

PNTM

Public Service Company of New Mexico

1980 Annual Report



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PNM STATEMENT OF PRINCIPLE

Public Service Company of New Mexico believes that each successive generation's quality of life will be progressively more dependent upon the availability and reliability of electric and water service.

Consistent with this belief, we recognize our obligations to:

Our Customers

An adequate and reliable source of electric and water service at the lowest reasonable cost;

Our Shareholders

A reasonable return on, with optimum security of, their investment;

Our Employees

An objective opportunity to progress and grow through productive and meaningful participation; and

Our Future Generations

A legacy of adequate electric and water service provided through free enterprise with environmental and economic compatibility.

To meet these obligations, we affirm a policy of:

Operating our Company in a responsible manner which reflects the highest corporate integrity;

Providing open communications order to achieve a high level of understanding and acceptance of our purpose and endeavors;

Sharing our technical and administrative skills with all levels of government to assist in assuring best decisions are made; and

Promoting, supporting and participating in worthwhile community activities and development.

J. D. Geist, President

The annual meeting of stockholders is scheduled to be held April 28, 1981. A proxy form and notice of the annual meeting will be mailed to all stockholders on March 16, 1981.

For further information and details pertaining to the information provided in this report, contact D. E. Peckham, Secretary, Public Service Company of New Mexico, Alvarado Square, Albuquerque, New Mexico 87158.

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.

FINANCIAL HIGHLIGHTS

	1980	1979	% Change
Operating revenues	\$ 280,516,000	\$ 244,370,000	14.8
Operating expenses	\$ 208,718,000	\$ 184,554,000	13.1
Operating income	\$ 71,798,000	\$ 59,816,000	20.0
Earnings	\$ 71,436,060	\$ 54,803,000	30.4
Earnings applicable to common stock	\$ 53,602,000	\$ 42,607,000	25.8
Return on average common equity	14.9%	13.6%	9.6
Average number of common shares outstanding	15,933,000	14,363,000	10.9
Earnings per common share	\$ 3.36	\$ 2.97	13.1
Dividends paid per common share	\$ 2.04	\$ 1.88	8.5
Construction expenditures	\$ 283,864,000	\$ 323,361,000	(12.2)
Net investment in utility property	\$1,477,744,000	\$1,197,514,000	23.4
Net watt-hour sales	5,402,098,000	4,960,451,000	8.9
Number of electric customers served at year end	213,000	206,000	3.4
Average kWhr usage per residential customer	5,782	5,929	(2.5)
Number of employees	2,598	2,311	12.4
Number of common stockholders	34,436	31,160	10.5

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PRESIDENT'S LETTER

Change. It has challenged mankind's imagination for thousands of years. But today change is no longer a philosopher's puzzle, it is an essential fact of business life. What makes change of such concern today is that so many events are crowded into ever smaller bits of time, making prediction and planning both extraordinarily difficult as well as more important.

This compression forces business to organize itself in a way that allows it to respond quickly to its environment and be ready to innovate as circumstances dictate. Economic conditions are in a state of flux, expectations of customers and employees are changing, technology and information systems are constantly evolving. Clearly, for business managers in the 1980s, our task will be to manage change or even to be agents of that change.

Recently, the business press has been discussing a new social contract, "the reindustrialization of America." This concept calls for a change in direction of the country's business in order to revitalize it. Have we been going about the country's business wrong all these years? Or is this just sloganeering?

I think a more precise statement of affairs would be that the context in which we do business is suffering from the strain of rapid change. On top of that, business is growing in complexity at an almost geometric rate; markets grow, evolving toward a climax, then decline in much

shorter time periods; financial instruments gain or lose viability quickly, demanding constant in-depth research; public opinion ebbs and flows around us; and those business practices that worked so well in the past somehow no longer seem adequate. It is as though business is on a moving platform shooting at moving targets.

These kaleidoscopic changes in the corporate environment force us to reconsider how to pursue our businesses. If we suspend for a moment the moral tone some associate with the concept of reindustrialization, we see an extraordinary opportunity in history to reindustrialize as our predecessors in business did more than a century ago. We must move in many new directions rapidly and decisively, seeking new opportunities for success.

This is precisely what PNM is doing. As we have discussed in other publications, PNM has shifted from using natural gas as a boiler fuel to coal during the past decade. In 1980, about 84 percent of our generation was from coal. Such a change is more than a matter of fuels. It also demonstrates the strength and flexibility of the open market. We made this conversion with no mandate or assistance from government. We chose this path because of price and supply signals from the marketplace. Furthermore, this increased use of coal was achieved without abandoning environmental concerns. In fact, we actually increased our commitment to environmental protection.



Because of this rapid growth, PNM has become skilled at adapting to change. A case in point is our current forecast indicating a slower rate of economic growth in New Mexico during the near term than occurred in the late 1970s. Uncertainties regarding the uranium market and other costs of energy along with our Company's aggressive load management program have lowered our growth projections. But this ease in the growth rate allows us to maneuver, seeking new business opportunities. Further, we are now refining our plans for the future in terms of energy management and not merely expansion to meet a spot on the growth curve. More specifically, the purchase of Juan Unit 4 from our partner at San Juan Plant, Tucson Electric Power Company, will add 236 MW to PNM's 1982 capacity. The Palo Verde Nuclear Generating Station will provide us with 130 MW from two of its three units in 1983, 1984, and 1986. These additions have allowed us to reschedule our Pumped Storage Project from 1985 to 1990. The result is we will have an adequate reserve margin in generating capacity. Thus, we can take advantage of the opportunity and market part of this capacity to West Coast utilities. These contingency reserves benefit both our ratepayers and shareholders. The significance of these power sources goes beyond revenues. In effect, we are inventorying generating capacity at today's costs, for future when the cost of adding capacity will be significantly higher. This is energy management.

Additionally, our changing business environment has led us to sell certain assets of Western Coal Co. to Utah International, Inc. Jointly owned by PNM and Tucson Electric Power Company, Western Coal Co. sold its coal processing equipment for \$25 million. We are also currently pursuing the acquisition of New Mexico Electric Service Company which is headquartered in Hobbs, New Mexico.

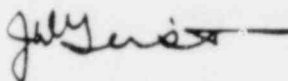
Beyond these events, your Company is managing the changing environment in more far-reaching ways. While the utility business will remain our main concern, we are aggressively seeking new directions for PNM. These new business opportunities will strengthen PNM's financial integrity while at the same time provide areas of growth for our many talented employees.

A more current goal we have set for ourselves is to keep the growth of electric rates equal to or below the rate of inflation. We recently filed for new revenue requirements under the Cost of Service Indexing format that proposed a rate increase that was significantly below the rate of inflation. This indicates a decline in the real price of electricity. The decline is due, in large measure, to various programs we have in place to reduce operating expenses and increase productivity.

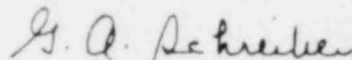
The credit for these programs belongs to the employees of PNM. Their enthusiasm, innovation and aggressive commitment to increased efficiency, combined with the leadership and stability of our directors and officers, has made the difference.

But it does not end there. Efficiency and productivity are necessary but not sufficient. One could, for instance, be very efficient at manufacturing buggywhips. We have found that creative, innovative employees who consciously seek new opportunities for the Company are the key to success in a world characterized by change.

As you meet part of PNM's management team later in this report, you will read in more detail of some of the programs put in place to enhance your Company's performance. For now, it is enough to say that the cumulative effect of these programs is that we are not only fulfilling our mandate for service but we are also in a strong position to seize future opportunities that may arise.



J.D. Geist
President



G.A. Schreiber
Chairman of the Board

REVENUES AND EXPENSES

Revenues for 1980 were \$280.5 million, up 14.8 percent over 1979 revenues of \$244.4 million. The increase in revenues was due primarily to rate relief secured from the New Mexico Public Service Commission and the Federal Energy Regulatory Commission, power sales to the Department of Water and Power of the City of Los Angeles, and increased kilowatt-hour sales. Average residential rates increased 7.25 percent during 1980, demonstrating the beginning of an expected trend in which PNM's rates will increase slower than the rate of inflation. PNM generated revenues of approximately \$10 million from the sale of power not needed by New Mexico customers at this time to the City of Los Angeles. Kilowatt-hour sales increased 8.9 percent, from 4,960,451,000 kWhr to 5,402,098,000 kWhr.

In 1980, fuel and purchased power expenses and other operating and maintenance expenses increased by 12.5 percent, compared to a 29.5 percent increase in 1979. These operating economies were the result of careful management of expenses while simultaneously maintaining system reliability. The Company's operating ratio declined from 55.1 percent in 1979 to 54.0 percent in 1980.

As a result of the necessary financing for the Company's construction program, increased borrowing costs and higher levels of short-term borrowing, the interest on short-term debt increased from \$4.3 million in 1979 to \$12.3 million in 1980. Interest on long-term debt also grew in 1980 from \$24.2 million in 1979 to \$29.0 million. Preferred dividends increased about \$5.6 million in 1980.

1980 EARNINGS

The Company's increased earnings reflect operating economies resulting from cost control programs, a higher rate for allowance for funds used during construction, and increased operating revenues.

During 1980, PNM's net earnings applicable to common stock grew from approximately \$42.6 million to \$53.6 million, while the number of average shares of common stock outstanding increased from 14.4 million shares to 15.9 million shares.

Earnings per average common share for 1980 increased to \$3.36 versus \$2.97 in 1979. Return on average common equity was 14.9 percent compared to 13.6 percent in 1979.

CONSTRUCTION PROGRAM AND FINANCING REQUIREMENTS

Increase in utility plant in 1980 totaled approximately \$280 million, compared to \$317 million in 1979. To finance these additions, external funding for 1980 included the sale of \$50 million of preferred stock, \$50 million in privately placed first mortgage bonds, a \$28 million take-down from the \$45 million privately placed first mortgage bonds issued in October 1979, \$58 million in draw-downs from pollution control trust accounts, and \$14 million in common stock raised through PNM's special stock plans including dividend reinvestment and the employee stock purchase plan. Including an increase in short-term debt of \$33 million, PNM's external financing for 1980 totaled approximately \$233 million.

Additionally, the City of Farmington, New Mexico issued, on behalf of the Company, \$26 million principal amount of pollution control revenue bonds in June 1980 to fund the costs of pollution control equipment for Units 4 and 5 at the Four Corners Generating Station.

The Company's five-year construction budget for the period 1981 to 1985 provides for the expenditure of approximately \$1,077 million, including allowance for funds used during construction of \$161 million. Included in this total amount are proposed expenditures during the five-year period of approximately \$72 million for PNM's share of nuclear fuel for the Palo Verde Nuclear Generating Station. In addition, the Company forecasts expenditures of \$100 million by its wholly-owned subsidiaries, Paragon Resources, Inc. and Sunbelt Mining Company, Inc. Construction expenditures for the years 1981 and 1982 are estimated at \$372 million and \$325 million, respectively, and were approximately \$284 million in 1980.

External capital requirements for 1981 to 1985 are estimated to be approximately \$633 million, including approximately \$316 million for 1981.

In order to meet 1981 requirements and reduce short-term debt, the Company proposes to sell approximately \$173 million of common stock, \$60 million of first mortgage bonds, and \$25 million of preferred stock, depending on market conditions and other factors, and also to utilize \$120 million of proceeds from pollution control financings.

RATES AND REGULATIONS

As an electric and water utility operating in the state of New Mexico, PNM is subject to the jurisdiction of the New Mexico Public Service Commission (Commission). Many activities of the Company are regulated by the Commission, including rates, quality of service, issuance of securities, and permitting for generation and transmission construction. The Federal Energy Regulatory Commission (FERC) has jurisdiction over rates charged by PNM for electricity sold for resale and various accounting and reporting procedures.

Since mid-1975, rates under the jurisdiction of the Commission have been adjusted using Cost of Service Indexing. This method was applied to approximately 75 percent of PNM's equity investment in 1980. Indexing provides for recovery of operating costs for generating and distributing electricity based on the most recent calendar year. As originally designed, rates under jurisdiction of the Commission were adjusted quarterly when return on average common equity fell below or exceeded a band of 13.5 percent to 14.5 percent. Today, adjustments are made annually when the return on year-end common equity varies from the allowed 15.5 percent.

On April 16, 1980, the Commission issued an order approving a stipulation allowing an \$11 million increase in retail rates. This increase was based on operating results for the calendar year 1979. This boost in rates reflected the increased cost of providing electric service as well as certain changes made by the Commission in the Cost of Service Index calculation. In early 1981, PNM filed an updated Cost of Service Index factor applicable for the year based on 1980 operating results. The Company anticipates that the 1981 fac-

become effective, subject to review, on March 1, 1981. The final decision will be reached by June 1981.

