

PNM RESOURCES INC  
Form 10-K/A  
April 19, 2006

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-K/A  
(Amendment No. 1)**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Fiscal Year Ended December 31, 2005**

<b>Commission File Number</b>	<b>Registrants, State of Incorporation, Address and Telephone Number</b>	<b>I.R.S. Employer Identification No.</b>
001-32462	PNM Resources, Inc. (A New Mexico Corporation) Alvarado Square Albuquerque, New Mexico 87158 (505) 241-2700	85-0468296
001-06986	Public Service Company of New Mexico (A New Mexico Corporation) Alvarado Square Albuquerque, New Mexico 87158 (505) 241-2700	85-0019030
002-97230	Texas-New Mexico Power Company (A Texas Corporation) 4100 International Plaza, P.O. Box 2943 Fort Worth, Texas 76113 (817) 731-0099	75-0204070

**Securities Registered Pursuant To Section 12(b) Of The Act:**

<b>Registrant</b>	<b>Title of Each Class</b>	<b>Name of Each Exchange on Which Registered</b>
PNM Resources, Inc.	Common Stock, no par value	New York Stock Exchange
PNM Resources, Inc.	6.75% Equity Units, \$50 stated value	New York Stock Exchange

**Securities Registered Pursuant To Section 12(g) Of The Act:**

<b>Registrant</b>	<b>Title of Each Class</b>
Public Service Company of New Mexico	1965 Series, 4.58% Cumulative Preferred Stock

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(\$100 stated value without sinking fund)

Indicate by check mark whether each registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

PNM Resources, Inc. ("PNMR")	YES	<input type="checkbox"/>	NO
Public Service Company of New Mexico ("PNM")	YES	<input type="checkbox"/>	NO <input type="checkbox"/>
Texas-New Mexico Power Company ("TNMP")	YES	<input type="checkbox"/>	NO <input type="checkbox"/>

Indicate by check mark if each registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

PNMR	YES	<input type="checkbox"/>	NO <input type="checkbox"/>
PNM	YES	<input type="checkbox"/>	NO <input type="checkbox"/>
TNMP	YES	<input type="checkbox"/>	NO <input type="checkbox"/>

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Indicate by check mark whether PNMR and PNM (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) have been subject to such filing requirements for the past 90 days.  
YES  NO

Indicate by check mark whether TNMP (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.  
YES  NO

(NOTE: As a voluntary filer, not subject to the filing requirements, TNMP filed all reports under Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months.)

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrants' knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether PNMR is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Act).

Large accelerated filer                       Accelerated filer                       Non-accelerated filer

Indicate by check mark whether PNM and TNMP are large accelerated filers, accelerated filers, or non-accelerated filers (as defined in Rule 12b-2 of the Act).

Large accelerated filer                       Accelerated filer                       Non-accelerated filer

Indicate by check mark whether the registrants are a shell company (as defined in Rule 12b-2 of the Exchange Act).  
YES  NO

As of February 28, 2006, 68,786,286 shares of common stock, no par value per share, of PNMR were outstanding.

The total number of shares of Common Stock of PNM outstanding as of February 28, 2006 was 39,117,799 all held by PNMR (and none held by non-affiliates).

The total number of shares of Common Stock of TNMP outstanding as of February 28, 2006 was 9,615 all held indirectly by PNMR (and none held by non-affiliates).

On June 30, 2005 the aggregate market value of the voting stock held by non-affiliates of PNMR as computed by reference to the New York Stock Exchange composite transaction closing price of \$28.81 per share reported by The Wall Street Journal, was \$1,980,440,339.

**EXPLANATORY NOTE REGARDING AMENDMENT NO. 1**

This Form 10-K/A (the "Amendment") is being filed to amend Part II, Item 8 of the Registrants' Annual Reports filed on Form 10-K for the fiscal year ended December 31, 2005, which was filed with the SEC on March 14, 2006 (the "Original Filing").

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The Amendment is being filed solely to correct an inadvertent typographical error that occurred during the conversion of the 10-K to the SEC's EDGAR system software. After the Company submitted the Original Filing to the SEC, Company management noted a typographical error in the PNM Consolidated Statement of Cash Flows for the year ended December 31, 2005, on page B-26. The line item reported as "Change in intercompany borrowings"

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in the Cash Flows From Financing Activities was reported as \$25,555 (in thousands) rather than \$255 (in thousands). This typographical error did not have an impact on any other amounts reported in PNM's Consolidated Statement of Cash Flows.

For the convenience of the reader, the Amendment sets forth the Original Filing in its entirety, with the exception of the correction described above. In addition, this Amendment has been signed as of a current date and all certifications of the Registrants' Chief Executive Officer and Chief Financial Officer are given as of a current date. This Amendment does not reflect events occurring after the filing of the Original Filing or modify or update the Original Filing in any way other than to correct the inadvertent typographical error described above.

**PNM AND TNMP MEET THE CONDITIONS SET FORTH IN GENERAL INSTRUCTIONS (I) (1) (a) AND (b) OF FORM 10-K AND ARE THEREFORE FILING THIS FORM WITH THE REDUCED DISCLOSURE FORMAT PURSUANT TO GENERAL INSTRUCTION (I) (2).**

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the following document are incorporated by reference into Part III of this report:

Proxy Statement to be filed by PNMR with the SEC pursuant to Regulation 14A relating to the annual meeting of stockholders of PNMR to be held on May 16, 2006.

This Form 10-K represents separate filings by PNMR, PNM and TNMP. Information herein relating to an individual registrant is filed by that registrant on its own behalf. PNM makes no representations as to the information relating to PNMR and its subsidiaries other than PNM. TNMP makes no representations as to the information relating to PNMR and its subsidiaries other than TNMP. When this Form 10-K is incorporated by reference into any filing with the SEC made by PNM or TNMP, the portions of this Form 10-K that relate to PNMR and its subsidiaries other than PNM or TNMP, respectively, are not incorporated by reference therein.

On June 6, 2005, PNMR completed its acquisition of TNP Enterprises, Inc. and Subsidiaries. See Note 2 in the Notes to Consolidated Financial Statements under Part II, Item 8. "Financial Statements and Supplementary Data," of this report for further information. Commencing with the Form 10-Q for the quarter ended June 30, 2005, TNMP was included in the filing of PNMR and PNM.

**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARY**  
**TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES**

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**GLOSSARY**

Afton	Afton Generating Station
ALJ	Administrative Law Judge
Altura	Altura Power L.P.
APB	Accounting Principles Board
APS	Arizona Public Service Company
ARO	Asset Retirement Obligation
Avistar	Avistar, Inc.
BLM	U.S. Department of the Interior Bureau of Land Management
BNCC	BHP Navajo Coal Company
Board	Board of Directors
BTU	British Thermal Unit
Cal PX	California Power Exchange
Cal ISO	California Independent System Operator
CCN	Certificate of Public Convenience and Necessity
Company	PNM Resources, Inc. and Subsidiaries
Congress	United States Congress
Constellation	Constellation Energy Commodities Group, Inc.
Decatherm	1,000,000 BTUs
Delta	Delta-Person Limited Partnership
DOJ	United States Department of Justice
Duke	Duke Energy Corporation
EaR	Earnings at Risk
EIP	Eastern Interconnection Project
EITF	Emerging Issues Task Force
EPE	El Paso Electric Company
EPA	United States Environmental Protection Agency
ERCOT	Electric Reliability Council of Texas
ESPP	Employee Stock Purchase Plan
FASB	Financial Accounting Standards Board
Farmington	City of Farmington, New Mexico
FCPSP	First Choice Power Special Purpose, L.P.
FERC	Federal Energy Regulatory Commission
First Choice	First Choice Power, L. P. and Subsidiaries
FIP	Federal Implementation Plan
Four Corners	Four Corners Power Plant
FPL	FPL Energy New Mexico Wind, LLC
GAAP	Generally Accepted Accounting Principles in the United States of America
GCT	Grand Canyon Trust
Global Electric Agreement	Signed by PNMR and other parties in 2003; provides for a five-year rate path for New Mexico jurisdictional customers that began in September 2003
Great Southwestern	Great Southwestern Construction, Inc.

IBLA	Interior Board of Land Appeals
IRS	United States Internal Revenue Service
ISO	Independent System Operator
LIBOR	London Interbank Offered Rate
Lordsburg	Lordsburg Generating Station
Luna	Luna Energy Facility
MMBTUs	Million British Thermal Units
Moody's	Moody's Investor Services, Inc.

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MW	Megawatt
MWh	Megawatt Hour
Navajo Acts	Navajo Nation Air Pollution Prevention and Control Act, the Navajo Nation Safe Drinking Water Act, and the Navajo Nation Pesticide Act
Ninth Circuit	United States Court of Appeals for the Ninth Circuit
NMED	New Mexico Environment Department
NMPRC	New Mexico Public Regulation Commission
NNHPD	Navajo Nation Historic Preservation Department
NRC	United States Nuclear Regulatory Commission
NSPS	New Source Performance Standards
NSR	New Source Review
OASIS	Open Access Same Time Information System
OATT	Open Access Transmission Tariff
O&M	Operations and Maintenance
PGAC	Purchased Gas Adjustment Clause
PG&E	Pacific Gas and Electric Co.
PNM	Public Service Company of New Mexico and Subsidiary
PNMR	PNM Resources, Inc. and Subsidiaries
PPA	Power Purchase Agreement
PRG	Power Resource Group, Inc.
PSA	Power Supply Agreement
PSD	Prevention of Significant Deterioration
PUCT	Public Utility Commission of Texas
PUHCA	The Public Utility Holding Company Act
PURPA	Public Utility Regulatory Policy Act of 1978
PVNGS	Palo Verde Nuclear Generating Station
Reeves	Reeves Generating Station
REP	Retail Electricity Provider
Restructuring Act	New Mexico Electric Utility Industry Restructuring Act of 1999, as amended
RMC	Risk Management Committee
RMRR	Routine Maintenance, Repair or Replacement
RTO	Regional Transmission Organization
SCE	Southern California Edison Company
SCPPA	Southern California Public Power Authority
SDG&E	San Diego Gas and Electric Company
SEC	United States Securities and Exchange Commission
Sempra	Sempra Energy
Senate Bill 7	Legislation that established retail competition in Texas
SESCO	San Angelo Electric Service Company
SFAS	Statement of Financial Accounting Standards
SJCC	San Juan Coal Company
SJGS	San Juan Generating Station

SO2	Sulfur Dioxide
S&P	Standard and Poors Ratings Services
SPS	Southwestern Public Service Company
SW Acquisition	SW Acquisition, L.P.
TCEQ	Texas Commission on Environmental Quality
TECA	Texas Electric Choice Act (also known as Senate Bill 7)
TNMP	Texas-New Mexico Power Company and Subsidiaries
TNP	TNP Enterprises, Inc. and Subsidiaries
Throughput	Volumes of gas delivered, whether or not owned by the Company
Tri-State	Tri-State Generation and Transmission Association, Inc.
Tucson	Tucson Electric Power Company

Twin Oaks	Assets of Twin Oaks Power, LP and Twin Oaks Power III, LP
UAMPS	Utah Associated Municipal Power Systems
USBR	United States Bureau of Reclamation
USFS	United States Forest Service
VaR	Value at Risk
Wood River	Wood River Partners, L.P.
WSPP	Western Systems Power Pool

## PART I

### ITEM 1. BUSINESS

#### THE COMPANY

PNMR was incorporated in the State of New Mexico in 2000. The Company's three primary subsidiaries are PNM, TNMP and First Choice. PNM was incorporated in the State of New Mexico in 1917. Upon the completion in 2001 of a one-for-one share exchange between PNM and PNMR, PNMR became the parent company of PNM. Prior to the share exchange, PNMR had existed as a subsidiary of PNM. The new parent company began trading on the New York Stock Exchange under the same PNM symbol beginning in December 2001.

On June 6, 2005, PNMR completed the acquisition of TNP. Prior to the consummation of the acquisition, TNP was a privately owned holding company based in Fort Worth, Texas. TNP's principal subsidiaries are TNMP and First Choice. TNMP's predecessor was organized in the State of Texas in 1925 and First Choice was organized in the State of Texas in 2000. See Note 2 in the Notes to Consolidated Financial Statements for details about the acquisition of TNP.

These filings for PNMR, PNM and TNMP include disclosures for PNMR, PNM and TNMP. For discussion purposes, this report will use the term "Company" when discussing matters of common applicability to PNMR, PNM and TNMP. Discussions regarding only PNMR, PNM or TNMP will be clearly indicated as such.

In December 2004, PNMR became a registered holding company under PUHCA. As a result of the requirement to register as a holding company, PNMR created PNMR Services Company, a wholly owned services company, which began operation in January 2005. PNMR's status as a registered holding company did not change the utility operations of the Company. Effective with the acquisition of TNP on June 6, 2005, all TNMP employees who were providing corporate support to TNP and First Choice became employees of PNMR Services Company. Energy legislation enacted in August 2005 resulted in the repeal of PUHCA effective February 2006. PNMR is in the process of evaluating the effects of that repeal, along with the other provisions of the legislation.

PNMR is an investor-owned holding company of energy and energy-related businesses. PNM is an integrated public utility with regulated and unregulated operations primarily engaged in (i) the generation, transmission and distribution of electricity, (ii) transmission, distribution and sale of natural gas within New Mexico, and (iii) unregulated operations primarily focused on the sale and marketing of electricity in the western United States. TNMP is a regulated utility operating in Texas and New Mexico. In Texas, TNMP provides regulated transmission and distribution services. In New Mexico, TNMP provides integrated electric services that include the transmission, distribution, purchase and sale of electricity. First Choice is a competitive retail electric provider operating in Texas. In addition, PNMR provides energy and technology related services through its wholly owned subsidiary, Avistar.

In January 2006, Altura, an indirect, wholly owned subsidiary of PNMR, entered into an agreement to purchase Twin Oaks no earlier than April 17, 2006. The Twin Oaks facility is a 305 MW coal-fired plant located in Texas. See Note 22 in the Notes to Consolidated Financial Statements for further details about the proposed acquisition of Twin Oaks.

Financial information relating to amounts of sales, revenue, net income and total assets of the Company's reportable segments is contained in "Part II, Item 7. - Management's Discussion and Analysis of Financial Condition and Results of Operation" and Note 3 in the Notes to Consolidated Financial Statements.

#### COMPANY WEBSITE

The Company's Internet address is <http://www.pnmresources.com>. The contents of the website are not a part of this Form 10-K. The Company's filings with the SEC, including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports, filed or furnished pursuant to Section 13(a) or 15(d) of the Securities and Exchange Act of 1934, are accessible free of charge at <http://www.pnmresources.com> as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the SEC. These reports are also available upon request in print from the Company free of charge. Additionally, the Company's Corporate Governance Principles, code of ethics (*Do the Right Thing-*

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*Principles of Business Conduct*) and charters of the Company's Audit and Ethics Committee, Governance and Public Policy Committee, Human Resources and Compensation Committee and Finance Committee are available on the Company's website at <http://www.pnmresources.com/ge/index> and such information is available in print, without charge, to any shareholder who requests it.

## REGULATED OPERATIONS

### PNM Electric

PNM Electric is an integrated electric utility that consists of generation, transmission and distribution of electricity for retail electric customers in New Mexico and the sale of transmission to third parties as well as to PNM Wholesale and TNMP. PNM Electric provides retail electric service to a large area of north central New Mexico, including the cities of Albuquerque and Santa Fe, and certain other areas of New Mexico. PNM Electric owns or leases transmission lines, interconnected with other utilities in New Mexico, south and east into Texas, west into Arizona, and north into Colorado and Utah. The Company's largest non-affiliated retail electric customer was served by PNM Electric and accounted for approximately 8.3% of the Company's total retail electric revenues for the year ended December 31, 2005.

In 1990, the NMPRC established an off-system sales methodology that provided for a sharing mechanism whereby a certain amount of revenues from off-system sales were credited to reduce retail cost of service. Off-system sales above the amounts credited to retail customers accrue to the benefit of shareholders. Subsequent rate case settlements have continued to utilize this methodology.

Customer rates for retail electric service are set by the NMPRC based on the provisions of the Global Electric Agreement. In 2003, the NMPRC approved the Global Electric Agreement that set a rate path through 2007. PNM agreed to decrease retail electric rates by 6.5% in two phases over three years. The first phase of the rate reductions became effective in September 2003 and the second phase became effective September 1, 2005. (See Note 17 in the Notes to Consolidated Financial Statements.)



Weather-normalized retail electric load growth was 2.5% in 2005. PNM Electric's system peak demands for its retail customers and firm requirements customers in the summer and the winter for the last three years are shown in the following table:

**System Peak Demands**

	<b>2005</b>	<b>2004</b>	<b>2003</b>
	(Megawatts)		
Summer	1,779	1,655	1,661
Winter	1,530	1,481	1,434

PNM holds long-term, non-exclusive franchise agreements for its electric retail operations, with varying expiration dates. These franchise agreements allow PNM to access public rights-of-way for placement of PNM's electric facilities. Franchise agreements have expired in Albuquerque, Santa Fe, Bernalillo County, Sandoval County, San Miguel County, Village of Bosque Farms, Pueblo de Cochiti, Village of Tijeras, McKinley County and the City of Las Vegas. PNM remains obligated under New Mexico state law to provide service to customers in these franchise areas despite the absence of an effective franchise agreement. The Albuquerque metropolitan area accounted for approximately 53% of PNM Electric's 2005 electric utility operating revenues (excluding transmission revenues), and no other franchise area represents more than approximately 10%. PNM continues to collect and pay franchise fees to Albuquerque and Santa Fe, Village of Bosque Farms, Village of Tijeras and the City of Las Vegas. PNM currently does not pay franchise fees to Bernalillo County, Luna County, Sandoval County, McKinley County, Pueblo de Cochiti or San Miguel County.

PNM Electric owns or leases 2,897 circuit miles of electric transmission lines, interconnected with other utilities in New Mexico, east and south into Texas, west into Arizona, and north into Colorado and Utah. Due to rapid load growth in PNM Electric's service territory in recent years and the lack of transmission development, most of the capacity on this transmission system is fully committed and there is very little or no additional access available on a firm commitment basis. These factors result in physical constraints on the system and limit the ability to wheel power into PNM Electric's service area from outside of New Mexico.

**TNMP Electric**

TNMP Electric consists of the operations of TNMP. TNMP is a regulated utility operating in Texas and New Mexico. In Texas, TNMP Electric provides regulated transmission and distribution services under the provisions of TECA in accordance with Senate Bill 7. TNMP Electric serves a market niche of small-to-medium-sized communities. Only three of the 84 communities in TNMP Electric's service territory have populations exceeding 50,000. TNMP Electric's service territory is organized into two operating areas: Texas and New Mexico. In most areas that TNMP Electric serves, it is the exclusive provider of transmission and distribution services.

TNMP Electric's Texas territory consists of three non-contiguous areas. One portion of this territory extends from Lewisville, which is approximately 10 miles north of the Dallas-Fort Worth International Airport, eastward to municipalities near the Red River, and to communities north, west and south of Fort Worth. The second portion of its territory includes the area along the Texas Gulf Coast between Houston and Galveston, and the third portion includes areas of far west Texas between Midland and El Paso. TNMP Electric's Texas operations lie entirely within the ERCOT region. ERCOT is the independent system operator that is responsible for maintaining reliable operations for the bulk electric power supply system in the ERCOT region, which is located entirely within Texas and serves approximately 85% of the electrical load in ERCOT. See "Rates and Regulation" below for more information about ERCOT. In New Mexico, TNMP provides integrated electricity services that include the transmission, distribution,

purchase and sale of electricity to its customers in southwest and south central New Mexico as well as transmission to third parties and to PNM.

TNMP Electric provides transmission and distribution services at regulated rates to various retail electric providers that, in turn, provide retail electric service within TNMP Electric's Texas service area. As of December 31, 2005, 30 retail electric providers served customers that receive transmission and distribution services from TNMP Electric. First Choice, TNMP Electric's affiliated retail electric provider, was TNMP Electric's largest customer and accounted for approximately 56% of TNMP's total retail electric revenues for the year ended December 31, 2005.

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TNMP holds long-term, non-exclusive franchise agreements for its electric transmission and distribution services, with varying expiration dates. These franchises accounted for approximately 7% of TNMP's 2005 total electric utility operating revenues. TNMP intends to negotiate and execute new or amended franchise agreements with municipalities as they expire. Sales within the remaining 84 franchises contributed approximately 63% of TNMP's 2005 total electric utility operating revenues. The remainder of TNMP's revenues are earned from service provided to facilities in its service area that lie outside the territorial jurisdiction of the municipalities with which TNMP has franchise agreements.

## **PNM Gas**

PNM Gas distributes natural gas to most of the major communities in New Mexico, including Albuquerque and Santa Fe. The Albuquerque metropolitan area accounted for approximately 50% of the total gas revenues in 2005. No single sales-service customer accounted for more than 0.9% of PNM Gas' therm sales in 2005. PNM holds long-term non-exclusive franchises with varying expiration dates in all incorporated communities in New Mexico requiring franchise agreements except for the municipalities of Aztec, Bosque Farms, Eunice, Gallup, Grants, Hurley, Los Ranchos de Albuquerque, Milan, Santa Clara, Santa Fe County, and Silver City. PNM Gas remains obligated to serve these franchise areas pursuant to state law despite the absence of an effective franchise agreement.

PNM Gas has a customer base that includes both sales-service customers and transportation-service customers. Sales-service customers purchase natural gas and receive transportation and delivery services from PNM Gas for which PNM Gas receives both cost-of-gas and cost-of-service revenues. In 2005, the market price of natural gas across the United States increased significantly, due to a hot 2005 summer, which led to more demand from natural gas-fired power plants, as well as due to the hurricanes in the Gulf Coast region of the United States. Cost-of-gas revenues collected from its sales-service customers are recovered in accordance with NMPRC regulations through the PNM Gas PGAC and represent a pass-through of the cost of natural gas to the customer. As a result, increases or decreases in gas revenues resulting from wholesale gas price fluctuations do not impact the Company's consolidated gross margin (gross margin is equal to operating revenues minus cost of energy sold). An order was issued by the NMPRC in 2001 that approved an agreement regarding the hedging strategy of PNM Gas and the implementation of a price management fund program which includes a continuous monthly balancing account with a carrying charge. This carrying charge has the effect of keeping PNM Gas whole on purchases of gas since it is compensated for the time value of money that exists due to any delay in collections from customers. Additionally, PNM Gas makes occasional gas sales to off-system sales customers. Off-system sales deliveries generally occur at pipeline interconnections with the PNM Gas system and profits are shared between PNM Gas and its customers on a 30%/70% basis.

PNM Gas had 26 transportation-service customers in 2005, which procure gas for their end users independently of PNM Gas end users. Transportation-service customers are gas marketers and producers contracting with PNM Gas for transportation services to their end users and for other related services that provide PNM Gas with cost-of-service revenues only. Transportation services are provided to transportation-service customers at locations throughout the PNM Gas distribution system, as well as points on and off PNM Gas transmission pipelines. Through its transportation-service customers, PNM Gas provided gas transportation deliveries to 1,823 end users that were not PNM Gas customers during 2005.

In 2005, 38% of the total gas throughput of PNM Gas was related to transportation gas deliveries. The transportation rates of PNM Gas are unbundled, and transportation customers only pay for the service they receive. In 2005, revenues from transportation customers accounted for 3% of the total gas revenues of PNM Gas. Revenues from sales-service customers accounted for the remaining 97%. Cost of gas, on which PNM Gas makes no margin, accounted for 71% of total sales-service revenue. Because a major portion of the PNM Gas load is related to heating, sales levels are affected by the weather. In 2005, 60% of the total sales occurred in the months of January, February, March and December.

PNM Gas obtains its supply of natural gas primarily from sources within New Mexico by contracting with third party producers and marketers. These contracts are generally sufficient to meet its peak-day demand. PNM Gas serves certain cities that depend on El Paso Natural Gas Company or Transwestern Pipeline Company for transportation of gas supplies. Because these cities are not directly connected to the transmission facilities of PNM Gas, gas transported by these companies is the sole supply source for these cities. Such gas transportation is regulated by the FERC.

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## UNREGULATED OPERATIONS

### PNM Wholesale

PNM Wholesale consists of the generation and sale of electricity into the wholesale market based on two product lines, long-term contracts and short-term sales. The source of these sales is supply created by selling the unused capacity of PNM's jurisdictional assets as well as the capacity of PNM's wholesale plants excluded from retail rates. Both regulated and unregulated generation is jointly dispatched in order to improve reliability, provide the most economic power to retail customers, and maximize profits on any wholesale transactions.

Long-term contracts include sales to firm-requirements and other wholesale customers with multi-year arrangements. At December 31, 2005, these contracts ranged from 1 to 14.5 year terms with an average term of 5.3 years. Short-term sales include transactions entered into for less than one year. They include forward market opportunities, which transactions do not qualify as normal sales and purchases as defined in SFAS No. 133, as amended, "*Accounting for Derivative Instruments and Hedging Activities*," ("SFAS 133") and, as a result, are marked to market. Also included in short-term sales are spot market, hour ahead, day ahead, week ahead and other sales of any excess generation not required to fulfill PNM Electric's retail load and contractual commitments.

The PNM Wholesale strategy calls for increased asset-backed energy sales supported by long-term contracts in the wholesale market, where PNM's aggregate net open forward electric sales position, including short-term sales and long-term contracts, is generally covered by its forecasted excess generation capacity. Company management actively monitors the asset-backed sales by the use of stringent risk management policies. The Company's future growth plans call for approximately 75% of its new generation portfolio to be committed through long-term contracts. The 75% threshold is in compliance with the Global Electric Agreement. Growth is dependent on market development and on the Company's ability to generate funds for the Company's future expansion. The Company continues to operate in the wholesale market and seek appropriately priced asset additions such as the proposed acquisition of the Twin Oaks facility. Expansion of the Company's generation portfolio is dependent on the Company's ability to acquire favorably priced assets at strategic locations and to secure long-term commitments for the purchase of power from the acquired plants.

In 2005 and 2004, PNM Wholesale revenues stabilized following the preceding years when volatility was high. The Company has been successful in developing its wholesale power marketing activities in the western United States, even in times of market volatility. Management believes this success is due to its business strategy of providing electric power customized to meet the special needs of its customers. This marketing strategy is based on PNM Wholesale's net asset-backed methodology, which helps mitigate the risks inherent in wholesale power marketing activities. PNM Wholesale also utilizes long-term transactions to enhance its product offerings.

Certain of PNM's generation resources are excluded from retail electric rates. As a result, PNM Wholesale developed a wholesale power marketing strategy in which it sells the generation from its resources that are excluded from retail rates. This strategy also includes the forward purchase and sale of electricity to take advantage of market price opportunities in the electric wholesale market. During 2005, 2004 and 2003, PNM's sales in the wholesale electric markets accounted for approximately 58%, 62% and 62%, respectively, of its total MWh sales. Of the total wholesale electric sales made in 2005, 2004 and 2003, 87%, 80% and 82%, respectively, were transacted through purchases for resale. (See Item 2. "Properties.")

PNM Wholesale has entered into various firm wholesale electric sales contracts. These contracts contain fixed capacity charges in addition to energy charges. Capacity charges are fixed monthly payments for a commitment of resources to service the contract requirements. Energy charges are payments based on the amount of electricity delivered to the customer intended to compensate PNM Wholesale for its variable costs incurred to provide the energy. PNM Wholesale's firm-requirements demand was 281 MW in 2005, and is expected, based solely on existing contracts, to be 273 MW in 2006, 161 MW in 2007, 154 MW in 2008 and 90 MW in 2009. Firm requirements for TNMP's New Mexico customers are included in these amounts through 2006. In accordance with the NMPRC's

stipulation approving PNMR's acquisition of TNP, beginning January 1, 2007, TNMP's New Mexico customers will be included in the PNM Electric load (see "Acquisition Agreements" below). No firm-requirements PNM Wholesale customer accounted for more than 6.9% of the Company's total electric sales for resale revenues for the year ended December 31, 2005.

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## **First Choice**

First Choice is a certified retail electric provider operating in Texas, which allows it to provide electricity to residential, small and large commercial, industrial and institutional customers. First Choice's responsibilities include acquiring new retail customers, setting up retail accounts, handling customer inquiries and complaints, and acting as a liaison between the transmission and distribution companies and retail customers. First Choice was organized in 2000 to act as TNMP's affiliated retail electric provider, as required by TECA. Although First Choice is regulated in certain respects by the PUCT under ERCOT, the Company includes First Choice in the unregulated portion of its business because First Choice is not subject to traditional rate of return regulation.

First Choice serves price-to-beat and competitive customers (residential, commercial, and aggregated municipalities) in Texas. The price-to-beat customers are former customers of TNMP that have chosen to remain with First Choice, TNMP's affiliated retail electric provider. First Choice focuses its competitive customer acquisition efforts in the major metropolitan areas that are open to electric choice within ERCOT, including Dallas-Fort Worth, Houston, Corpus Christi, and McAllen-Harlingen.

