

This new plan is intended to provide firm guidelines both now and as we approach various decision points in the future. Its end object is to produce value for our shareholders, and that is what we are about.

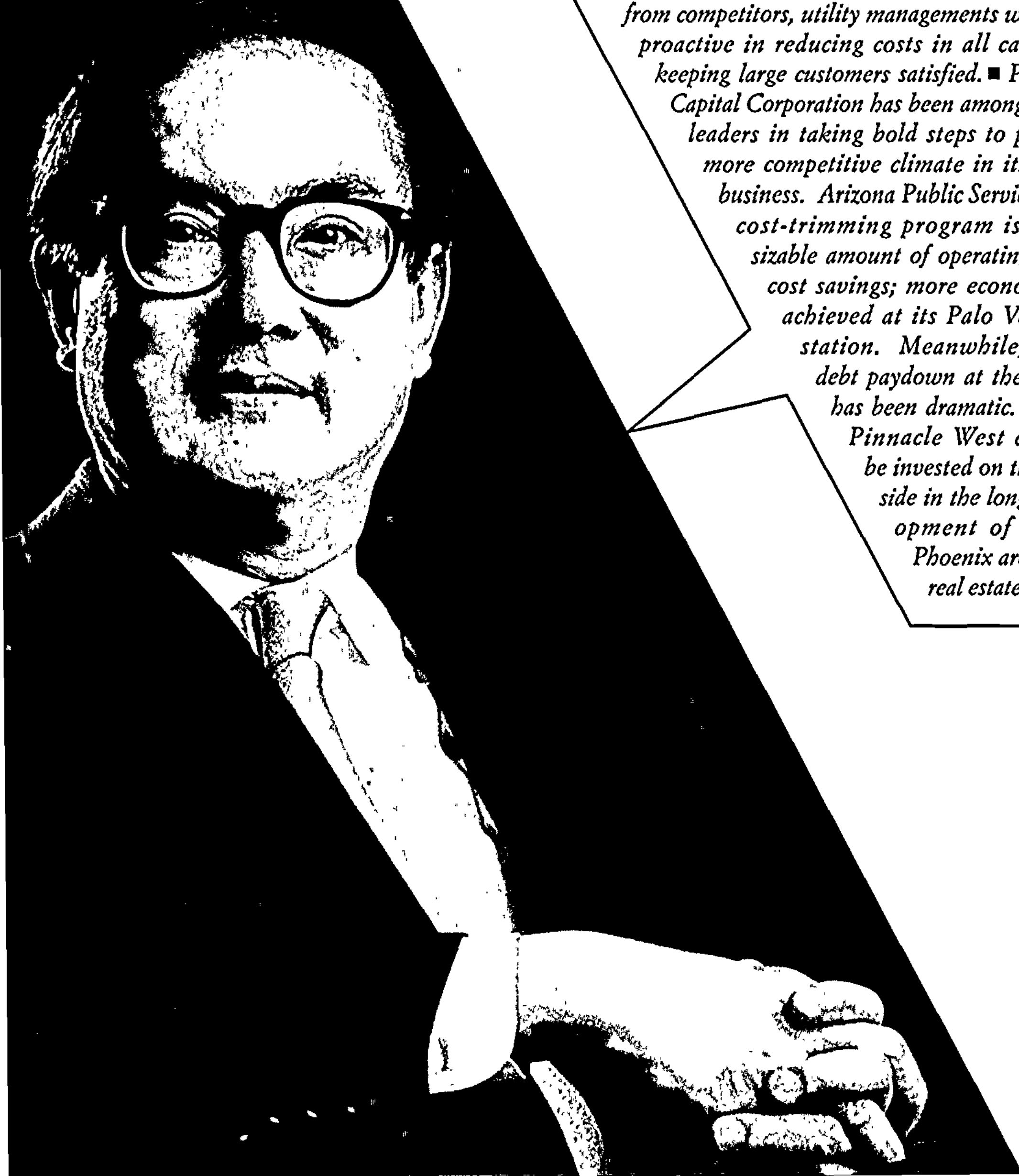
R Snell

Richard Snell

Chairman and President

This year in our annual report we asked eight individuals to comment on issues of great importance to our businesses.