Toward the end of 1980, PNM achieved settlement with four supplemental wholesale power customers and the FERC staff on four of the outstanding rate proceedings with these customers. The settlement resulted in an increase of \$8 million in 1980 settlement rates over 1979 filed rates. This settlement has been approved by the FERC and will not include the 1980 rate cases pending for the City of Gallup, New Mexico. Hearings for the test year 1980 Gallup case are scheduled to begin in April 1981. Final FERC results on the earlier cases are pending.

A new rate case based upon forecasts of revenues and expenses for 1981 was filed in December 1980 for all five customers. The new case requests an additional \$13.9 million increased rates.

The Company has fuel adjustment clauses for both FERC and Commission jurisdictional rates which allow for pass-through of increased fuel costs. The adjustments apply to all rates. A revised Commission fuel adjustment clause is currently being reviewed. The greatest change would be the use of an estimated fuel expense on a quarterly basis rather than actual cost on a monthly basis.

ELECTRIC OPERATIONS

The Company holds 13 percent ownership of Units 4 and 5 of the Four Corners Generating Station, a 50 percent ownership of San Juan Units 1, 2, and 3, and 100 percent ownership of the gas- and oil-fired stations. The Prager, Santa Fe and Las Vegas stations are used primarily to meet peak loads.

In 1980, PNM's generating fuel was mostly coal, accounting for about 84 percent of total kilowatt-hours produced. Natural gas provided 15.9 percent and oil 0.1 percent. PNM forecasted generation requirements in 1981 are 82.8 percent coal, 16.6 percent natural gas and 0.6 percent oil.

The power produced by PNM comes from generating facilities as shown in the following table:

Location and Generating Station	PNM's Share of Capacity (MW)
Coal-fired Stations Near Farmington	
Four Corners Units 4 & 5	208
San Juan Units 1, 2 & 3	548
Gas- and Oil-fired Stations	
Albuquerque	
Person Station	96
Reeves Station	175
Prager Station	22
Santa Fe	
Santa Fe Station	11
Las Vegas	
Las Vegas Turbine	20
	<u>1,080</u>

PNM, through its operating divisions, provides electric service to about half the people in New Mexico. The Albuquerque Division service area includes roughly a third of the population of the entire state. The Belen and Bernalillo divisions serve the rapidly growing areas south and north of Albuquerque. The Santa Fe Division serves the state capital and surrounding communities. The Las Vegas Division serves Las Vegas in north-central New Mexico. The Deming Division service area lies in the extreme southern portion of the state, just north of the Mexican border. The Western Division serves a portion of the uranium and coal-mining areas west of Albuquerque.

In addition to the operating divisions, PNM-generated electricity is purchased by several other utilities, both publicly and privately owned, for distribution to their customers within the state.

Total system requirements in 1980, including sales to wholesale customers, were 5,683,373 megawatt-hours, an increase of 8.8 percent over 1979. Total peak demand in 1980 was 913 megawatts. This was an increase of 6.8 percent over 1979. The forecasted peak demand for the summer of 1981 is 997 megawatts. To supply this peak demand and maintain an adequate reserve margin for contingencies, PNM will have a total installed capacity of 1,080 megawatts and ready capacity of 1,047 megawatts. The Company also has contractually arranged to purchase an additional 190 megawatts of capacity. This provides a total resource capacity of 1,237 megawatts.

WATER OPERATIONS

Under the terms of the recently negotiated franchise with the City of Santa Fe, water service will now be available in certain areas outside the city limits. The new Metropolitan Water Board will play a lead role in determining those new service area boundaries as well as studying long-range source of supply and other water policy matters. The new Service Expansion Policy prompted franchise negotiations with the County of Santa Fe, and during 1980 those negotiations were successfully completed.

The Las Vegas Division is proceeding with a review of various methods of increasing the water supply to the community. The decision concerning what methods will be used to incorporate this supply will be made in the near future.

SUBSIDIARIES

PNM has an interest in three subsidiaries: Paragon Resources, Inc., Sunbelt Mining Company, Inc. and Western Coal Co.

Paragon Resources, Inc. is a wholly-owned subsidiary, principally engaged in the acquisition of water rights and property for the Company's various projects and business-related needs. Chief among these needs are future generating plant sites and water for both the Company's water systems and future use at generating plants.

Sunbelt Mining Company, Inc. began operation in 1980 on a limited basis. It holds coal leases and will provide supplemental fuel to the San Juan Generating Station. It is anticipated that Sunbelt will supply coal to the proposed New Mexico Station and, in addition, will mine coal for sale to others.

Western Coal Co. adopted a plan of liquidation in December 1980. All of its coal processing equipment was subsequently sold to San Juan Coal Company, a wholly-owned subsidiary of Utah International, Inc., for approximately \$25 million.

The surface coal leases adjacent to the San Juan plant were subleased to Utah. As part of the transaction, San Juan Coal Company contracted to provide coal to San Juan Generating Station under a 37-year fuel supply contract.

"The use of Cost of Service Indexing... has demonstrated the extent to which risk can be minimized in utility operations... Indexing saved our customers millions of dollars through reduced cost of capital."

As we begin the 1980s, we find

ourselves facing some of the familiar financial challenges with which we wrestled in the 1970s. In the forefront, of course, is inflation along with the ability to earn the full cost of borrowed capital. While these themes remain the same, our response, as well as the environment in which we are operating, is changing. This means new opportunities and the need for new financial strategies to achieve our corporate mission.

During the past several years, our main concern was raising the capital necessary to fund our very heavy construction program. There were times when PNM was the fastest

growing utility in the nation in terms of increasing capitalization. We are clearly in the top group today. The raising of capital in cost-effective ways has been paramount to us, and we have been successful chiefly because of the financial strength we have achieved under our unique indexing format for rates and through the efforts of our employees working to solve the complex problems facing PNM.

The use of Cost of Service Indexing during recent years has demonstrated the extent to which risk can be minimized in utility operations. Because investors loan on risk premiums, indexing saved our customers millions of dollars through reduced cost of capital. Equally important, indexing allowed PNM to maintain its AA/Aa first mortgage bond rating. This financial strength gave PNM access to financial markets which at times were unavailable to most of the utility industry.

If we take this experience of lowering risk and project it into the 1980s, our next logical step is to improve profitability of PNM by diversifying our risks over more activities. If



A.J. Robinson
Vice President, Finance

PNM's financial risk can continue to be reduced, the Company's owners and ratepayers will benefit.

A.J. Robinson
Vice President, Finance

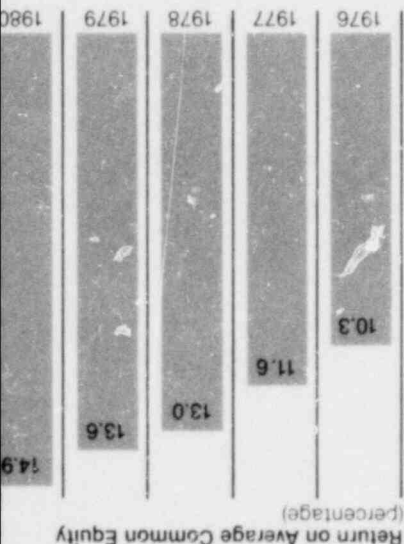
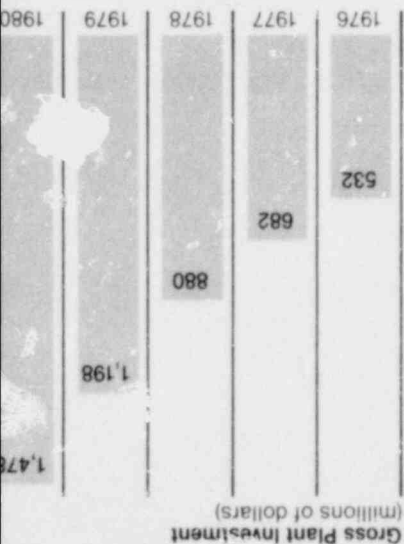
In Revenue Planning, we are addressing today a different environment than we have known in the

past. The first change is in the number of responses now required of PNM by our regulators. We have about twice as many reporting and filing requirements this year as we had last year. Much of this is the result of the National Energy Act.

The second major change is that all regulatory cases today are more sophisticated than they were a few years ago. When you combine increased complexity and increased frequency of filing, the problems can be staggering. We are working very hard to manage the process and simplify it where we can.

An example is our posture with the Federal Energy Regulatory Commission (FERC), which has jurisdiction over our rates for wholesale customers. Over the past few years, we have litigated a number of new-rate issues at the FERC. This was

done to protect the Company in its changing environment and maintain a healthy, contemporary rate-making posture. As a result, we are now in a position where we do not have to litigate every issue.



Another major area we are addressing is our rate design concepts. We are now participating in New Mexico hearings to shift our rate design from an imbedded or historical cost basis to a marginal cost basis. The new rate designs will more correctly reflect the actual cost of providing additional service without over-collecting revenues while providing proper price signals to our customers. These rates will then work in harmony with our load management efforts.

L. Yaryan
Manager, Revenue Planning

Because of the significant economic pressures PNM felt during its recent growth period, we were forced to innovate programs to enhance the company's financial performance. We basically rethought the whole concept of financing. We were successful, and today as a company, we are much better off.

During the past few years, we are experiencing operating ratios in the range of 55.1 percent to 55.5 percent; that is, the ratio of fuel, purchased power, operation and maintenance expenses to total operating revenues. In mid-1979 we established a Cost Reduction Task Force, which represented all areas of the Company, to investigate ways of reducing expenditures. As a result of these activities, we were able to reduce the 1980 operating ratio from 61 percent to about 54 percent. If we not reduced our operating ratio, PNM's return on equity for 1980 would have been about 14.4 percent rather than approximately 19 percent.

In the planning area, we have developed the ability to look into the future with some very sophisticated computer models. These include distribution planning models used in the Company's operating divisions to make long-range predictions about system requirements, resource utilization models to optimize our generation plans, load and energy econometric and end-use models as well as corporate financial modeling systems. These capabilities allow management to make good decisions about circumstances that are going to arise not only in the short-term but also out into the 10- to 20-year time horizon.

I think it is important from the stockholders' perspective to recognize that we have some financial objectives that are specifically related to them. These include maintaining financial performance levels of return on equity that are adequate for those stockholders, achieving good quality of earnings, coverage ratios that allow us to maintain protection for our bondholders and to maintain the AA/Aa rating. We are working toward achieving a market-to-book ratio of at least one.

M. A. Clifton
Manager, Financial Planning

Inflation, and the resulting high cost of capital, has created financing problems which heretofore had never been experienced. As a result, companies like PNM have had to adapt to new ideas to finance the growth in assets required to meet the ever-increasing demands of its market.

This has been especially true in the working capital finance area. It was not too long ago that a bank prime rate of over 10 percent was tantamount to economic chaos. Today, we hope to see the prime rate once more drop to 10 percent. This drastic rise in interest rates experienced in 1980 resulted in tremendous increases in the costs of financing construction projects.

Because of the large cash flow requirements generated by PNM's construction program (we expect to spend around \$30 million per month in 1981), cash management has quickly risen in importance. In 1980, it cost PNM approximately 13¢ to finance every dollar in the bank. By initiating good cash management procedures, such as zero balance accounts, we have been able to hold the cost of bank balances to a minimum.

To minimize the impact of borrowing short-term, we have expanded our efforts in daily cash flow forecasting. Through a better understanding of our cash needs, we have eliminated unnecessary borrowing and implemented a more aggressive program of investing of cash. We have also expanded our source of borrowings. PNM has entered into borrowing arrangements which open up a number of money market sources of funds, such as Bankers Acceptances, Commercial Paper or Federal Funds. The multiple sources increase our availability of funds and allow us to borrow in whichever market has the lowest prevailing interest rate.

M. J. Marzec
Director
Working Capital Finance

"The pressure from increased customer demands and the economy have spurred us to find new opportunities for service."

My business is people. As Vice President of Division Operations, I am the corporate link between PNM and our customers. I am responsible for the six operating divisions which provide electricity to about half the state's population, plus the water operations in Santa Fe and Las Vegas.

Thus, our operating divisions are charged with providing quality service to our customers. But the world is changing, and what was quality service yesterday may not be perceived that way today.

We are seeing more and more groups raising new customer demands and we are experiencing more governmental regulations in all areas of our operations. Usually, this is not a major problem because one of our main goals is to anticipate and plan for impending regulations and customer demands.

A case in point is the "Consumer Bill of Rights" issued by our state Public Service Commission. At the time the order was adopted, PNM already was in 90 percent to 95 percent compliance. We were doing what the regulators required before the order was written. And we were providing these services not because someone outside PNM insisted we do them but because we felt it was the proper thing to do.