First Choice experiences increased sales and operating revenues during the summer months as a result of increased air conditioner usage in hot weather. In 2005, approximately 43% of First Choice's consolidated annual revenues were recorded in June, July, August and September.

First Choice's load fluctuates continuously due to among other things, customer additions and losses, changes in customer usage, unseasonal weather and customer switching. First Choice continually monitors and revises its load forecast to account for changing price-to-beat and competitive customer loads. First Choice develops short-term load forecasts to identify short-term load surpluses and shortages, and to ensure that hedges are in place to cover forecasted sales. To the extent these short-term load forecasts identify shortages, First Choice covers shortages through short-term power purchases or through purchases on the ERCOT balancing market.

In Texas, capacity auctions were a semi-regular event mandated by the TECA to promote liquidity in the marketplace. In the most recent auctions, First Choice was the successful bidder for four 25 MW baseload blocks of capacity in October 2005 and two 25 MW cyclic blocks of capacity in September 2005.

## **CORPORATE AND OTHER**

PNMR Services Company provides corporate services to PNMR and to all of PNMR's business units, including PNM, Avistar, TNP, TNMP and First Choice based on shared services agreements. These services are billed at cost on a monthly basis and allocated to the business units. PNMR Services Company and Avistar are included in the Corporate and Other segment.

## SOURCES OF POWER

### PNMR

The Company has sources of power from property it owns or leases and power purchased through various long-term PPAs. For the year ended December 31, 2005, the Company had a 2,393 MW generation capacity from these sources.

First Choice assumed the energy supply activities of TNMP in Texas in 2002. In 2003, First Choice and Constellation executed a PSA that resulted in Constellation being the primary supplier of power for First Choice's customers through the end of 2007. Additionally, Constellation has agreed to supply power in certain transactions under the PSA beyond the date when that commitment expires. The Company's basic strategy is to minimize its exposure to fluctuations in market energy prices by matching fixed price sales contracts with fixed price supply. In addition, First Choice uses various financial instruments to hedge against the risk of adverse changes in natural gas prices. The PSA with Constellation resulted in Constellation assuming weather related risks because the contract is based on customer usage profiles as determined by ERCOT. First Choice retained the risks associated with customer attrition. (See Note 17 in the Notes to Consolidated Financial Statements.)

### PNM

#### *Sources of Power - Owned*

As of December 31, 2005, the total net generation capacity of facilities owned by PNM was 1,744 MW, which includes all of PNM's interests in PVNGS, portions of which are held under operating leases. (See Item 2. "Properties.")

PNM is committed to increasing the utilization of its generation capacity at SJGS, Four Corners and PVNGS. SJGS is operated by PNM. SJGS' equivalent availability was 89.4% and 89.8% for the years ended December 31, 2005 and 2004, respectively. PVNGS' equivalent availability was 76.0% and 81.7% for the years ended December 31, 2005 and 2004, respectively. Four Corners' equivalent availability was 86.3% and 82.4% for the years ended December 31, 2005 and 2004, respectively. Four Corners and PVNGS are operated by APS.

PNM's Lordsburg and Afton plants were built to serve wholesale customers and other sales rather than New Mexico retail customers and, therefore, are not currently included in the retail rates. However, these plants may be needed in the future to serve the growing retail load as is the case for Afton, as described below. If so, these plants would have to be certified by the NMPRC and would then be subject to inclusion in PNM's retail rates in a future rate case. These plants were built as part of PNM's ongoing strategy of increasing generation capacity over time to serve increasing retail load, sales under long-term contracts and other sales. The plants owned by PNM are available through joint dispatch to support service to the retail customers of PNM.

In July 2005, PNM filed with the NMPRC an application for a CCN in which PNM requested NMPRC approval to operate Afton as a public utility plant and include in PNM's retail rate base in its next retail electric rate case the costs associated with the conversion of Afton from a combustion turbine to a combined cycle unit. In November 2005, PNM filed a joint stipulation with the NMPRC that would allow PNM to convert Afton to a combined cycle plant and bring Afton into retail rates, with 50% of Afton's capacity designated to serve PNM's customers and the other 50% designated to serve TNMP's New Mexico customers. Hearings were held in February 2006 before the NMPRC.

In November 2004, PNMR Development, a subsidiary of PNMR, purchased a one-third interest in Luna. Luna is a 570 MW, partially constructed, natural gas-fired power plant near Deming in southern New Mexico. The purchasers are investing approximately \$100.0 million, one-third from each purchaser, to complete construction. In November 2005, the one-third interest in Luna was transferred from PNMR Development to PNM. PNM will continue to develop Luna and will utilize it as merchant plant. Luna is expected to be operational no later than the second quarter of 2006.



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*Sources of Power - Leased*

In 1996, PNM entered into an operating lease agreement for the rights to all the output of the Delta gas-fired generating plant for 20 years. The plant received FERC approval for "exempt wholesale generator" status. The maximum dependable capacity under the lease is 132 MW. The gas turbine generating unit is operated by Delta and is located on PNM's retired Person Generating Station site in Albuquerque. Primary fuel for the gas turbine generating unit is natural gas provided by wholesale gas purchases. In addition, the unit has the capability to utilize low sulfur fuel oil if natural gas is neither available nor cost effective.

As discussed above, PNM leases portions of PVNGS. See Item 2. "Properties" and Note 7 in the Notes to Consolidated Financial Statements.

*Sources of Power - PPAs*

In addition to generating its own power, PNM purchases power in the open market. PNM's purchases under its long-term PPAs, including the Delta lease and the contract described below, were 649 MW in 2005 and are expected to be 599 MW in 2006, 532 MW in 2007, 532 MW in 2008, and 532 MW in 2009. This projected capacity assumes that contracts that end during the period are not renewed or extended. PNM also purchases power in the forward, day-ahead and real-time markets.

In 2002, PNM entered into an agreement with FPL to develop a 200 MW wind generation facility in New Mexico. PNM began receiving commercial power from the project in June 2003. FPL owns and operates the New Mexico Wind Energy Center, which consists of 136 wind-powered turbines on a site in eastern New Mexico. PNM has a contract to purchase all the power generated by the New Mexico Wind Energy Center for 25 years. In 2003, PNM received approval from the NMPRC for a voluntary tariff that allows PNM retail customers to buy wind-generated electricity for a small monthly premium. Power from the New Mexico Wind Energy Center is used to service load under the voluntary tariff and as part of PNM's electric supply mix for meeting retail load. Any wind-generated electricity in excess of these amounts is sold on the wholesale power market, either within New Mexico or outside the state.

TNMP

TNMP purchases all electricity for its New Mexico customers' needs and energy-scheduling services under a wholesale power contract with PNM that extends through December 2006. As discussed below, in "Rates and Regulation," in accordance with the NMPRC stipulation approving PNMR's acquisition of TNP, PNM will remain the power supplier for TNMP's New Mexico needs through 2010. As discussed above, First Choice performs the energy supply activities for TNMP's Texas customers.

**MARKET REACH**

As of the date of this report, PNM owns firm transmission capacity to the Mead market hub in the amount of 100 MW, which serves various wholesale power markets and loads in the greater Las Vegas, Nevada area, and serves as a delivery point for the Cal ISO. In addition, PNM owns transmission capacity to serve major load centers in the Phoenix, Arizona area in amounts varying from 100 MW to 150 MW.

**FUEL AND WATER SUPPLY****PNM**

The percentages of PNM's generation of electricity (on the basis of KWh) fueled by coal, nuclear fuel and gas and oil, and the average costs to PNM of those fuels (in cents per million BTU), during the past three years were as follows:

	<b>Coal</b>		<b>Nuclear</b>		<b>Gas and Oil</b>	
	<b>Percent of Generation</b>	<b>Average Cost</b>	<b>Percent of Generation</b>	<b>Average Cost</b>	<b>Percent of Generation</b>	<b>Average Cost</b>
2005	71.3%	163.9	26.3%	45.7	2.4%	687.6
2004	70.1%	154.4	28.1%	52.5	1.8%	693.9
2003	68.0%	163.8	29.5%	44.5	2.5%	625.2

The generation mix for 2006 is expected to be 67.4% coal, 27.7% nuclear and 4.9% gas and oil. Due to locally available natural gas and oil supplies, the utilization of locally available coal deposits and the generally abundant supply of nuclear fuel, PNM believes that adequate sources of fuel are available for its generating stations into the foreseeable future.

*Coal*

See Note 16 in the Notes to Consolidated Financial Statements for information about PNM's coal supply.

*Natural Gas*

The natural gas used as fuel for the electric generating plants located in Albuquerque (Reeves and the Delta operating lease) is procured on the open market and delivered by PNM Gas through its transportation services. PNM Wholesale procures its gas supply independently of PNM Gas but obtains gas transportation services from PNM Gas.

*Nuclear Fuel*

PNM is one of several participants in PVNGS. (See Note 14 in the Notes to Consolidated Financial Statements.) The fuel cycle for PVNGS is comprised of the following stages:

- mining and milling of uranium ore to produce uranium concentrates;
  - conversion of uranium concentrates to uranium hexafluoride;
    - enrichment of uranium hexafluoride;
      - fabrication of fuel assemblies;
  - utilization of fuel assemblies in reactors; and
  - storage and disposal of spent nuclear fuel.

The PVNGS participants have contracted for all of the PVNGS requirements for uranium concentrates and conversion services through 2008. The PVNGS participants have also contracted for all of the PVNGS enrichment services through 2010, 80% of enrichment services through 2013 and all of the fuel assembly fabrication services until at least 2015.

*Water Supply*

See Note 16 in the Notes to Consolidated Financial Statements for information about PNM's water supply.

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## **RATES AND REGULATION**

PNM is subject to the jurisdiction of the NMPRC, with respect to its retail electric and gas rates, service, accounting, issuance of securities, construction of major new generation and transmission facilities and other matters regarding retail utility services provided in New Mexico. The FERC has jurisdiction over rates and other matters related to wholesale electric sales and cost recovery for a portion of PNM's transmission network.

In Texas, TNMP provides regulated transmission and distribution services and is subject to the jurisdiction of the PUCT and certain municipalities with respect to rates and service. Within New Mexico, TNMP is subject to the jurisdiction of the NMPRC. TNMP is subject to traditional cost-of-service regulation in both Texas and New Mexico. TNMP is subject to the jurisdiction of the FERC for some of its activities, including the issuance of securities and the acquisition or disposition of properties in New Mexico. TNMP's transmission and distribution activities in Texas are not subject to FERC regulation, because those activities occur solely within the ERCOT system of Texas.

First Choice is a member of ERCOT, the ISO responsible for maintaining reliable operations of the bulk electric power supply system in the Texas electric market. The responsibilities of ERCOT include ensuring that information relating to a customer's choice of retail electric provider is conveyed in a timely manner to anyone needing the information. ERCOT is also responsible for ensuring that electricity production and delivery are accurately accounted for among the generation resources and wholesale buyers and sellers in the ERCOT region. The ERCOT ISO does not operate a centrally dispatched pool and does not procure energy on behalf of its members other than to maintain the reliable operation of the transmission system. ERCOT also serves as agent for procuring ancillary services for those who elect not to secure their own ancillary services requirements.

Members of ERCOT include retail customers, investor and municipal owned electric utilities, rural electric cooperatives, river authorities, independent generators, power markets and retail electric providers. The electric market served by ERCOT operates under the reliability standards set by the North American Electric Reliability Council. The PUCT has primary jurisdictional authority over the electric market served by ERCOT and the reliability of electricity across Texas' main interconnected power grid.

First Choice provides energy to retail customers in Texas. Senate Bill 7 contains no provisions for the specific recovery of fuel and purchased power costs, although First Choice can request that the PUCT change the price-to-beat fuel factor twice a year to recognize changes in natural gas prices. The rates charged to new customers acquired by First Choice outside of TNMP's service territory are not regulated by the PUCT, but are negotiated by First Choice with each customer. As a result, changes in fuel and purchased power costs will affect First Choice's operating results.

The items below describe certain of the more significant rate and regulatory matters that are relevant to the Company. See Notes 16 and 17 in the Notes to Consolidated Financial Statements for a discussion of additional rate and regulatory matters.

### **PNMR**

#### **Energy Policy Act**

In August 2005, the Energy Policy Act of 2005 was enacted, effective February 2006. Implementation of various portions of the law requires the issuance of rules by the FERC. The FERC adopted final rules implementing various provisions of the Energy Policy Act including rules pertaining to repeal of PUHCA of 1935 and implementation of PUHCA of 2005, the FERC's expanded mergers and acquisitions approval authority and prohibition of energy market manipulation. The FERC has also issued a number of other proposed rules that are pending, including rules pertaining to preventing undue discrimination in transmission services and electric reliability standards. The Company will continue to monitor, and participate in, as appropriate, proceedings involving implementation of the Energy Policy

Act.

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## PNM

### **Regional Transmission Issues**

In July 2005, the FERC issued an order terminating its proceeding on standard market design, stating that since issuance of the standard market design notice of proposed rulemaking, the electric industry has made significant progress in the development of voluntary RTOs and ISOs. In September 2005, the FERC issued a Notice of Inquiry on Preventing Undue Discrimination and Preference in Transmission Services seeking information from the industry regarding the provisions of the OATT for possible revision in a future rulemaking.

In November 2005, the FERC issued a Notice of Proposed Rulemaking Promoting Transmission Investment through Pricing Reform. In the proposed rulemaking, the FERC notes declining investment in the national transmission grid and proposes certain incentive actions it is considering to increase transmission investment to improve the reliability of national transmission grid. In addition to the incentive proposals, the FERC would implement additional reporting requirements for public utilities that operate transmission systems. The Company intends to monitor and participate in these FERC notices and rulemakings.

### **Generation Market Power Filings**

In its triennial market power screen filing in 2004, PNM reported that it continued to face transmission constraints in northern New Mexico and would continue to abide by the cost-based rate limitation on transmission service during times of transmission congestion for the northern New Mexico market. PNM also reported that for the EPE control area, PNM's revised wholesale market share screen was below 20% for all seasons. In its order in PNM's market-based rate filing, the FERC initiated a proceeding to determine if PNM's mitigation measure in northern New Mexico is sufficiently adequate to prevent the exercise of market power and also required additional explanation of PNM's revised wholesale market share calculation. The FERC established that rates reviewed under this proceeding for transactions completed in these two markets would be subject to refund effective March 6, 2005.

In April 2005, the FERC issued an order denying PNM's petition for rehearing regarding the FERC's finding that the existing mitigation measure for the northern New Mexico control area was insufficient, rejecting PNM's February 2005 compliance filing as to both the northern and southern New Mexico control areas and requiring PNM to submit a compliance filing containing one of the alternatives listed in the order. The FERC's order also clarified that market-based sales made at SJGS are sales made within PNM's northern control area and are subject to these proceedings. In July 2005, PNM made its compliance filing at the FERC. The filing indicated that, as a result of the completion of its analysis pursuant to the FERC's order, PNM did show failures in its own control area, but did not show failures in the EPE control area, with the exception of one measure. PNM maintained its position that when the historical data is considered, it is clear that PNM does not possess generation market power in either the PNM or EPE control area destination markets and PNM should maintain its market-based sales authority in those markets. In the event the FERC does not so find, PNM also proposed mitigation measures in both the PNM and EPE control area destination markets that will be applicable during the limited time periods when the failures occurred.

PNM cannot predict the outcome of the additional FERC proceedings on PNM's financial position or results of operations; however, should the FERC determine that PNM has generation market power in these two markets, PNM could continue to make sales at cost-based or otherwise mitigated rates and thus not have future revenues subject to refund in this matter.

### **FERC Office of Market Oversight and Investigations Audit**

In November 2005, PNM received notice that the FERC Division of Operational Audits of the Office of Market Oversight and Investigations would perform a compliance audit of PNM. The audit covers the period from January

2004 to the present and will examine PNM's compliance with the FERC standards of conduct and OASIS requirements, compliance of PNM's transmission practices with the FERC regulations and applicable OATT, and compliance of PNM's wholesale electricity marketing operation with its market-based rate tariff. This audit is part of a series of routine, mandatory audits of all of the utilities under FERC oversight, focused on compliance with the FERC's rules and regulations. Similar audits have been conducted of other regional utilities. The FERC will issue its findings upon conclusion of the audit, which could take from six months to a year, or more to complete.

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In preparing for an on-site visit by OMOI as part of its audit, and during the visit itself, the Company discovered computer system paths that could have permitted unauthorized Company personnel to access certain real-time transmission information concerning the PNM and TNMP transmission systems. The Company immediately reported to OMOI its discovery and disabled the paths. The Company's preliminary examination has not revealed any evidence that unauthorized access to transmission information was, in fact, obtained by use of these paths.

PNM has been cooperating, and will continue to cooperate, fully with the FERC to complete the audit. The Company cannot predict the outcome of the audit or whether the FERC will make any adverse findings related to PNM's compliance with the FERC's rules and regulations.

### **Global Electric Agreement**

In 2003, PNM signed the Global Electric Agreement, which provided for the repeal of a majority of the New Mexico Restructuring Act, a fixed rate path, procedures for PNM's participation in unregulated generating plant activities and other regulatory issues. In accordance with this rate path, PNM reduced its retail rates by 2.5% in September 2005. The rate path is effective through December 31, 2007, at which time rates are subject to review by the NMPRC.

### **Renewable Portfolio Standard**

The NMPRC issued a renewable resources rule in 2002 to encourage the development of renewable energy in New Mexico. The rule includes a provision requiring the use of a minimum of 5% renewable energy by January 1, 2006, with the minimum amount to increase 1% per year for each year until a renewable portfolio standard of 10% is reached in the year 2011. The Renewable Energy Act passed by the New Mexico Legislature establishes a mandatory renewable energy portfolio standard similar to the structure established by the NMPRC. The Renewable Energy Act provides for streamlined proceedings for utilities to obtain approval of procurement plans, provided certainty to utilities and protection for customers and required the NMPRC to establish a reasonable cost threshold for the procurement of renewable energy to prevent excessive costs being added to rates. Under the Renewable Energy Act, if renewable energy cannot be acquired under the threshold, the mandate would be suspended.

In September 2005, PNM made its 2006 annual portfolio summary filing and renewable energy procurement plan filing. PNM proposed to continue to procure renewable energy and certificates from wind resources, to pursue renewable energy projects and to implement a program to purchase renewable energy certificates from net-metered customers with small solar systems. The NMPRC approved this plan; however, with respect to cost recovery, costs incurred pursuant to the plan, with the exception of those for the small solar program, are subject to a rebuttable presumption of prudence.

### TNMP

#### **FERC Office of Market Oversight and Investigations Audit**

In November 2005, the Company received notice that the FERC Division of Operational Audits of the Office of Market Oversight and Investigations would begin a compliance audit of the FERC jurisdiction transmission system of TNMP. The audit covers the period from the effective date of PNM's acquisition of TNP in June 2005 to the present. The audit is substantially the same as the PNM audit discussed above.

### **Acquisition Agreements**

In 2005, the PUCT approved a settlement agreement finding the acquisition of TNP to be in the public interest. Among other things, the settlement agreement called for:

- a two-year electric rate freeze that includes a \$13.0 million annual rate reduction in TNMP's retail delivery rates effective May 1, 2005;
- an authorized return on equity of 10.25% on an implied capital structure of 60% debt and 40% equity for certain reporting purposes;
- the use of a 60/40% debt/equity capital structure in TNMP's next base rate case if filed before January 1, 2009; and

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- a \$6.0 million synergy savings credit amortized over 24 months effective after the close of the transaction.

Also in 2005, the NMPRC approved a stipulation in connection with the acquisition of TNP. Among other things, the stipulation called for:

- a three-phase rate reduction totaling 15%, to TNMP's electric customers in southern New Mexico, beginning January 2006 and ending December 2010; the rate reduction will lower TNMP electric rates by approximately \$9.6 million in the first year;
  - an imputed 55/45% debt/equity structure with an assumed rate of return on equity of 10.5% for TNMP;
    - PNM to remain the power supplier for TNMP's New Mexico needs through 2010; and
  - integration of TNMP's New Mexico assets into PNM effective January 1, 2007, the companies, however, will maintain separate rates, at minimum, through 2010.

## ENVIRONMENTAL MATTERS

PNM and TNMP, in common with other electric and gas utilities, are subject to stringent laws and regulations for protection of the environment by local, state, federal and tribal authorities. In addition, PVNGS is subject to the jurisdiction of the NRC, which has the authority to issue permits and licenses and to regulate nuclear facilities in order to protect the health and safety of the public from radioactive hazards and to conduct environmental reviews pursuant to the National Environmental Policy Act. The liabilities under these laws and regulations can be material and, in some instances, may be imposed without regard to fault, or may be imposed for past acts, whether or not such acts were lawful at the time they occurred. See Part II, Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operation - Critical Accounting Policies" for a discussion of applicable accounting policies. In addition, see Note 16 and Note 18 in the Notes to Consolidated Financial Statements for information related to the following matters, incorporated in this item by reference.

- Person Station
- Retired Fossil-Fueled Plant Decommissioning Costs
  - Nuclear Spent Fuel and Waste Disposal
  - Navajo Nation Environmental Issues
    - New Source Review Rules
    - The Clean Air Act
  - Citizen Suit Under the Clean Air Act
    - Four Corners Air Emissions
    - Excess Emissions Reports
    - Santa Fe Generating Station
  - SESCO Matter (for both PNM and TNMP)
    - Coal Combustion Waste Disposal
    - Environmental Issues

## COMPETITION

PNM Wholesale is involved in the generation and sale of electricity into the wholesale market. It is subject to competition from regional utilities with similar opportunities to generate and sell energy at market-based prices and larger trading entities that typically do not own or operate generating assets. The Company believes that it is well positioned to compete in this market due to its long history in the marketplace, its product offerings, and stringent risk management practices. The Company's energy marketers are operationally trained and maintain effective marketing relationships with competitors and counterparties. The Company has maintained an investment-grade rating for its long-term debt despite turbulent wholesale markets, which enables the Company to fully participate in the marketplace.

The Texas electricity market has been open to retail competition since January 2002. Prior to 2002, TNMP operated as an integrated utility in Texas. In accordance with Senate Bill 7 and in compliance with a plan approved by the PUCT, TNMP separated its Texas utility operations into three components: (1) an unregulated retail sales

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business operated by First Choice; (2) a regulated power transmission and distribution business operated by TNMP and (3) power generation, a business which TNMP is no longer engaged in. In accordance with Senate Bill 7, TNMP provides transmission and distribution services at regulated rates to various retail electric providers that, in turn, provide retail electric service within TNMP's Texas service area.

The Company is exposed to competition in the unregulated Texas retail electricity market through First Choice. First Choice serves customers at competitive rates and customers at price-to-beat rates approved by the PUCT. In order to compete effectively in the Texas retail electricity market, First Choice must be able to attract and retain customers on the basis of cost and service, while managing the cost of its energy supply.

Since 2002, Texas' electric consumers have been encouraged to switch from their traditional affiliated retail energy provider, such as TNMP, to a competitive retail energy provider, such as First Choice. Currently under TECA, Texas' consumers whose chosen retail energy provider has exited the Texas market are provided electric service by a "provider of last resort." The rates of a provider of last resort are regulated by the PUCT and are fixed for the two-year period that each provider of last resort serves. The current contracts for default service offered by providers of last resort under TECA will expire on December 31, 2006. On January 1, 2007 new providers of last resort will be identified and those providers as well as the rates offered will be effective until December 31, 2008.

On December 31, 2006, the price-to-beat rate mechanism will cease to exist and First Choice and other retail energy providers subject to providing price-to-beat rates will only market retail electricity at competitive rates. There is currently an open rulemaking at the PUCT evaluating the potential need for a replacement rate for the price-to-beat rate mechanism. Other services being evaluated in this rulemaking are provider of last resort functions and pricing and the possible creation of a default provider. The Company cannot currently predict what, if any, changes will occur to either mechanism and what, if any, impact such changes may have on its results of operations and financial position.

## EMPLOYEES

The following table sets forth the number of employees of PNMR, PNM and TNMP and for each business segment as of December 31, 2005:

	PNMR	PNM	TNMP
Corporate *	751	-	-
PNM Electric	1,165	1,165	-
TNMP Electric	469	-	469
PNM Gas	736	736	-
PNM Wholesale	70	70	-
First Choice	174	-	-
Other	17	-	-
Total	3,382	1,971	469

\* Represents employees of PNMR Services Company.

TNMP does not have any employees that are represented by unions. The following table sets forth the number of employees of PNMR and PNM, by business segment, who are represented by unions as of December 31, 2005:

	PNMR	PNM
PNM Electric	496	496
PNM Gas	82	82
PNM Wholesale	45	45
Total	623	623

Not all of the Company's business segments are separate legal entities. The employees disclosed in the tables above for PNM Electric, PNM Gas and PNM Wholesale are allocated, in part, in a manner consistent with the allocation of labor costs to those segments.

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## ITEM 1A. RISK FACTORS

The business and financial results of PNMR, PNM and TNMP are subject to a number of risks and uncertainties, including those set forth below and in Part II. Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operation.”

### **PNMR may fail to successfully integrate acquisitions, including the TNP acquisition and the proposed acquisition of Twin Oaks, into its other businesses or otherwise fail to achieve the anticipated benefits of pending and future acquisitions.**

As part of PNMR’s growth strategy, PNMR is pursuing, and intends to continue to pursue, a disciplined acquisition strategy. While PNMR expects to identify potential synergies, cost savings, and growth opportunities prior to the acquisition and integration of acquired companies or assets, PNMR may not be able to achieve these anticipated benefits due to, among other things:

- delays or difficulties in completing the integration of acquired companies or assets,
- higher than expected costs or a need to allocate resources to manage unexpected operating difficulties,
  - diversion of the attention and resources of its management,
- reliance on inaccurate assumptions in evaluating the expected benefits of a given acquisition,
  - inability to retain key employees or key customers of acquired companies, and
  - assumption of liabilities unrecognized in the due diligence process.

### **Acquisition of TNP in 2005**

PNMR cannot assure that it will successfully integrate TNP with PNMR’s current businesses. The integration of TNP with PNMR’s other businesses presents significant challenges and, as a result, PNMR may not be able to operate the combined company as effectively as expected. PNMR may also fail to achieve the anticipated benefits of the acquisition as quickly or as anticipated or may not be able to achieve those benefits at all. Even if PNMR manages to realize greater than anticipated benefits from the integration of TNP into its business, PNMR’s regulated subsidiaries may be required by their regulators to return these benefits to ratepayers.

While the acquisition of TNP was accretive to earnings and cash flow in 2005, the 2005 results were based on a number of factors, which may not continue in the future. At FCP, the gross margin increased, which was driven mainly by natural gas hedging, lower transmission costs and gains from capacity auction participation. However, at TNMP, gross margin decreased in 2005 compared to the prior year. The decrease was primarily due to a decrease in revenues due to a rate reduction effective May 1, 2005 that was part of the PUCT’s approval of the TNP acquisition.

The ultimate success of the acquisition is also dependent upon PNMR’s ability to achieve operational benefits from operating the companies as a unified operation and the management of customer retention at First Choice and TNMP.

### **Proposed Acquisition of Twin Oaks in 2006**

On January 14, 2006, Altura, a newly formed indirect wholly owned subsidiary of PNMR, entered into an agreement with Sempra to purchase Twin Oaks in an acquisition of assets for \$480.0 million in cash. The Twin Oaks facility is a 305 MW coal-fired power plant located 150 miles south of Dallas, Texas. The transaction is expected to close no earlier than April 17, 2006. The Twin Oaks purchase agreement also includes the development rights for a possible

600 MW expansion of the plant. The necessary permits are expected to be granted in 2007. An additional \$2.5 million payment will be made to Sempra upon the issuance of an air permit for the expansion and an additional \$2.5 million will be paid when Altura begins construction of the expansion.

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The proposed acquisition of Twin Oaks is the latest step in implementing PNMR's strategy of expanding its merchant generation fleet to serve a growing wholesale market in the Southwest, including the ERCOT market in Texas. The Twin Oaks plant provides PNMR with the opportunity for lower-cost coal generation in an ERCOT market that is driven by natural gas.

PNMR and Sempra are also parties to the purchase agreement and have agreed to guarantee certain obligations of their respective subsidiaries relating to the acquisition. Consequently, PNMR is at risk that Altura will not be able to meet its obligations that are guaranteed by PNMR.

Under the purchase agreement, substantially all of the assets and contractual commitments relating to Twin Oaks are to be transferred to Altura upon closing, including fuel supply and power purchase and sale agreements. For the next five years the majority of the plant's output will be sold via two existing contracts. All of the plant's capacity is committed through September 2007. After expiration, the first contract is expected to be replaced with another contract for approximately 75% of the plant's capacity through 2010. Although PNMR plans to market the excess energy and capacity within ERCOT, PNMR is at risk that its marketing efforts may not be successful due to a number of factors, including competition, market prices and demand for electricity and economic conditions.