An Analyst View – *The electric utility industry is facing its greatest challenge in decades; the generation and transmission markets are becoming increasingly competitive, and utilities will need to respond to the changing environment. Large industrial and commercial customers, as well as municipal users, are pursuing low-cost energy alternatives and are applying pressure to the traditional utility supplier to provide discounted rates. The proliferation of low-cost non-utility generators (NUGs), and the passage of the National Energy Policy Act of 1992 which requires open access to the transmission grid, have contributed to the mounting pressure of more competitive markets.* ■ *Although transmission pricing is still under hot debate, the open access mandate does encourage requests by NUGs and even other utilities for wholesale wheeling transactions. Furthermore, retail wheeling, which can only be mandated by state commissions, is being studied in a number of states. If utilities are unable to retain large users that make significant contributions to fixed costs, high-cost generating assets could become stranded investments. In order to retain existing load and even garner new load from competitors, utility managements will need to be proactive in reducing costs in all categories and keeping large customers satisfied.* ■ *Pinnacle West Capital Corporation has been among the industry leaders in taking bold steps to prepare for a more competitive climate in its core utility business. Arizona Public Service Company's cost-trimming program is realizing a sizable amount of operating and capital cost savings; more economies can be achieved at its Palo Verde nuclear station. Meanwhile, the rate of debt paydown at the parent level has been dramatic. In addition, Pinnacle West continues to be invested on the non-utility side in the long-range development of the greater Phoenix area through its real estate subsidiary.*



Ernest Liu
PARTNER
GOLDMAN, SACHS & CO.
NEW YORK, NEW YORK

Thomas R. Kuhn
PRESIDENT
EDISON ELECTRIC INSTITUTE
WASHINGTON, D.C.

An Industry View – *The Edison Award is presented annually to a member of the Edison Electric Institute for "distinguished contribution to the development of the electric light and power industry..." As the industry's most prestigious honor, it reflects the values most admired.* ■ *In giving Arizona Public Service Company the Edison Award in 1993, the judges praised APS "for a corporate-culture restructuring process that has transformed the company from a traditional rate-driven utility to a competitive, strategically-guided, customer-driven utility that encourages innovation and achievement among its employees."* ■ *All APS employees may take pride in this outstanding achievement, which obviously required teamwork of a very high order.* ■ *Those words "competitive" and "customer-driven" clearly are the stars to steer by in the 1990s. As a result of the Energy Policy Act of 1992, many regulatory decisions remain to be made — at both the state and federal levels — before the risks and rewards of a competitive environment are reconciled with the needs of society for a reliable power supply. But, as APS exemplifies, America's investor-owned electric utilities are not waiting for that process to run its course before becoming more efficient and more customer-oriented.* ■ *To paraphrase Satchel Paige, you don't want to look back and find that something's gaining on you.*

Frank Fairbanks
CITY MANAGER
PHOENIX, ARIZONA

A Phoenix Perspective –

These are exciting times in Phoenix! Steady, solid growth is occurring across the metropolitan area. In February, the U.S. Census Bureau announced that we have moved ahead of Detroit to become the eighth largest city in America. Downtown Phoenix is growing and regenerating itself rapidly. A new Science Museum, a History Museum, a new Central Library and a major Art Museum expansion are underway. ■ The City of Phoenix has worked to build excellence in local government management. In September, the City was awarded the Bertelsmann Prize for Democracy and Efficiency in Government, sharing with Christ Church, New Zealand the honor of "best run city in the world." The award was made by the Bertelsmann Corporation, a major international media firm, after a year-long competition for excellence in government. In 1993, the City was also cited for excellence by several national publications and was used as an example in Osborne and Gaebler's bestseller REINVENTING GOVERNMENT. Many of the City's successful strategies have been borrowed from leading corporations in the Phoenix area, including APS. ■ For example, the City of Phoenix contracts with APS to construct and maintain our street lighting system. During our recent budget cutbacks, we examined our potential for reducing costs by performing our own street light maintenance. Although the City of Phoenix has won awards for efficiency, we found that we could not beat APS' cost on this service. ■ Recently, we have sought assistance from APS on methods for reducing the operating costs of our water and wastewater utilities. Our goal is to reduce costs without reducing service quality or incurring environmental risks. We believe APS has set an excellent benchmark in this area over the last few years. ■ The vibrancy of a city and the health of its businesses are clearly linked, which is why the cooperation of an APS, or the development standards of a SunCor apparent at its northeast Phoenix community, Tatum Ranch, are so important for our area's future. Together, Pinnacle West and its companies are a vital part of this community's leadership, and are making Phoenix a better and more desirable place to live through their support of community activities and their participation in economic development efforts.