Overall, I think we will be seeing in the 1980s an expansion of the concept of service. Customer information needs regarding electric or water bills and energy in general are growing; even the technology of customer service is growing. Because of the increased number of PNM customers, more advanced systems are being put in place to manage customer information for our billing department. This last factor also means we have to pursue better ways of managing our work force in terms of productivity and



efficiency. We have a Work Force Management program in effect now to help us manage that change and growth.

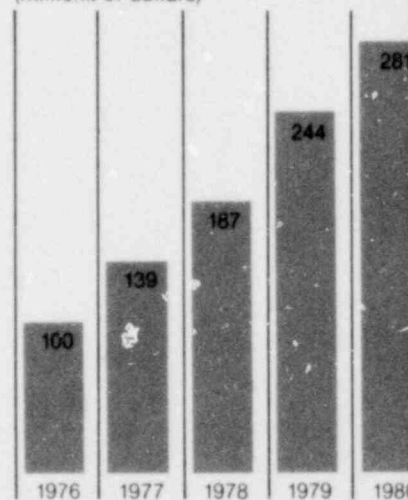
Thus far, we have succeeded in providing high-quality service to both our electric and water customers. The demands will grow in the future and the job will become more complex. The pressure from increased customer demands and the economy have spurred us to find new opportunities for service. In this regard, my job is made easier because of the exceptional managers who work with me.

J. P. Bundrant
Vice President
Division Operations

As the number of PNM customers has grown in recent years, we have been pressed to come up with a better way to process customer information in order to provide quality service. Our Customer Service System Project is one answer to this problem. This \$3.6 million computerized customer accounting system replaces our present system which, while it was state of the art 15 years ago, can no longer accommodate the growing number of customer data required.



Total Operating Revenues
(millions of dollars)



The new system automates a great deal of manual work plus provides for customer service employees with instant and complete billing information for each of our customers. This means our customer service people can handle more telephone calls more quickly, thus increasing their efficiency. For our customers it means they can get the information they want faster and they deal with only one person at PNM.

This Customer Service System project is just one of several programs we are pursuing to provide better services. It is important to remember that the notion of customer service is a dynamic one. Soon as one problem is solved, it involves into something else. The world of customer information needs and demands changes constantly. It is our job to keep up with those changes.

R. Stone
Operations Manager

Improving the management of our work force and our people has grown in importance in recent years. These improvements affect not only customer service but all aspects of PNM. As a result of a total Company Management Audit we commissioned in 1977, we have created a Work Force Management Program designed to help us identify a methodology for determining when a unit of work should be done, how

long it should take, and measuring the results. This program allows us to make adjustments and reach a higher level of utilization of the day-to-day work force.

In addition, our concept of service is expanding in other areas. Working with New Mexico State University, we have a wind power project in Deming which we hope will eventually be a cost-effective alternative for ranchers and farmers. Through our many solar energy projects around the state, we are getting good data on passive and active systems as well as water heating. I think that in the not-too-distant future, PNM will be using some of these energy sources that today are called "exotic." Ten years ago, we were not even thinking about wind power, solar energy, geothermal, and pumped storage; today, PNM has an exciting array of programs in these areas.

R. A. Lake
District Vice President
Belen, Bernalillo and Deming Divisions

A consistent theme emerges in the day-to-day management and operations of PNM: uncertainty. Change is occurring (as it always has), but at a much faster rate than ever before. When economic conditions, human and natural resource constraints, regulatory constraints, customer expectations and, of course, expectations and desires of our employees change at such a rapidly increasing rate, our daily working environment becomes heavily influenced by uncertainty. The future has become a rapidly moving target of unknown destination.

As a result of these conditions, our ultimate challenge is not just to manage the change, but to deal with the uncertainty introduced by rapid change. Many of the programs already discussed and underway at PNM are attempts to address this. These programs not only tell us how we do, they also contain predictive elements that enable us to look ahead and minimize some of the uncertainty.

Those of us who serve today must strive to identify the expectations that will be placed upon our successors, and by doing so, help ensure a company responsive to the expectations of the communities we serve. Fortunately, we are blessed with people whose dedication, vision and leadership have positioned the Company to meet this challenge.

J. T. Ackerman
District Vice President
Albuquerque and Western Area

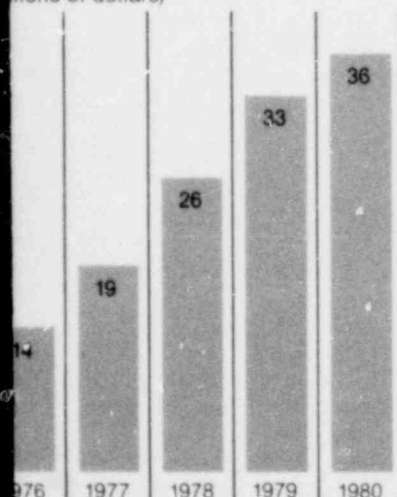
I think our challenges in the water business are essentially the same as the electric business, but in some cases more intense. An obvious difference is that water is more of a necessity than electricity. Customers are more willing to cut down on electricity than water. In the 1970s there were significant price increases for water, with a resulting price elasticity for the first 25 percent or 30 percent of the demand.

Because of the semiarid climate of New Mexico, the source of water supply is a major concern. In Santa Fe and Las Vegas, we had been using water that was replenishable every year from the snowfall and rain in the mountains. We have now gone beyond the capacity of river systems to supply the total needs. Water now has to be pumped out of wells in Santa Fe and Las Vegas. The cost of doing that is much greater than the cost of the water we used before.

P. R. Gamertsfelder
District Vice President
Santa Fe and Las Vegas

W. M. Hicks, Jr.
Manager
Water Operations, Santa Fe

General, State, Local and General Taxes
(in millions of dollars)



"Meeting PNM's manpower needs in energy generation and the managing of advanced dispatch systems is my first priority in the 1980s."

In recent years we have seen growth in complexity of power plant operations and dispatch systems. The power plants are becoming more computer directed and, in the case of coal plants, more sophisticated pollution control equipment has gone into operation. Dispatch systems, too, are undergoing a similar trend in complexity. We are now installing a computerized system called the Energy Management System which will allow us to monitor and control more precisely our overall generation and transmission system.

Beyond providing reliable and economic service to our customers, these growth trends mean the increasing need for highly skilled plant operators, craftsmen and technicians. Meeting PNM's manpower needs in energy generation and the managing of advanced dispatch systems is my first priority in the 1980s.

As Vice President of Operations, my other major priority is fuel. In this regard, PNM is in an enviable position; in 1975 about 55 percent of our total requirements were met with coal; in 1980 this figure grew to about 84 percent. PNM is a coal-firer! utility operating in a state with enormous coal reserves. Thus, unlike utilities which have to transport coal to their plants at significant cost, we can build and operate mine-mouth plants. This is the case with Four Corners, San Juan and the proposed New Mexico Generating Station.

In the long-term, we expect PNM's fuel mix to continue to be dominated by coal, with the addition of nuclear energy from the Palo Verde Nuclear Generating Station, geothermal energy, hydro by way of the Pumped Storage Project, and possibly gas from coal gasification proj-



ects. As technology and economic conditions dictate, we will continue to pursue fuel operations in many areas, trying to take advantage of the enormous energy resources of New Mexico.

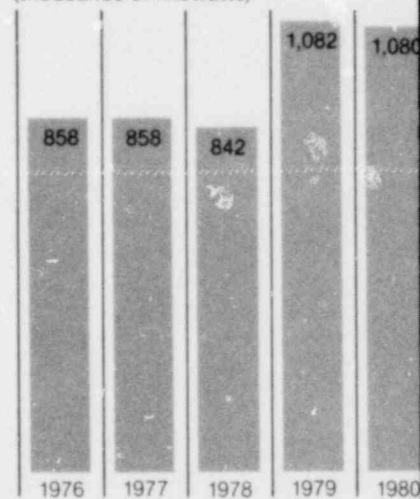
R. Mullins
Vice President, Operations

As Mr. Mullins mentioned, PNM is primarily a coal-fired utility. But we still use the natural gas- and oil-fired plants for mid-range and peaking purposes. To give you some idea of the difference in fuel costs, in 1980 we paid an average of about \$2.45 per million Btu for natural gas and about \$4.25 per million Btu for residual fuel oil. In contrast, our coal cost about 79¢ per million Btu. Very quickly you have the basic picture of the tremendous benefits realizable from coal.

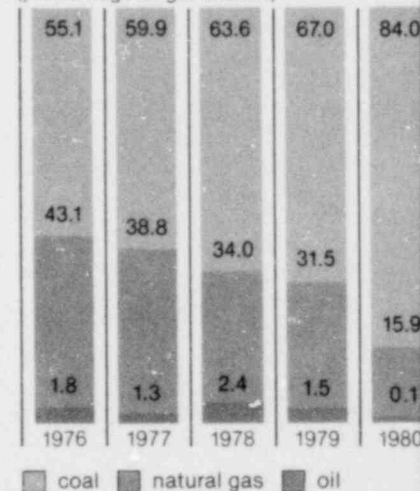
Furthermore, the Power Plant and Industrial Fuel Use Act mandates a cutoff in the use of natural gas as a boiler fuel by 1990. However, there are exemptions. For instance, if gas-fired units are used for mid-range or peaking and their retirement dates are in the 1990s, natural gas can still be used after the legislated cutoff date. Our natural gas and oil plants clearly fall within these exemptions.



Net Generating Capability
(thousands of kilowatts)



Generation Mix
(percentage of generation)



A point to remember, particularly when speaking of natural gas and oil, is that we are moving into a transition stage where other fuel sources will gain ascendancy. Granted, we will need coal and nuclear energy for base-loaded generation. But under such legislation as the Synfuels Bill, we can expect to see growth in areas like coal gasification and liquefaction, shale oils and tar sands. The economics presently do not exist for development of these resources but we will see that change in the 1980s.

**Schanning
Supervisor
Operations Administration**

With the growth of coal as PNM's major fuel source, certain opportunities have arisen in the use of our natural gas- and oil-fired power plants. Recently we completed a study which indicated that if we cycled these older plants, PNM could save more than \$100 million in fuel costs over the remaining life of the units. Cycling means that we bring our gas and oil plants into service every morning and shut them down at night. In this way, the units become mid-range and peaking facilities. Of course, there is a price tag for cycling. These older units were designed for base loading which means that they were designed to be put on-line and run at their full capacity continuously. They were normally brought down once a year for maintenance. Cycling has put additional stresses on the units that they were not designed to handle. To compensate for these additional stresses, we have started a maintenance program that is much more aggressive than normal operations call for. The resulting fuel savings more than cover the cost of the program. Besides cycling, there is another opportunity that could be realized in these plants. Due to the large quantities of oil being burned by other utilities in the West, there is an opportunity to sell electricity

generated from PNM's gas-fired plants. Natural gas may not be as cheap as coal but it is cheaper than oil. Assuming transmission paths are available, we can make money for PNM's ratepayers and stockholders and help people in other states save on the high cost of burning oil.

**T. Merse
Manager, Gas and Oil Plants**

My area of responsibility is the operation of PNM's bulk transmission system. As PNM's generation facilities have grown in size and complexity, so too has the bulk transmission system operation. To keep pace, we have computerized our operations to monitor our own system and the array of transmission interties we have with many other western utilities.

We will have our third generation of system dispatch computers in-service this summer. Called the Energy Management System, this computer system will allow us a continuous review of what is happening on our bulk transmission system. It also gives us better and faster control over dispatching our generating units. That is, we go to our most economical generating units first, such as coal, and then load other units into the system following the most economic criterion.

Through the use of new computer systems, we have economic opportunities that were unavailable to us in the past. For example, PNM is participating in a computerized energy brokerage system. With this system, we are able to increase our exposure to more economic purchases or sales. This may mean that we are buying cheaper power from another utility or we are selling power and making money for PNM. Either way, our customers benefit.

**R. Lowry
Manager, Power Operations**

"This sharing of resources is not only beneficial to our customers and shareholders, but also helps achieve our national goal of reduced dependency on foreign oil."

As Vice President of Administration, my responsibilities range widely over the corporation. They include System Planning, Load Management and Forecasting, Resource Development, Environmental Affairs, Procurement and Contracting, Information Systems, and Methods Analysis. All of these areas interact on Company projects and activities. In fact, such interactive processes are part of the strength of PNM.

As a function of Resource Development, PNM conducts and supports RD&D. We have been very active in research over the years, and expect new solutions to some problems to come out of this area. For instance, we and the other participating utilities in the Western Energy and Supply Transmission Associates have an elaborate network in the Southwest to measure solar insolation. There are more than 50 monitoring stations in this program. We have participated in many other solar research projects as well, mostly in demonstrations of technology. Wind is another area in which we have taken the initiative. We have several monitoring stations to measure how much of the resource is actually available in our service territory.