PNMR has arranged for bridge financing to close the transaction. It is expected that the permanent financing will come from the issuance of debt and equity structured to maintain PNMR's investment grade rating. However, PNMR is at risk that it will be unable to obtain financing for the acquisition at a reasonable cost or terms that will permit PNMR to maintain its investment grade rating, due to conditions in the capital markets or PNMR's financial condition.

While the acquisition of the Twin Oaks facility is expected to be neutral to slightly accretive to earnings in the first 18 months of ownership, approximately 15% to 20% of earnings during this period will include the amortization of certain contracts, which will be recorded at fair market value under purchase accounting and amortized into income. Although the acquisition of Twin Oaks is expected to be fully accretive to earnings after the first 18 months and to be neutral to cash flow in 2006 and accretive thereafter, PNMR cannot assure that it will be able to achieve the expected earnings and cash flow results from the Twin Oaks plant.

**PNMR, PNM and TNMP are subject to complex government regulation, which may have a negative impact on their business, financial position and results of operations.**

PNMR, PNM and TNMP are subject to comprehensive regulation by several federal, state and local regulatory agencies, which significantly influences their operating environment and may affect their ability to recover costs from utility customers. In particular, the NMPRC, the PUCT, the FERC, the NRC, the EPA, ERCOT, the NMED and the TCEQ regulate many aspects of their utility operations, including siting and construction of facilities, conditions of service, the issuance of securities, and the rates that the regulated entities can charge customers. PNMR, PNM and TNMP are required to have numerous permits, approvals and certificates from these agencies to operate their business. The rates that PNM and TNMP are allowed to charge for their retail services significantly influence PNMR's and those subsidiaries' business, financial position, results of operations and liquidity. Due to pending federal regulatory reforms, the public utility industry continues to undergo change.

The Energy Policy Act of 2005 was enacted into law in August 2005, effective in February 2006. The legislation covers many areas, including the items set forth in Note 17 in the Notes to the Consolidated Financial Statements and elsewhere in this report. Implementation of various portions of the law requires the issuance of rules by the FERC. The FERC has adopted final rules implementing various provisions of the Energy Policy Act including rules pertaining to repeal of PUHCA of 1935 and implementation of PUHCA of 2005, the FERC's expanded mergers and acquisitions approval authority and prohibition of energy market manipulation. FERC has also issued a number of other proposed rules that are pending, including rules pertaining to preventing undue discrimination in transmission services and electric reliability standards. PNMR will continue to monitor, and participate in as appropriate, the FERC and other proceedings involving implementation of the Energy Policy Act, in order to assess the implications of the

new law and rules on its operations.

PNMR and its subsidiaries are unable to predict the impact on their business and operating results from the future regulatory activities of any agency that regulates them or from the implementation of the Energy Policy Act of 2005. Changes in regulations or the imposition of additional regulations may require PNMR and its regulated subsidiaries to incur additional expenses or change business operations, and therefore may have an adverse impact on PNMR's and those subsidiaries' results of operations.

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**PNM's retail electric rate reduction and retail electric rate freeze, and the New Mexico settlement relating to the TNP acquisition, could adversely affect its profit margin if it does not control costs.**

Pursuant to an electric retail rate freeze stipulation, PNM decreased its retail electric rates by 6.5% as follows:

- a 4% reduction effective September 1, 2003,
- an additional 2.5% reduction effective September 1, 2005, and
- maintain these reduced retail electric rates through December 31, 2007.

The TNP acquisition settlement in New Mexico established how synergy savings would be allocated among PNM's gas and electric customers. The settlement provides that:

- PNM's 413,000 electric customers will receive rate credits totaling \$4.6 million or nearly \$1.84 million annually over a 30-month period beginning January 2008.
- PNM's 471,000 gas customers will receive \$4.3 million in rate credits over five years, or \$860,000 annually, beginning June 6, 2005.

PNM's costs, however, are not frozen. Thus, PNM's ability to maintain its profit margins depends upon increased demand for electricity and PNM's efforts to control costs incurred in supplying that electricity, including, in particular, its coal costs.

PNM does not have the benefit of a fuel adjustment clause for its retail electric operations that would allow it to recover increased fuel and purchased power costs from customers. Therefore, to the extent that fuel and power prices increase, it is exposed to changes in fuel and power prices to the extent fuel for its electric generating facilities and power must be purchased on the open market in order for it to serve its retail electric customers. If PNM cannot control other operating expenses, the retail electric rate freeze may decrease PNM's profit margin. The retail electric rate freeze will also affect PNM's ability to earn a return or recover from its customers costs associated with investments in generation, transmission and distribution facilities since it will not be able to increase retail electric rates to recover those costs until at least after the end of the rate freeze.

PNMR and PNM are not able to predict what rate treatment PNM will receive following the expiration of the retail electric rate freeze in New Mexico. Some of the factors that influence rates are largely outside their control. In response to competitive, economic, political, legislative and/or regulatory pressures, PNM may have to agree to further rate freezes, rate refunds or rate reductions, any or all of which could have a significant adverse effect on PNMR's and PNM's business, financial position, results of operations and liquidity.

**The impact from the TNP acquisition settlements could adversely affect TNMP's profit margin if TNMP does not control costs.**

The TNP acquisition settlements for TNMP in Texas and New Mexico provide for the following:

- a two-year electric rate freeze that includes a \$13.0 million annual rate reduction in TNMP's retail delivery rates effective May 1, 2005,
- a \$6.0 million synergy savings credit (whether or not these savings are actually achieved) amortized over 24 months effective after the closing of the transaction,
- a three-phase rate reduction totaling 15%, beginning January 2006 and ending December 2010, to TNMP's electric customers in southern New Mexico; the rate reduction, which includes TNMP's annual synergy-savings allocation, will lower TNMP electric rates by \$9.6 million in the first year, and

- maintain PNM as the power supplier for TNMP's New Mexico needs through 2010.

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In addition, as part of the New Mexico settlement relating to the TNP acquisition, TNMP's current fuel and purchased power adjustment clauses will be eliminated no later than March 31, 2006. Also, the New Mexico settlement requires the integration of TNMP's New Mexico assets into PNM effective January 1, 2007. The companies, however, will maintain separate rates, at a minimum, through 2010.

PNMR and TNMP are not able to predict what rate treatment TNMP will receive following the expiration of the retail electric rate provisions in New Mexico. Some of the factors that influence rates are largely outside their control. In response to competitive, economic, political, legislative and/or regulatory pressures, TNMP may have to agree to further rate freezes, rate refunds or rate reductions, any or all of which could have a significant adverse effect on PNMR's and TNMP's business, financial position, results of operations and liquidity.

**The ability of First Choice to attract and retain customers and its ability to mitigate the fluctuation in costs of energy supply could have a significant adverse effect on PNMR's business, financial position, results of operations and liquidity.**

As a result of the acquisition of TNP, PNMR is exposed to competition in the unregulated Texas retail electricity market through First Choice, which serves customers at price-to-beat rates and customers at competitive rates. In order to compete effectively in the Texas retail electricity market, First Choice must be able to attract and retain customers on the basis of cost and service, while managing the cost of its energy supply. The ability of First Choice to compete successfully in the Texas market could have a significant effect on PNMR's business, financial position, results of operations and liquidity.

**There are inherent risks in the operation of nuclear facilities, such as environmental, health and financial risks and the risk of terrorist attack.**

PNM has a 10.2% undivided interest in PVNGS, with portions of its interests in Units 1 and 2 held under leases. PVNGS is subject to environmental, health and financial risks such as the ability to dispose of spent nuclear fuel, the ability to maintain adequate reserves for decommissioning, potential liabilities arising out of the operation of these facilities and the costs of securing the facilities against possible terrorist attacks and unscheduled outages due to equipment and other problems. PNM maintains nuclear decommissioning trust funds and external insurance coverage to minimize its financial exposure to some of these risks; however, it is possible that damages could exceed the amount of insurance coverage. Although the decommissioning trust funds are designed to provide adequate funds for decommissioning at the end of the expected life of the PVNGS units, there is the risk of insufficient decommissioning trust funds in the event of early decommissioning of the units.

The NRC has broad authority under federal law to impose licensing and safety-related requirements for the operation of nuclear generation facilities. In the event of non-compliance, the NRC has the authority to impose fines or shut down a unit, or both, depending upon its assessment of the severity of the situation, until compliance is achieved. In addition, if a serious nuclear incident were to occur at PVNGS, it could materially and adversely affect PNM's and PNMR's business, financial position, results of operations and liquidity. A major incident at a nuclear facility anywhere in the world could cause the NRC to limit or prohibit the operation or licensing of any domestic nuclear unit.

**PNMR's and its electric subsidiaries' financial performance may be adversely affected if their power plants and transmission and distribution system are not successfully operated.**

#### *General*

PNMR's and its electric subsidiaries' financial performance depends on the successful operation of their generation, transmission and distribution assets. Unscheduled or longer than expected maintenance outages, other performance problems with the electric generation assets, severe weather conditions, accidents and other catastrophic events,

disruptions in the delivery of fuel and other factors could reduce its excess generation capacity and therefore limit the electric subsidiaries' ability to opportunistically sell excess power in the wholesale market. Diminished generation capacity could also result in the aggregate net open forward electric sales position being larger than forecasted generation capacity. If this were to occur, purchases of electricity in the wholesale market would be required under contracts priced at the time of execution or, if in the spot market, at the then-current market price. There can be no assurance that sufficient electricity would be available at reasonable prices, or at all, if such a

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situation were to occur. Failures of transmission or distribution facilities may also cause interruptions in the services the electric subsidiaries provide. These potential generation, distribution and transmission problems, and any potentially related service interruptions, could result in lost revenues and additional costs.

#### *PVNGS*

During 2005, PVNGS had the lowest capacity factor (measured against maximum dependable capacity) that the plant has had since 1994. The equivalent availability for PVNGS was 76.0% for 2005. This reflects bottom quartile performance relative to the 103 operating reactors in the United States. There were nine unscheduled outages during 2005 that had a variety of causes. In 2004, the NRC determined that there had been a safety concern at PVNGS related to the safety injection systems for the three PVNGS units. This led to a "yellow" finding and a \$50,000 civil penalty under the NRC's reactor oversight process. A "yellow" finding places a unit in the "degraded safety cornerstone" column of the NRC's performance matrix, which results in an enhanced NRC inspection regimen. During 2005, the NRC completed its enhanced inspection. The "yellow" finding remains unresolved.

APS has encountered tube cracking in the steam generators and has taken, and will continue to take, remedial actions that it believes have slowed the rate of tube degradation. The PVNGS Unit 2 steam generators were replaced in 2003, and the replacement of PVNGS Unit 1 steam generators was completed in December 2005. Installation of the PVNGS Unit 3 steam generators should be completed by December 2007.

APS has been operating PVNGS Unit 1 at reduced power levels since December 25, 2005 due to a vibration in the PVNGS Unit 1 shutdown cooling lines. As a result, PNM is receiving approximately 24 MW of power from PVNGS Unit 1 based on its 10.2% undivided interest in PVNGS.

Implementation of a potential solution preliminarily scheduled by APS for February 2006 was canceled after comprehensive analysis concluded that the desired improvement likely would not have been achieved. APS had informed PNM that it was in the process of formulating other potential remedies to address the issue and that it was scheduling another attempt to remedy this issue sometime in April 2006. APS has more recently informed PNM that the preferred solution will require Unit 1 to undergo an outage of approximately five weeks in order to effect the necessary modifications to Unit 1 and that it plans to begin this outage in the June 2006 timeframe. In addition, an outage of approximately one week for preparatory work will begin in mid-March 2006. This preferred solution was initially planned for installation in the spring of 2007.

The operation of PVNGS not only affects PNM's ability to make off-system sales, but can also cause PNM to purchase power to serve its retail electric customers. Based on current forward market energy prices, PNM estimates that operation of PVNGS Unit 1 at the reduced power level could result in a reduction in consolidated gross margin, or operating revenues minus cost of energy sold, of \$3.0 million to \$4.0 million per month before income taxes. However, PNM is taking steps to mitigate the impact on consolidated gross margin while PVNGS Unit 1 operates at the reduced power level.

The financial performance of PNMR and PNM may be adversely affected if PVNGS Unit 1 cannot be operated at a satisfactory level or if the NRC imposes restrictions on operation of the plant or any of the three units at PVNGS.

#### **The operations of PNMR and its operating subsidiaries are subject to risks beyond their control that may reduce their revenues.**

The revenues of PNMR and its operating subsidiaries are affected by the demand for electricity and natural gas. That demand can vary greatly based upon:

- weather conditions, including hurricanes, seasonality and temperature extremes,

- fluctuations in economic activity and growth in PNMR's service area and the western region of the United States,
- the extent of additional energy available from current or new competitors, and
- the ability of First Choice to attract and retain customers.

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Weather conditions will impact the revenues that PNMR and its operating subsidiaries obtain from electric retail and wholesale sales. Temperature extremes, especially for prolonged periods, can dramatically increase the demand for electricity, as opposed to the effect of more moderate temperatures. Temperature extremes inside the subsidiary's service territory reduce the amount of power available to sell on the wholesale market.

Drought conditions in New Mexico generally, and especially in the Four Corners region, in which SJGS and the Four Corners Generating Station are located, may affect the water supply for PNM's generating plants. If adequate precipitation is not received in the watershed that supplies the Four Corners region, PNM may have to decrease generation at these plants, which would reduce PNM's ability to sell excess power on the wholesale market and reduce its revenues. If the drought conditions continue or regulators or legislators take action to limit PNM's supply of water, PNM's and PNMR's business may be adversely impacted. Although PNM has been able to maintain adequate access to water through supplemental contracts and voluntary shortage sharing agreements with tribes and other water users in the San Juan Basin, PNM cannot be certain that it will be able to do so in the future.

**The inability to raise capital could limit PNMR's ability to execute its growth strategy and finance its capital requirements, which could adversely affect PNMR's business, financial position, results of operations and liquidity.**

PNMR and its operating subsidiaries rely on access to both short-term money markets and longer-term capital markets as a source of liquidity for any capital requirements not satisfied by the cash flow from operations, which could include capital requirements for energy infrastructure investments and funding new projects. If PNMR and its operating subsidiaries are not able to access capital at competitive rates or at all, PNMR's ability to implement its growth strategy and its ability to finance capital requirements, if needed, will be limited. Market disruptions or any downgrade of PNMR's or its operating subsidiaries' credit rating may increase the cost of borrowing or adversely affect their ability to raise capital through the issuance of securities or other borrowing arrangements, which could have a material adverse effect on their business, financial position, results of operations and liquidity. These disruptions could include:

- an economic downturn,
- changes in capital market conditions generally,
- the bankruptcy of an unrelated energy company,
- increased market prices for electricity and gas,
- terrorist attacks or threatened attacks on facilities of PNMR's operating subsidiaries or those of unrelated energy companies, and
- deterioration in the overall health of the utility industry.

A significant reduction in the credit ratings of PNMR or its operating subsidiaries could materially and adversely affect their business, financial position, results of operations and liquidity.

PNMR, PNM and TNMP cannot be sure that any of their current ratings will remain in effect for any given period of time or that a rating will not be lowered or withdrawn entirely by a rating agency. Any downgrade:

- could increase borrowing costs, which would diminish financial results,
- could require payment of a higher interest rate in future financings and the potential pool of investors and funding sources could decrease,

- could increase borrowing costs under certain of existing credit facilities,
- could also require the provision of additional support in the form of letters of credit or cash or other collateral to various counterparties,
  - could limit access to or increase the cost of access to the commercial paper market, and
- below investment grade credit ratings would also require approvals from the NMPRC for new wholesale plant projects and for continuing to participate in wholesale plant projects of more than a certain dollar value and under certain conditions.

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On January 20, 2006, S&P revised PNMR's outlook from stable to negative and downgraded the commercial paper of PNMR and PNM from A-2 to A-3, citing concerns about reduced plant availability at PVNGS, the higher cost of replacement power due to high natural gas prices and the lack of a fuel adjustment clause that would permit PNM to pass these costs to customers. The ratings action by S&P has increased short-term borrowing costs for PNMR and PNM and could increase long-term borrowing costs for PNMR and PNM.

The ratings from rating agencies reflect only the views of such rating agencies and are not recommendations to buy, to sell or to hold our securities. Each rating should be evaluated independently of any other rating. Any downgrade or withdrawal of PNMR's, PNM's or TNMP's current ratings may have an adverse effect on the market price of their outstanding debt.

**Costs of environmental compliance, liabilities and litigation could exceed estimates by PNMR's and its operating subsidiaries, which could adversely affect their business, financial position, results of operations and liquidity.**

Compliance with federal, state and local environmental laws and regulations may result in increased capital, operating and other costs, including remediation and containment expenses and monitoring obligations. PNMR, PNM and TNMP cannot predict how they would be affected if existing environmental laws and regulations were revised, or if new environmental laws and regulations seeking to protect the environment were adopted, but any such changes could increase their financing requirements or otherwise adversely affect their business, financial position, results of operations and liquidity, unless increased environmental costs are recovered in customer rates. Revised or additional laws and regulations could also result in additional operating restrictions on their facilities or increased compliance costs that may not be fully recoverable in rates, thereby reducing net income. For example, any future changes in the interpretation of the Clean Air Act's new source review provisions could potentially increase operating and maintenance costs substantially. Similarly, in March 2005, the EPA adopted the Clear Air Act Mercury Rule, which is intended to reduce mercury emissions from coal-fired generation plants. PNMR and PNM cannot be certain how this rule will affect them.

In addition, PNM or TNMP may be designated as a responsible party for environmental clean up at a site identified by a regulatory body. PNMR, PNM and TNMP cannot predict with certainty the amount and timing of all future expenditures related to environmental matters because of the difficulty of estimating clean-up and compliance costs, and the possibility that changes will be made to the current environmental laws and regulations. There is also uncertainty in quantifying liabilities under environmental laws that impose joint and several liability on all potentially responsible parties. Failure to comply with environmental laws and regulations, even if caused by factors beyond PNM's or TNMP's control, may result in the assessment of civil or criminal penalties and fines.

**PNMR's business, results of operations and financial position may be adversely affected if PNMR and its operating subsidiaries do not successfully compete for wholesale customers and generation plant acquisition opportunities. Wholesale plants will be exposed to price risk to the extent they must compete for the sale of energy and capacity.**

As a result of the changing regulatory environment and the relatively low barriers to entry (which include, in addition to open access transmission service, relatively low construction costs for new generating facilities), PNMR expects competition to steadily increase. This increased competition could affect load forecasts, acquisition opportunities and wholesale energy sales and related revenues. Since PNM's sales in the wholesale electric market accounted for approximately 58% of total MWh sales in 2005, the impact of these changes on PNMR's and PNM's financial results could be material. The effect on results of operations and financial position could vary depending on the extent to which:

- PNMR and its operating subsidiaries are able to acquire additional generation to compete in the wholesale market,

- new opportunities are created for the expansion of wholesale load, and
- current wholesale customers elect to purchase from other suppliers after existing contracts expire.

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As of December 31, 2005, PNM's long-term contracts to supply power ranged from 1 to 14.5 year terms with an average term of 5.3 years. PNM's ability to renew these contracts at terms comparable to those currently in place is dependent upon prevailing market conditions at the time of negotiations.

To the extent electric capacity generated by wholesale plants is not under contract to be sold, the business, results of operations and financial position of PNMR and PNM will generally depend on the prices that can be obtained for energy and capacity in New Mexico, in Texas (if the proposed acquisition of Twin Oaks is completed) and in adjacent markets.

**PNMR and its operating subsidiaries may not be able to mitigate fuel and wholesale electricity pricing risks, which could result in unanticipated liabilities or increased volatility in earnings.**

The business and operations of PNMR and its operating subsidiaries are subject to changes in purchased power prices and fuel costs that may cause increases in the amounts that must be paid for power supplies on the wholesale market and the cost of producing power in owned generation plants. Prices for electricity, fuel and natural gas may fluctuate substantially over relatively short periods of time and expose PNMR and its operating subsidiaries to significant commodity price risks.

Among the factors that could affect market prices for electricity and fuel are:

- prevailing market prices for coal, oil, natural gas and other fuels used in the generation plants of PNMR and its operating subsidiaries, including associated transportation costs, and supplies of such commodities,
  - prevailing market conditions in the general wholesale electricity market,
  - liquidity in the commodity markets,
- the rate of growth in electricity as a result of population changes, regional economic conditions and the implementation of conservation programs,
  - weather conditions impacting demand for electricity or availability of hydroelectric power or fuel supplies,
- changes in the regulatory framework for the commodities markets that PNMR and its operating subsidiaries rely on for purchased power and fuel,
- the actions of external parties, such as the FERC or independent system operators, that may impose price limitations and other mechanisms to address some of the volatility in the United States' western energy markets,
  - changes in federal and state energy and environmental laws and regulations,
  - union and labor relations, and
  - natural disasters, wars, embargoes and other catastrophic events.

PNMR and its operating subsidiaries rely on derivatives such as forward contracts, futures contracts, options and swaps to manage these risks. They attempt to manage their exposure from these activities through enforcement of established risk limits and risk management procedures. PNMR and its operating subsidiaries cannot be certain that these strategies will be successful in managing pricing risk, or that they will not result in net liabilities as a result of future volatility in these markets.

**Impairments of tangible long-lived assets of PNMR, PNM and TNMP could adversely affect their business, financial position, liquidity and results of operations.**

PNMR, PNM and TNMP evaluate their tangible long-lived assets for impairment whenever indicators of impairment exist pursuant to SFAS No. 144 “*Accounting for the Impairment or Disposal of Long-Lived Assets*” (“SFAS 144”). These potential impairment triggers could include changing customer purchase commitments and market share; fluctuating market prices resulting from weather patterns; changing fuel costs; industry deregulation and other economic and market conditions and trends. Except as described below, PNMR, PNM and TNMP determined that no triggering events occurred during the period for their tangible long-lived assets.

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PNM determined that as of December 31, 2005, its D-11 steam turbine, which is in a temporary storage facility in southern New Mexico, was impaired in the amount of approximately \$15.0 million. The D-11 steam turbine was impaired since it is no longer being utilized in the Afton generation facility and has been designated as available for sale.

PNM will continue to analyze all tangible long-lived assets for impairment on an on-going basis in accordance with SFAS 144.

**Impairments of goodwill and intangible assets of PNMR and its subsidiaries could adversely affect their business, financial position, liquidity and results of operations.**

As a result of the acquisition of TNP in 2005, PNMR recorded \$499.2 million of goodwill composed of \$456.1 million of goodwill at TNMP and \$43.1 million of goodwill at FCP. As required by SFAS 142, “*Goodwill and Other Intangible Assets*” (“SFAS 142”), PNMR and TNMP will evaluate goodwill for impairment annually and between annual tests whenever indicators of impairment exist. Impairment of goodwill exists when the carrying amount of goodwill exceeds its implied fair value.

PNMR also recorded \$79.3 million of other intangible assets as a result of its acquisition of TNP. Of the \$79.3 million of acquired intangible assets, \$68.8 million was assigned to the trade name “First Choice.” The trade name has an indefinite useful life and therefore, no amortization will be recognized until its useful life is determined to be no longer indefinite. As required by SFAS 142, PNMR evaluates the First Choice trade name for impairment annually and between annual tests whenever indicators of impairment exist. PNMR evaluates the useful life of the First Choice trade name each reporting period as required by SFAS 142 to determine whether events or circumstances continue to support an indefinite useful life.

The remaining \$10.5 million of acquired intangible assets was assigned to the First Choice customer list. The useful life of the customer list is estimated to be eight years and is being amortized on a straight-line basis over eight years. As required by SFAS 144, PNMR evaluates the First Choice customer list for impairment whenever indicators of impairment exist. PNMR evaluates the remaining useful life of the First Choice customer list each reporting period as required by SFAS 144 to determine whether events or circumstances continue to support the remaining amortization period.

Due to the significant amounts of goodwill and intangible assets recorded by PNMR and its subsidiaries, the impairment of goodwill or intangible assets could adversely affect their business, financial position, liquidity and results of operations.

**Actual results could differ from estimates used to prepare PNMR’s, PNM’s and TNMP’s financial statements.**

In preparing the financial statements in accordance with GAAP, management must often make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures at the date of the financial statements and during the reporting period. Some of those judgments can be subjective and complex, and actual results could differ from those estimates. For more information about these estimates and assumptions, see Item 7. “Management's Discussion and Analysis of Financial Condition and Results of Operation - Critical Accounting Policies” and Footnote 1 in the Notes to Consolidated Financial Statements.

**Provisions of PNMR’s organizational documents, as well as several other statutory and regulatory factors, will limit another party’s ability to acquire PNMR and could deprive PNMR’s shareholders of the opportunity to gain a takeover premium for shares of PNMR’s common stock.**

PNMR’s restated articles of incorporation and by-laws include a number of provisions that may have the effect of discouraging persons from acquiring large blocks of PNMR’s common stock or delaying or preventing a change in

control of PNMR. The material provisions that may have such an effect include:

- authorization for the PNMR Board to issue PNMR's preferred stock in series and to fix rights and preferences of the series (including, among other things, whether, and to what extent, the shares of any series will have voting rights, subject to certain limitations, and the extent of the preferences of the shares of any series with respect to dividends and other matters),

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- advance notice procedures with respect to any proposal other than those adopted or recommended by PNMR's Board, and
- provisions specifying that only a majority of the Board, the chairman of the Board, the president or holders of not less than one-tenth of all of PNMR's shares entitled to vote may call a special meeting of stockholders.

Under the New Mexico Public Utility Act, NMPRC approval is required for certain transactions that may result in PNMR's change in control or exercise of control. Certain acquisitions of PNMR's outstanding voting securities would also require FERC approval under the FERC's authority resulting from the Energy Policy Act and the repeal of PUHCA. See Note 17 in the Notes to Consolidated Financial Statements for further discussion.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

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**ITEM 2. PROPERTIES****PNMR**

The significant properties owned by PNMR include those owned by PNM and TNMP and are disclosed below.

**PNM****Electric**

PNM's ownership and capacity in electric generating stations in commercial service as of December 31, 2005 follow:

<b>Type</b>	<b>Name</b>	<b>Location</b>	<b>Total Net Generation Capacity (MW)</b>
Coal	SJGS (a)	Waterflow, New Mexico	765
Coal	Four Corners (b)	Fruitland, New Mexico	192
Gas/Oil	Reeves Station	Albuquerque, New Mexico	154
Gas/Oil	Las Vegas (c)	Las Vegas, New Mexico	18
Gas/Oil	Afton (d)	La Mesa, New Mexico	141
Gas	Lordsburg (e)	Lordsburg, New Mexico	72
Nuclear	PVNGS (f)	Wintersburg, Arizona	402
			(g)
			1,744

(a) SJGS Units 1, 2 and 3 are 50% owned by PNM; SJGS Unit 4 is 38.5% owned by PNM.

(b) Four Corners Units 4 and 5 are 13% owned by PNM.

(c) PNM has filed with the NMPRC for approval to close the Las Vegas Generating Station in 2006.

(d) Subject to NMPRC approval, PNM plans to convert Afton to a combined cycle plant and bring Afton into retail rates, with 50% of Afton's capacity designated to serve PNM's customers and the other 50% designated to serve TNMP's New Mexico customers.

(e) PNM's Lordsburg plant was built to serve wholesale customers and other sales rather than New Mexico retail customers and, therefore, is not currently included in the retail rates. However, it is possible that this plant may be needed in the future to serve the growing retail load.

(f) PNM is entitled to 10.2% of the power and energy generated by PVNGS. PNM has a 10.2% ownership interest in Unit 3 and has leasehold interests in approximately 7.9% of Units 1 and 2 and an ownership interest in approximately 2.3% of Units 1 and 2.

(g) For load and resource purposes, PNM has notified the NMPRC that the maximum dependable capacity rating for PVNGS is 395 MW.

**Fossil-Fueled Plants**

SJGS is located in northwestern New Mexico, and consists of four units operated by PNM. Units 1, 2, 3 and 4 at SJGS have net rated capacities of 327 MW, 316 MW, 497 MW and 507 MW, respectively. SJGS Units 1 and 2 are owned on a 50% shared basis with Tucson. SJGS Unit 3 is owned 50% by PNM, 41.8% by SCPPA and 8.2% by Tri-State. SJGS Unit 4 is owned 38.457% by PNM, 28.8% by M-S-R Public Power Agency, 10.04% by Anaheim, 8.475% by Farmington, 7.2% by Los Alamos and 7.028% by UAMPS.

PNM also owns 192 MW of net rated capacity derived from its 13% interest in Units 4 and 5 of Four Corners located in northwestern New Mexico on land leased from the Navajo Nation and adjacent to available coal deposits. Units 4 and 5 at Four Corners are jointly owned with SCE, APS, Salt River Project, Tucson and EPE and are operated by APS.

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Four Corners and a portion of the facilities adjacent to SJGS are located on land held under easements from the United States and also under leases from the Navajo Nation. The enforcement of these leases could require Congressional consent. PNM does not deem the risk that is associated with the enforcement of these easements and leases to be material. However, PNM is dependent in some measure upon the willingness and ability of the Navajo Nation to protect these leased properties.

PNM owns 154 MW of generation capacity at Reeves Station in Albuquerque and 18 MW of generation capacity at Las Vegas Station in Las Vegas, New Mexico. PNM also owns Afton, a 141 MW gas or oil fired combustion turbine plant in La Mesa, New Mexico, and Lordsburg, a 72 MW gas fired combustion turbine generator in Lordsburg, New Mexico. In addition, PNM has 132 MW of generation capacity in Albuquerque under an operating lease. These power sources are used primarily for peaking and transmission support. During times of excess capacity, these resources have been used to augment PNM's wholesale power trading activities. PNM owns a one-third interest in a partially constructed, combined-cycle power plant near Deming, New Mexico, called Luna. The facility is expected to be completed no later than the second quarter of 2006 and is designed to be capable of producing 570 MW, of which PNM will be entitled to 190 MW. PNM plans to convert Afton to a combined cycle plant and bring Afton into retail rates, with 50% of Afton's capacity designated to serve PNM's customers and 50% designated to serve TNMP's New Mexico customers. (See "Sources of Power" in Item 1. "Business.")

## **Nuclear Plant**

### *PNM's Interest in PVNGS*

PNM is participating in the three units of PVNGS, also known as the Arizona Nuclear Power Project, with APS (the operating agent), Salt River Project, EPE, SCE, SCPPA and the Department of Water and Power of the City of Los Angeles. PNM has a 10.2% undivided interest in PVNGS, with portions of its interests in Units 1 and 2 held under leases.

### *Other PVNGS Matters*

See Note 16 in the Notes to Consolidated Financial Statements for information on other PVNGS matters.

## **Transmission and Distribution**

As of December 31, 2005, PNM owned, jointly owned or leased, 2,897 circuit miles of electric transmission lines, 4,077 miles of distribution overhead lines, 4,504 cable miles of underground distribution lines (excluding street lighting) and 237 substations.

## **Gas**

As of December 31, 2005, the natural gas properties consisted primarily of natural gas storage, transmission and distribution systems. Provisions for storage made by PNM include ownership and operation of an underground storage facility located near Albuquerque. The transmission systems consisted of 1,578 miles of pipe and compression facilities. The distribution systems consisted of 12,205 miles of pipe.

## **Other Information**

PNM's electric and gas transmission and distribution lines are generally located within easements and rights-of-way on public, private and Native American lands. PNM leases interests in PVNGS Units 1 and 2 and related property, EIP and associated equipment, data processing, communication, office and other equipment, office space, joint use utility poles, vehicles and real estate. PNM also owns and leases service and office facilities in Albuquerque and in other areas throughout its service territory.

TNMP

TNMP's facilities are located within its Texas and New Mexico service areas. TNMP's Texas transmission and distribution facilities are located in three non-contiguous areas. One area extends from Lewisville, which is approximately 10 miles north of the Dallas-Fort Worth International Airport, eastward to municipalities near the Red River, and to communities north, west, and south of Fort Worth. The second area includes counties along the Texas Gulf Coast between Houston and Galveston, and the third area includes portions of far west Texas between Midland

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and El Paso. TNMP's New Mexico transmission and distribution facilities are located in southwest and south central New Mexico, including the cities of Alamogordo, Ruidoso, Sliver City, Lordsburg and surrounding communities. TNMP also owns and leases service and office facilities in other areas throughout its service territory.

### ITEM 3. LEGAL PROCEEDINGS

See Note 16 in the Notes to Consolidated Financial Statements for information related to the following matters for PNMR, PNM and TNMP, incorporated in this item by reference.

- Tax Refund Litigation
- PVNGS Water Supply Litigation
  - San Juan River Adjudication
- Navajo Nation Environmental Issues
- Citizen Suit Under the Clean Air Act
  - Excess Emissions Reports
  - Santa Fe Generating Station
- Natural Gas Royalties Qui Tam Litigation
  - Asbestos Cases
- SESCO Matter (for both PNM and TNMP)
  - Archaeological Site Disturbance
- Legal Proceedings discussed under the caption "Western United States Wholesale Power Market"
  - Wholesale Power Marketing Antitrust Suit
    - TNMP True-Up Proceeding
  - Power Resource Group Litigation

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**SUPPLEMENTAL ITEM - EXECUTIVE OFFICERS OF PNM RESOURCES, INC.**

All officers are elected annually by the Board of the PNMR. Executive officers, their ages as of February 26, 2006 and offices held with PNMR for the past five years, or other companies if less than five years with PNMR, are as follows:

<b>Name</b>	<b>Age</b>	<b>Office</b>	<b>Initial Effective Date</b>
J. E. Sterba	50	Chairman, President and Chief Executive Officer	December 2001
		Chairman, President and Chief Executive Officer, PNM	October 2000
		President and Chief Executive Officer, PNM	June 2000
		President, PNM	March 2000
C. N. Eldred <sup>1</sup>	52	Senior Vice President and Chief Financial Officer	January 2006
		Vice President and Chief Financial Officer, Omaha Public Power District	November 1999
A. A. Cobb	58	Senior Vice President and Chief Administrative Officer	June 2005
		Senior Vice President, Peoples Services and Development	December 2001
		Senior Vice President, Peoples Services and Development, PNM	September 2001
		Global Human Resources Officer, Clientlogic	November 1999
P. T. Ortiz	56	Senior Vice President and General Counsel	June 2005
		Senior Vice President, General Counsel and Secretary	December 2001
		Senior Vice President, General Counsel and Secretary, PNM	August 1999
W.J. Real	57	Senior Vice President, Public Policy (PNMR and PNM)	July 2002
		Executive Vice President, Power Production and Marketing	December 2001
		Executive Vice President, Power Production and Marketing, PNM	January 1999
H. W. Smith <sup>2</sup>	48	Senior Vice President, Energy Resources (PNMR and PNM)	March 2004

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		Vice President, Energy Supply, Trading and Services, TECO Energy, Inc.	January 2001
W.D Hobbs <sup>3</sup>	62	Senior Vice President, Customer and Delivery Services	June 2005
		Senior Vice President and Chief Operations Officer, TNMP	August 2002
		Vice President, Transmission and Distribution Operations, TNMP	June 2002
		Vice President, Texas Transmission and Distribution Operations, TNMP	October 2000
J. D. Shorter <sup>4</sup>	40	Senior Vice President	April 2005
		Managing Partner, Wolfrox Partners LLP	August 2004
		Senior Vice President, North America Commercial Operations, TXU Corp.	June 2003
		Vice President and Director of Trading, TXU Corp.	March 1999
T. G. Sategna	52	Vice President and Corporate Controller (PNMR and PNM)	October 2003
		Controller, Utility Operations (PNMR and PNM)	August 2002
		Controller, Electric and Gas	December 2001
		Controller, Electric and Gas Services, PNM	May 2000



<sup>1</sup> C. N. Eldred was Chief Financial Officer at Omaha Public Power District prior to joining PNMR. Prior to that he was head of financing and capital markets for Southern Company. At Southern Company Mr. Eldred executed debt and equity financing strategies and managed rating agency and investment banking relationships associated with capital markets.

<sup>2</sup> H.W. Smith had 25-years of experience in the utility industry prior to joining PNMR, which included executive-level experience in marketing and customer service, economic development, generation development and engineering.

<sup>3</sup> W.D. Hobbs had more than 24 years of experience in engineering, power production, business development and utility operations prior to joining PNMR. He most recently served as Senior Vice President and Chief Operations Officer for TNMP.

<sup>4</sup> J. D. Shorter had more than 16 years of experience in strategic planning, pricing and wholesale power marketing prior to joining PNMR, including extensive knowledge of the deregulated market in Texas.

**PART II****ITEM 5. MARKET FOR THE COMPANY'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

PNMR's common stock is traded on the New York Stock Exchange. On May 18, 2004, PNMR's Board approved a 3-for-2 stock split effective on June 11, 2004 for shareholders of record on June 1, 2004. All references to numbers of shares outstanding and per share amounts have been restated to reflect the stock split.

Ranges of sales prices of PNMR's common stock, reported as composite transactions (Symbol: PNM), and dividends declared on the common stock for 2005 and 2004, by quarters, are as follows:

<b>Quarter Ended</b>	<b>Range of Sales Prices</b>		<b>Dividends Per Share</b>
	<b>High</b>	<b>Low</b>	
<b>2005</b>			
December 31	\$29.22	\$24.03	\$0.200
September 30	\$30.45	\$27.62	\$0.400
June 30	\$30.38	\$26.12	\$ -
March 31	\$28.20	\$23.83	\$0.185
Fiscal Year	\$30.45	\$23.83	\$0.785
<b>2004</b>			
December 31	\$26.11	\$22.57	\$0.185
September 30	\$22.75	\$20.09	\$0.160
June 30	\$20.87	\$18.70	\$0.160
March 31	\$21.20	\$18.77	\$0.160
Fiscal Year	\$26.11	\$18.70	\$0.665

Dividends declared during the quarter ended September 30, 2005 include a \$0.20 per share dividend declared on July 19, 2005 for the quarter ended June 30, 2005 and a \$0.20 per share dividend declared on September 27, 2005 for the quarter ended September 30, 2005.

On July 19, 2005, PNMR's Board approved an 8.0% increase in the common stock dividend. The increase raised the quarterly dividend to \$0.20 per share, for an indicated annual dividend of \$0.80 per share. On February 14, 2006, the Board approved a 10.0% increase in the Company's common stock dividend for an indicated annual rate of \$0.88 per share. PNMR targets a payout ratio of 50% to 60% of consolidated earnings.

On February 28, 2006, there were 14,350 holders of record of the Company's common stock.

See Part II. Item 7. "Management's Discussion and Analysis of Results of Operation and Financial Condition - Liquidity and Capital Resources - Dividends," for a discussion on the payment of future dividends.

See Part III. Item 12. "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters."

### **Cumulative Preferred Stock**

#### PNMR

PNMR does not have any cumulative preferred stock outstanding.

#### PNM

PNM is not aware of any active trading market for its cumulative preferred stock. Quarterly cash dividends were paid on PNM's outstanding cumulative preferred stock at the stated rates during 2005 and 2004.

### **Sales of Unregistered Securities**

None not previously reported on a Quarterly Report on Form 10-Q or a Current Report on Form 8-K.

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**ITEM 6. SELECTED FINANCIAL DATA**

The selected financial data and comparative operating statistics should be read in conjunction with the Consolidated Financial Statements and Notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operation. All references to numbers of shares outstanding and per share amounts have been restated to reflect the 3-for-2 stock split that occurred on June 11, 2004. PNMR results include TNP results are included from the date of acquisition, June 6, 2005, in the table below.

**PNM RESOURCES, INC. AND SUBSIDIARIES**

	2005	2004	2003	2002	2001
	(In thousands except per share amounts and ratios)				
<b>Total Operating Revenues</b>	\$ 2,076,810	\$ 1,604,792	\$ 1,455,653	\$ 1,118,694	\$ 2,254,178
<b>Net Earnings Before Cumulative Effect of Changes in Accounting Principles</b>	\$ 68,153	\$ 87,686	\$ 58,552	\$ 63,686	\$ 149,847
<b>Net Earnings</b>	\$ 67,227	\$ 87,686	\$ 95,173	\$ 63,686	\$ 149,847
<b>Net Earnings per Common Share</b>					
Basic	\$ 1.02	\$ 1.45	\$ 1.60	\$ 1.09	\$ 2.55
Diluted	\$ 1.00	\$ 1.43	\$ 1.58	\$ 1.07	\$ 2.51
<b>Cash Flow Data</b>					
Net cash flows provided from operating activities	\$ 210,451	\$ 235,142	\$ 225,915	\$ 97,359	\$ 327,346
Net cash flows used in investing activities	\$ (154,643)	\$ (143,838)	\$ (98,790)	\$ (200,427)	\$ (407,014)
Net cash flows generated (used) by financing activities	\$ (4,804)	\$ (86,803)	\$ (118,133)	\$ 78,362	\$ 385
<b>Total Assets</b>	\$ 5,124,709	\$ 3,487,635	\$ 3,378,629	\$ 3,247,227	\$ 3,127,602
<b>Long-Term Debt</b>	\$ 1,746,395	\$ 987,823	\$ 987,210	\$ 980,092	\$ 953,884
<b>Common Stock Data</b>					
Market price per common share at year end	\$ 24.49	\$ 25.29	\$ 18.73	\$ 15.88	\$ 18.63
Book value per common share at year end	\$ 19.51	\$ 18.20	\$ 18.07	\$ 16.60	\$ 17.25
Average number of common shares outstanding	65,928	60,414	59,620	58,677	58,677
Dividends declared per common share	\$ 0.785	\$ 0.665	\$ 0.600	\$ 0.587	\$ 0.533
Return on average common equity	5.6%	8.1%	9.3%	6.4%	15.5%
<b>Capitalization</b>					
Common stockholders' equity	42.3%	52.4%	51.9%	49.5%	50.8%
Preferred stock without mandatory redemption requirements	0.4	0.6	0.6	0.7	0.6
Long-term debt	57.3	47.0	47.5	49.8	48.6
	100.0%	100.0%	100.0%	100.0%	100.0%



**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**COMPARATIVE OPERATING STATISTICS**

	2005	2004	2003	2002	2001
<b>Regulated Operations</b>					
<b>PNM Electric MWh Sales</b>					
Residential	2,652,475	2,509,449	2,405,488	2,298,542	2,197,889
Commercial	3,526,133	3,450,503	3,379,147	3,254,576	3,213,208
Industrial	1,277,156	1,283,769	1,292,711	1,612,723	1,603,266
Other	256,202	253,393	247,255	267,070	240,934
Total PNM Electric MWh Sales	7,711,966	7,497,114	7,324,601	7,432,911	7,255,297
<b>TNMP Electric MWh Sales *</b>					
Residential	1,859,020	-	-	-	-
General Services	144,203	-	-	-	-
Primary/Economy/Transmission	1,311,208	-	-	-	-
Secondary	1,174,587	-	-	-	-
Municipal/Lighting	86,307	-	-	-	-
Total TNMP MWh Sales	4,575,325	-	-	-	-
<b>PNM Gas Throughput - Decatherms</b>					
(In thousands):					
Residential	28,119	30,618	27,416	29,627	27,848
Commercial	10,554	11,639	10,810	12,009	10,421
Industrial	369	413	485	749	3,920
Transportation	37,013	43,208	50,756	44,889	51,395
Other	9,780	13,871	5,510	4,807	4,355
Total PNM Gas Throughput	85,835	99,749	94,977	92,081	97,939
<b>Unregulated Operations</b>					
<b>PNM Wholesale MWh Sales</b>					
Long-term contracts	2,516,907	2,943,372	2,469,707	844,169	1,463,031
Short-term sales	8,069,751	9,057,172	9,432,297	8,605,985	11,133,669
Total PNM Wholesale MWh Sales	10,586,658	12,000,544	11,902,004	9,450,154	12,596,700
<b>First Choice MWh Sales *</b>					
Residential	1,591,005	-	-	-	-
Mass-market	400,839	-	-	-	-
Mid-market	478,531	-	-	-	-
Other	29,780	-	-	-	-
Total First Choice MWh Sales	2,500,155	-	-	-	-

\* TNMP and First Choice are reported from the date of acquisition, June 6, 2005.

Under TECA, customers of TNMP Electric in Texas can choose First Choice or any other REP to provide energy. However, TNMP Electric delivers energy to customers within its service area regardless of the REP chosen. Therefore, TNMP Electric earns revenue for energy delivery and First Choice earns revenue on the usage of that energy by its customers. The MWh reported above for TNMP Electric and First Choice include approximately 1,644,675 MWh used by customers of TNMP Electric who have chosen First Choice as their REP.



**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**COMPARATIVE OPERATING STATISTICS**

	2005	2004	2003	2002	2001
	(In thousands)				
<b>Regulated Operations</b>					
<b>PNM Electric Revenues</b>					
Residential	\$ 216,890	\$ 206,950	\$ 203,710	\$ 197,174	\$ 187,600
Commercial	254,480	251,092	252,876	247,800	242,372
Industrial	61,146	61,905	64,549	82,009	82,752
Transmission	21,509	18,327	19,453	23,857	26,553
Other	19,951	20,138	19,876	19,956	19,949
Total PNM Electric Revenues	\$ 573,976	\$ 558,412	\$ 560,464	\$ 570,796	\$ 559,226
<b>TNMP Electric Revenues *</b>					
Residential	\$ 57,732	\$ -	\$ -	\$ -	\$ -
General Services	18,864	-	-	-	-
Primary/Economy/Transmission	25,815	-	-	-	-
Secondary	29,925	-	-	-	-
Municipal/Lighting	5,311	-	-	-	-
Other	16,703	-	-	-	-
Total TNMP Revenues	\$ 154,350	\$ -	\$ -	\$ -	\$ -
<b>PNM Gas Revenues</b>					
Residential	\$ 311,043	\$ 292,163	\$ 226,799	\$ 176,284	\$ 221,409
Commercial	98,929	92,128	72,269	53,734	65,654
Industrial	3,375	2,889	2,820	2,872	27,519
Transportation	13,813	15,274	18,906	17,735	20,188
Other	84,282	88,467	37,473	26,781	36,495
Total PNM Gas Revenues	\$ 511,442	\$ 490,921	\$ 358,267	\$ 277,406	\$ 371,265
<b>Unregulated Operations</b>					
<b>PNM Wholesale Revenues</b>					
Long-term contracts	\$ 154,692	\$ 158,085	\$ 135,674	\$ 58,546	\$ 77,250
Short-term sales	473,336	430,158	417,486 (a)	285,234	1,244,899
Total PNM Wholesale Revenues	\$ 628,028	\$ 588,243	\$ 553,160	\$ 343,780	\$1,322,149
<b>First Choice Revenues *</b>					
Residential	\$ 198,218	\$ -	\$ -	\$ -	\$ -
Mass-market	53,111	-	-	-	-
Mid-market	46,584	-	-	-	-
Other	18,417	-	-	-	-
Total First Choice Revenues	\$ 316,330	\$ -	\$ -	\$ -	\$ -

\* TNMP and First Choice are reported from the date of acquisition, June 6, 2005.

(a) Includes intersegment sales of \$1,535 in 2003.





**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**COMPARATIVE OPERATING STATISTICS**

	2005	2004	2003	2002	2001
<b>Regulated Operations</b>					
<b>PNM Electric Customers</b>					
Residential	378,116	367,491	358,099	345,588	340,656
Commercial	44,721	43,425	42,391	41,092	40,065
Industrial	281	290	296	311	377
Other	838	818	822	796	924
Total PNM Electric Customers	423,956	412,024	401,608	387,787	382,022
<b>TNMP Electric Customers *</b>					
Residential	222,688	-	-	-	-
General Services	6,147	-	-	-	-
Primary/Economy/Transmission	208	-	-	-	-
Secondary	29,038	-	-	-	-
Municipal/Lighting	2,188	-	-	-	-
Total TNMP Customers	260,269	-	-	-	-
<b>PNM Gas Customers</b>					
Residential	440,624	430,578	421,104	411,642	404,753
Commercial	35,136	34,993	34,645	35,194	32,894
Industrial	42	47	46	58	50
Transportation	26	23	40	27	34
Other	2,654	2,931	2,983	3,664	3,528
Total PNM Gas Customers	478,482	468,572	458,818	450,585	441,259
<b>Unregulated Operations</b>					
<b>PNM Wholesale Customers</b>					
Long-term and short-term	76	68	72	76	79
Total PNM Wholesale Customers	76	68	72	76	79
<b>First Choice Customers *</b>					
Residential	178,128	-	-	-	-
Mass-market	23,914	-	-	-	-
Mid-market	6,649	-	-	-	-
Other	1,760	-	-	-	-
Total First Choice Customers	210,451	-	-	-	-
<b>PNM Generation Statistics</b>					
Reliable Net Capability - MW	1,744	1,729	1,742	1,734	1,521
Coincidental Peak Demand - MW	1,779	1,655	1,661	1,478	1,431
Average Fuel Cost per Million BTU	\$ 1.4711	\$ 1.3751	\$ 1.4120	\$ 1.3910	\$ 1.6007
BTU per KWh of Net Generation	10,706	10,442	10,854	10,568	10,549

\* TNMP and First Choice are reported from the date of acquisition, June 6, 2005.

The customers reported above for TNMP Electric and First Choice include 150,787 customers of TNMP who have chosen First Choice as their REP. These TNMP Electric customers are also included in the First Choice segment.

## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION**

The following Management's Discussion and Analysis of Financial Condition and Results of Operation for PNMR, PNM and TNMP is presented both on a combined basis as applicable, and on a separate basis. For discussion purposes, this report will use the term "Company" when discussing matters of common applicability to PNMR, PNM and TNMP. Discussions regarding specific contractual obligations generally reference the entity that is legally obligated. In the case of contractual obligations of PNM and TNMP, these obligations are consolidated with PNMR and its subsidiaries under GAAP. A reference to a "Note" in this Item 7 refers to the accompanying Notes to Consolidated Financial Statements.

### **RESULTS OF OPERATION - EXECUTIVE SUMMARY**

During 2005, the Company's results were impacted by unexpected plant outages and the extension of planned outages, particularly at PVNGS, higher purchased power costs and charges for refinancing and TNP acquisition integration costs. As experienced in its 2005 results, the Company expects that the TNP acquisition will be accretive to earnings in 2006, the first full year of operation after the transaction was completed. This expectation is based on certain assumptions, including assumptions related to interest rates and market prices for power, among other things. In 2005, the market price of natural gas across the United States increased significantly, due to a hot 2005 summer, which led to more demand from natural gas-fired power plants, as well as due to the hurricanes in the Gulf Coast region of the United States. The Company cannot predict what impact the increase in market prices for natural gas will have on its future results of operations.

PNM is a participant in PVNGS, of which APS is the operating agent. During 2005, PVNGS had the lowest capacity factor (measured against maximum dependable capacity) that the plant has had since 1994. The equivalent availability for PVNGS was 76.0% for 2005. This reflects bottom quartile performance relative to the 103 operating reactors in the United States. There were nine unscheduled outages during 2005 that had a variety of causes. In 2004, the NRC determined that there had been a safety concern at PVNGS related to the safety injection systems for the three PVNGS units. This led to a "yellow" finding and a \$50,000 civil penalty under the NRC's reactor oversight process. A "yellow" finding places a unit in the "degraded safety cornerstone" column of the NRC's performance matrix, which results in an enhanced NRC inspection regimen. During 2005, the NRC completed its enhanced inspection. The "yellow" finding remains unresolved.

PVNGS has encountered tube cracking in the steam generators. The PVNGS Units 2 steam generators were replaced in 2003 and the replacement of PVNGS Unit 1 steam generators was completed in December 2005. Completion of installation of the PVNGS Unit 3 steam generators is expected by December 2007.

APS has been operating PVNGS Unit 1 at reduced power levels since December 25, 2005 due to a vibration in the PVNGS Unit 1 shutdown cooling lines. As a result, PNM is receiving approximately 24 MW of power from PVNGS Unit 1 based on its 10.2% undivided interest in PVNGS.

Implementation of a potential solution preliminarily scheduled by APS for February 2006 was canceled after comprehensive analysis concluded that the desired improvement likely would not have been achieved. APS had informed PNM that it was in the process of formulating other potential remedies to address the issue and that it was scheduling another attempt to remedy this issue sometime in April 2006. APS has more recently informed PNM that the preferred solution will require Unit 1 to undergo an outage of approximately five weeks in order to effect the necessary modifications to Unit 1 and that it plans to begin this outage in the June 2006 timeframe. In addition, an outage of approximately one week for preparatory work will begin in mid-March 2006. This preferred solution was initially planned for installation in the spring of 2007.

The operation of PVNGS not only affects PNM's ability to make off-system sales, but can also cause PNM to purchase power to serve its retail electric customers. Based on current forward market energy prices, PNM estimates that operation of PVNGS Unit 1 at the reduced power level could result in a reduction in consolidated gross margin, or operating revenues minus cost of energy sold, of \$3.0 million to \$4.0 million per month before income taxes. However, PNM is taking steps to mitigate the impact on consolidated gross margin while PVNGS Unit 1 operates at the reduced power level.

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The Company is positioned as a merchant utility, primarily operating as a regulated energy service provider. The Company is engaged in the sale and marketing of electricity in the competitive wholesale energy marketplace. In addition, through First Choice, the Company is a retail electric provider in Texas under legislation that established retail competition. PNM is under the jurisdiction of the NMPRC while TNMP operates under the jurisdiction of the PUCT in Texas and the NMPRC in New Mexico.

### ***Regulated Operations***

The regulated operations strategy is directed at supplying reasonably priced and reliable energy to retail customers through customer-driven operational excellence, high quality customer service, cost efficient processes and improved overall organizational performance.

### **PNM Electric**

PNM Electric is an integrated electric utility that consists of generation, transmission and distribution of electricity for retail electric customers in New Mexico and the sale of transmission to third parties as well as to PNM Wholesale and TNMP Electric. PNM Electric provides retail electric service to a large area of north central New Mexico, including the cities of Albuquerque and Santa Fe, and certain other areas of New Mexico. Customer rates for retail electric service are set by the NMPRC based on the provisions of the Global Electric Agreement. (See Note 17.) PNM Electric owns or leases transmission lines, interconnected with other utilities in New Mexico, south and east into Texas, west into Arizona, and north into Colorado and Utah.

### **PNM Gas**

PNM Gas distributes natural gas to most of the major communities in New Mexico, including two of New Mexico's three largest metropolitan areas, Albuquerque and Santa Fe. The customer base for PNM Gas includes both sales-service customers and transportation-service customers. PNM Gas operates under a purchase gas adjustment clause that allows it to purchase natural gas in the open market and resell it at cost to its distribution customers. As a result, increases or decreases in gas revenues resulting from wholesale gas price fluctuations do not impact PNM's consolidated gross margin or earnings.

### **TNMP Electric**

TNMP Electric is a regulated utility operating in Texas and New Mexico. In Texas, TNMP provides regulated transmission and distribution services under TECA. In New Mexico, TNMP provides integrated electric services that include the transmission, distribution, purchase and sale of electricity to its New Mexico customers as well as transmission to third parties and to PNM. TNMP's Texas and New Mexico operations are subject to traditional cost of service regulation. PNM Wholesale is TNMP's sole supplier for its load in New Mexico. In accordance with the NMPRC stipulation approving PNM's acquisition of TNP, PNM Wholesale will remain the sole power supplier for TNMP's New Mexico needs through 2010 (see Note 17).

### ***Unregulated Operations***

### **PNM Wholesale**

PNM Wholesale is engaged in the generation and sale of electricity into the wholesale market based on two product lines, long-term contracts (including a contract with TNMP that expires December 31, 2006) and short-term sales. PNM wholesale sells the unused capacity of jurisdictional assets as well as the capacity of PNM's wholesale plants excluded from retail rates. Both regulated and unregulated generation is jointly dispatched in order to improve reliability, provide the most economic power to retail customers and maximize profits on any wholesale transactions. Although PNM Wholesale is regulated in certain respects, including FERC jurisdiction over its rates, the Company

includes PNM Wholesale in the unregulated segment of its business because PNM Wholesale is not subject to traditional rate of return regulation.

The PNM Wholesale strategy utilized by the Company calls for net asset-backed energy sales supported by long-term contracts sold into the wholesale market. PNM Wholesale's aggregate net open forward electric sales position, including short-term sales and long-term contracts, is covered by its forecasted excess generation capacity. Management actively monitors the net asset-backed sales by the use of stringent risk management policies.

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## **First Choice**

First Choice is a certified retail electric provider operating in Texas that provides electricity to residential, small and large commercial, industrial and institutional customers. First Choice serves Texas retail customers by acquiring new retail customers, by setting up retail accounts, handling customer inquiries and complaints, and acting as a liaison between the transmission and distribution companies and retail customers. First Choice was organized in 2000 to act as TNMP's affiliated retail electric provider, as required by TECA. Although First Choice is regulated in certain respects by the PUCT under ERCOT, the Company includes First Choice in the unregulated segment of its business because First Choice is not subject to traditional rate of return regulation.

## ***Corporate and Other***

PNMR was established as the holding company in 2001. On December 30, 2004, PNMR became a registered holding company under PUHCA and created PNMR Services Company, which began operating on January 1, 2005.

Comprehensive energy legislation enacted in August 2005 resulted in the repeal of PUHCA effective February 2006. PNMR is in the process of evaluating the effects of the repeal, along with the other provisions of the legislation.