The Baca Geothermal Project is demonstration of a new technology on a much larger scale. PNM's share of the power plant is about \$20 million to \$25 million, and the total project cost is about five times that amount. The contracts we arranged among Union Geothermal of New Mexico, the Department of Energy (DOE) and PNM called for the construction of a geothermal unit which would produce energy at a cost comparable to that produced by a base load coal-fired unit built in the same time frame.

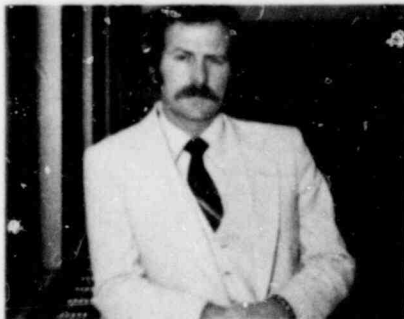
These research projects tend to originate from our planning process. In this process, we begin with a load



forecast. We take econometric variables into consideration. What is the population growth going to be in the service area? What is the competing fuel going to cost? What rate of growth in income is expected? We look at a broader range of load alternatives than just a single estimate. That way, we design our system so that we can reasonably meet a higher forecast but not have our customers paying for excess capacity if the forecast load is not actually that high.

Looking to the future, I expect there will be much tighter interconnection with all the utilities in the United States within five years. Presently there are substantial quantities of oil being burned on the West Coast. We ship that region as much coal energy as possible to displace oil, but we are constrained by the lack of transmission capacity. Such regional utilization of coal-fired electricity can materially reduce the total amount of imported oil consumed. This sharing of resources is not only beneficial to our customers and shareholders, but also helps achieve our national goal of reduced dependency on foreign oil. I expect to see more resource sharing in the future.

C.D. Bedford
Vice President, Administration



PNM's load forecast is constantly shifting. In the last few years, we have seen softening of load growth from what we expected. Changes in the economic picture require that we devise a planning envelope. After the explicit forecast is developed, we create a high and low around that forecast, based on our view of how economic parameters may shift. In this way, we anticipate the contingency that the forecast envelope may be this high or that low.

Only a short time ago, load forecasting was relatively straightforward. The utility industry had a good understanding of how the load was going to grow and how to meet it. Then came 1973 and the era of the oil embargo. Some parts of the country had negative growth. But PNM, after a momentary lull, picked up and had substantial growth from 1975 to 1978. With double-digit inflation and the uncertainty surrounding the uranium industry, in 1980 PNM experienced slower load growth than anticipated, although its load growth is above the national average.

PNM is required by law to provide electric service to our customers. Once we make a decision to build and funds are committed to a project, it is pretty hard to turn that around. It is our position that it is prudent to go ahead and build the facilities as long as there is a market for that surplus capacity when the plant comes in-service. Studies show that insufficient capacity is far more costly than excess capacity.

W.C. Wygant
Group Manager
Planning and Resources

R.C. Cainski
Manager, System Planning

Unless there are major changes in the National Environmental Policy Act (NEPA), we anticipate a continuing need for extensive environmental work. And this work must be done early in the project planning process. For instance, we have been doing environmental work for four years on the potential

the New Mexico Generating Station site. The plant is not scheduled for completion for 10 more years. Because of the many regulatory requirements, the Company is put in a position where it has to spend considerable money and energy to maintain project options or flexibility.

This long process explains why we have an extensive environmental affairs staff. With such people, PNM is a resource of substantial skills that it can draw upon as a project changes. If the site changes, for example, we have the ability to inform the engineers very quickly how that change impacts the plant and the approval process. Such responsiveness saves time and money. Having a skilled staff gives PNM additional flexibility other companies may not have.

We expect that the 1980s will see a balance among the environmental, engineering and economic issues. While environmental issues will still be considered important, they will be viewed in conjunction with other issues, specifically, the state of the economy. The pendulum will swing more toward the middle. Not many laws will be taken off the books, but they will be made more workable or more practical.

D. Kist
Manager, Environmental Affairs

R. Rodney
Supervisor
Environmental Sciences

Load management is defined as the changes to real or projected demands for electric energy requirements. When load management is effective, it alters the way people consume electricity in a way beneficial to customers and PNM. For customers, load management means a savings in dollars, and for PNM, it means more efficient use of its resources.

For example, if we invested \$1000 in a coal plant, we would like to have that coal plant run full time, even during off-peak periods. Economically, there is no sense in shutting the coal unit down when its variable costs are relatively inexpensive. By the same token, PNM wants to defer the use of electricity during peak periods to off-peak periods

when electricity costs about one-quarter as much to produce.

Load management can also provide a more reliable system when one considers options such as direct load control of end uses. This includes uses that can be deferred for a number of hours without any customer inconvenience and that have inherent storage capabilities. Electric water heating is an example. If a major generating station suddenly broke down, under direct load control PNM could flip a few switches to turn off nonessential uses, protecting its system from an outage or blackout.

Basically, the primary emphasis in achieving load management is to provide our customers with a price incentive to defer or modify their consumption behavior. PNM is currently in a rate hearing in which we are proposing the use of time-of-day rates. These rates could provide our customers with a price incentive that could lead to cost-effective load management.

D. Peck
Director, Load Management

The biggest problem we have in providing data processing service for PNM is forecasting data processing needs for the timely upgrading of computer capacity. We have to predict a demand in order to have computer capacity available when needed.

One of the strategies that we have recently adopted to meet the growing demand for electronic information processing service is acquiring predeveloped systems of packaged software. We try to match these systems as closely as possible to PNM's requirements in order to save developmental costs.

In 1980, we increased our computer capacity by 40 percent, the minimum needed to meet growth in data processing requirements for PNM.

In our Information Systems Division, we are rapidly adopting advanced computer hardware and software strategies which will be required to support the Company's growth expected in future years. Major emphasis has been placed on

state-of-the-art data base and data communications strategies to support the increasing requirements for rapid information retrieval and analysis for decision making and productivity improvement.

R. L. Barber
Manager
Information Systems Division

For its size, PNM is possibly the most active utility in the RD&D area. Our research, development and demonstration program is based on both internal and external research activities. The internal program is directed very specifically toward PNM's needs. The principal method of external research is through the Electric Power Research Institute (EPRI), which tailors its programs to national needs.

PNM is active in EPRI's utility advisory structure. The advisors determine what research will be undertaken and evaluate potential projects for benefit to the industry. PNM also has selective research and development programs with the Department of Energy (DOE). In 1980, we were awarded \$2.7 million for an underground coal gasification feasibility study. In previous years, we have done some large solar power generation studies for DOE.

Additionally, in the solar energy field, we have several projects underway. One example, now in the data monitoring phase, is the EPRI-SHAC (solar heating and cooling) solar home project. The goal of this multi-million dollar program is to assess how utilities and solar homes should be interfaced and integrated to the optimum benefit of the solar customer and the utility's other customers. Another solar study is a power plant project in which we are acting as the lead utility in the operation of a small solar plant to be built at Sandia Laboratories, Albuquerque. This will be among the first hands-on utility experience with solar generation of electricity.

D. J. Groves
Resource Analysis Supervisor

"But the world is changing and the way of doing business is constantly evolving... We have to control and manage the change... and direct it where it will do the most good for our customers and shareholders."

In recent years, we have seen tremendous growth in New Mexico, and we expect that trend to continue. With growth has come changes in how we do business and how we seek opportunities as a corporation. As Senior Vice President of PNM, I am charged with acquiring future resources for generation and other projects. This means water, fuel and land resources. But because water rights, for instance, can be maintained only if they are used, we have been led into farming and ranching. These kinds of businesses are managed by our wholly-owned subsidiary, Paragon Resources, Inc.

Another of our subsidiaries is Sunbelt Mining Company, Inc. Its main function relates to future fuel needs of the parent company. However, Sunbelt is aggressively pursuing other mineral-related opportunities as well. We fully expect Sunbelt to be involved in mining beyond the immediate needs of PNM's power plants. We anticipate a number of coal opportunities in New Mexico in the coming years, such as coal-fired power and gasification plants.

PNM's subsidiaries will expand their operations in the years to come, providing the Company with opportunities that we can only guess at today. The business environment in which we are operating is becoming more complex and more difficult. The trend is toward more regulation, not less, and economic uncertainty will be with us for years. Through subsidiaries, the parent company has the flexibility to adapt to change more quickly, benefiting our customers and investors.



Some people find the whole notion of subsidiaries confusing, particularly when the parent company is a utility. But the world is changing and the way of doing business is constantly evolving. For us to maintain quality service and enhance the financial integrity of the corporation, we have to control and manage the change that is occurring and direct it where it will do the most good for our customers and shareholders.

R.B. Rountree

Senior Vice President, PNM

President

Paragon Resources, Inc.,

Sunbelt Mining Company, Inc.,

and Western Coal Co.

While holding land and water resources for possible future use by PNM, Paragon is engaged in extensive cattle ranching and farming activities. Our major crops are alfalfa, pinto beans, potatoes and small grains.

While the 1960s and 1970s were difficult years for the farmer and rancher, prices of farm products rose sharply across the board in 1980. This was partially due to the 1980 drought but, I feel, more importantly, due to increased world demand of United States' agriculture products.



see this trend continuing into the future. There may be instances where oversupply can be a problem, but the overall supply and demand situation is projected to result in higher farm prices into the 1980s.

The competitive nature of agriculture has forced us to strive for high yields and quality at low cost.

Nature is very unforgiving and does not tolerate mistakes. If we are going to be successful in agriculture, or any competitive venture, we must consistently achieve a high-quality product or service at competitive costs.

Other areas Paragon is involved in include construction, building maintenance and property management.

In addition to these ongoing operations, Paragon is always alert and searching for opportunities to increase growth and profitability. Thorough screening of these opportunities is critical to our future success, and that is being done. I am confident that we will select one or several of the dozens of opportunities that are being reviewed, with the effect that we can achieve greater growth and profitability.

G. Frank
Vice President
Paragon Resources, Inc.

Sunbelt Mining Company's first objective is to provide a mining and energy fuel supply service. Through development of the De-Na-Zin Mine and establishment of Sunbelt's trucking operations, we have taken the first step in meeting this objective. Production of crushed stone for use in facilities construction is an additional service business in which we are involved.

Probably the most exciting thing about Sunbelt is our charter to seek new business opportunities and to develop those opportunities into profitable operations. It clearly is our responsibility as a management team to channel Sunbelt's business objectives into areas that can most effectively utilize our past surface mining experience in New Mexico.

Aside from the development of San Juan Basin coal resources which we currently have under our jurisdiction, we are looking for ways to employ our engineering and production expertise in the surrounding Rocky Mountain states as well as New Mexico. Our principal search is for energy-related resources that might be amenable to development for PNM. However, we are also looking for nonenergy resources that might be required for power production in the future, such as limestone, sand, gravel and even salt.

Because we depend on regulatory agencies from all levels of government, Sunbelt has to continue to build bridges of understanding with them. We are sharing information, such as drill logs or cores used in mining but which are also valuable in paleontological research. We also work with governmental agencies on wildlife and archaeological research. This is the collaborative approach, a mutual benefit approach. We stand our ground when we need to, but we also work well with groups and agencies.

Although small, Sunbelt's staff has a full range of capability in mineral exploration, mining engineering, environmental quality control, marketing and mining operations. With the dedication and resourcefulness of our people, I am confident that Sunbelt Mining Company has a bright future that will contribute significantly to PNM's earnings for many years to come.

C. E. Hunter
Vice President
Sunbelt Mining Company, Inc.

DIRECTORS AND OFFICERS

Board of Directors

A.B. Collins, Jr.*

President, Reddy
Communications, Inc.,
Greenwich, Connecticut

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

D.W. Reeves**

Chairman of the Executive
Committee of the Board of
Directors, Public Service Company
of New Mexico

R.R. Rehder*

Professor of Management,
Robert O. Anderson Graduate
School of Management,
University of New Mexico
Albuquerque, New Mexico

G.A. Schreiber**

Chairman of the Board of Directors
Public Service Company
of New Mexico

R.H. Stephens*

Stephens-Irish Agency
Las Vegas, New Mexico

E.R. Wood

President, Santa Fe Motor Company
Santa Fe, New Mexico

*Members of the Audit Committee

**Members of the Executive
Committee

Officers

J.D. Geist

President

R.B. Rountree

Senior Vice President

C.D. Bedford

Vice President, Administration

J.P. Bundrant

Vice President, Division Operations

B.D. Lackey

Controller

R.F. Mershon

Vice President, Industrial Relations

J.B. Mulcock, Jr.

Vice President, Public Affairs

R. Mullins

Vice President, Operations

D.E. Peckham

Secretary and Assistant Treasurer

A.J. Robison

Vice President, Finance

P.J. Archibeck

Treasurer and Assistant Secretary

J.L. Wilkins

Vice President, Engineering
and Construction

B.P. Lopez

Assistant Secretary

H.L. Hitchins, Jr.

Assistant Secretary and
Assistant Treasurer

J.T. Ackerman

District Vice President,
Albuquerque and Western Area

P.R. Gamertsfelder

District Vice President,
Santa Fe and Las Vegas

F.E. Gray

Vice President, Urban Development

R.A. Lake

District Vice President, Belen,
Bernalillo and Deming Divisions

W.A. Badsgard

Western Division Manager

L.C. Edwards

Bernalillo Division Manager

E.L. Fogleman

Las Vegas Division Manager

R.H. Hallford

Deming Division Manager

W.M. Hicks, Jr.

Manager, Water Operations, Santa Fe

J.L. Smith

Belen Division Manager

Executive Offices

Alvarado Square
Albuquerque, New Mexico

Transfer Agents

Albuquerque National Bank
Albuquerque, New Mexico

Chemical Bank, New York, New York

Registrars

First National Bank in Albuquerque
Albuquerque, New Mexico

Chemical Bank, New York, New York

COMPARATIVE OPERATING STATISTICS

	1980	1979	1978	1977	1976
Electric Service					
Energy Sales—kWhr (in thousands)					
Residential	1,090,003	1,067,755	1,000,564	957,390	916,748
Commercial	1,441,634	1,403,282	1,353,805	1,320,651	1,277,025
Industrial	859,178	858,533	797,314	686,845	643,559
Other ultimate customers	167,070	159,396	164,901	160,922	157,694
Total sales to ultimate customers	3,557,885	3,488,966	3,316,584	3,125,808	2,957,026
Sales for resale	1,844,213	1,471,485	1,211,242	1,241,195	638,207
Total energy sales	5,402,098	4,960,451	4,527,826	4,367,003	3,595,233
Electric Revenues (in thousands)					
Residential	\$ 72,596	\$ 66,262	\$ 51,414	\$ 39,547	\$ 32,423
Commercial	85,480	77,806	50,125	45,520	36,198
Industrial	44,524	40,467	28,860	18,918	13,070
Other ultimate customers	9,750	8,704	7,052	5,215	4,168
Total revenue from ultimate customers	212,350	193,239	147,451	109,200	85,859
Sales for resale	59,475	44,000	32,568	23,219	9,340
Total revenue from energy sales	271,825	237,239	180,019	132,419	95,199
Miscellaneous electric revenues	2,598	2,532	2,581	2,505	1,935
Total electric revenue	\$ 274,423	\$ 239,771	\$ 182,600	\$ 135,024	\$ 97,134
Customers at Year End					
Residential	191,495	184,979	175,439	164,803	156,116
Commercial	20,932	20,334	19,496	18,374	17,483
Industrial	466	485	482	493	489
Other	264	264	263	265	250
Total ultimate customers	213,157	206,062	195,680	183,935	174,338
Sales for resale	6	5	5	5	5
Total customers	213,163	206,067	195,685	183,940	174,343
Reliable net capability—kW	1,080,000	1,082,000	842,000	858,000	858,000
Coincidental peak demand—kW	913,000	855,000	809,000	715,000	633,000
Average fuel cost per million BTU	109.61¢	120.72¢	105.52¢	92.74¢	61.83¢
BTU per kWhr of net generation	10,551	10,746	10,993	11,004	11,084
Water Service					
Sales—Gallons (in thousands)					
	2,699,816	2,515,815	2,753,122	2,731,801	2,963,223
Revenues (in thousands)					
	\$ 6,093	\$ 4,599	\$ 4,605	\$ 3,612	\$ 2,389
Customers at Year End					
	19,303	18,755	18,079	17,427	16,838

SELECTED FINANCIAL DATA

	1980	1979	1978	1977	1976
	(In thousands except per share amounts and ratios)				
Operating revenues:					
As reported	\$ 280,516	\$ 244,370	\$ 187,205	\$ 138,636	\$ 99,521
In average 1980 dollars	\$ 280,516	\$ 277,417	\$ 236,449	\$ 188,514	\$ 144,060
Net earnings:					
As reported	\$ 71,436	\$ 54,803	\$ 37,464	\$ 24,921	\$ 17,357
In average 1980 dollars:					
Adjusted for general inflation*	\$ 54,303	\$ 51,110			
Adjusted for changes in specific prices*	\$ 53,639	\$ 49,632			
Net earnings per common share:					
As reported	\$ 3.36	\$ 2.97	\$ 2.83	\$ 2.46	\$ 2.10
In average 1980 dollars:					
Adjusted for general inflation*	\$ 2.29	\$ 2.59			
Adjusted for changes in specific prices*	\$ 2.25	\$ 2.49			
Total assets	\$1,458,412	\$1,186,426	\$888,747	\$664,449	\$498,948
Net assets at net recoverable cost:					
As reported	\$ 487,525	\$ 453,328	\$ 382,289	\$ 271,448	\$ 214,371
In average 1980 dollars	\$ 465,099	\$ 486,652	\$ 482,850	\$ 369,109	\$ 310,300
Preferred stock with mandatory redemption requirements	\$ 90,000	\$ 40,000	—	—	—
Long-term debt, less current maturities	\$ 567,190	\$ 431,655	\$ 356,347	\$ 244,720	\$ 178,431
Common stock data:					
Cash dividends declared per common share:					
As reported	\$ 2.04	\$ 1.88	\$ 1.72	\$ 1.61	\$ 1.44
In average 1980 dollars	\$ 2.04	\$ 2.13	\$ 2.17	\$ 2.19	\$ 2.00
Market price per common share at year end:					
As reported	\$ 19.75	\$ 13.25	\$ 19.87	\$ 21.50	\$ 24.00
In average 1980 dollars	\$ 18.84	\$ 19.59	\$ 24.18	\$ 28.51	\$ 33.90
Dividend pay-out ratio	60.7%	63.3%	60.8%	65.4%	65.7%
Book value per common share at year end	\$ 23.36	\$ 22.26	\$ 21.85	\$ 21.61	\$ 21.00
Average number of common shares outstanding	15,933	14,363	10,289	7,569	6,100
Return on average common equity	14.9%	13.6%	13.0%	11.6%	10.3%
Excess of increase in general price level over increase in specific prices after reduction to net recoverable cost*	\$ 121,508	\$ 116,265			
Gain from decline in purchasing power of net amounts owed*	\$ 87,092	\$ 72,531			
Average consumer price index	246.8	217.4	195.4	181.5	176.0

* See page 34 for discussion of Supplementary Information on Changing Prices.

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

Liquidity and Capital Resources

The Company's five-year construction budget for the period 1981-1985 provides for the expenditure of approximately \$1,077 million including allowance for funds used during construction (AFUDC) of \$161 million. In addition, the Company forecasts expenditures of \$100 million by the Company's wholly-owned subsidiaries, Paragon Resources, Inc., Sunbelt Mining Company, Inc. The Company's construction expenditures for the years 1981 and 1982 are estimated at \$372 million and \$325 million, respectively, and were approximately \$284 million in 1980.

The Company conducts a continuing review of its construction program, and such program and the above estimates are subject to periodic revisions based upon changes in assumptions as to system load growth, rates of inflation, the availability and timing of environmental and other regulatory approvals and the availability and costs of outside sources of capital. The Company has in the past revised its construction budget in light of such factors and may effect further revisions in the future.

The construction program which will be necessary to meet prospective customer service requirements will require substantial external capital. The cost and availability of such additional capital may be adversely affected unless revenues and net earnings can be maintained at levels which will attract capital on a favorable basis, and may be dependent upon conditions prevailing in the financial markets.

In order to meet its external capital needs in 1980 of approximately \$233 million, the Company sold 500,000 shares of cumulative preferred stock, realizing therefrom approximately \$50 million, issued \$78 million principal amount of first mortgage bonds, drew down approximately \$58 million from pollution control revenue bond financings, raised \$14 million in equity capital through PNM's special stock plans, and utilized proceeds from the sale of commercial paper as well as short-term borrowings.

The Company currently estimates its external capital requirements for the 1981-1985 period to be approximately \$800 million, including approximately \$316 million for 1981. In order to meet such 1981 requirements and reduce short-term debt, the Company proposes to sell approximately \$173 million of common stock, \$60 million of first mortgage bonds and \$25 million of cumulative preferred stock, depending on market conditions and other factors, and also use \$120 million of proceeds from pollution control financings.

Results of Operations

Electric revenues increased \$47.6 million in 1978, \$57.2 million in 1979 and \$34.6 million in 1980. The principal factors contributing to these increases are as follows:

	1980	1979	1978
	(In thousands)		
Increase in electric revenues due to:			
Increased kWhr sales (a)	\$13,915	\$14,660	\$ 4,584
Increased base rates (b)	27,711	27,597	29,912
Increased (decreased) fuel cost adjustment factor (c)	(7,039)	14,963	13,104
	<u>\$34,587</u>	<u>\$57,220</u>	<u>\$47,600</u>

(a) kWhr sales—the number of customers increased in each period while the kWhr sales increased 3.7% in 1978, 4.1% in 1979 and 8.9% in 1980.

(b) Base rates—the Company bills most customers under a Cost-of-Service Index Order based upon the jurisdictional return on common equity. The Index Order, formerly a quarterly adjustment, was revised to provide for annual adjustments to base rates effective May 15, 1979. These rates are subject to the jurisdiction of the New Mexico Public Service Commission (Commission). The Company has periodically negotiated higher rates with certain other customers, whose rates being subject to the jurisdiction of the Federal Energy Regulatory Commission.

(c) Fuel cost adjustment factor—during 1978 and 1979 the increased costs of fuels used for generation were passed on to the customers, increasing revenues during the respective periods. During 1980, the Company utilized coal, a less expensive fuel, for a greater proportion of its generation, reducing fuel cost adjustment revenues during this period.

Operation and maintenance expenses increased \$27.3 million in 1978, \$30.7 million in 1979 and \$16.8 million in 1980. Principal causes are:

(a) Production of energy from the Company's own generating units decreased 14.3% in 1978, increased 16.3% in 1979 and increased 16.6% in 1980. A boiler explosion causing the shutdown of the first unit at the San Juan Generating Station in July of 1977 and the return to service of the unit in May 1978, coupled with the purchase of lower-cost energy on the interchange market rather than generating from the Company's gas and oil-fired units, resulted in the Company being a net purchaser of 957 million kWhr in 1978. The growth in kWhr sales in 1979 over 1978 resulted in the Company being a net purchaser of 752 million kWhr for the year. The third San Juan unit, providing the Company with 240 megawatts of coal-fired capacity, became operational in December 1979. This added generating capacity, coupled with increased plant efficiency, resulted in the Company being a net purchaser of 471 million kWhr in 1980, a decrease of approximately 281 million kWhr from 1979.

(b) Fuel costs—increased generation and rapidly rising fuel costs.

(c) Higher cost of labor and related benefits due to higher wage rates and an increase in the number of employees necessary to operate the expanded electric generating and water facilities.

(d) General inflationary factors.

(e) Maintenance and repair expenses increased by \$3.0 million in 1978, \$1.9 million in 1979 and \$6.1 million in 1980. Overhauls and inspections at Las Vegas, Person Station, Four Corners Generating Station, and the San Juan Generating Station accounted for increased costs of \$2.4 million in 1978, \$1.3 million in 1979 and \$5.5 million in 1980.

The Company's gross utility plant increased by approximately 29% in 1978, 36% in 1979 and 23% in 1980 as a result of expanded operations, the need to maintain reliable service, and increasing environmental protection requirements. In addition, the Company purchased the fifty-percent undivided interest of Tucson Electric Power Company in San Juan Unit 4 in 1979. 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, primarily franchise and ad valorem taxes.

(c) AFUDC—increased construction at the San Juan Generating Station and Palo Verde Nuclear Generating Station and increased AFUDC rates ordered by the Commission.

(d) Interest charges and preferred stock dividend requirements—from December 31, 1977 through December 31, 1980 the Company has issued \$160 million principal amount of First Mortgage Bonds, utilized \$169 million principal amount of Pollution Control Revenue Bonds and issued \$116 million of preferred stock, generally at higher rates than previous issues, and had up to \$130 million principal amount of short-term debt outstanding.

As a result of items detailed above, earnings before income taxes, income taxes, net earnings and earnings per share of common stock all increased in 1978, 1979 and 1980.