PNMR performed substantially all of the corporate activities of PNM from 2001 to 2004. These activities were billed to PNM on a cost basis to the extent they were for the corporate management of PNM and were allocated to the business units. The services functions previously performed by PNMR were assumed by PNMR Services Company effective January 1, 2005.

TNMP provided First Choice and TNP with corporate support services under a shared services agreement with First Choice and a similar agreement with TNP. These services were billed at TNMP's cost and, in return, TNP and First Choice compensated TNMP for the use of the services. These agreements were in effect through June 6, 2005 when they were replaced by a new service arrangement.

Effective with the acquisition of TNP on June 6, 2005 (see Note 2) all TNMP employees who were providing corporate support to TNP and First Choice became employees of PNMR Services Company. PNMR Services Company provides corporate services to PNMR and its subsidiaries including PNM, Avistar, TNP, TNMP and First Choice based on shared services agreements. These services are billed at cost on a monthly basis and are allocated to PNMR and its subsidiaries.

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes thereto. Trends and contingencies of a material nature are discussed to the extent known. Refer also to Item 1A. "Risk Factors" and to "Disclosure Regarding Forward Looking Statements" in this Item 7.

## ***TNP Acquisition***

On June 6, 2005, PNMR acquired all of the outstanding common shares of TNP, including its principal subsidiaries, TNMP and First Choice, in order to complement its existing New Mexico electric operations and to expand into the retail and wholesale markets in Texas. The results of TNP's operations have been included in the Consolidated Financial Statements of PNMR from that date.

The aggregate purchase price was \$1,221 million, including a net payment to the previous owner of \$162.0 million consisting of \$74.6 million of cash and common stock valued at \$87.4 million. The value of the 4,326,337 common shares issued was determined based on \$20.20 per common share as provided for in the Stock Purchase Agreement, dated as of July 24, 2004, by and between PNMR and SW Acquisition. In addition, the aggregate purchase price included \$1,037 million of TNP debt and preferred stock and incurred transaction and other costs of \$21.5 million. During the fourth quarter of 2005, PNMR completed the valuations of acquired property and intangible assets.





Pursuant to the Stock Purchase Agreement, PNMR provided SW Acquisition its proposed final purchase price, reflecting a reduction from the estimated purchase price of approximately \$37.0 million. SW Acquisition filed a lawsuit that disputed PNMR's proposed final purchase price. In November 2005, the parties reached a settlement of the lawsuit resulting in a reduction of approximately \$13.0 million to the original purchase price based on working capital adjustments from the closing of the second-quarter financial statements and stranded cost recovery payments. PNMR received the \$13.0 million payment from SW Acquisition in the fourth quarter of 2005. The net cash paid and purchase price stated above reflect this reduction.

In 2005, the PUCT approved a settlement agreement finding the acquisition of TNP to be in the public interest. Among other things, the settlement agreement calls for:

- a two-year electric rate freeze that includes a \$13.0 million annual rate reduction in TNMP's retail delivery rates effective May 1, 2005;
- an authorized return on equity of 10.25% on an implied capital structure of 60% debt and 40% equity for certain reporting purposes;
- the use of a 60/40% debt/equity capital structure in TNMP's next base rate case if filed before January 1, 2009; and
- a \$6.0 million synergy savings credit (whether or not savings are achieved) amortized over 24 months effective after the close of the transaction.

Also in 2005, the NMPRC approved a stipulation in connection with the acquisition of TNP. Among other things, the stipulation calls for:

- a three-phase rate reduction totaling 15%, to TNMP's electric customers in southern New Mexico, beginning January 2006 and ending December 2010; the rate reduction will lower TNMP electric rates by approximately \$9.6 million in the first year;
  - an imputed 55/45% debt/equity structure with an assumed rate of return on equity of 10.5% for TNMP;
  - PNM to remain the power supplier for TNMP's New Mexico needs through 2010; and
- integration of TNMP's New Mexico assets into PNM effective January 1, 2007, the companies, however, will maintain separate rates through 2010.

### ***Proposed Twin Oaks Acquisition***

In January 2006, Altura, an indirect wholly owned subsidiary of PNMR, entered into an agreement with subsidiaries of Sempra to purchase the Twin Oaks power facility in an acquisition of assets for \$480 million in cash. PNMR and Sempra are also parties to the agreement and have agreed to provide parental guarantees for certain obligations of their respective subsidiaries relating to the acquisition.

The Twin Oaks power facility is a 305 MW coal-fired power plant located 150 miles south of Dallas, Texas. Under the agreement, substantially all of the assets and contractual commitments relating to Twin Oaks are to be transferred to Altura upon closing, including fuel supply and power purchase and sale agreements. The agreement also includes the development rights for a possible 600 MW expansion of the plant. The Sempra subsidiaries are pursuing necessary permits for the plant expansion, which permits are expected to be granted in 2007. An additional \$2.5 million payment will be made to Sempra upon the issuance of an air permit for the expansion and an additional \$2.5 million will be paid when Altura begins construction of the expansion.

The transaction is expected to close no earlier than April 17, 2006, subject to third-party consents and anti-trust clearance under the Hart-Scott-Rodino Act. PNMR has arranged for bridge financing to close the transaction. It is expected that the permanent financing will be provided from the issuance of debt and equity.

### ***Competitive Strategy***

The Company's vision is to "Build America's Best Merchant Utility." To achieve this objective, management intends to:



*Expand Regulated and Unregulated Operations.* The Company intends to develop both its retail and wholesale business by expanding its current operations and by acquiring additional value-enhancing assets. As evidenced by the Luna and TNP acquisitions and the proposed Twin Oaks acquisition, the Company intends to continue to increase its revenues by expanding its geographic coverage in the southwest, a region which not only exhibits rapid customer and load growth, but which the Company knows well. The Company also intends to increase its presence in the southwest market by buying additional generating resources and selling power from those resources through long-term contracts. The Company's future growth plans call for approximately 75% of its new generation portfolio to be committed through long-term contracts as required by the Global Electric Agreement. In October 2005, PNM entered into a 150 MW long-term sale contract with APS that begins in June 2007. In addition, the Company expects that the acquisition of First Choice as part of the TNP acquisition will provide a solid foundation for entry into the competitive retail market in Texas. In addition, PNMR intends to continue to provide energy and technology related services through its wholly owned subsidiary, Avistar.

*Acquire Additional Generating Assets in the Southwest Region.* The Company intends to enhance and diversify its presence in the southwest region through the acquisition or development of quality generation assets, including renewable or clean technology resources, to serve the Company's retail and wholesale load while maintaining diversity of fuel mix. The Company also plans to increase long-term sales contracts in tandem with increases in its generation capacity. In 2004, the Company purchased a one-third interest in Luna, a partially constructed, combined-cycle power plant near Deming, New Mexico. The Company will be entitled to 190 MW from the 570 MW facility, which is expected to be completed no later than the second quarter of 2006. The Company also believes that Luna strategically fits well into its portfolio of generation assets because of the facility's location in southern New Mexico, its low capital costs, its efficient heat rate, its anticipated low dispatch costs and its use of clean burning gas technology. In addition, the proposed acquisition of the Twin Oaks facility, discussed above, would provide access to wholesale markets in Texas. As in the past, the Company intends to continue a disciplined approach to any acquisition, to match acquisitions to demand and to hedge capacity with long-term contracts.

*Maintain Prudent Cost Controls.* Management maintains cost control procedures for PNMR and its subsidiaries.

*Continue to Improve Credit Strength and Reduce Cost of Capital.* A high priority and long-term commitment is to maintain the Company's investment grade rating in any type of regulatory, natural gas or electricity price scenario. The Company believes TNP offers an opportunity to derive additional value through the stronger credit profile of the combined entity. In conjunction with the acquisition of TNP, on June 6, 2005, PNMR made an equity investment of approximately \$110.5 million in TNP, which TNP used to repay in full amounts owing under TNP's credit agreement. In addition, in July 2005, PNMR provided funds to TNP to enable TNP to redeem its preferred stock and senior notes. See "Financing Activities - PNMR" below in "Liquidity and Capital Resources" for further details of this transaction. In addition, PNMR plans to obtain the permanent financing for the proposed acquisition of the Twin Oaks facility from the issuance of debt and equity, structured to maintain the Company's investment grade rating.

*Commitment to Corporate Citizenship.* The Company is committed to its guiding principle, "Do the Right Thing." This commitment serves as the cornerstone of the Company's ethics and compliance efforts and underscores its effort to ensure that dealings with customers, employees, shareholders and business partners are above reproach. This is evidenced by the Company's environmental sustainability program with aggressive five-year goals for reducing water usage, improving air quality, reducing waste streams and becoming a leader in the development of renewable energy.

## RESULTS OF OPERATION - PNMR

### YEAR ENDED DECEMBER 31, 2005 COMPARED TO YEAR ENDED DECEMBER 31, 2004

PNMR's net GAAP earnings for the year ended December 31, 2005 were \$67.2 million, or \$1.00 per diluted share of common stock, compared to \$87.7 million or \$1.43 per diluted share of common stock in 2004. The decrease in earnings per share was driven primarily by acquisition related and other charges of \$36.5 million, net of income taxes, which consisted of the following:

- TNP acquisition integration costs of \$10.1 million;
- turbine impairment of \$9.0 million (see Note 1);
- charge related to issuance of equity-linked units of \$7.3 million (see Note 6);
  - TNP debt refinancing costs of \$5.1 million;
  - software write-off of \$2.7 million;
- charge associated with the NMPRC's approval of the TNP acquisition of \$1.4 million; and
- cumulative effect of adoption of FIN 47 of \$0.9 million (see Note 1).

In addition, as discussed above, PNM experienced below normal levels of plant performance due to unexpected plant outages, particularly at PVNGS, which reduced the amount of electricity PNM sold in the wholesale market and forced PNM to purchase power to meet jurisdictional and contractual wholesale needs. In addition, the margin on fixed-price contracts decreased, as increases in purchased power prices that were driven by increasing fuel prices that could not be passed on to customers with fixed sales prices. These decreases to net earnings were partially offset by the addition of TNP operations from June 6 through December 31, 2005.

The following discussion is based on the methodology that management uses for making operating decisions and assessing performance of its various business activities. See Note 3 for additional information regarding these results and the Consolidated Financial Statements.

In addition, adjustments related to EITF Issue 03-11, "*Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133 and Not Held for Trading Purposes*," are excluded from the PNM Wholesale segment and are instead included in the Corporate and Other segment. This accounting pronouncement requires a net presentation of realized gains and losses for certain non-trading derivatives. Management evaluates PNM Wholesale on a gross presentation basis due to its primarily net-asset-backed marketing strategy and the importance it places on PNM's ability to repurchase and remarket previously sold capacity. The other segments are not affected by this EITF.

Corporate costs, income taxes and non-operating items are discussed on a consolidated basis for PNMR and are in conformity with the presentation in PNMR's Consolidated Financial Statements.

**Regulated Operations****PNM Electric**

The table below sets forth the operating results for PNM Electric:

	<b>Year Ended December 31,</b>		<b>Variance</b>
	<b>2005</b>	<b>2004</b>	
	(In thousands)		
<b>Operating revenues</b>	<b>\$ 573,976</b>	<b>\$ 558,412</b>	<b>\$ 15,564</b>
Less: Cost of energy	210,169	186,517	23,652
Intersegment energy transfer	(35,829)	(42,769)	6,940
<b>Gross margin</b>	<b>399,636</b>	<b>414,664</b>	<b>(15,028)</b>
Energy production costs	118,633	113,848	4,785
Transmission and distribution O&M	30,462	31,360	(898)
Customer related expense	19,454	18,190	1,264
Administrative and general	11,001	4,640	6,361
<b>Total non-fuel O&amp;M</b>	<b>179,550</b>	<b>168,038</b>	<b>11,512</b>
Corporate allocation	64,170	69,820	(5,650)
Depreciation and amortization	69,798	63,050	6,748
Taxes other than income taxes	19,726	20,324	(598)
Income taxes	13,065	23,141	(10,076)
<b>Total non-fuel operating expenses</b>	<b>346,309</b>	<b>344,373</b>	<b>1,936</b>
<b>Operating income</b>	<b>\$ 53,327</b>	<b>\$ 70,291</b>	<b>\$ (16,964)</b>

The following table shows electric revenues by customer class and average customers:

**PNM Electric Revenues**

	<b>Year Ended December 31,</b>		<b>Variance</b>
	<b>2005</b>	<b>2004</b>	
	(In thousands, except customers)		
Residential	\$ 216,890	\$ 206,950	\$ 9,940
Commercial	254,480	251,092	3,388
Industrial	61,146	61,905	(759)
Transmission	21,509	18,327	3,182
Other	19,951	20,138	(187)
	<b>\$ 573,976</b>	<b>\$ 558,412</b>	<b>\$ 15,564</b>
Average customers	417,986	406,968	11,018

The following table shows electric sales by customer class:

**PNM Electric Sales**

	<b>Year Ended December 31,</b>		<b>Variance</b>
	<b>2005</b>	<b>2004</b>	
		(Megawatt hours)	
Residential	2,652,475	2,509,449	143,026
Commercial	3,526,133	3,450,503	75,630
Industrial	1,277,156	1,283,769	(6,613)
Other	256,202	253,393	2,809
	7,711,966	7,497,114	214,852

Operating revenues increased \$15.6 million, or 2.8%, from the prior year. Retail electricity sales increased 2.9%, to 7.7 million MWh in 2005 compared to 7.5 million MWh in 2004. Customer growth was 2.7% year over year and weather-normalized retail electric load growth was 2.5%. Average customer load growth, when normalized for the impact of weather and the leap year in 2004, increased revenues by \$14.0 million. Cooling Degree Days for Albuquerque increased approximately 19.6% and Heating Degree Days decreased approximately 4.7%, resulting in a net overall increase in revenues of \$3.7 million. In addition, increased transmission revenues, primarily from point-to-point customers, increased revenues \$3.2 million. These revenue increases were partially offset by a decrease of \$1.3 million attributable to the 2004 leap year, with 2005 including one less day of revenues, and by a decrease of \$3.8 million due to the 2.5% electric rate reduction effective September 1, 2005.

The gross margin, or operating revenues minus cost of energy sold and intersegment energy transfer, decreased \$15.0 million, or 3.6%, from the prior year due to a reduction in power plant availability resulting from plant outages and a related increase in purchased power requirements to serve load. In addition, an increase in purchased power contract prices on pre-existing contracts reduced the margin earned on fixed-price sales. These decreases were partially offset by the increased revenues associated with retail load growth.

Total non-fuel O&M expenses increased \$11.5 million, or 6.9%, over the prior year. Energy production costs increased \$4.8 million, or 4.2%, due to higher plant maintenance costs in 2005 compared to 2004. Plant outage costs at PVNGS and Reeves increased costs \$2.8 million and \$1.4 million, respectively, in 2005. In addition, there were higher general plant maintenance and other costs of \$1.0 million compared to 2004. These increases were partially offset by reduced outage costs at Four Corners and SJGS of \$0.4 million and \$0.3 million, respectively. Transmission and distribution O&M expense decreased \$0.9 million, or 2.9%, primarily due to a decrease in maintenance and labor expenses. Customer related expense increased \$1.3 million, or 6.9%, primarily due to increased consulting fees related to FERC proceedings. Administrative and general expenses increased \$6.4 million over the prior year primarily due to increased incentive compensation, labor and insurance costs of \$5.3 million (compensation costs were recorded at the corporate level in 2004 but charged to the business segments in 2005) and increased legal and other outside services costs of \$0.6 million for routine business matters.

Depreciation and amortization increased \$6.7 million, or 10.7%, primarily due to asset and software additions placed in service in December 2004 and in 2005. PNMR expects depreciation to rise going forward as a result of increased investment in new information technology platforms and other capital spending.



**TNMP Electric**

PNMR acquired TNP, the parent of TNMP, on June 6, 2005, and results in this section are presented from the acquisition date forward only. Comparable results from 2004 are not presented. For the year ended December 31, 2005, which includes results from June 6 through December 31, 2005, the TNMP Electric segment increased PNMR revenues by \$154.4 million.

The table below sets forth the operating results for TNMP Electric:

	<b>For the Period</b>	
	<b>June 6 - December 31, 2005</b>	
	(In thousands)	
<b>Operating revenues</b>	<b>\$</b>	<b>154,350</b>
Less: Cost of energy		58,014
<b>Gross margin</b>		<b>96,336</b>
Transmission and distribution O&M		12,403
Customer related expense		3,111
Administrative and general		415
<b>Total non-fuel O&amp;M</b>		<b>15,929</b>
Corporate allocation		9,386
Depreciation and amortization		17,596
Taxes other than income taxes		14,261
Income taxes		8,442
<b>Total non-fuel operating expenses</b>		<b>65,614</b>
<b>Operating income</b>	<b>\$</b>	<b>30,722</b>

The following table shows electric revenues by customer class and average customers:

<b>TNMP Electric Revenues</b>		
	<b>For the Period</b>	
	<b>June 6 - December 31, 2005</b>	
	(In thousands, except customers)	
Residential	\$	57,732
General Services		18,864
Primary/Economy/Transmission		25,815
Secondary		29,925
Municipal/Lighting		5,311
Other		16,703
	\$	154,350
Average customers *		255,335

\* Under TECA, customers of TNMP Electric in Texas have the ability to choose First Choice or any other REP to provide energy. However, TNMP Electric delivers energy to customers within its service area regardless of the REP chosen. Therefore, TNMP Electric earns revenue for the delivery of energy to First Choice and First Choice earns revenue on the usage of that energy by its customers. The average customers reported above include 154,252 customers of TNMP Electric who have chosen First Choice as their REP. These TNMP Electric customers are also included below in the First Choice segment. For PNMR consolidated reporting purposes, these customers are included only once in the consolidated customer count.



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The following table shows electric sales by customer class:

**TNMP Electric Sales \***

**For the Period**  
**June 6 - December 31, 2005**  
(Megawatt hours)

Residential	1,859,020
General Services	144,203
Primary/Economy/Transmission	1,311,208
Secondary	1,174,587
Municipal/Lighting	86,307
	4,575,325

\* The MWh reported above include 1,644,675 MWh used by customers of TNMP Electric who have chosen First Choice as their REP. These MWh are also included below in the First Choice segment.

TNMP Electric's gross margin was \$96.3 million for the period June 6 through December 31, 2005. The significant factors that impacted gross margin include increases due to load growth because of warmer than normal weather, a decrease in revenues due to a 9.3% Texas rate reduction, synergy savings effective in May 2005, and lower revenues due to a reduction in operations of a major customer in New Mexico.

**PNM Gas**

The table below sets forth the operating results for PNM Gas:

	<b>Year Ended December 31,</b>			<b>Variance</b>
	<b>2005</b>	<b>2004</b>		
	(In thousands)			
<b>Operating revenues</b>	<b>\$ 511,442</b>	<b>\$ 490,921</b>	<b>\$ 20,521</b>	
Less: Cost of energy	364,205	343,219	20,986	
<b>Gross margin</b>	<b>147,237</b>	<b>147,702</b>	<b>(465)</b>	
Energy production costs	2,444	2,338	106	
Transmission and distribution O&M	27,817	28,006	(189)	
Customer related expense	19,616	19,283	333	
Administrative and general	3,487	1,648	1,839	
<b>Total non-fuel O&amp;M</b>	<b>53,364</b>	<b>51,275</b>	<b>2,089</b>	
Corporate allocation	37,028	38,725	(1,697)	
Depreciation and amortization	22,548	18,894	3,654	
Taxes other than income taxes	8,010	7,412	598	
Income taxes	5,853	8,063	(2,210)	
<b>Total non-fuel operating expenses</b>	<b>126,803</b>	<b>124,369</b>	<b>2,434</b>	
<b>Operating income</b>	<b>\$ 20,434</b>	<b>\$ 23,333</b>	<b>\$ (2,899)</b>	

The following table shows gas revenues by customer and average customers:

**PNM Gas Revenues**

	<b>Year Ended December 31,</b>			<b>Variance</b>
	<b>2005</b>	<b>2004</b>		
	(In thousands, except customers)			
Residential	\$ 311,043	\$ 292,163	\$ 18,880	
Commercial	98,929	92,128	6,801	
Industrial	3,375	2,889	486	
Transportation*	13,813	15,274	(1,461)	
Other	84,282	88,467	(4,185)	
	\$ 511,442	\$ 490,921	\$ 20,521	
Average customers	471,321	461,399	9,922	

\*Customer-owned gas.

The following table shows gas throughput by customer class:

### PNM Gas Throughput

	Year Ended December 31,		Variance
	2005	2004	
	(Thousands of decatherms)		
Residential	28,119	30,618	(2,499)
Commercial	10,554	11,639	(1,085)
Industrial	369	413	(44)
Transportation*	37,013	43,208	(6,195)
Other	9,780	13,871	(4,091)
	85,835	99,749	(13,914)

\*Customer-owned gas.

Operating revenues increased \$20.5 million, or 4.2% over the prior year, primarily due to higher natural gas prices in 2005 compared to 2004. PNM Gas purchases natural gas in the open market and resells it at the same price to its sales-service customers. As a result, increases or decreases in gas revenues driven by gas costs do not impact the consolidated gross margin or earnings of PNM Gas. Total gas sales volumes decreased 13.9%, due to a 4.7% decrease in Heating Degree-Days and additional customer conservation resulting from higher natural gas prices. These decreases were partially offset by average customer growth of 2.2%, which increased gas revenues \$2.2 million, and an increase of \$6.7 million due to a residential cost of service rate increase beginning in April 2004.

The gross margin, or operating revenues minus cost of energy sold, was largely unchanged, decreasing only \$0.5 million, or 0.3%, from the prior year. Warmer weather resulted in a \$7.9 million decrease to margin and additional customer conservation resulted in reduced usage of \$1.4 million. These decreases were offset by the residential cost of service rate increase and the customer growth discussed above.

Total non-fuel O&M expenses increased \$2.1 million, or 4.1%, over the prior year. Administrative and general expense increased \$1.8 million primarily due to a \$1.5 million increase in incentive based compensation, which was recorded at the corporate level in 2004 but charged to the business segments in 2005. Administrative and general expense also increased by \$0.9 million due to reduced capitalization of expenses, which increased the costs allocated to administrative and general expense. The increase in administrative and general expense was offset in part by a \$0.9 million decrease in workmen's compensation and insurance.

Depreciation and amortization increased \$3.7 million, or 19.3%, primarily due to the addition of \$16.0 million in distribution assets, \$14.2 million in transmission assets and \$18.2 million in software assets. PNMR expects depreciation to continue to rise going forward as a result of increased investment in new information technology platforms and other capital spending.

**Unregulated Operations****PNM Wholesale**

The table below sets forth the operating results for PNM Wholesale:

	<b>Year Ended December 31,</b>		
	<b>2005</b>	<b>2004</b>	<b>2005</b>
	(In thousands)		
<b>Operating revenues</b>	<b>\$ 628,028</b>	<b>\$ 588,243</b>	<b>\$ 39,785</b>
Less: Cost of energy	506,935	449,059	57,876
Intersegment energy transfer	35,829	42,769	(6,940)
<b>Gross margin</b>	<b>85,264</b>	<b>96,415</b>	<b>(11,151)</b>
Energy production costs	29,614	29,967	(353)
Transmission and distribution O&M	54	81	(27)
Customer related expense	879	1,049	(170)
Administrative and general	6,446	7,255	(809)
<b>Total non-fuel O&amp;M</b>	<b>36,993</b>	<b>38,352</b>	<b>(1,359)</b>
Corporate allocation	4,395	4,557	(162)
Depreciation and amortization	15,669	14,809	860
Taxes other than income taxes	3,439	3,533	(94)
Income taxes	3,612	8,537	(4,925)
<b>Total non-fuel operating expenses</b>	<b>64,108</b>	<b>69,788</b>	<b>(5,680)</b>
<b>Operating income</b>	<b>\$ 21,156</b>	<b>\$ 26,627</b>	<b>\$ (5,471)</b>

The following table shows revenues by customer class:

#### PNM Wholesale Revenues

	Year Ended December 31,		Variance
	2005	2004	
	(In thousands)		
Long-term contracts	\$ 154,692	\$ 158,085	\$ (3,393)
Short-term sales	473,336	430,158	43,178
	\$ 628,028	\$ 588,243	\$ 39,785

The following table shows sales by customer class:

#### PNM Wholesale Sales

	Year Ended December 31,		Variance
	2005	2004	
	(Megawatt hours)		
Long-term contracts	2,516,907	2,943,372	(426,465)
Short-term sales	8,069,751	9,057,172	(987,421)
	10,586,658	12,000,544	(1,413,886)

Operating revenues increased \$39.8 million, or 6.8%, from the prior year. This increase in wholesale electric sales was primarily due to increased short-term sales of \$43.2 million, or 10.0%, resulting from a 23.5% increase in average short-term prices in 2005 compared to 2004. In addition, long-term sales increased due to higher prices associated with SO<sub>2</sub> credit sales. These increases were partially offset by a decrease in revenues from long-term contracts in 2005 due primarily to the expiration of a customer contract and lower sales volumes resulting from below normal levels of plant performance. PNM Wholesale sold 10.6 million MWh of electricity in 2005 compared to 12.0 million MWh in 2004, a decrease of 11.8%.

The gross margin, or operating revenues minus cost of energy sold and intersegment energy transfer, decreased \$11.2 million, or 11.6%, from the prior year. Decreased plant availability and increased retail load decreased the availability of less expensive excess energy for sale in the wholesale market. In addition, higher purchased power contracts prices decreased the margin on fixed-price sales contracts. The long-term sales margin was relatively unchanged from the prior year due to the impacts of customer load growth and higher prices associated with SO<sub>2</sub> credit sales that were offset by a decrease in sales volume due to the expiration of a long-term contract and increased purchased power contract prices that could not be passed through to customers based on fixed-price sales contracts. The short-term margin decreased \$11.5 million primarily resulting from lower plant availability and increased retail loads, which caused a decrease in energy available to sell on the wholesale market. PNM Wholesale's mark-to-market position fell to a \$0.2 million loss in 2005 from a \$1.6 million gain in 2004.

Total non-fuel O&M expense decreased \$1.4 million, or 3.5%, from the prior year. Administrative and general expense decreased \$0.8 million, or 11.2%, due primarily to the capitalization of expenses from administrative and general activities related to the construction of Luna.

Depreciation and amortization increased \$0.9 million, or 5.8%, over the prior year due to the addition of new technology platforms that were placed in service in December 2004 and in 2005. PNMR expects depreciation to rise going forward as a result of increased investment in new information technology platforms and other capital spending.

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**First Choice**

PNMR acquired TNP on June 6, 2005, and results in this section are presented from the acquisition date forward only. For the year ended December 31, 2005, which includes results from June 6 through December 31, 2005, the First Choice segment increased PNMR revenues by \$316.3 million.

The table below sets forth the operating results for First Choice:

	<b>For the Period</b>	
	<b>June 6 - December 31, 2005</b>	
	(In thousands)	
<b>Operating revenues</b>	<b>\$</b>	<b>316,330</b>
Less: Cost of energy		243,053
<b>Gross margin</b>		<b>73,277</b>
Customer related expense		2,539
Administrative and general		13,008
<b>Total non-fuel O&amp;M</b>		<b>15,547</b>
Corporate allocation		8,434
Depreciation and amortization		1,094
Taxes other than income taxes		3,916
Income taxes		15,450
<b>Total non-fuel operating expenses</b>		<b>44,441</b>
<b>Operating income</b>	<b>\$</b>	<b>28,836</b>

The following table shows electric revenues by customer class and average customers:

<b>First Choice Electric Revenues</b>		
<b>For the Period</b>		
<b>June 6 - December 31, 2005</b>		
(In thousands, except customers)		
Residential	\$	198,218
Mass-market		53,111
Mid-market		46,584
Other		18,417
	\$	316,330
Average customers *		209,464

The following table shows electric sales by customer class:

<b>First Choice Electric Sales *</b>	
<b>For the Period</b>	
<b>June 6 - December 31, 2005</b>	
(Megawatt hours)	
Residential	1,591,005
Mass-market	400,839
Mid-market	478,531
Other	29,780



\* See note above in the TNMP Electric segment discussion about the impact of TECA.

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First Choice's gross margin was \$73.3 million for the period June 6 through December 31, 2005. The significant factors that impacted gross margin include revenues of \$9.4 million due to an increase in the price-to-beat fuel factor in October 2005, higher purchased power costs, that were lessened by gas hedges, gains of \$4.2 million from the amortization of purchase power and power sale contracts (see Note 2), and gains of \$4.2 million from a capacity auction.

In Texas, capacity auctions were a semi-regular event mandated by the TECA to promote liquidity in the marketplace. In the most recent auctions, First Choice was the successful bidder for four 25 MW baseload blocks of capacity in October 2005 and two 25 MW cyclic blocks of capacity in September 2005.

## **Corporate and Other**

### *Corporate Administrative and General Expenses*

Corporate administrative and general expenses, which represent costs that are driven primarily by corporate-level activities, are allocated to the business segments and are presented in the corporate allocation line item in the segment statements. These costs increased \$10.5 million, or 9.3%, from the prior year to \$123.6 million. The increase was primarily due to charges in 2005 related to the TNP acquisition of \$19.3 million and increased audit and costs related to the cost of compliance with the Sarbanes-Oxley Act of \$3.1 million. These increases were offset in part by a decrease of \$14.2 million for incentive based compensation at the corporate level, which were recorded at the corporate level in 2004 but charged to the business segments in 2005.

## **PNMR Consolidated**

### *Other Income and Deductions*

Interest income increased \$4.8 million, or 12.7%, due primarily to interest income of \$2.5 million earned from the investment of TNP's cash balance, which PNMR did not have in the prior year, interest income of \$1.9 million earned from the investment of cash received from PNMR's issuance of equity-linked units, and \$1.4 million of interest income earned from higher cash balances from the PGAC caused by increasing gas prices. The increase in interest income was partially offset by lower interest income of \$2.0 million due to a lower level of investment in the Palo Verde capital trust.

Other income increased \$7.6 million, or 75.3%, due to a realized gain of \$4.1 million on the sale of certain PVNGS decommissioning trust assets, a \$2.1 million increase in trust earnings in excess of the required amount and a \$2.2 million increase in merchandising revenues, primarily from emergency assistance services to other utilities (offset by the related expenses in other deductions below). The increase in other income was offset in part by a \$0.8 million decrease from the sale of water rights in 2004 that did not reoccur in 2005.

Carrying charges on regulatory assets were \$4.4 million from June 6 through December 31, 2005. This represents interest income on TNMP regulatory assets from the date of acquisition.

Other deductions increased approximately \$16.0 million due primarily to an \$11.3 million charge related to the issuance of equity-linked units (see Note 6). In addition, other deductions increased due to a \$2.5 million contribution by PNMR to the PNM Resources Foundation and a \$2.4 million increase in expenses related to emergency assistance services to other utilities (offset by the related revenues in other income above).

### *Interest Charges*

Interest charges increased \$42.3 million, or 82.3%, primarily due to \$16.8 million of interest charges related to debt from the TNP operations, which PNMR did not have in the prior year, interest and refinancing costs of \$10.8 million

related to the hybrid income term securities issued in March and October of 2005 and \$8.1 million of interest charges related to increased commercial paper borrowings.

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*Cumulative Effect of a Change in Accounting Principle*

Effective January 1, 2005, PNMR adopted FASB Interpretation No. 47, “*Accounting for Conditional Asset Retirement Obligations*” (“FIN 47”), and recognized a cumulative effect of a change in accounting principle that decreased 2005 earnings \$0.9 million, net of the income tax benefit, or \$0.01 per diluted common share. The \$0.9 million decrease to 2005 earnings is net of amounts expensed in prior years for cost of removal included in depreciation. FIN 47 requires the accrual of costs associated with conditional retirement obligations.

*Income Taxes*

PNMR’s consolidated income tax expense was \$32.9 million for the year ended December 31, 2005 before the cumulative effect of a change in accounting principle, compared to \$49.2 million in 2004. The decrease in consolidated income tax expense was due to the impact of lower pre-tax earnings. PNMR’s effective operating income tax rates for the years ended December 31, 2005 and 2004 were 30.80% and 36.95%, respectively. The decrease in the effective operating tax rate, year-over-year, was due to lower pre-tax earnings and changes in permanent tax differences. PNMR’s effective non-operating income tax rates for the years ended December 31, 2005 and 2004 were 32.92% and 33.03%, respectively.

**RESULTS OF OPERATION - PNM**

**YEAR ENDED DECEMBER 31, 2005 COMPARED TO YEAR ENDED DECEMBER 31, 2004**

PNM's segments are PNM Electric, PNM Gas and PNM Wholesale and are identical to the segments presented above in "Results of Operation" for PNMR.

*Cumulative Effect of a Change in Accounting Principle*

In 2005, PNM adopted FIN 47 and recognized a cumulative effect of a change in accounting principle that decreased 2005 earnings \$0.5 million, net of the income tax benefit. The \$0.5 million decrease to 2005 earnings is net of amounts expensed in prior years for cost of removal included in depreciation. FIN 47 requires the accrual of costs associated with conditional retirement obligations.

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## RESULTS OF OPERATION - TNMP

### YEAR ENDED DECEMBER 31, 2005 COMPARED TO YEAR ENDED DECEMBER 31, 2004

TNMP operates in only one reportable segment, "TNMP Electric." Results for the year ended December 31, 2005 include the effects of purchase accounting on June 6, 2005, which are not included in the year ended December 31, 2004. Amounts for the period June 6 through December 31, 2005 are post-acquisition and amounts for the period January 1 through June 6, 2005 and the year ended December 31, 2004 are pre-acquisition. (See Note 2.)

Operating revenues decreased \$2.5 million, or 0.9%, from the prior year. Gross margin for the year ended December 31, 2005 decreased \$3.0 million, or 1.8%, compared with the year ended December 31, 2004. The decrease was primarily due to a \$10.5 million decrease in revenues due to a rate reduction effective May 1, 2005 that was part of the PUCT's approval of the TNP acquisition and \$0.9 million decrease in margin due to the reduced operations of a major customer. Partially offsetting the decrease in operating revenues were an increase in revenues of \$6.1 million due to customer growth and an increase in revenues of \$1.8 million resulting from warm weather.

Total non-fuel operating expenses increased \$0.3 million, or 0.2%, due primarily to a decrease in non-fuel O&M of \$0.6 million offset by an increase of \$0.9 million in depreciation and amortization expense.

Administrative and general expenses decreased \$2.8 million primarily due to decreased legal, environmental and regulatory expenses of \$4.4 million. The decrease in administrative and general expense was partially offset by increased expenses of \$1.5 million related to synergy credits passed to customers.

Transmission and distribution O&M increased \$2.2 million primarily due to \$0.6 million in increased expenses for the preparation and restoration efforts related to hurricane Rita, \$0.9 million related to the maintenance of overhead lines in 2005, and increased payroll expenses of \$0.6 million.

Depreciation expenses increased as a result of additions to fixed assets.

#### *Cumulative Effect of a Change in Accounting Principle*

In 2005, TNMP adopted FIN 47 and recognized a cumulative effect of a change in accounting principle that decreased 2005 earnings \$0.4 million, net of the income tax benefit. The \$0.4 million decrease to 2005 earnings is net of amounts expensed in prior years for cost of removal included in depreciation. FIN 47 requires the accrual of costs associated with conditional retirement obligations.

**RESULTS OF OPERATION - PNMR**

**YEAR ENDED DECEMBER 31, 2004 COMPARED TO YEAR ENDED DECEMBER 31, 2003**

The Company's net GAAP earnings for the year ended December 31, 2004 were \$87.7 million, or \$1.43 per diluted share of common stock, a 7.8% decrease in net earnings compared to \$95.2 million, or \$1.58 per diluted share of common stock, in 2003. This decrease primarily resulted from items that occurred in 2003 that did not recur in 2004. In 2003, the Company recognized \$36.6 million, net of income taxes, as an addition to net income for the cumulative effect of changes in accounting principles for the adoption of SFAS No. 143, "*Accounting for Asset Retirement Obligations*" ("SFAS 143") and the change in the pension actuarial valuation measurement date (\$0.61 per diluted share of common stock). This increase to 2003 income was partially offset by the write-off of transition costs of \$9.5 million, net of income taxes, or \$0.16 per diluted share of common stock, that resulted from the repeal of electric deregulation in New Mexico in 2003, and a charge of \$10.0 million, net of income taxes, or \$0.17 per diluted share of common stock, for costs related to long-term debt refinancing.

The following discussion is based on the methodology that the Company's management uses for making operating decisions and assessing performance of its various business activities. As such, these statements report operating results without regard to the effect of accounting or regulatory changes, and similar items not related to normal operations. See Note 3 for additional information regarding these results and the Consolidated Financial Statements.

In addition, adjustments related to EITF Issue 03-11 are excluded from the PNM Wholesale segment and are instead included in the Corporate and Other segment. This accounting pronouncement requires a net presentation of realized gains and losses for certain non-trading derivatives. Management evaluates PNM Wholesale on a gross presentation basis due to its primarily net-asset-backed marketing strategy and the importance it places on PNM's ability to repurchase and remarket previously sold capacity. The other segments are not affected by this EITF.

Corporate costs, income taxes and non-operating items are discussed only on a consolidated basis and are in conformity with the presentation in the Consolidated Financial Statements.

**Regulated Operations****PNM Electric**

The table below sets forth the operating results for PNM Electric:

	<b>Year Ended December 31,</b>		<b>Variance</b>
	<b>2004</b>	<b>2003</b>	
	(In thousands)		
<b>Operating revenues</b>	<b>\$ 558,412</b>	<b>\$ 560,464</b>	<b>\$ (2,052)</b>
Less: Cost of energy	186,517	177,767	8,750
Intersegment energy transfer	(42,769)	(34,760)	(8,009)
<b>Gross margin</b>	<b>414,664</b>	<b>417,457</b>	<b>(2,793)</b>
Energy production costs	113,848	108,734	5,114
Transmission and distribution O&M	31,360	31,596	(236)
Customer related expense	18,190	15,543	2,647
Administrative and general	4,640	6,972	(2,332)
<b>Total non-fuel O&amp;M</b>	<b>168,038</b>	<b>162,845</b>	<b>5,193</b>
Corporate allocation	69,820	69,269	551
Depreciation and amortization	63,050	73,532	(10,482)
Taxes other than income taxes	20,324	20,520	(196)
Income taxes	23,141	23,750	(609)
<b>Total non-fuel operating expenses</b>	<b>344,373</b>	<b>349,916</b>	<b>(5,543)</b>
<b>Operating income</b>	<b>\$ 70,291</b>	<b>\$ 67,541</b>	<b>\$ 2,750</b>

The following table shows electric revenues by customer class and average customers:

**PNM Electric Revenues**

	<b>Year Ended December 31,</b>		<b>Variance</b>
	<b>2004</b>	<b>2003</b>	
	(In thousands, except customers)		
Residential	\$ 206,950	\$ 203,710	\$ 3,240
Commercial	251,092	252,876	(1,784)
Industrial	61,905	64,549	(2,644)
Transmission	18,327	19,453	(1,126)
Other	20,138	19,876	262
	<b>\$ 558,412</b>	<b>\$ 560,464</b>	<b>\$ (2,052)</b>
Average customers	406,968	396,303	10,665



The following table shows electric sales by customer class:

**PNM Electric Sales**

	<b>Year Ended December 31,</b>		<b>Variance</b>
	<b>2004</b>	<b>2003</b>	
		(Megawatt hours)	
Residential	2,509,449	2,405,488	103,961
Commercial	3,450,503	3,379,147	71,356
Industrial	1,283,769	1,292,711	(8,942)
Other	253,393	247,255	6,138
	7,497,114	7,324,601	172,513

Operating revenues decreased \$2.1 million, or 0.4%, from the prior year. The decrease in revenues was primarily due to an electric rate reduction under the Global Electric Agreement. The rate reduction decreased 2004 revenues by \$16.7 million. Under the agreement, rates will decrease again by 2.5% in September 2005 and remain at that level through 2007. PNM Electric sales grew 2.4%, to 7.5 million MWh in 2004 compared to 7.3 million MWh in 2003. Weather-normalized retail electric load growth was 3.3% in 2004. This volume increase was due to customer growth, which increased revenues by \$21.2 million. This volume increase was offset slightly by warmer summer weather in 2003 compared to 2004. Cooling Degree Days for Albuquerque declined 22% to 1,304 during the year ended December 31, 2004 compared to 1,671 during the year ended December 31, 2003.

The gross margin, or operating revenues minus cost of energy sold and intersegment energy transfer, decreased \$2.8 million, or 0.7%, from the prior year. Generation costs decreased by \$3.5 million driven by lower fuel costs at SJGS, while purchased power costs increased \$5.4 million due to higher prices. In addition, costs of \$5.9 million related to the amortization of certain coal mine reclamation costs as agreed to in the current electric rate agreement were incurred during 2004, an increase of \$4.0 million compared to 2003. These costs are amortized over 17 years.

Total non-fuel O&M expenses increased \$5.2 million, or 3.2%, over the prior year. Energy production costs increased \$5.1 million, or 4.7%, primarily due to increased plant maintenance costs of \$4.3 million for planned and unplanned outages in 2004. Transmission and distribution O&M expense decreased \$0.2 million, or 0.8%, primarily due to a decrease in operating lease costs of \$1.1 million for a transmission line, a portion of which was purchased in April 2003 and decreased maintenance costs of \$0.3 million in 2004, which were mostly offset by increased labor and outside services costs. Customer-related expense increased \$2.6 million, or 17.0%, as a result of favorable collection outcomes in 2003. Administrative and general expense decreased \$2.3 million, or 33.5%, due to lower expenses for paid-time-off and insurance, regulatory commission expense and outside service costs.

Depreciation and amortization decreased \$10.5 million, or 14.3%. This reduction was primarily attributable to a decrease in depreciation rates to align depreciation expenses with NMPRC approved rates based on a new five-year depreciation study, which decreased depreciation expense by \$8.2 million year over year. Additionally, depreciation decreased \$3.0 million due to the Company's billing system being fully depreciated at the end of 2003. The Company expects to see depreciation rise going forward as a result of increased investment in new information technology platforms.

**PNM Gas**

The table below sets forth the operating results for PNM Gas:

	Year Ended December 31,			Variance
	2004	2003		
	(In thousands)			
<b>Operating revenues</b>	\$ 490,921	\$ 358,267		\$ 132,654
Less: Cost of energy	343,219	228,345		114,874
<b>Gross margin</b>	<b>147,702</b>	<b>129,922</b>		<b>17,780</b>
Energy production costs	2,338	1,930		408
Transmission and distribution O&M	28,006	29,515		(1,509)
Customer related expense	19,283	16,832		2,451
Administrative and general	1,648	2,040		(392)
<b>Total non-fuel O&amp;M</b>	<b>51,275</b>	<b>50,317</b>		<b>958</b>
Corporate allocation	38,725	39,543		(818)
Depreciation and amortization	18,894	22,186		(3,292)
Taxes other than income taxes	7,412	6,886		526
Income taxes	8,063	(956)		9,019
<b>Total non-fuel operating expenses</b>	<b>124,369</b>	<b>117,976</b>		<b>6,393</b>
<b>Operating income</b>	<b>\$ 23,333</b>	<b>\$ 11,946</b>		<b>\$ 11,387</b>

The following table shows gas revenues by customer and average customers:

**PNM Gas Revenues**

	Year Ended December 31,			Variance
	2004	2003		
	(In thousands, except customers)			
Residential	\$ 292,163	\$ 226,799		\$ 65,364
Commercial	92,128	72,269		19,859
Industrial	2,889	2,820		69
Transportation*	15,274	18,906		(3,632)
Other	88,467	37,473		50,994
	\$ 490,921	\$ 358,267		\$ 132,654
Average customers	461,399	452,328		9,071

\*Customer-owned gas.

The following table shows gas throughput by customer class:

**PNM Gas Throughput**

	Year Ended December 31,		Variance
	2004	2003	
	(Thousands of decatherms)		
Residential	30,618	27,416	3,202
Commercial	11,639	10,810	829
Industrial	413	485	(72)
Transportation*	43,208	50,756	(7,548)
Other	13,871	5,510	8,361
	99,749	94,977	4,772

\*Customer-owned gas.

Operating revenues increased \$132.7 million, or 37.0%, over the prior year primarily because of higher natural gas prices in 2004 as compared to 2003 and the rate increase discussed below. The Company purchases natural gas in the open market and resells it at the same price to its sales-service customers. As a result, increases or decreases in gas revenues driven by gas costs do not impact the Company's consolidated gross margin or earnings. In 2004, off-system sales revenues increased \$47.7 million due to the revision of an interstate transportation contract and improved conditions in the gas market. Total gas sales volumes increased 5.0%, resulting from off-system sales and customer growth of 2.0%; customer growth increased revenues \$2.7 million over the prior year. A normal early winter season compared to a warmer 2003 increased revenues \$3.0 million. In addition, revenues grew \$11.4 million due to a cost of service rate increase granted by the NMPRC in January 2004. The rate increase is expected to increase gas revenues by approximately \$22.0 million annually; however, implementation of the residential increase was delayed until April 2004. The increase in operating revenues was partially offset by a decrease in off-system transportation of \$5.4 million due to lower price differences between the San Juan and Permian basins.

The gross margin, or operating revenues minus cost of energy sold, increased \$17.8 million, or 13.7%, over the prior year. This increase was due mainly to customer growth, a normal winter heating season during the first quarter 2004 compared to the first quarter of 2003, and the NMPRC-approved rate increase, partially offset by the decrease in off-system transportation sales described above.

Total non-fuel O&M expenses increased \$1.0 million, or 1.9%, over the prior year. Customer-related expense increased \$2.5 million, or 14.6%, primarily due to an improvement in collection rates in 2003 that was maintained in 2004. Transmission and distribution O&M expense decreased \$1.5 million primarily due to a reduction in payroll costs from a Company reorganization. Administrative and general expense decreased \$0.4 million due primarily to a \$1.3 million decrease in paid-time-off expense, offset in part by increased insurance expense of \$0.5 million and increased capital activity in 2004.

Depreciation and amortization decreased \$3.3 million, or 14.8%, primarily due to the Company's customer billing system being fully depreciated at the end of 2003. The Company expects to see depreciation rise going forward as a result of increased investment in new information technology platforms and other capital spending.

**Unregulated Operations****PNM Wholesale**

The table below sets forth the operating results for PNM Wholesale:

	<b>Year Ended December 31,</b>		<b>Variance</b>
	<b>2004</b>	<b>2003</b>	
	(In thousands)		
<b>Operating revenues</b>			
External sales	\$ 588,243	\$ 551,625	\$ 36,618
Intersegment sales	-	1,535	(1,535)
<b>Total revenues</b>	<b>588,243</b>	<b>553,160</b>	<b>35,083</b>
Less: Cost of energy	449,059	413,089	35,970
Intersegment energy transfer	42,769	34,760	8,009
<b>Gross margin</b>	<b>96,415</b>	<b>105,311</b>	<b>(8,896)</b>
Energy production costs	29,967	29,919	48
Transmission and distribution O&M	81	59	22
Customer related expense	1,049	711	338
Administrative and general	7,255	8,390	(1,135)
<b>Total non-fuel O&amp;M</b>	<b>38,352</b>	<b>39,079</b>	<b>(727)</b>
Corporate allocation	4,557	2,586	1,971
Depreciation and amortization	14,809	14,230	579
Taxes other than income taxes	3,533	3,263	270
Income taxes	8,537	12,111	(3,574)
<b>Total non-fuel operating expenses</b>	<b>69,788</b>	<b>71,269</b>	<b>(1,481)</b>
<b>Operating income</b>	<b>\$ 26,627</b>	<b>\$ 34,042</b>	<b>\$ (7,415)</b>

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The following table shows revenues by customer class:

**PNM Wholesale Revenues**

	Year Ended December 31,		Variance
	2004	2003	
	(In thousands)		
Long-term contracts	\$ 158,085	\$ 135,674	\$ 22,411
Short-term sales	430,158	415,951	14,207
Intersegment sales	-	1,535	(1,535)
	\$ 588,243	\$ 553,160	\$ 35,083

The following table shows sales by customer class:

**PNM Wholesale Sales**

	Year Ended December 31,		Variance
	2004	2003	
	(Megawatt hours)		
Long-term contracts	2,943,372	2,469,707	473,665
Short-term sales	9,057,172	9,432,297	(375,125)
	12,000,544	11,902,004	98,540

Operating revenues increased \$35.1 million or 6.3% over the prior year. This increase in wholesale electric sales primarily reflects additional long-term contract sales and wholesale electric price improvements in short-term prices. New long-term contracts added 437,446 MWWhs, or \$21.0 million in revenues, slightly offset by a decrease in certain existing contract sales prices of \$3.3 million due largely to a price reduction for sales to Kirtland Air Force Base. These contracts support the Company's long-term growth plans and net asset-backed strategy. In addition, the Company's short-term sales increased \$14.2 million, or 3.4%, compared to the prior year period, partially due to an increase in average short-term prices. Short-term sales volume decreased 4.0% due to less favorable energy purchase-to-sale market spreads between PVNGS and the Mead market hub.

The gross margin, or operating revenues minus cost of energy sold and intersegment energy transfer, decreased \$8.9 million, or 8.4%, from the prior year. Short-term sales margin decreased \$15.6 million primarily due to the effect of higher purchase costs and less available excess energy resulting from increased electric retail load growth and unplanned outages on certain of the Company's generation facilities, partially offset by higher sales volumes and higher market prices. Average short-term market purchase prices increased 10.7% over the prior year while average short-term market sale prices increased 4.4% over the prior year. The Company had an unfavorable change in the unrealized mark-to-market position of \$1.7 million from the prior year (\$1.8 million gain in 2004 versus \$3.5 million gain in 2003), reflecting depressed pricing caused by cooler weather. Long-term contracts margin increased \$6.8 million due to additional long-term sales under new and existing contracts. In addition, the long-term margin increase included \$6.1 million from sales of pollution credits.

Total non-fuel O&M decreased \$0.7 million, or 1.9%, from the prior year. Administrative and general decreased \$1.1 million, or 13.5%, due to transportation costs of \$1.0 million recognized in 2003 for turbines that were placed in storage, which did not recur in 2004.

**Corporate and Other**

*Corporate Administrative and General Expenses*

Corporate administrative and general expenses, which represent costs that are driven primarily by corporate-level activities, is allocated to the business segments and is presented in the corporate allocation line item in the segment statements. These costs increased \$1.7 million, or 1.5%, from the prior year to \$113.1 million, primarily due to a net increase in compensation and benefit costs.

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Taxes other than income increased \$2.7 million due to the 2003 favorable resolution of tax issues of \$2.4 million and increased social security taxes due to overall higher payroll costs.

## **PNMR Consolidated**

### *Other Income and Deductions*

Other income decreased \$4.6 million, or 8.8%, from the prior year due to decreased tax credits of \$2.4 million, and a decrease in the equity component of allowance for funds used during construction of \$1.3 million. Additionally, other income decreased due to favorable 2003 customer settlements of \$0.8 million, which did not recur in 2004.

Other deductions decreased \$38.0 million from the prior year primarily due to a charge of \$16.7 million in 2003 for the write-off of transition costs due to the repeal of deregulation in New Mexico and a charge of \$16.6 million in 2003 for costs related to long-term debt refinancing.

### *Interest Expense*

Interest expense decreased \$14.8 million, or 22.4%, over the prior year due to debt refinancing, including senior unsecured notes and pollution control bonds, and lower short-term debt balances, which decreased interest costs \$10.1 million. Additionally, the Company had lower borrowing levels in 2004, which reduced interest expense by \$2.6 million, and a favorable interest rate swap which further reduced interest expense by \$2.1 million.

### *Income Taxes*

PNMR's consolidated income tax expense was \$49.2 million for the year ended December 31, 2004, compared to \$27.9 million in 2003 before the cumulative effect of a change in accounting principles. The increase was due to the impact of higher pre-tax earnings. PNMR's effective operating income tax rates for the years ended December 31, 2004 and 2003 were 36.95% and 34.88%, respectively. The increase in the effective operating tax rate was due to a decrease in permanent tax differences, resulting from tax credits in 2003. PNMR's effective non-operating income tax rates for the years ended December 31, 2004 and 2003 were 33.03% and (2.79)%, respectively. The increase in the effective tax rate was due to a decrease in permanent tax differences, resulting from allowance for funds used during construction and tax credits in 2003.

### *Cumulative Effect of Changes in Accounting Principles*

In 2003, the Company adopted SFAS 143. The effect of the initial application of the new standard is reported as a cumulative effect of a change in accounting principle. As a result, PNMR recorded income, net of income tax expense, of approximately \$37.4 million, or \$0.62 per diluted common share, representing amounts expensed in prior years for its asset retirement obligations in excess of the actual legal obligations as established under the new accounting standard.

In 2003, the Company changed its valuation date for its pension and post retirement benefits plans from September 30 to December 31 to better reflect the actual plan balances as of the PNMR's year end balance sheet date. The effect of the change in the plans' valuation date is reported as a cumulative effect of a change in accounting principle. PNMR recorded additional expense, net of income tax benefit, of approximately \$0.8 million, or \$0.01 per diluted common share reflecting the effect of changing the valuation date.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with GAAP requires Company management to select and apply accounting policies that best provide the framework to report the results of operations and financial position for PNMR, PNM and TNMP. The selection and application of those policies requires management to make difficult subjective or complex judgments concerning reported amounts of revenue and expenses during the reporting period and the reported amounts of assets and liabilities at the date of the financial statements. As a result, there exists the likelihood that materially different amounts would be reported under different conditions or using different assumptions. Company management has identified the following accounting policies that it deems critical to the portrayal of the financial condition and results of operations of PNMR, PNM and TNMP and that involve significant subjectivity. Company management believes that its selection and application of these policies best represent the operating results and financial position of PNMR, PNM and TNMP. The following discussion provides information on the processes utilized by Company management in making judgments and assumptions as they apply to its critical accounting policies.

### *Revenue Recognition*

Operating revenues are recorded as services are rendered to customers. Revenues subject to refund are recorded with a reserve also established for the potential refund. The Company's subsidiaries record unbilled revenues representing management's assessment of the estimated amount customers will be billed for services rendered between the meter-reading dates in a particular month and the end of that month. Company management estimates unbilled revenues based on sales recorded in the billing system, taking into account weather impacts. The method is consistent with the approach to normalization employed for rate case billing determinants and the load forecast. To the extent the estimated amount differs from the amount subsequently billed, revenues will be affected. Unbilled revenues are separately reported on the Consolidated Balance Sheets of PNMR, PNM and TNMP.

### *Regulatory Assets and Liabilities*

The Company is subject to the provisions of SFAS No. 71, as amended, "Accounting for the Effects of Certain Types of Regulation" ("SFAS 71"). Accordingly, the Company's utility subsidiaries, PNM and TNMP, have recorded assets and liabilities on the Consolidated Balance Sheets resulting from the effects of the ratemaking process, which would not be recorded under GAAP for non-regulated entities. Regulatory assets represent incurred costs that have been deferred because they are probable of future recovery in customer rates. Regulatory liabilities generally represent probable future reductions in revenue or refunds to customers. The Company's continued ability to meet the criteria for application of SFAS 71 may be affected in the future by competitive forces and restructuring in the electric industry. In the event that SFAS 71 no longer applied to all, or a separable portion, of Company's operations, the related regulatory assets and liabilities would be written off unless an appropriate regulatory recovery mechanism is provided.

Until its next rate case, PNM's electric rates are fixed; therefore, the opportunity to recover increased costs and the costs of new investment in facilities through rates is limited through 2007 due to the rate-freeze. As a result, PNM defers certain costs based on its expectation that it will recover these costs in future rate cases. If future recovery of these costs ceases to be probable, PNM would be required to record a charge in current period earnings for the portion of the costs that were not recoverable.

### *Asset Impairment*

Tangible long-lived assets are evaluated in relation to the future undiscounted cash flows to assess recoverability in accordance with SFAS 144 when events and circumstances indicate that the assets might be impaired. These potential impairment indicators include Company management's assessment of fluctuating market conditions as a result of industry deregulation; planned and scheduled customer purchase commitments; future market penetration; fluctuating



market prices resulting from factors including changing fuel costs and other economic conditions; weather patterns; and other market trends. The amount of impairment recognized is the difference between the fair value of the asset and the carrying value of the asset.

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PNM has three turbines currently in storage, with a combined book value of approximately \$64.7 million at December 31, 2005. PNM believes that it will be able to place two of the turbines in service and recover the costs of these two turbines in rates. As previously reported, PNM had planned to convert Afton from a combustion turbine to a combined-cycle unit using another turbine in storage. As part of negotiations that will allow PNM to convert Afton to a combined cycle plant and include it as a jurisdictional resource, Company management found that an alternative equipment configuration will be used and this turbine will not be used. In the fourth quarter of 2005, Company management determined that it would make the turbine available for sale. Based on its market survey, PNM recorded an impairment charge of \$15.0 million for the year ended December 31, 2005. The impairment charge is recorded in the Corporate and Other segment.

#### *Goodwill and Other Intangible Assets*

In accordance with SFAS No. 141, as amended, “*Business Combinations*” (“SFAS 141”), the Company has revalued the assets and liabilities acquired as part of the acquisition of TNP at their respective fair values. Under the provisions of SFAS 142, the Company does not amortize goodwill. Certain intangible assets are amortized over their estimated useful lives. Goodwill and unamortized intangible assets are evaluated for impairment at least annually, or more frequently if events and circumstances indicate that the goodwill and intangible assets might be impaired. Amortized other intangible assets are evaluated for impairment in accordance with SFAS 144 when events and circumstances indicate that the assets might be impaired.