See page 34 for discussion of Supplementary Information on Changing Prices.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The management of Public Service Company of New Mexico is responsible for the preparation and presentation of accompanying financial statements. The financial statements have been prepared in conformity with generally accepted accounting principles and include amounts that are based on informed estimates and judgments of management. Management maintains a system of internal accounting controls which it believes is adequate to provide reasonable assurance that assets are safeguarded, transactions are executed in accordance with management authorization, and the financial records are reliable for preparing the financial statements. The system of internal accounting controls is supported by written policies and procedures, a staff of internal auditors who conduct comprehensive internal audits, and the selection and training of qualified personnel.

The Board of Directors, through its Audit Committee comprised entirely of outside directors, meets periodically with management, internal auditors, and the Company's independent public accountants to discuss auditing, internal control and financial reporting matters. To ensure the auditors' independence, both the internal auditors and independent public accountants have full and free access to the Audit Committee.

The independent auditors, Peat, Marwick, Mitchell & Co., are engaged to examine the Company's financial statements in accordance with generally accepted auditing standards.

ACCOUNTANTS' REPORT

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

We have examined the consolidated balance sheet of Public Service Company of New Mexico and subsidiaries as of December 31, 1980 and 1979 and the related consolidated statements of earnings, capitalization and changes in financial position for each of the years in the three-year period ended December 31, 1980. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and 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 subsidiaries at December 31, 1980 and 1979 and the results of their operations and changes in their financial position for each of the years in the three-year period ended December 31, 1980, in conformity with generally accepted accounting principles applied on a consistent basis.

PEAT, MARWICK, MITCHELL & CO.

Albuquerque, New Mexico
January 9, 1981

CONSOLIDATED BALANCE SHEET

Assets

	December 31,	
	1980	1979
	(In thousands)	
Utility plant, at original cost (notes 4 and 8):		
Electric plant in service	\$ 743,837	\$ 712,311
Water plant in service	33,535	31,177
Common plant in service	18,643	17,611
	<u>796,015</u>	<u>761,102</u>
Less accumulated depreciation and amortization	152,102	127,633
	<u>643,913</u>	<u>633,469</u>
Construction work in progress	680,603	435,126
Electric plant held for future use	1,126	1,069
Net utility plant	<u>1,325,642</u>	<u>1,069,264</u>
Other property and investments:		
Non-utility property, at cost, net of accumulated depreciation of \$1,340,000 in 1980 and \$757,000 in 1979	33,588	17,603
Investment in fifty-percent-owned company	3,099	6,126
Other, at cost	2,738	1,069
Total other property and investments	<u>39,425</u>	<u>24,798</u>
Current assets:		
Cash (note 5)	6,012	3,126
Receivables:		
Customers	29,794	23,131
Other	5,320	13,603
Allowance for doubtful receivables	(192)	(603)
Fuel, materials and supplies, at average cost	26,353	22,131
Prepaid expenses	2,220	2,131
Deferred fuel costs	8,536	11,603
Total current assets	<u>78,043</u>	<u>76,287</u>
Deferred charges	<u>15,302</u>	<u>14,603</u>
	<u>\$1,458,412</u>	<u>\$1,186,264</u>

See accompanying notes to consolidated financial statements.

Capitalization and Liabilities

	December 31,	
	1980	1979
	(In thousands)	
Capitalization:		
Common stock equity (note 2):		
Common stock of \$5 par value. Authorized 40,000,000 shares; outstanding 16,330,304 shares in 1980 and 15,601,739 shares in 1979	\$ 81,652	\$ 78,009
Additional paid-in capital	195,026	185,600
Retained earnings	104,847	83,719
Total common stock equity	381,525	347,328
Cumulative preferred stock. Authorized 10,000,000 shares (note 3):		
Without mandatory redemption requirements.		
Outstanding 860,000 shares of \$100 stated value and 800,000 shares of \$25 stated value	106,000	106,000
With mandatory redemption requirements.		
Outstanding 900,000 shares in 1980 and 400,000 shares in 1979 of \$100 stated value	90,000	40,000
Long-term debt, less current maturities (note 4)	567,190	431,655
Total capitalization	1,144,715	924,983
Current liabilities:		
Short-term debt (note 5)	129,355	95,960
Accounts payable	49,836	51,695
Preferred dividends declared	4,712	2,869
Current maturities of long-term debt (note 4)	1,487	5,224
Accrued interest	10,456	5,577
Accrued taxes	7,141	9,418
Other current liabilities	5,645	4,220
Total current liabilities	208,632	174,963
Deferred credits:		
Cumulated deferred investment tax credits (note 6)	62,991	47,896
Cumulated deferred income taxes (note 6)	25,756	22,529
Other deferred credits	16,318	16,075
Total deferred credits	105,065	86,500
Commitments and contingencies (notes 8, 9 and 11)		
	<u>\$1,458,412</u>	<u>\$1,186,446</u>

CONSOLIDATED STATEMENT OF EARNINGS

	Year ended December 31,		
	1980	1979	1978
	(In thousands except per share amounts)		
Operating revenues:			
Electric (note 10)	\$274,423	\$239,771	\$182,000
Water	6,093	4,599	4,600
Total operating revenues	280,516	244,370	187,200
Operating expenses:			
Fuel and purchased power	84,125	85,143	62,600
Other operation expenses	46,017	34,351	28,000
Maintenance and repairs	21,201	15,045	13,100
Provision for depreciation and amortization	25,003	17,603	14,400
Taxes, other than income taxes	12,299	10,531	8,200
Income taxes (note 6)	20,073	21,881	16,700
Total operating expenses	208,718	184,554	143,200
Operating income	71,798	59,816	43,900
Other income and deductions:			
Allowance for equity funds used during construction	27,236	15,594	10,500
Equity in earnings of fifty-percent-owned company, net of taxes (note 6)	2,953	2,151	1,400
Other, net of taxes (note 6)	385	250	700
Net other income and deductions	30,574	17,995	12,700
Income before interest charges	102,372	77,811	56,700
Interest charges:			
Interest on long-term debt	29,012	24,236	21,300
Other interest charges	12,771	4,696	2,000
Allowance for borrowed funds used during construction	(10,847)	(5,924)	(4,000)
Net interest charges	30,936	23,008	19,200
Net earnings	71,436	54,803	37,500
Preferred stock dividend requirements	17,834	12,196	8,300
Net earnings applicable to common stock	\$ 53,602	\$ 42,607	\$ 29,200
Average number of common shares outstanding	15,933	14,363	10,200
Per share amounts:			
Net earnings	\$ 3.36	\$ 2.97	\$ 2.86
Dividends	\$ 2.04	\$ 1.88	\$ 1.88

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CAPITALIZATION

	1980	Year ended December 31,				1978
		1979				
		(In thousands)				
Common stock equity:						
Common stock:						
Balance at beginning of year	\$ 78,009		\$ 63,211		\$ 44,287	
Issuance of common stock	<u>3,643</u>		<u>14,798</u>		<u>18,924</u>	
Balance at end of year	<u>81,652</u>		<u>78,009</u>		<u>63,211</u>	
Additional paid-in capital:						
Balance at beginning of year	185,600		145,433		90,947	
Premium on common stock issued	10,120		42,466		57,241	
Expenses of stock issuance	<u>(694)</u>		<u>(2,299)</u>		<u>(2,755)</u>	
Balance at end of year	<u>195,026</u>		<u>185,600</u>		<u>145,433</u>	
Retained earnings:						
Balance at beginning of year	83,719		67,645		56,213	
Net earnings	<u>71,436</u>		<u>54,803</u>		<u>37,464</u>	
	<u>155,155</u>		<u>122,448</u>		<u>93,677</u>	
Cash dividends:						
Cumulative preferred stock	17,834		12,196		8,383	
Common stock	<u>32,474</u>		<u>26,533</u>		<u>17,649</u>	
	<u>50,308</u>		<u>38,729</u>		<u>26,032</u>	
Balance at end of year	<u>104,847</u>		<u>83,719</u>		<u>67,645</u>	
Total common stock equity	<u>381,525</u>	33.3%	<u>347,328</u>	37.5%	<u>276,289</u>	37.4%
Cumulative preferred stock:						
Without mandatory redemption requirements:						
Balance at beginning of year	106,000		106,000		80,000	
Issuance of preferred stock	<u>—</u>		<u>—</u>		<u>26,000</u>	
Balance at end of year	<u>106,000</u>	9.3	<u>106,000</u>	11.5	<u>106,000</u>	14.4
With mandatory redemption requirements:						
Balance at beginning of year	40,000		—		—	
Issuance of preferred stock	<u>50,000</u>		<u>40,000</u>		<u>—</u>	
Balance at end of year	<u>90,000</u>	7.9	<u>40,000</u>	4.3	<u>—</u>	—
Long-term debt, less current maturities:						
Balance at beginning of year	431,655		356,347		244,721	
Addition to long-term debt	137,837		82,763		114,561	
Reduction of long-term debt	<u>(2,284)</u>		<u>(6,544)</u>		<u>(2,305)</u>	
Net change in unamortized discount and premium	<u>(18)</u>		<u>(911)</u>		<u>(630)</u>	
Balance at end of year	<u>567,190</u>	49.5	<u>431,655</u>	46.7	<u>356,347</u>	48.2
Total capitalization at end of year	<u>\$1,144,715</u>	100.0%	<u>\$924,983</u>	100.0%	<u>\$738,636</u>	100.0%
Number of shares issued:						
\$100 stated value cumulative preferred stock	<u>500</u>		<u>400</u>		<u>260</u>	
Common stock	<u>729</u>		<u>2,960</u>		<u>3,785</u>	

accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year ended December 31,		
	1980	1979	1978
	(in thousands)		
Funds provided:			
Net earnings	\$ 71,436	\$ 54,803	\$ 37,400
Charges (credits) to earnings not requiring funds:			
Depreciation and amortization	26,889	19,128	15,500
Provision for noncurrent deferred income taxes, net	3,227	4,549	1,500
Investment tax credit, net	15,095	11,672	10,300
Allowance for equity funds used during construction	(27,236)	(15,594)	(10,500)
Undistributed earnings of fifty-percent-owned company	(6,856)	(2,216)	(1,000)
Funds derived from operations	82,555	72,342	52,200
Sale of first mortgage bonds	78,000	17,000	65,000
Sale of cumulative preferred stock	50,000	40,000	26,000
Proceeds from pollution control revenue bonds	57,942	62,166	48,800
Sale of common stock	13,763	57,264	76,000
Proceeds from other long-term debt	1,895	3,597	—
Proceeds from short-term debt	308,834	290,315	142,200
Dividends from fifty-percent-owned company	9,868	—	—
Decrease in deferred charges	—	12,405	—
Utility plant retirements, net of removal costs	141	14,137	8,000
Decrease in working capital other than short-term debt	—	8,154	—
Other	311	6,113	4,000
	<u>\$603,309</u>	<u>\$583,493</u>	<u>\$416,200</u>
Funds used:			
Cash dividends	\$ 50,308	\$ 38,729	\$ 26,000
Utility plant additions	254,805	308,526	189,300
Payment of short-term debt	275,439	218,160	168,300
Reduction of long-term debt	2,284	6,544	2,300
Additions to non-utility property	16,749	8,157	—
Increase in deferred charges	966	—	22,300
Increase in working capital other than short-term debt	1,121	—	4,300
Other	1,637	3,377	3,300
	<u>\$603,309</u>	<u>\$583,493</u>	<u>\$416,200</u>
Changes in working capital other than short-term debt:			
Cash	\$ 2,202	\$ 1,881	\$ (3,700)
Receivables	(2,481)	443	15,300
Fuel, materials and supplies	4,280	6,058	1,800
Prepaid expenses	180	924	(1,000)
Deferred fuel costs	(2,786)	(553)	4,700
Accounts payable	1,859	(8,623)	(9,800)
Preferred dividends declared	(1,843)	(875)	(9,800)
Current maturities of long-term debt	3,737	(4,035)	—
Accrued interest	(4,879)	(1,153)	(8,000)
Accrued taxes	2,277	(2,227)	(3,000)
Other current liabilities	(1,425)	6	6,000
Increase (decrease) in working capital other than short-term debt	<u>\$ 1,121</u>	<u>\$ (8,154)</u>	<u>\$ 4,300</u>

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1980, 1979 and 1978

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 (Commission). As a result of the rate-making process, 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 items 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 subsidiaries, Paria Resources, Inc. and Sunbelt Mining Company, Inc. 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.

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

Depreciation

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

	1980	1979	1978
Electric plant	3.36%	3.62%	3.39%
Water plant	1.94%	1.88%	1.89%
Common plant	<u>7.36%</u>	<u>7.13%</u>	<u>5.89%</u>

The provision for depreciation and amortization of certain equipment, including amortization applicable to capital assets, 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 by the straight-line method.