#### *Purchase Accounting*

The acquisition of TNP was accounted for using the purchase method of accounting as prescribed in SFAS 141; accordingly, purchase accounting adjustments have been reflected in the financial statements of TNP for all periods subsequent to June 6, 2005. The purchase accounting entries are reflected on PNMR’s financial statements as of the purchase date. PNMR “pushed down” the effects of purchase accounting to the financial statements of TNMP and First Choice. Accordingly, TNMP’s post-acquisition financial statements reflect a new basis of accounting. TNP’s largest subsidiary, TNMP, is a regulated utility; therefore, in accordance with SFAS 71, the fair value of the majority of the assets and liabilities did not change significantly. The business operations of TNP were not significantly changed as a result of the acquisition, and post-acquisition and pre-acquisition operating results, except as noted in the discussion, are comparable.

#### *Decommissioning Costs*

Accounting for decommissioning costs for nuclear and fossil-fuel generation involves significant estimates related to costs to be incurred many years in the future after plant closure. Changes in these estimates could significantly impact PNMR’s and PNM’s financial position, results of operations and cash flows. PNM owns and leases nuclear and fossil-fuel generation facilities that are within and outside of its retail service areas. In accordance with SFAS 143, PNM is only required to recognize and measure decommissioning liabilities for tangible long-lived assets for which a legal obligation exists (see Note 15). Adoption of SFAS 143 changed the method of accounting for both nuclear generation decommissioning and fossil-fuel generation decommissioning. Nuclear decommissioning costs are based on site-specific estimates of the costs for removing all radioactive and other structures at the site. PVNGS Unit 3 is excluded from PNM’s retail rates while PVNGS Units 1 and 2 are included. PNM collects a provision for ultimate decommissioning of PVNGS Units 1 and 2 in its rates and recognizes a corresponding expense and liability for these amounts. PNM believes that it will continue to be able to collect in rates for its legal asset retirement obligations for nuclear generation activities included in the ratemaking process.

#### *Financial Instruments*

The Company follows the provisions set forth under SFAS 133, as amended. SFAS 133 establishes accounting and reporting standards requiring derivative instruments to be recorded in the balance sheet as either an asset or liability

measured at their fair value. SFAS 133 also requires that changes in the derivatives' fair value be recognized currently in earnings unless specific hedge accounting or normal purchase and sale criteria are met. Special accounting for qualifying hedges allows derivative gains and losses to offset related results on the hedged item in the statement of earnings, and requires that a company must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. SFAS 133 provides that the effective portion of the gain or loss on a derivative instrument designated and qualifying as a cash flow hedging instrument be reported as a

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component of other comprehensive income and be reclassified into earnings in the period during which the hedged forecasted transaction affects earnings. The results of hedge ineffectiveness and the change in fair value of a derivative that an entity has chosen to exclude from hedge effectiveness are required to be presented in current earnings.

#### *Pension and Other Postretirement Benefits*

PNMR and its subsidiaries maintain a qualified defined benefit pension, a plan providing medical and dental benefits to eligible retirees, and an executive retirement program (“PNM Plans”). PNMR maintains the legal obligation for the benefits owed to participants under these plans. TNMP also maintains a qualified defined benefit pension plan covering substantially all of its employees, a plan providing medical and death benefits to eligible retirees and an executive retirement program (“TNMP Plans”). The actuarial estimates of retiree benefits and the associated significant weighted-average assumptions for these plans are discussed in Note 12.

One of the most significant assumptions is the return on assets assumption, which was 9.0% for the PNM pension plan for the year ending December 31, 2005 and 7.8% for the TNMP pension plan from January 1 through June 6 and 9.0% from June 6 through December 31, 2005. This assumption will be 9.0% for both the PNM and TNMP pension plans for 2006. In developing the expected long-term rate of return assumption, the Company evaluated input from its actuaries and its investment consultant, including their review of asset class return expectations as well as long-term inflation assumptions. The 9.0% assumption was based on a passive return of 8.7% and a premium for active management of 0.3% reflecting the target asset allocation and current investment array. If all other factors were to remain unchanged, it is expected that a 1% decrease in the expected long-term rate of return would cause PNM’s 2006 net pension income to decrease approximately \$4.5 million (analogous change would result from a 1% increase). If all other factors were to remain unchanged, it is expected that a 1% decrease in the expected long-term rate of return would cause TNMP’s 2006 net pension income to decrease approximately \$0.8 million (analogous change would result from a 1% increase).

Under SFAS No. 87, “*Employers' Accounting for Pensions*” (“SFAS 87”) and SFAS No. 106, “*Employers' Accounting for Postretirement Benefits Other Than Pensions*” (“SFAS 106”), the expected long-term rate of return on pension and postretirement plan assets is calculated on the market-related value of assets. SFAS 87 and SFAS 106 require that actual gains and losses on pension and postretirement plan assets be recognized in the market-related value of assets equally over a period of not more than five years, which reduces year-to-year volatility. For the PNM Plans and TNMP Plans, the market-related value of assets is equal to the prior years’ market related value of assets adjusted for contributions, benefit payments and investment gains and losses that lie within a corridor of plus or minus 4.0% around the expected return on market value. Gains and losses that lie outside the corridor are amortized over five years, i.e., if investment return is outside a range of 5.0% to 13.0% (expected long-term rate of return plus or minus 4.0%), this market-related value recognizes the portion of return that is outside the range over a five-year period from the year in which the return occurs. As such, the future value of assets will be impacted as previously deferred returns are recorded.

The discount rate that the Company utilizes for determining future pension and postretirement obligations is based on a review of long-term high-grade bonds and management’s expectations. As a result of this review, the Company adjusted the discount rate for the PNM pension plan to 5.75% at December 31, 2005 from 6.0% at December 31, 2004. The rate for the TNMP pension plan was adjusted to 5.75% at December 31, 2005 from 5.25% at June 6, 2005 and was 5.75% at December 31, 2004. Lowering the discount rate by 0.5% would have decreased 2005 pension income for PNM by approximately \$0.5 million and would have no impact on TNMP pension expense.

Based on an expected rate of return of 9.0%, a discount rate of 5.75% and various other assumptions, it is estimated that the PNM pension income for the qualified and non-qualified pension plans will be approximately \$2.8 million in 2006 and \$2.8 million in 2007. It is estimated that TNMP pension income for the qualified and non-qualified pension plans will be approximately \$2.6 million in 2006 and \$2.7 million in 2007. Future actual pension income or expense will depend on future investment performance, changes in future discount rates and various other factors related to the

populations participating in the Company's pension plans.

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Note 12 contains further details about the effects of certain changes in assumptions related to medical trend rates on retiree health costs. The Company will continue to evaluate its actuarial assumptions at least annually, and will adjust as necessary.

See Item 7A. "Quantitative and Qualitative Disclosure About Market Risk" for discussion regarding the Company's accounting policies and sensitivity analysis for the Company's financial instruments and derivative energy and other derivative contracts. See also "Financing Activities" below for additional discussion regarding the Company's accounting policies for forward interest rate swaps.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **PNMR**

At December 31, 2005, PNMR had cash and short-term investments of \$68.2 million compared to \$17.2 million in cash and short-term investments at December 31, 2004.

Cash provided by operating activities for the year ended December 31, 2005 was \$210.5 million compared to \$235.1 million for the year ended December 31, 2004. PNMR's net earnings for the year ended December 31, 2005 decreased 23.4% to \$67.2 million from \$87.7 million for the year ended December 31, 2004. The decrease in earnings, as well as higher natural gas prices in 2005, contributed to the decrease in cash provided by operating activities. The decrease in earnings was driven primarily by acquisition related costs, the write down of a turbine to fair market value and other charges. In addition, the Company experienced below normal levels of plant performance, which reduced the amount of electricity the Company sold on the wholesale market and forced the Company to purchase power to meet jurisdictional and contractual wholesale needs. In addition, the margin on fixed-price contracts decreased, as increases in purchased power contract prices driven by increasing fuel prices could not be passed on to customers with fixed sales prices. These decreases to net earnings were partially offset by the addition of the TNP operations for June 6 through December 31, 2005 and an increase in cost of service gas rates.

Cash used for investing activities was \$154.6 million for the year ended December 31, 2005 compared to \$143.8 million for the year ended December 31, 2004. The increase in cash used for investing activities in the current period was due primarily to increased cash payments for utility plant additions, offset in part by the cash balances acquired from TNP, net of the cash paid to acquire TNP.

Cash used for financing activities was \$4.8 million for the year ended December 31, 2005 compared to cash used for financing activities of \$86.8 million for the year ended December 31, 2004. Cash used for financing activities in 2005 decreased due to the issuance of short-term debt of \$237.5 million to fund a portion of the cost of redemption of TNP preferred stock and senior notes, the issuance of the equity-linked units for \$339.8 million and the issuance of common stock for \$101.2 million. The decrease in cash used for financing activities was partially offset by the redemption of TNP preferred stock of \$224.6 million and the repayment of long-term debt of \$399.6 million, including the repayment of \$289.1 million in TNP senior notes (excluding the final interest payment) and the repayment of \$110.5 million under the TNP credit agreement. Financing activities in 2004 consisted primarily of common stock dividend payments and short-term debt repayments.

### **PNM**

Cash provided by operating activities for the year ended December 31, 2005 was \$171.5 million compared to \$261.0 million for the year ended December 31, 2004. This decrease in cash provided by operating activities was due primarily to lower earnings in 2005 and higher natural gas prices in 2005.

Cash used for investing activities was \$151.3 million for the year ended December 31, 2005 compared to \$131.8 million for the year ended December 31, 2004. The increase in cash used for investing activities was due primarily to

increased utility plant additions in 2005, offset in part by a \$12.2 million purchase of EIP bond investments in 2004 that did not recur in 2005.

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Cash used by financing activities was \$24.0 million for the year ended December 31, 2005 compared to cash used for financing activities of \$124.4 million for the year ended December 31, 2004. The decrease in cash used for financing activities was due primarily to cash received from short-term borrowings in 2005 of \$67.8 million compared to the use of cash in 2004 of \$64.5 million to repay short-term borrowings. The decrease in cash flows from financing activities was offset in part by the payment of \$91.0 million in dividends to PNMR in 2005.

### TNMP

TNMP's cash provided by operating activities for the year ended December 31, 2005 was \$66.9 million compared to \$67.4 million for the year ended December 31, 2004. TNMP's net earnings for the year ended December 31, 2005 were \$26.7 million compared to a net loss of \$51.2 million in the year ended December 31, 2004. TNMP's net earnings increased \$77.9 million in 2005 compared to 2004 due primarily to a charge of \$97.8 million, net of tax, in 2004 for the disallowance of stranded costs, which did not recur in 2005. The charge for stranded costs was offset in part by the recording of \$32.0 million of carrying charges related to deferred stranded costs in 2004.

Cash used for investing activities was \$42.8 million for the year ended December 31, 2005, relatively unchanged from \$43.2 million for the year ended December 31, 2004.

Cash used for financing activities for the year ended December 31, 2005 was \$73.7 million compared to cash used for financing activities for the year ended December 31, 2004 of \$15.4 million. During 2005, TNMP, a wholly owned subsidiary of TNP, paid \$62.0 million to redeem a portion of the TNMP stock held by TNP. TNMP also paid \$12.0 million to redeem senior notes in 2005. Cash used for financing activities in 2004 consisted primarily of long-term debt costs/repayments and dividends paid.

### *Pension and Other Postretirement Benefits*

### PNMR

PNMR and its subsidiaries maintain a qualified defined benefit pension, a plan providing medical and dental benefits to eligible retirees, and an executive retirement program ("PNM Plans"). PNMR maintains the legal obligation for the benefits owed to participants under these plans. TNMP also maintains a qualified defined benefit pension plan covering substantially all of its employees, a plan providing medical and death benefits to eligible retirees and an executive retirement program ("TNMP Plans").

The total 2005 contributions to the PNM Plans, in addition to contributions to the TNMP Plans from the date of PNMR's acquisition of TNP, or June 6, 2005 through December 31, 2005, are included in PNMR's Consolidated Statement of Cash Flows. TNMP Plan contributions of \$0.5 million are included in PNMR's Consolidated Statement of Cash Flows for the year ended December 31, 2005. See PNM and TNMP contribution detail below.

### PNM

During 2005, PNM did not make any contributions to its qualified pension plan and does not anticipate making any contributions to the qualified pension plan in 2006. PNM made contributions totaling \$6.2 million to its postretirement benefit plan for the plan year 2005 and expects to make contributions totaling \$6.2 million to its postretirement benefit plan in 2006.

### TNMP

During 2005, TNMP did not make any contributions to its qualified pension plan and does not anticipate making any contributions to the qualified pension plan in 2006. TNMP made contributions totaling \$0.9 million to its postretirement benefit plan for the plan year 2005 and expects to make contributions totaling \$0.3 million to its



postretirement benefit plan in 2006.

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## *Capital Requirements*

### PNMR

Total capital requirements include construction expenditures as well as other major capital requirements and cash dividend requirements for both common and preferred stock. The main focus of the Company's current construction program is upgrading generation resources, upgrading and expanding the electric and gas transmission and distribution systems and purchasing nuclear fuel. Projections for total capital requirements for 2006, including TNMP and First Choice, are \$458.0 million with projections for construction expenditures for 2006 constituting \$418.0 million of that total. Total capital requirements, including TNMP and First Choice, are projected to be \$1,833.8 million and construction expenditures are projected to be \$1,602.8 million for 2006-2010. These estimates are under continuing review and subject to on-going adjustment. This projection includes \$16.0 million for the construction of Luna and \$147.0 million for expansion at Afton. In November 2005, PNM filed a joint stipulation with the NMPRC that would allow PNM to convert Afton to a combined cycle plant and bring Afton into retail rates effective January 1, 2008. The Afton book value for ratemaking in PNM's 2007 rate case will be 50% of the lower of the actual cost to construct or \$187.6 million. PNM cannot recover costs for Afton in excess of this amount in its retail rates. The stipulation is subject to approval by the NMPRC. This projection does not include any amounts for the proposed Twin Oaks acquisition.

The Company continues to look for appropriately priced generation acquisition and expansion opportunities to support retail electric load growth, for the continued expansion of its long-term contract business, and to supplement its natural transmission position in the southwest and west areas of the United States.

During the year ended December 31, 2005, the Company utilized cash generated from operations and cash on hand, as well as its liquidity arrangements, to cover its capital requirements and construction expenditures. Except for the proposed acquisition of the Twin Oaks facility, the Company anticipates that internal cash generation and current debt capacity will be sufficient to meet all of its capital requirements and construction expenditures for the years 2006 through 2010. To cover the difference in the amounts and timing of cash generation and cash requirements, the Company intends to use short-term borrowings under its current and future liquidity arrangements.

### PNM

The main focus of PNM's current construction program is to upgrade generation resources, to upgrade and expand the electric and gas transmission and distribution systems and to purchase nuclear fuel. Projections for total capital requirements for 2006 are \$386.2 million with projections for construction expenditures for 2006 constituting \$346.2 million of that total. Total capital requirements are projected to be \$1,520.0 million and construction expenditures are projected to be \$1,289.0 million for the years 2006 through 2010. These estimates are under continuing review and subject to on-going adjustment.

Until November 2005, the Company's one-third interest in the 570 MW Luna facility, currently under construction, was held in a wholly owned subsidiary, PNMR Development and Management Corporation. In November 2005, the Company transferred its one-third interest in the Luna facility to PNM. PNM will complete construction of the Luna facility for use as merchant plant.

### TNMP

The main focus of TNMP's current construction program is to upgrade and expand its electric transmission and distribution systems. Projections for total capital requirements for 2006 are \$44.3 million. Total capital requirements are projected to be \$233.7 million for the years 2006 through 2010. These estimates are under continuing review and subject to on-going adjustment.

*Liquidity*

PNMR

As of February 28, 2006, PNMR had \$615.0 million of liquidity arrangements. The liquidity arrangements consist of \$600.0 million from an unsecured revolving credit facility, referred to as the PNMR Facility for purposes of this discussion, and \$15.0 million in local lines of credit. As of February 28, 2006, there were no amounts borrowed under the PNMR Facility and \$9.8 million borrowed under the local lines of credit.

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At February 28, 2006, First Choice had up to \$300.0 million of borrowing capacity under the PNMR Facility. Any borrowings made by First Choice under this sublimit are guaranteed by PNMR. At February 28, 2006, First Choice had no borrowings outstanding under the PNMR Facility; however, First Choice had \$16.9 million of letters of credit outstanding, which reduces the available capacity under the PNMR Facility. TNMP is also a borrower under the PNMR Facility, see "TNMP" detail below.

In addition, in February 2006, the Board approved intercompany borrowing arrangements between PNMR and its subsidiaries that would authorize each subsidiary to borrow up to \$50.0 million from PNMR.

PNMR has established a commercial paper program under which it may issue up to \$400.0 million in commercial paper for up to 270 days. The commercial paper is unsecured and the proceeds are used for short-term cash management needs. The PNMR Facility serves as a backstop for the outstanding commercial paper. As of February 28, 2006, there were \$208.4 million of borrowings outstanding under this program.

PNMR's ability, if required, to access the capital markets at a reasonable cost and to provide for other capital needs is largely dependent upon its ability to earn a fair return on equity, its results of operations, its credit ratings, its ability to obtain required regulatory approvals and conditions in the financial and wholesale markets. Financing flexibility is enhanced by providing a high percentage of total capital requirements from internal sources and having the ability, if necessary, to issue long-term securities and to obtain short-term credit.

Moody's considered PNMR's credit outlook stable as of the date of this report. In January 2006, S&P revised its outlook for PNMR to negative from stable. The Company is committed to maintaining or improving its investment grade ratings. S&P and Moody's rated PNMR's senior unsecured notes issued in March 2005 (see "Financing Activities" below) as BBB- and Baa3, respectively. PNMR's commercial paper program discussed above has been rated P-3 by Moody's, but was lowered to A-3 from A-2 by S&P in January 2006.

Investors are cautioned that a security rating is not a recommendation to buy, sell or hold securities, that it is subject to revision or withdrawal at any time by the assigning rating organization, and that each rating should be evaluated independently of any other rating.

## PNM

As of February 28, 2006, PNM had \$493.5 million of liquidity arrangements. The liquidity arrangements consist of \$400.0 million from an unsecured revolving credit facility, referred to as the PNM Facility for purposes of this discussion, \$70.0 million from an accounts receivable securitization program and \$23.5 million in local lines of credit. As of February 28, 2006, there were no amounts borrowed against the accounts receivable securitization, the local lines of credit, or the PNM Facility; however, \$4.5 million of letters of credit were outstanding, which reduces the available capacity under the PNM Facility. The accounts receivable securitization program expires in April 2006.

At February 28, 2006, PNM also had a \$20.0 million borrowing arrangement with PNMR, which is not included in the \$493.5 million of liquidity arrangements discussed above. As of February 28, 2006 there were no amounts outstanding under this arrangement.

PNM has a commercial paper program under which PNM may issue up to \$300.0 million in commercial paper for up to 365 days. The commercial paper is unsecured and the proceeds are used for short-term cash management needs. The PNM Facility serves as a backstop for PNM's outstanding commercial paper. As of February 28, 2006, PNM had \$133.9 million in commercial paper outstanding under this program.

PNM's ability, if required, to access the capital markets at a reasonable cost and to provide for other capital needs is largely dependent upon its ability to earn a fair return on equity, its results of operations, its credit ratings, its ability to obtain required regulatory approvals and conditions in the financial and wholesale markets. Financing flexibility is

enhanced by providing a high percentage of total capital requirements from internal sources and having the ability, if necessary, to issue long-term securities and to obtain short-term credit.

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Moody's considered PNM's credit outlook stable as of the date of this report. In January 2006, S&P revised its outlook for PNM to negative from stable. PNM is committed to maintaining or improving its investment grade ratings. As of December 31, 2005, S&P rated PNM's business position as six, its senior unsecured notes as BBB with a stable outlook and its preferred stock as BB+. As of December 31, 2005, Moody's rated PNM's senior unsecured notes as Baa2 and its preferred stock as Ba1. PNM's commercial paper program is rated P-3 by Moody's, but was lowered to A-3 from A-2 by S&P in January 2006.

### TNMP

In June 2005, TNMP filed an application with the NMPRC to become a borrower and issue notes of up to \$100.0 million under the PNMR Facility. In July 2005, the NMPRC issued an order approving the application, SEC approval was received in September 2005 and TNMP was added as a borrower under the PNMR Facility in September 2005. Any borrowings made by TNMP under this sublimit are not guaranteed by PNMR. At February 28, 2006, TNMP had no outstanding borrowings under the PNMR Facility, but did have \$2.5 million letters of credit outstanding, which reduces available capacity under the PNMR Facility.

In September 2005, as part of the TNP acquisition financing, TNMP redeemed and cancelled 1,090 shares of its privately held stock held by TNP at the book value of \$56,888.91 per share, for a total of \$62.0 million. TNP subsequently paid a cash dividend of \$62.0 million to PNMR.

In June 2003, TNMP issued \$250.0 million of 6.125% senior notes due in 2008. In May 2003, TNMP executed a \$250.0 million Treasury rate lock transaction designed to manage interest rate risk associated with the issuance of the senior notes. TNMP paid \$4.2 million upon the issuance of senior notes in June 2003 to settle the rate lock. Through the date of the acquisition, the cost of the rate lock was recorded in accumulated other comprehensive income and was amortized to interest expense over the life of the senior notes. The book value of the rate lock acquired was \$1.7 million. In conjunction with the acquisition of TNP by PNMR on June 6, 2005, the balance for the rate lock remaining in accumulated other comprehensive income was recorded at fair market value as of the date of acquisition, which was zero, in accordance with SFAS 141.

TNMP's ability, if required, to access the capital markets at a reasonable cost and to provide for other capital needs is largely dependent upon its ability to earn a fair return on equity, its results of operations, its credit ratings, its ability to obtain required regulatory approvals and conditions in the financial and wholesale markets. Financing flexibility is enhanced by providing a high percentage of total capital requirements from internal sources and having the ability, if necessary, to issue long-term securities and to obtain short-term credit.

Moody's considered TNMP's credit outlook stable as of the date of this report. In January 2006, S&P revised its outlook for TNMP to negative from stable. The Company is committed to maintaining or improving its investment grade ratings. As of December 31, 2005, S&P rated TNMP's senior unsecured notes at BBB. As of December 31, 2005, Moody's rated TNMP's senior unsecured notes at Baa3.

### *Off-Balance Sheet Arrangements*

The Company's off-balance sheet arrangements consist of PNM's operating lease obligations for PVNGS Units 1 and 2, the EIP transmission line and the entire output of Delta, as gas-fired generating plant. These arrangements help ensure PNM the availability of lower-cost generation needed to serve customers.

The total capitalization for these obligations was \$170.9 million as of December 31, 2005 and \$176.0 million as of December 31, 2004.

### *Commitments and Contractual Obligations*

Tabular information for PNMR, PNM and TNMP is presented below. See also Note 7 for further details about the Company's significant leases, including those for PNM and TNMP.

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PNMR

The following table sets forth PNMR's long-term contractual obligations as of December 31, 2005:

Contractual Obligations	Total	Payments Due			
		Less than 1 year	2-3 years (In thousands)	4-5 years	After 5 years
Long-Term Debt (a)	\$ 1,749,745	\$ -	\$ 548,935	\$ 514,940	\$ 685,870
Interest on Long-Term Debt (b)	810,713	97,174	186,725	110,838	415,976
Equity-Linked Units Forward					
Contracts	16,038	5,983	9,988	67	-
Interest on Forward Contracts	759	465	294	-	-
Operating Leases	380,593	34,363	69,005	62,749	214,476
Purchased Power Agreements	85,457	32,027	24,924	24,119	4,387
Coal Contracts (c)	694,307	49,905	103,635	110,206	430,561
Other Purchase Obligations (d)	1,609,268	424,376	752,061	432,831	-
<b>Total</b>	<b>\$ 5,346,880</b>	<b>\$ 644,293</b>	<b>\$ 1,695,567</b>	<b>\$ 1,255,750</b>	<b>\$ 1,751,270</b>

(a) Represents total long-term debt excluding unamortized discount of \$3.4 million.

(b) Represents the annual interest expense on fixed and variable rate debt. Projections of interest expense on variable rate debt are based on current interest rates as of December 31, 2005.

(c) Represents only certain minimum payments that may be required under the coal contracts if no deliveries are made.

(d) Represents commitments for capital expenditures, pension and postretirement benefit obligations and other obligations.

The following table sets forth PNMR's other commercial commitments as of December 31, 2005:

Other Commercial Commitments	Total Amounts Committed	Amount of Commitment Expiration Per Period			
		1 year	2-3 years (In thousands)	4-5 years	After 5 years
Short-Term Debt (a)	\$ 967,492	\$ 395,500	\$ -	\$ 571,992	\$ -
Local Lines of Credit	38,500	38,500	-	-	-
<b>Total</b>	<b>\$ 1,005,992</b>	<b>\$ 434,000</b>	<b>\$ -</b>	<b>\$ 571,992</b>	<b>\$ -</b>

(a) Represents the unused borrowing capacity of the various credit facilities less outstanding letters of credit of \$22.5 million and borrowings of \$10.0 million as of December 31, 2005.



PNM

The following table sets forth PNM's long-term contractual obligations as of December 31, 2005:

Contractual Obligations	Total	Payments Due				After 5 years
		Less than 1 year	2-3 years (In thousands)	4-5 years		
Long-Term Debt (a)	\$ 985,870	\$ -	\$ 300,000	\$ -	\$ 685,870	
Interest on Long-Term Debt (b)	637,861	49,657	99,314	72,914	415,976	
Operating Leases	353,430	29,322	61,353	57,990	204,765	
Purchased Power Agreements	71,239	17,809	24,924	24,119	4,387	
Coal Contracts (c)	694,307	49,905	103,635	110,206	430,561	
Other Purchase Obligations (d)	1,295,107	352,316	610,613	332,178	-	
<b>Total</b>	<b>\$ 4,037,814</b>	<b>\$ 499,009</b>	<b>\$ 1,199,839</b>	<b>\$ 597,407</b>	<b>\$ 1,741,559</b>	

(a) Represents total long-term debt excluding unamortized premium of \$1.2 million.

(b) Represents the annual interest expense on fixed and variable rate debt. Projections of interest expense on variable rate debt are based on current interest rates as of December 31, 2005.

(c) Represents only certain minimum payments that may be required under the coal contracts if no deliveries are made.

(d) Represents commitments for capital expenditures, pension and postretirement benefit obligations and other obligations.

The following table sets forth PNM's other commercial commitments as of December 31, 2005:

Other Commercial Commitments	Total Amounts Committed	Amount of Commitment Expiration Per Period				After 5 years
		1 year	2-3 years (In thousands)	4-5 years		
Short-Term Debt (a)	\$ 395,500	\$ 395,500	\$ -	\$ -	\$ -	
Local Lines of Credit	23,500	23,500	-	-	-	
<b>Total</b>	<b>\$ 419,000</b>	<b>\$ 419,000</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	

(a) Represents the unused borrowing capacity of the various credit facilities less outstanding letters of credit of \$4.5 million as of December 31, 2005.

TNMP

The following table sets forth TNMP's long-term contractual obligations as of December 31, 2005:

Contractual Obligations	Total	Payments Due			
		Less than 1 year	2-3 years (In thousands)	4-5 years	After 5 years
Long-Term Debt (a)	\$ 416,625	\$ -	\$ 248,935	\$ 167,690	\$ -
Interest on Long-Term Debt (b)	74,800	25,728	43,832	5,240	-
Operating Leases	8,493	3,159	3,887	993	454
Purchased Power Agreements	14,218	14,218	-	-	-
Other Purchase Obligations (c)	233,979	44,555	110,809	78,615	-
<b>Total</b>	<b>\$ 748,115</b>	<b>\$ 87,660</b>	<b>\$ 407,463</b>	<b>\$ 252,538</b>	<b>\$ 454</b>

(a) Represents total long-term debt excluding unamortized discount of \$0.8 million.

(b) Represents the annual interest expense on fixed and variable rate debt. Projections of interest expense on variable rate debt are based on current interest rates as of December 31, 2005.

(c) Represents commitments for capital expenditures, pension and postretirement benefit obligations and other obligations.

The following table sets forth TNMP's other commercial commitments as of December 31, 2005:

Other Commercial Commitments	Total Amounts Committed	Amount of Commitment Expiration Per Period			
		1 year	2-3 years (In thousands)	4-5 years	After 5 years
Short-Term Debt (a)	\$ 97,587	\$ -	\$ -	\$ 97,587	\$ -
<b>Total</b>	<b>\$ 97,587</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 97,587</b>	<b>\$ -</b>

(a) Represents the unused borrowing capacity of TNMP on the PNMR credit facility less outstanding letters of credit of \$2.4 million as of December 31, 2005.