Allowance for Funds Used During Construction (AFUDC)

In accordance with the uniform system of accounts, AFUDC, a non-cash item, is charged to utility plant. AFUDC represents the cost of borrowed funds (allowance for borrowed funds used during construction) and a return on other funds (allowance for equity funds used during construction). The Commission, which has primary rate-making jurisdiction over the Company, has limited AFUDC to electric generation construction, including pollution control devices and water plant construction. The allowance is charged to other construction projects to the extent they pertain to projects subject to FERC jurisdiction.

The AFUDC was computed using rates of 6 1/2 percent until May 15, 1979 and 7 1/2 percent from then until December 31, 1979 and was allocated between borrowed funds and equity funds based on the method required by FERC. Beginning January 1, 1980 AFUDC was computed using the maximum rate, net of taxes, permitted by FERC which was 8.65 percent for 1980. The Commission also ordered the Company to record additional AFUDC in 1980 representing a recalculation of 1979 AFUDC based on the maximum rate allowed by FERC. The effect of this adjustment was not significant.

Capitalized Interest

The Company capitalizes interest costs on non-utility property in compliance with Financial Accounting Standards Board Statement No. 34. Interest capitalized amounted to \$2,003,000 in 1980 and \$626,000 in 1979.

Investment in Fifty-Percent-Owned Company

The Company's investment in a fifty-percent-owned company is stated at equity. The co-owner, Tucson Electric Power Company, is participating with the Company in the construction and operation of a steam turbo-electric generating plant described in note (8). Prior to December 1, 1980, the generating plant utilized coal from properties of the fifty-percent-owned company as a source of fuel. Effective December 1, 1980, the coal supply for the generating plant was restructured with an unrelated supplier. The fifty-percent-owned company has adopted a plan of liquidation.

Deferred Fuel Costs

The Company uses the deferral 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 income taxes, to the extent of the sum of the additional investment tax credits which would have been realized if taxes payable had been based on pretax accounting income adjusted for permanent differences and the existing net deferred tax credits which would reverse during the investment tax credit carryforward period.

Income Taxes

Certain revenue and expense items in the Consolidated Statement of Earnings are recorded in a year different from the year in which they are recorded for income tax purposes. Deferred income taxes are provided on these timing differences to the extent allowed for rate-making purposes. This normalization method is used primarily for differences attributable to deferred fuel costs, the use of liberalized depreciation methods and different lives under the asset depreciation range (ADR) than under the guideline depreciation provisions. Certain other differences result in a reduction in income tax expense in the current year. This flow-through method is used primarily for differences between tax depreciation computed under the guideline life provisions and book depreciation and certain capitalized construction costs, principally AFUDC, deducted currently for income tax purposes.

At present, rates applicable to certain customers subject to FERC control allow recovery of amounts necessary to provide additional tax normalization of the items described above which are accounted for under the flow-through method for other customers. Provision has been made for additional deferred income taxes attributable to amounts collected under these rates.

Revenues

Revenues are recognized based on cycle billings rendered to customers monthly. The Company does not accrue revenues for services provided but not billed at the end of a fiscal period.

Pension Plan

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

(2) Common Stock Equity

The Board of Directors has reserved 2,700,000 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 1,200,847 shares remained unissued at December 31, 1980.

Charter provisions relating to the cumulative 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, 1980, there were no retained earnings restricted under such provisions.

Cumulative Preferred Stock

Information concerning the cumulative preferred stock is as follows:

Series	Stated Value	Shares Outstanding	Aggregate Stated Value (In thousands)	Stated Redemption Price (a)
Without mandatory redemption requirements:				
1965 Series, 4.58%	\$100	130,000	\$ 13,000	\$102.516
1974 Series, 9.2%	100	170,000	17,000	107.00
1975 Series, 10.12%	100	100,000	10,000	107.00
9.16% Series (b)	25	800,000	20,000	27.29
8.48% Series (b)	100	200,000	20,000	108.48
8.80% Series (b)	100	260,000	26,000	108.80
		<u>1,660,000</u>	<u>\$196,000</u>	
With mandatory redemption requirements:				
8.75% Series (b) (c)	100	400,000	\$ 40,000	108.75
14.75% Series (b) (c)	<u>100</u>	<u>500,000</u>	<u>50,000</u>	<u>114.75</u>
		<u>900,000</u>	<u>\$ 90,000</u>	

The cumulative preferred stock may be redeemed by the Company, upon thirty days notice thereof, at stated redemption prices (plus accrued and unpaid dividends). Redemption prices are at reduced premiums in future years.

Redemption may not be made through certain refunding operation prior to June 1, 1981 for the 9.16% Series, April 1, 1982 for the 8.48% Series, April 1, 1983 for the 8.80% Series, February 1, 1984 for the 8.75% Series, or April 1, 1990 for the 14.75% Series.

Beginning in 1984 for the 8.75% Series and 1986 for the 14.75% Series, the Company must annually redeem 13,000 and 20,000 shares, respectively, at a price of \$100 per share plus accrued and unpaid dividends.

Long-Term Debt

The details of the Company's outstanding long-term debt including unamortized discount and premium, less current maturities, are as follows:

Issue and Maturity	Interest Rates	1980	1979
(In thousands)			
Mortgage Bonds:			
1981 through 1985	3 5/8% to 12.95%	\$ 55,171	\$ 5,241
1986 through 1990	4 3/8%	8,470	8,580
1991 through 1995	4 7/8%	9,762	9,880
1996 through 2000	5 7/8% to 7 1/4%	31,876	32,197
2001 through 2005	7 1/2% to 10 1/8%	107,239	79,781
2006 through 2010	8 1/8% to 9%	94,355	94,323
2000 through 2010 - pollution control series, securing pollution control revenue bonds	6% to 8 1/8%	300,014	274,061
Funds held by trustee		<u>(121,717)</u>	<u>(153,660)</u>
Total first mortgage bonds		485,170	350,403
Pollution control revenue bonds, due 1984	5% to 7.6%	77,000	77,000
		<u>5,020</u>	<u>4,252</u>
Total long-term debt		<u>\$ 567,190</u>	<u>\$ 431,655</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 (in thousands) of maturities on all long-term debt outstanding at December 31, 1980 are as follows:

1981	\$ 1,487
1982	5,566
1983	2,887
1984	4,992
1985	<u>52,479</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 7.6% Pollution Control Revenue Bonds and 5% Pollution Control Revenue 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.

(5) 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 or to pay fees in lieu of such balances. Compensating balances are generally equal to 20 percent of the outstanding indebtedness or 10 percent of the lines of credit at such banks, whichever is greater. Details of the Company's short-term debt at December 31, 1980, 1979 and 1978 and for the years then ended are as follows:

	1980	1979	1978
		(In thousands)	
Aggregate short-term debt outstanding:			
Notes payable to banks	\$79,575	\$37,250	\$ 4,000
Commercial paper	\$49,780	\$58,710	\$19,000
Average interest rate on outstanding debt:			
Notes payable to banks	18 3/8%	14 3/4%	11 1/2%
Commercial paper	18 3/8%	13 3/8%	10 1/2%
Maximum outstanding during year:			
Notes payable to banks	\$80,175	\$51,835	\$50,000
Commercial paper	\$67,825	\$58,710	\$37,000
Average outstanding during year:			
Notes payable to banks	\$31,092	\$ 8,747	\$10,000
Commercial paper	\$61,437	\$29,713	\$12,000
Weighted average stated interest rate on debt outstanding during year, computed using daily outstanding balances:			
Notes payable to banks	14 1/4%	12 5/8%	8 1/2%
Commercial paper	12 3/8%	11 1/2%	7 1/2%
Unused lines of credit (subject to cancellation at the banks' option)	\$76,878	\$60,140	\$53,000
Compensating balances at end of year	<u>\$ 3,193</u>	<u>\$ 1,956</u>	<u>\$</u>

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

Income Taxes

Income taxes consist of the following components:

	1980	1979	1978
		(In thousands)	
Current Federal income tax	\$ 4,185	\$ 3,864	\$ 1,609
Current state income tax	1,205	1,467	1,041
Deferred Federal income tax	2,347	3,583	2,130
Deferred state income tax	1,089	677	657
Amount equivalent to current investment tax credit	16,688	13,611	12,413
Amortization of accumulated investment tax credit	(1,802)	(742)	(527)
Total income taxes	<u>\$23,712</u>	<u>\$22,460</u>	<u>\$17,330</u>
Charged to operating expenses	<u>\$20,073</u>	<u>\$21,881</u>	<u>\$16,722</u>
Charged to other income and deductions	<u>3,639</u>	<u>579</u>	<u>608</u>
Total income taxes	<u>\$23,712</u>	<u>\$22,460</u>	<u>\$17,330</u>

The Company has investment tax credit carryforwards, for tax purposes, of approximately \$58,000,000 as of December 31, 1980 which will expire in 1986 and 1987. Of this amount, approximately \$21,954,000 has been recorded for financial statement purposes, as a reduction of deferred Federal income tax credits.

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

	1980	1979	1978
		(In thousands)	
Deferred fuel costs	\$ (1,353)	\$ (495)	\$ 2,396
Accelerated depreciation methods and asset class lives shorter than guideline lives	9,386	8,049	4,376
Other miscellaneous items	282	662	47
Investment tax credit carryforward	(4,879)	(3,956)	(4,032)
	<u>\$ 3,436</u>	<u>\$ 4,260</u>	<u>\$ 2,787</u>

The current portion of deferred income taxes (included in accrued taxes) results from timing differences on deferred costs. Such balances amounted to \$1,529,000 as of December 31, 1980 and \$1,688,000 as of December 31, 1979 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:

	1980	1979	1978
Federal income tax statutory rate	46.0%	46.0%	48.0%
Depreciation in excess of book depreciation caused by use of guideline depreciation provisions	(1.0)	(2.7)	(1.2)
Advance for funds used during construction, net of depreciation adjustments	(17.8)	(12.1)	(12.3)
Gain on employee benefits and taxes capitalized for financial statements, net of depreciation adjustments	(.6)	(.5)	(.7)
Amortization of investment tax credits	(1.9)	(1.0)	(1.0)
Other miscellaneous items	.2	(.6)	(1.2)
Company's effective income tax rate	<u>24.9%</u>	<u>29.1%</u>	<u>31.6%</u>

(7) Pension Plan

The Company and its subsidiaries have a pension plan covering substantially all of their 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 of service. The amount of such payments are dependent upon length of service and the average wage of the five most highly compensated consecutive years of employment.

The total pension expense was \$4,815,000 in 1980, \$3,058,000 in 1979 and \$2,807,000 in 1978 including amortization of past service cost over 30 years.

As of January 1, 1980, the most recent valuation date, accumulated plan benefits and plan net assets (in thousands) of the Company's defined benefit plan are as follows:

Actuarial present value of accumulated plan benefits:	
Vested	\$ 17,892
Nonvested	1,825
	<u>\$ 19,717</u>
Net assets available for benefit (market value)	<u>\$ 21,539</u>

The weighted average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was seven percent.

(8) Construction Program and Jointly-Owned Plants

The Company is participating with Tucson Electric Power Company in the construction of the steam turbo-electric San Juan Generating Station. The Company owns an undivided fifty-percent interest in the first three units of the station. The Company purchased Tucson's fifty-percent undivided interest in the fourth and final unit of the San Juan Station in 1979 and now owns all of such unit. In 1980, the Company entered into a Letter of Intent regarding the potential sale of a 10.6 percent undivided interest in San Juan Unit 4.

The Company is also participating with several other utilities in the construction of the Palo Verde Nuclear Generating Station with the first unit scheduled for completion in 1983.

It is estimated that the Company and its subsidiaries' construction expenditures for 1981 will approximate \$372,000,000 including expenditures on the jointly-owned projects. In connection, therewith, substantial commitments have been made.

Details of the Company's interest in jointly-owned plants at December 31, 1980 are as follows:

	Plant In Service	Accumulated Depreciation	Construction Work in Progress	Share of Total Plant
		(In thousands)		
San Juan Generating Station	\$407,165	\$40,649	\$335,411	65 %
Palo Verde Nuclear Generating Station	—	—	\$254,627	10.2 %
Four Corners Generating Station Units 4 and 5	<u>\$ 26,600</u>	<u>\$ 7,062</u>	<u>\$ 8,866</u>	<u>13 %</u>

These amounts represent the Company's share of capital costs, and the Company has provided its own financing. Company's share of direct expenses is included in the corresponding operating expenses in the Consolidated Statement of Earnings. The Company also has undivided interests in transmission facilities which are not significant.

Lease Commitments

The Company leases data processing, communication, office and other equipment, office space, utility poles (jointly owned) and real estate. Certain leases, primarily for data processing equipment, are capital leases. All other leases are operating leases.

Certain leases provide purchase options in the approximate amount of \$1,401,000 for data processing equipment and \$9,000 for construction equipment. The lease for an office building provides for a purchase option equal to fair market value at the end of the primary term of 35 years. Renewal options and contingent rental provisions were not significant.

Leased property under capital leases at December 31, 1980 and 1979 is as follows:

	1980	1979
	(In thousands)	
Data processing equipment	\$3,888	\$3,871
Other	543	232
	4,431	4,103
Accumulated amortization	2,209	1,550
	<u>\$2,222</u>	<u>\$2,553</u>

Future minimum lease payments at December 31, 1980 are:

	Capital Leases	Operating Leases
	(In thousands)	
1981	\$1,042	\$ 1,462
1982	941	1,310
1983	439	1,240
1984	349	2,075
1985	253	1,926
After years	234	56,671
Total minimum lease payments	3,258	<u>\$64,684</u>
Amount representing executory costs	270	
Total minimum lease payments	2,988	
Amount representing interest	579	
Present value of net minimum lease payments	<u>\$2,409</u>	

Rents charged to operating expenses were \$1,486,000 in 1980, \$1,277,000 in 1979 and \$1,091,000 in 1978. Such amounts exclude payments made on capital leases. Rents charged to utility plant were \$914,000 in 1980, \$236,000 in 1979 and \$577,000 in 1978.

Revenues Subject to Refund

The Company has collected revenues subject to refund since 1977 under wholesale rate cases filed with the FERC. In 1980 the Company and the FERC customers settled these rate cases, with the Company agreeing to refund approximately \$9.6 million plus interest. The Company recorded \$3.3 million as a provision for refund in 1979 and the refund was recorded in 1980.

(11) Subsequent Event

In January 1981 the Company's directors approved a plan of merger, whereby the electric utility business of New Mexico Electric Service Company (NMESC) will be merged into the Company. NMESC provides electric service to the southern portion of Lea County, New Mexico, including the communities of Hobbs, Jal and Eunice. The merger would involve the issuance of 562,500 shares of the Company's common stock in exchange for all of the common stock of NMESC. The Company would assume the long-term debt of NMESC. Consummation of the merger is contingent on the issuance of a ruling by the Internal Revenue Service that it will qualify as a tax-free reorganization and is also contingent on stockholder approvals and approvals by FERC and the Commission and on negotiation of formal agreements, including a fuel supply agreement for natural gas.

SUPPLEMENTARY INFORMATION ON CHANGING PRICES

The effect of changing prices upon the Company's operations is supplied in accordance with the requirements of the Financial Accounting Standards Board Statement No. 33. It should be viewed as an estimate of the approximate effect of inflation, rather than as a precise measure. Moreover, these effects of changing prices are not recognized for purposes of rate-making or income taxation.

For these presentations, "constant dollar" and "current cost" amounts were calculated by applying indices to historical or other amounts. In the case of constant dollars, the index was the Consumer Price Index for all Urban Consumers (CPI-U), which approximates the upward trend of prices in general during the indicated periods. In the case of current costs, the primary index was the Handy-Whitman Index of Public Utility Construction Costs, although CPI-U was used for construction work in progress.

Since the utility plant is not expected to be replaced in kind, current cost does not necessarily represent the replacement cost of the Company's production capacity.

Fuel inventories, the cost of fuel used in generation, and power purchased for resale have not been restated from their historical cost. Regulation limits the recovery of fuel through the operation of adjustment clauses. For this reason, fuel inventories are treated as monetary assets.

Cumulative preferred stock subject to mandatory redemption requirements is treated as a monetary item in calculating the gain from the decline in purchasing power of net amounts owed.

Depreciation is determined by applying the Company's composite depreciation rate to the indexed plant amounts.

As prescribed in Statement No. 33, income taxes were not adjusted. Accumulated deferred investment tax credits are treated as a monetary item since it is returned to customers through adjustments in rates.

Under the rate making prescribed by the regulatory commissions to which the Company is subject, only the historical cost of plant is recoverable in revenues as depreciation. Therefore, the excess of the cost of plant, stated in terms of constant dollars or current cost over the historical cost of plant, is not presently recoverable in rates as depreciation, and is reflected as a reduction to net recoverable cost. While the rate-making process gives no recognition to the current cost of replacing property, plant and equipment, the Company believes it will be allowed to earn on the increased cost of its net investment when replacement of facilities actually occurs.

To properly reflect the economics of rate regulation in the Statement of Earnings from Continuing Operations Adjusted for Changing Prices, the reduction of net property, plant and equipment should be offset by the gain from the decline in purchasing power of net amounts owed. During a period of inflation, holders of monetary assets suffer a loss of general purchasing power while holders of monetary liabilities experience a gain. The gain from the decline in purchasing power of net amounts owed is primarily attributable to the substantial amount of debt which has been used to finance property, plant and equipment. Since the depreciation on this plant is limited to the recovery of historical cost, the Company does not have the opportunity to realize a holding gain on debt and is limited to recovery only of the embedded cost of debt capital.

STATEMENT OF EARNINGS FROM CONTINUING OPERATIONS ADJUSTED FOR CHANGING PRICES

Year Ended December 31, 1980

	As Reported in the Primary Statement	Adjusted for General Inflation (Constant Dollars)	Adjusted for Changes in Specific Prices (Current Cost)
		(In thousands)	
Operating revenues	<u>\$280,516</u>	<u>\$ 280,516</u>	<u>\$ 280,516</u>
Cost of goods sold and purchased power	84,125	84,125	84,125
Other operation expenses	46,017	46,017	46,017
Maintenance and repairs	21,201	21,201	21,201
Depreciation and amortization	25,003	42,136	42,800
Expenses, other than income taxes	12,299	12,299	12,299
Income taxes	23,712	23,712	23,712
Interest charges	30,936	30,936	30,936
Other income and deductions—net	<u>(34,213)</u>	<u>(34,213)</u>	<u>(34,213)</u>
	<u>209,080</u>	<u>226,213</u>	<u>226,877</u>
Earnings from continuing operations (excluding reduction to net recoverable cost)	<u>\$ 71,436</u>	<u>\$ 54,303*</u>	<u>\$ 53,639</u>
Increase in current cost of property, plant and equipment held during the year			\$ 198,969
Reduction to net recoverable cost		\$(122,127)	(311,515)
Effect of increase in general price level			<u>(8,962)</u>
Excess of increase in general price level over increase in specific prices after reduction to net recoverable cost			(121,508)
Loss from decline in purchasing power of net amounts owed		<u>87,092</u>	<u>87,092</u>
		<u>\$ (35,035)</u>	<u>\$ (34,416)</u>

Including the reduction to net recoverable cost, the earnings (loss) from continuing operations on a constant dollar basis would have been \$(67,824) for 1980.

QUARTERLY RESULTS OF OPERATIONS

The unaudited results of operations (in thousands except per share amounts) by quarters for 1980 and 1979 are as follows:

Quarter Ended	Operating Revenues	Operating Income	Net Earnings	Net Earnings Per Share
December 31, 1980	\$74,386	\$18,429	\$18,104	\$.81
September 30, 1980	\$74,899	\$21,982	\$22,698	\$1.11
June 30, 1980	\$66,678	\$15,852	\$18,090	\$.84
March 31, 1980	\$64,553	\$15,535	\$12,544	\$.60
December 31, 1979	\$64,335	\$16,378	\$16,623	\$.87
September 30, 1979	\$66,725	\$18,998	\$16,661	\$.88
June 30, 1979	\$56,475	\$13,192	\$11,504	\$.61
March 31, 1979	\$56,835	\$11,248	\$10,015	\$.57

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

STOCK/DIVIDEND DATA

Common Stock:

Range of sales prices of the Company's common stock, on the New York Stock Exchange (Symbol: PNM), and dividends paid on common stock for fiscal 1980 and 1979, by quarters, are as follows:

	Range of Sales Prices		Dividends Per Share
	High	Low	
Fourth Quarter, 1980	20 1/4	17	\$0.52
Third Quarter, 1980	21 3/4	17 5/8	0.52
Second Quarter, 1980	20 3/4	16 1/2	0.52
First Quarter, 1980	18 1/2	15 1/4	0.48
Fiscal Year	21 3/4	15 1/4	<u>\$2.04</u>
Fourth Quarter, 1979	20 1/4	17 1/2	\$0.48
Third Quarter, 1979	21 1/2	17 3/8	0.48
Second Quarter, 1979	21 1/4	19	0.48
First Quarter, 1979	20 5/8	19 1/8	0.44
Fiscal Year	21 1/2	17 3/8	<u>\$1.88</u>

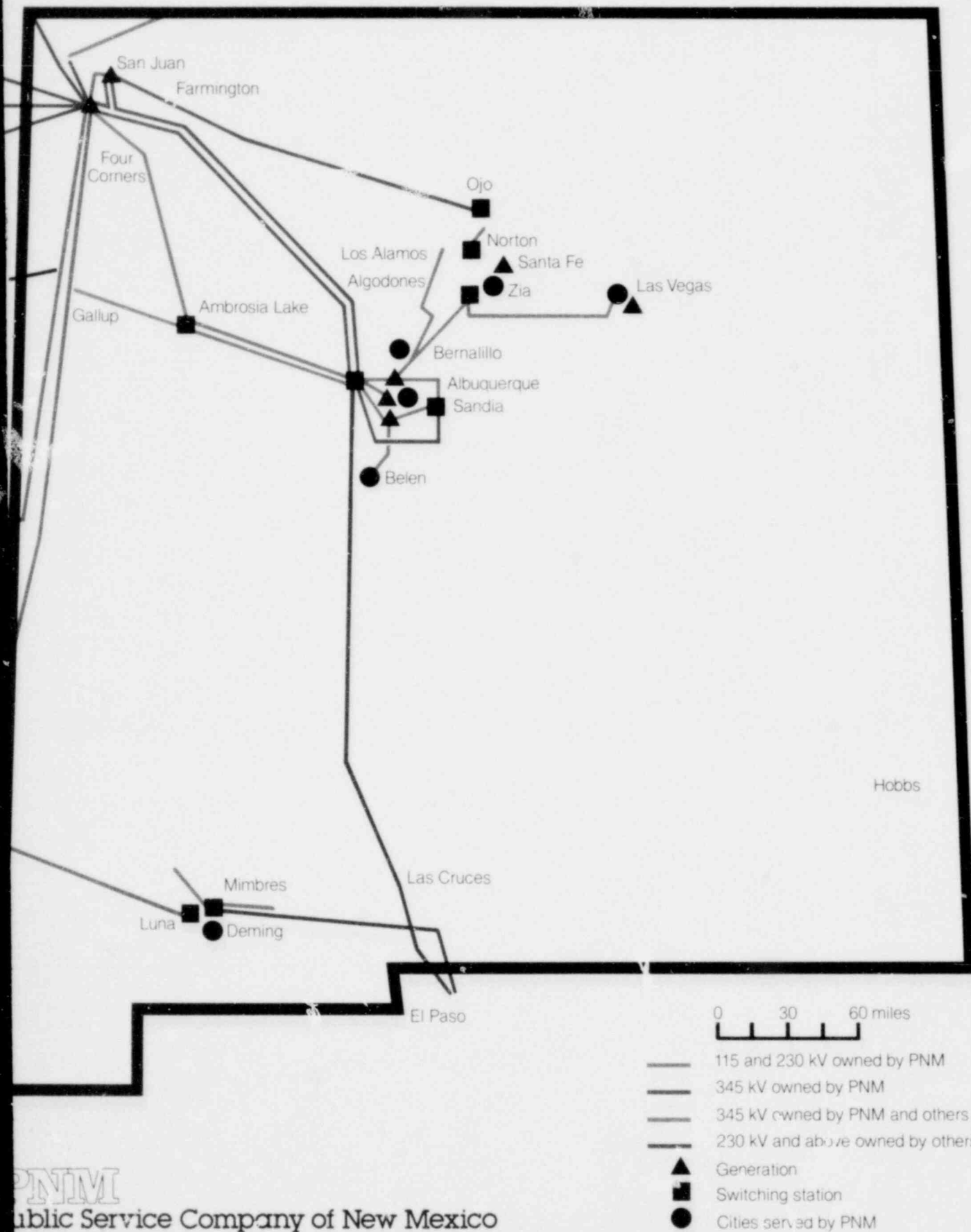
On January 14, 1981, the Board of Directors of the Company declared a dividend of \$.67 per share of common stock payable February 27, 1981 to stockholders of record February 6, 1981.

Cumulative Preferred Stock:

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.

Quarterly cash dividends were paid on each series of the Company's preferred stock at their stated rates during 1980 and 1979.

SYSTEM MAP



PNM

Public Service Company of New Mexico