### *Contingent Provisions of Certain Obligations*

PNMR, PNM and TNMP have a number of debt obligations and other contractual commitments that contain contingent provisions. Some of these, if triggered, could affect the liquidity of the Company. PNMR, PNM or TNMP could be required to provide security, immediately pay outstanding obligations or be prevented from drawing on unused capacity under certain credit agreements if the contingent requirements were to be triggered. The most significant consequences resulting from these contingent requirements are detailed in the discussion below.

#### PNMR

The committed PNMR Facility contains a “ratings trigger,” for pricing purposes only. If PNMR is downgraded or upgraded by the ratings agencies, the result would be an increase or decrease in interest cost, respectively. In addition, the PNMR Facility contains a contingent requirement that requires PNMR to maintain a debt-to-capital ratio, inclusive of off-balance sheet debt, of less than 65%. If PNMR’s debt-to-capital ratio, inclusive of off-balance sheet debt, were to exceed 65%, it could be required to repay all borrowings under the PNMR Facility, be prevented from drawing on the unused capacity under the PNMR Facility, and be required to provide security for all outstanding letters of credit issued under the PNMR Facility.

#### PNM

PNM's standard purchase agreement for the procurement of gas for its retail customers contains a contingent requirement that could require PNM to provide security for its gas purchase obligations if the seller were to reasonably believe that PNM was unable to fulfill its payment obligations under the agreement.

The master agreement for the sale of electricity in the WSPP contains a contingent requirement that could require PNM to provide security if its debt were to fall below investment grade rating. The WSPP agreement also contains a contingent requirement, commonly called a material adverse change provision, which could require PNM to provide security if a material adverse change in its financial condition or operations were to occur.

The committed PNM Facility contains a “ratings trigger,” for pricing purposes only. If PNM is downgraded or upgraded by the ratings agencies, the result would be an increase or decrease in interest cost, respectively. In addition, the PNM Facility contains a contingent provision that requires PNM to maintain a debt-to-capital ratio, inclusive of off-balance sheet debt, of less than 65%. If PNM’s debt-to-capital ratio, inclusive of off-balance sheet debt, were to exceed 65%, PNM could be required to repay all borrowings under the PNM Facility, be prevented from drawing on the unused capacity under the PNM Facility, and be required to provide security for all outstanding letters of credit issued under the PNM Facility.

If a contingent requirement were to be triggered under the PNM Facility resulting in an acceleration of the outstanding loans under the PNM Facility, a cross-default provision in the PVNGS leases could occur if the accelerated amount is not paid. If a cross-default provision is triggered, the lessors have the ability to accelerate their rights under the leases, including acceleration of all future lease payments.

#### TNMP

TNMP’s borrowing availability under the committed PNMR Facility contains a “ratings trigger,” for pricing purposes only. If TNMP is downgraded or upgraded by the ratings agencies, the result would be an increase or decrease in interest cost, respectively. In addition, the PNMR Facility contains a contingent requirement that requires TNMP to maintain a debt-to-capital ratio, inclusive of off-balance sheet debt, of less than 65%. If TNMP’s debt-to-capital ratio, inclusive of off-balance sheet debt, were to exceed 65%, TNMP could be required to repay all borrowings under the PNMR Facility, be prevented from drawing on the unused capacity under the PNMR Facility, and be required to

provide security for all outstanding letters of credit issued under the PNMR Facility.

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## *Financing Activities*

### PNMR

PNMR has a universal shelf registration statement filed with the SEC for the issuance of debt securities, equity securities, preferred stock, purchase contracts, purchase contract units and warrants. As of December 31, 2005, PNMR had approximately \$400.9 million of remaining unissued securities under this registration statement.

PNMR has entered into three fixed-to-floating interest rate swaps with an aggregate notional principal amount of \$150.0 million. Under these swaps, PNMR receives a 4.40% fixed interest payment on the notional principal amount on a semi-annual basis and pays a floating rate equal to the six month LIBOR plus 58.15 basis points (0.5815%) on the notional amount through September 15, 2008. The initial floating rate was 1.91% and will be reset every six months. The floating rate was reset on September 15, 2005, to 4.60%. The swap is accounted for as a fair-value hedge with a negative fair-market value (liability position) of approximately \$3.9 million as of December 31, 2005.

During October 2004, PNMR entered into two forward starting floating-to-fixed rate interest rate swaps with an aggregate notional principal amount of \$100.0 million. These swaps became effective August 1, 2005 and terminate November 15, 2009. Under these swaps, PNMR receives a floating rate equal to three month LIBOR on the notional principal amount and pays a fixed interest rate of 3.975% on the notional principal amount on a quarterly basis. The initial floating rate was set on August 1, 2005, at 3.693% and will be reset every three months.

From November 2004 through June 30, 2005, the swaps were accounted for as a cash flow hedge against borrowings under a five-year \$400.0 million PNMR revolving credit agreement dated November 15, 2004. The PNMR Facility replaced the November 2004 credit agreement in August 2005. Effective June 30, 2005, the swaps were de-designated as cash flow hedges due to a change in the underlying borrowings being hedged from the November 2004 credit agreement at the inception of the hedge to commercial paper. The mark-to-market change in the fair value of these swaps was subsequently recognized on PNMR's Consolidated Statement of Earnings. At December 31, 2005, the increase in fair value related to these swaps was \$2.8 million. Of this increase, \$0.4 million was recorded in accumulated other comprehensive income on PNMR's Consolidated Balance Sheet and \$2.4 million was recognized in other income on PNMR's Consolidated Statement of Earnings for the year ended December 31, 2005.

In March 2005, PNMR issued 3,910,000 shares of its common stock at \$26.76 per share. PNMR received net proceeds from this offering, after deducting underwriting discounts and commissions and estimated expenses, of approximately \$101.0 million. In addition, in March 2005, PNMR also completed a public offering of 4,945,000 equity-linked units at 6.75% yielding net proceeds after fees of \$239.6 million. See Note 6 for further details about this transaction.

In October 2005, PNMR completed a private offering of 4,000,000 equity-linked units at 6.625%. PNMR received \$100.0 million in proceeds from this transaction and there were no underwriting discounts or commissions. PNMR used the proceeds to repay short-term borrowings, a portion of which was incurred to finance the acquisition of TNP. See Note 6 for further details about this transaction.

In conjunction with the acquisition of TNP, on June 6, 2005, PNMR made an equity investment of approximately \$110.5 million in TNP, which TNP used to repay in full amounts owing under TNP's credit agreement. In addition, pursuant to PNMR's acquisition of TNP, PNMR agreed to provide funds to TNP to enable TNP to redeem (a) TNP's 14.5% Senior Redeemable Preferred Stock, Series C, (b) TNP's 14.5% Senior Redeemable Preferred Stock, Series D (collectively, "Preferred Stock"), and (c) TNP's 10.25% Senior Subordinated Notes due 2010, Series B ("Senior Notes"). On July 6, 2005, TNP redeemed the Preferred Stock by tendering \$224.6 million to the holders of the Preferred Stock and redeemed the Senior Notes by tendering \$296.5 million to holders of the Senior Notes (tendered amounts include interest, as applicable). In order to fund a portion of the cost of redemption of TNP's Preferred Stock and Senior Notes, PNMR issued \$370.0 million of commercial paper short-term notes under the PNMR commercial paper program. The

balance of the funds necessary for the redemption came from other cash available to PNMR and the total redemption amount was an equity investment by PNMR in TNP.

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As discussed above under “Proposed Twin Oaks Acquisition,” in addition to Altura, PNMR is a party to the purchase agreement and has agreed to provide parental guarantees for certain obligations of Altura relating to the acquisition. PNMR has arranged for bridge financing to close the transaction. It is expected that the permanent financing will come from the issuance of debt and equity structured to maintain PNMR’s investment grade rating. However, PNMR is at risk that it will be unable to obtain financing for the acquisition at a reasonable cost or terms that will permit PNMR to maintain its investment grade rating, due to conditions in the capital markets or PNMR’s financial condition.

### PNM

PNM has a universal shelf registration statement filed with the SEC for the issuance of debt securities, equity securities, preferred stock, purchase contracts, purchase contract units and warrants. As of December 31, 2005, PNM had approximately \$200.0 million of remaining unissued securities registered under its shelf registration statement. The amount of senior unsecured notes that may be issued is not limited by the senior unsecured notes indenture. However, debt-to-capital requirements in certain of PNM’s financial instruments and regulatory agreements could ultimately limit the amount of additional debt PNM could issue.

### TNMP

Depending on TNMP’s future business strategy, capital needs and market conditions, TNMP could enter into additional long-term financings for the purpose of strengthening TNMP’s balance sheet, funding growth and reducing its cost of capital. The Company continues to evaluate its investment and debt retirement options to optimize its financing strategy and earnings potential. The amount of senior unsecured notes that may be issued is not limited by the senior unsecured notes indenture. However, debt-to-capital requirements in certain of TNMP’s financial instruments and regulatory agreements would ultimately limit the amount of additional debt TNMP would issue.

### *Dividends*

The declaration of common dividends by PNMR is dependent upon a number of factors including the ability of PNMR’s subsidiaries to pay dividends. PNMR’s primary sources of dividends are PNM and TNMP.

PNM paid cash dividends of \$91.0 million, \$23.0 million and \$49.6 million to PNMR for the years ended December 31, 2005, 2004 and 2003, respectively. In 2005, TNMP paid cash dividends of \$12.0 million to its parent company, which were ultimately paid to PNMR.

As part of the order approving the formation of PNMR, the NMPRC placed certain restrictions on the ability of PNM and TNMP to pay dividends. The NMPRC order imposed the following conditions regarding dividends paid by PNM and TNMP: PNM or TNMP cannot pay dividends which cause its debt rating to fall below investment grade; and neither PNM nor TNMP can pay dividends in any year, as determined on a rolling four quarter basis, in excess of net earnings without prior NMPRC approval. The Global Electric Agreement (see Note 17) modified the PNM dividend restriction to allow PNM to dividend earnings as well as equity contributions made by PNMR. Additionally, PNM has various financial covenants that limit the transfer of assets, through dividends or other means.

In addition, the ability of PNMR to declare dividends is dependent upon the extent to which cash flows will support dividends, the availability of retained earnings, the financial circumstances and performance, the NMPRC’s and PUCT’s decisions in various regulatory cases currently pending and which may be docketed in the future, the effect of federal regulatory decisions, Congressional and legislative acts, and economic conditions in the United States. Conditions imposed by the NMPRC or PUCT, future growth plans and the related capital requirements and business considerations may also affect PNMR’s ability to pay dividends.

In July 2005, the Board of PNMR approved an 8.0% increase in the common stock dividend for an indicated annual dividend of \$0.80 per share. In February 2006, the Board of PNMR approved a 10.0% increase in the common stock

dividend for an indicated annual dividend of \$0.88 per share. PNMR targets a payout ratio of 50% to 60% of consolidated earnings.

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*Capital Structure*PNMR

PNMR's capitalization, including current maturities of long-term debt, at December 31, 2005 and December 31, 2004 is shown below:

	<b>December 31, 2005</b>	<b>December 31, 2004</b>
Common Equity	42.3%	52.4%
Preferred Stock	0.4%	0.6%
Long-term Debt	57.3%	47.0%
Total Capitalization	100.0%	100.0%

Total capitalization does not include as debt the present value of PNM's operating lease obligations for PVNGS Units 1 and 2, EIP and the Delta operating lease, which was approximately \$170.9 million as of December 31, 2005 and \$176.0 million as of December 31, 2004.

The change in PNMR's capitalization is due to the issuance of common stock and equity-linked units in March 2005, the equity-linked units in October 2005 (see Note 6) and the acquisition of TNP on June 6, 2005 (see Note 2).

PNM

PNM's capitalization, including current maturities of long-term debt, at December 31, 2005 and December 31, 2004 is shown below:

	<b>December 31, 2005</b>	<b>December 31, 2004</b>
Common Equity	50.2%	50.8%
Preferred Stock	0.6%	0.6%
Long-term Debt	49.2%	48.6%
Total Capitalization	100.0%	100.0%

TNMP

TNMP's capitalization, including current maturities of long-term debt, at December 31, 2005 and December 31, 2004 is shown below:

	<b>December 31, 2005</b>	<b>December 31, 2004</b>
Common Equity	58.6%	31.3%
Long-term Debt	41.4%	68.7%
Total Capitalization	100.0%	100.0%

The change in TNMP's capitalization is due to the acquisition of TNP on June 6, 2005 and the effects of purchase accounting.

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## COMPETITION

Under current law, the Company is not in any direct retail competition with any other regulated electric and gas utility, except for sales of natural gas. Nevertheless, the Company is subject to varying degrees of competition in certain territories adjacent to or within the areas it serves with other utilities in its region as well as with rural electric cooperatives and municipal utilities. PNM Wholesale is involved in the generation and sale of electricity into the wholesale market. It is subject to competition from regional utilities with similar opportunities to generate and sell energy at market-based prices and larger trading entities that do not own or operate generating assets. The Company believes that it is well positioned to compete in this market due to its long history in the marketplace, its niche product offerings, and stringent risk management practices. The Texas electricity market has been open to retail competition since January 2002. Prior to 2002, TNMP operated as an integrated utility in Texas. In accordance with Senate Bill 7, TNMP separated its Texas utility operations into three components: (1) an unregulated retail sales business operated by First Choice; (2) a regulated power transmission and distribution business operated by TNMP and (3) power generation, a business which TNMP is no longer engaged in. The Company is exposed to competition in the unregulated Texas retail electricity market through First Choice, which serves customers at price-to-beat rates approved by the PUCT and customers at competitive rates. In order to compete effectively in the Texas retail electricity market, First Choice must be able to attract and retain customers on the basis of cost and service, while managing the cost of its energy supply.

Since 2002, electric consumers in Texas have been encouraged to switch from their traditional affiliated retail energy provider, such as TNMP, to a competitive retail energy provider, such as First Choice. Currently under TECA, consumers whose chosen retail energy provider has exited the Texas market are provided electric service by a “provider of last resort.” Rates of the provider of last resort are regulated by the PUCT and are fixed for the two-year period that each provider of last resort serves. The current contracts for default service offered by providers of last resort under TECA will expire on December 31, 2006. On January 1, 2007 new providers of last resort will be identified and those providers as well as the rates offered will be effective until December 31, 2008. Also on December 31, 2006, the price-to-beat rate mechanism will cease to exist and First Choice and other retail energy providers subject to providing price-to-beat rates will only market retail electricity at competitive rates. There is currently an open rulemaking at the PUCT evaluating the potential need for a replacement rate for the price-to-beat rate mechanism. Other services being evaluated in this rulemaking are provider of last resort functions and pricing and the possible creation of a default provider. The Company cannot currently predict what, if any, changes will occur to either mechanism and what, if any, impact such changes may have on its results of operations and financial position.

## OTHER ISSUES FACING THE COMPANY

PNM is subject to the jurisdiction of the NMPRC, with respect to its retail electric and gas rates, service, accounting, issuance of securities, construction of major new generation and transmission facilities and other matters regarding retail utility services provided in New Mexico. The FERC has jurisdiction over rates and other matters related to wholesale electric sales and cost recovery for a portion of PNM’s transmission network.

In Texas, TNMP provides regulated transmission and distribution services and is subject to the jurisdiction of the PUCT and certain municipalities with respect to rates and service. Within New Mexico, TNMP is subject to the jurisdiction of the NMPRC. TNMP is subject to traditional cost-of-service regulation in both Texas and New Mexico. TNMP is subject in some of its activities, including the issuance of securities and the acquisition or disposition of properties in New Mexico, to the jurisdiction of the FERC. TNMP’s transmission and distribution activities in Texas are not subject to FERC regulation, because those activities occur solely within the ERCOT system of Texas.

First Choice is a member of ERCOT, the ISO, responsible for maintaining reliable operations of the bulk electric power supply system in the electric market served in Texas by ERCOT. The electric market served by ERCOT operates under the reliability standards set by the North American Electric Reliability Council. The PUCT has primary

jurisdictional authority over the electric market served by ERCOT and the reliability of electricity across Texas' main interconnected power grid.

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See Notes 16, 17 and 18 for a discussion of commitments and contingencies, rate and regulatory matters and environmental issues facing the Company.

### NEW ACCOUNTING STANDARDS

There have been no new accounting standards that materially affected PNMR, PNM or TNMP this period; however, see Note 1 for discussion of SFAS No. 123 (revised 2004), "*Share Based Payment*" and Note 15 for discussion of FASB Interpretation No. 47, "*Accounting for Conditional Asset Retirement Obligations*."

### DISCLOSURE REGARDING FORWARD LOOKING STATEMENTS

Statements made in this filing that relate to future events or PNMR's, PNM's or TNMP's expectations, projections, estimates, intentions, goals, targets and strategies, are made pursuant to the Private Securities Litigation Reform Act of 1995. Readers are cautioned that all forward-looking statements are based upon current expectations and estimates and PNMR, PNM and TNMP assume no obligation to update this information.

Because actual results may differ materially from those expressed or implied by these forward-looking statements, PNMR, PNM and TNMP caution readers not to place undue reliance on these statements. PNMR's, PNM's and TNMP's business, financial condition, cash flow and operating results are influenced by many factors, which are often beyond their control, that can cause actual results to differ from those expressed or implied by the forward-looking statements. These factors include:

- The potential unavailability of cash at TNP and its subsidiaries,
- The risk that TNP and its subsidiaries will not be integrated successfully into PNMR,
- The risk that the benefits of the TNP acquisition will not be fully realized or will take longer to realize than expected,
- Disruption from the TNP acquisition making it more difficult to maintain relationships with customers, employees, suppliers or other third parties,
  - The outcome of any appeals of the PUCT order in the stranded cost true-up proceeding,
    - The ability of First Choice to attract and retain customers,
      - Changes in ERCOT protocols,
    - Changes in the cost of power acquired by First Choice,
      - Collections experience,
    - Insurance coverage available for claims made in litigation,
      - Fluctuations in interest rates,
  - Weather (including impacts of the hurricanes in the Gulf Coast region),
    - Water supply,
    - Changes in fuel costs,
    - Availability of fuel supplies,
  - The effectiveness of risk management and commodity risk transactions,
- Seasonality and other changes in supply and demand in the market for electric power,
  - Variability of wholesale power prices and natural gas prices,
- Volatility and liquidity in the wholesale power markets and the natural gas markets,
- Changes in the competitive environment in the electric and natural gas industries,
- The performance of generating units, including PVNGS, and transmission systems,
  - The market for electrical generating equipment,
  - The ability to secure long-term power sales,
- The risks associated with completion of construction of Luna, including construction delays and unanticipated cost overruns,
  - State and federal regulatory and legislative decisions and actions,
    - The outcome of legal proceedings,

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- Changes in applicable accounting principles,
- The performance of state, regional and national economies, and
- The other factors described in Item 1A. “Risk Factors” in this Form 10-K.

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See Item 7A. “Quantitative and Qualitative Disclosure About Market Risk” for information about the risks associated with the use of derivative financial instruments.

### **SECURITIES ACT DISCLAIMER**

Certain securities, including commercial paper described in this report, have not been registered under the Securities Act of 1933, as amended, or any state securities laws and may not be reoffered or sold in the United States absent registration or an applicable exemption from the registration requirements of the Securities Act of 1933 and applicable state securities laws. This Form 10-K does not constitute an offer to sell or the solicitation of an offer to buy any securities.

### **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

The Company uses derivative financial instruments to manage risk as it relates to changes in natural gas and electric prices, changes in interest rates and, historically, adverse market changes for investments held by the Company’s various trusts. The Company also uses certain derivative instruments for wholesale power marketing and natural gas transactions in order to take advantage of favorable price movements and market timing activities in these power markets. The following additional information is provided.

PNMR controls the scope of its various forms of risk through a comprehensive set of policies and procedures and oversight by senior level management and the PNMR Board. The Board’s Finance Committee sets the risk limit parameters. The RMC, comprised of corporate and business segment officers and other managers, oversees all of the activities, which include commodity price, credit, equity, interest rate and business risks. The RMC has oversight for the ongoing evaluation of the adequacy of the risk control organization and policies. PNMR has a risk control organization, headed by a Risk Manager, which is assigned responsibility for establishing and enforcing the policies, procedures and limits and evaluating the risks inherent in proposed transactions, on an enterprise-wide basis.

The RMC’s responsibilities specifically include: establishment of a general policy regarding risk exposure levels and activities in each of the business segments; authority to approve the types of instruments traded; authority to establish a general policy regarding counterparty exposure and limits; authorization and delegation of transaction limits; review and approval of controls and procedures; review and approval of models and assumptions used to calculate mark-to-market and risk exposure; authority to approve and open brokerage and counterparty accounts; review of hedging and risk activities; and quarterly reporting to the Finance Committee and the PNMR Board on these activities.

The RMC also proposes risk limits, such as VaR and EaR, to the Finance Committee. The Finance Committee ultimately sets the Company’s risk limits.

It is the responsibility of each business segment to create its own control procedures and policies within the parameters established by the Finance Committee. The RMC reviews and approves these policies, which are created with the assistance of the Corporate Controller, Director of Internal Audit and the Director of Financial Risk Management. Each business segment’s policies address the following controls: authorized risk exposure limits; authorized instruments and markets; authorized personnel; policies on segregation of duties; policies on mark-to-market accounting; responsibilities for deal capture; confirmation procedures; responsibilities for reporting results; statement on the role of derivative transactions; and limits on individual transaction size (nominal value).

To the extent an open position exists, fluctuating commodity prices can impact financial results and financial position, either favorably or unfavorably. As a result, the Company cannot predict with certainty the impact that its risk management decisions may have on its businesses, operating results or financial position.

#### *Commodity Risk*

Marketing and procurement of energy often involve market risks associated with managing energy commodities and establishing open positions in the energy markets, primarily on a short-term basis. These risks fall into three different categories: price and volume volatility, credit risk of counterparties and adequacy of the control

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environment. The Company's operations subject to market risk routinely enter into various derivative instruments such as forward contracts, option agreements and price basis swap agreements to hedge price and volume risk on their purchase and sale commitments, fuel requirements and to enhance returns and minimize the risk of market fluctuations.

PNM's wholesale operations, including long-term contracts and short-term sales, are managed primarily through a net asset-backed marketing strategy, whereby PNM's aggregate net open forward contract position is covered by its forecasted excess generation capabilities. PNM is exposed to market risk if its generation capabilities were to be disrupted or if its retail load requirements were to be greater than anticipated. If PNM were required to cover all or a portion of its net open contract position as a result of the aforementioned unexpected situations, it would have to meet its commitments through market purchases. As such, PNM is exposed to risks related to fluctuations in the market price of energy that could impact the sales price or purchase price of energy. In addition, the wholesale operations utilize discrete market-based transactions to take advantage of opportunities that present themselves in the ordinary course of business. These positions are subject to market risk that is not mitigated by PNM's generation capabilities.

First Choice is responsible for energy supply related to the sale of electricity to retail customers in Texas. TECA contains no provisions for the specific recovery of fuel and purchased power costs. First Choice operates within a competitive marketplace; however, to the extent that it serves former TNMP customers under the provisions of the price-to-beat service, it has the ability to file with the PUCT to change the price-to-beat fuel factor twice each year, in the event of significant changes in natural gas prices. The rates charged to new customers acquired by First Choice outside of TNMP's service territory are not regulated by the PUCT, but are negotiated with each customer. As a result, changes in fuel and purchased power costs will affect First Choice's operating results. First Choice is exposed to market risk to the extent that its retail rates or cost of supply fluctuates with market prices. Additionally, fluctuations in First Choice retail load requirements greater than anticipated may subject First Choice to market risk. First Choice's basic strategy is to minimize its exposure to fluctuations in market energy prices by matching fixed price sales contracts with fixed price supply. In addition, First Choice utilizes discrete market-based transactions to take advantage of opportunities that present themselves in the ordinary course of business. These positions are subject to market risk that is not mitigated by First Choice's retail operations.

Additionally, in connection with the issuance of a final stranded cost true-up order for TNMP, the PUCT will adjust First Choice's fuel factor portion of the price-to-beat downward if natural gas prices are below the prices embedded in the then-current rates. (See Note 17.)

#### *Accounting for Derivatives*

Under the derivative accounting rules and the related accounting rules for energy contracts, the Company accounts for its various financial derivative instruments for the purchase and sale of energy differently based on the contract terms. Energy contracts that meet the definition of a derivative under SFAS 133 and do not qualify for a normal purchase or sale designation are recorded on the balance sheet at fair market value at each period end. The changes in fair market value are recognized in earnings unless specific hedge accounting criteria are met. Should an energy transaction qualify as a hedge under SFAS 133, fair market value changes from year to year are recognized on the balance sheet with a corresponding charge to other comprehensive income. Gains or losses are recognized when the hedged transaction settles. Derivatives that meet the normal sales and purchases exceptions within SFAS 133 are not marked to market but rather recorded in results of operations when the underlying transaction settles.

PNMR

The acquisition of TNP occurred on June 6, 2005; therefore First Choice activity is included in the PNMR activity from June 6, 2005 through December 31, 2005.

The following table shows the net fair value of mark-to-market energy contracts for First Choice and PNM Wholesale included in PNMR's Consolidated Balance Sheet:

	<b>December 31, 2005</b>	<b>December 31, 2004</b>
	(In thousands)	
Mark-to-Market Energy Contracts:		
Current asset	\$ 14,555	\$ 6,890
Long-term asset	21,292	316
Total mark-to-market assets	35,847	7,206
Current liability	(11,198)	(5,007)
Long-term liability	(20,903)	(126)
Total mark-to-market liabilities	(32,101)	(5,133)
Net fair value of mark-to-market energy contracts	\$ 3,746	\$ 2,073

The mark-to-market energy transactions represent net assets at December 31, 2005 and December 31, 2004 after netting all applicable open purchase and sale contracts.

The market prices used to value PNMR mark-to-market energy transactions are based on index prices and broker quotations.

The following table details the changes in the net asset or liability balance sheet position from one period to the next for mark to market energy transactions for the operations of First Choice and PNM Wholesale:

	<b>Year Ended December 31, 2005</b>	<b>2004</b>
	(In thousands)	
Sources of Fair Value Gain/(Loss):		
Fair value at beginning of year	\$ 2,073	\$ 433
Change in valuation method <sup>1</sup>	-	(227)
Amount realized on contracts delivered during period	(1,535)	(160)
Changes in fair value	3,208	1,800
Net fair value at end of period	\$ 3,746	\$ 1,846
Net change recorded as mark-to-market	\$ 1,673	\$ 1,640

<sup>1</sup> Change in valuation method based on illiquid market data utilized for initial valuation of long-term physical option contract and long-term gas swap contract.

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The following table provides the maturity of the net assets/(liabilities) of PNMR, giving an indication of when these mark-to-market amounts will settle and generate/(use) cash. The following values were determined using broker quotes:

**Fair Value at December 31, 2005**

Less than 1 year	Maturities		Total
	1-3 Years	4+ Years	
	(In thousands)		
\$3,325	\$194	\$227	\$3,746

As of December 31, 2005, a decrease in market pricing of PNMR's mark-to-market energy transactions by 10% would have resulted in a decrease in net earnings of less than 1%. Conversely, an increase in market pricing of these transactions by 10% would have resulted in an increase in net earnings of less than 1%.

**PNM**

The following table shows the net fair value of mark-to-market energy contracts for PNM Wholesale included in the Consolidated Balance Sheet:

	December 31, 2005	December 31, 2004
	(In thousands)	
Mark-to-Market Energy Contracts:		
Current asset	\$ 10,433	\$ 6,890
Long-term asset	21,292	316
Total mark-to-market assets	31,725	7,206
Current liability	(8,437)	(5,007)
Long-term liability	(20,903)	(126)
Total mark-to-market liabilities	(29,340)	(5,133)
Net fair value of mark-to-market energy contracts	\$ 2,385	\$ 2,073

The mark-to-market energy transactions represent net assets at December 31, 2005 and December 31, 2004 after netting all applicable open purchase and sale contracts.

The market prices used to value PNM Wholesale's mark-to-market energy transactions are based on index prices and broker quotations.

The following table details the changes in the net asset or liability balance sheet position from one period to the next for mark to market energy transactions for the operations of PNM Wholesale:

	<b>Year Ended December 31,</b>	
	<b>2005</b>	<b>2004</b>
	(In thousands)	
Sources of Fair Value Gain/(Loss):		
Fair value at beginning of year	\$ 2,073	\$ 433
Change in valuation method <sup>1</sup>	-	(227)
Amount realized on contracts delivered during period	(2,319)	(160)
Changes in fair value	2,631	1,800
Net fair value at end of period	\$ 2,385	\$ 1,846
Net change recorded as mark-to-market	\$ 312	\$ 1,640

<sup>1</sup> Change in valuation method based on illiquid market data utilized for initial valuation of long-term physical option contract and long-term gas swap contract.

The following table provides the maturity of the net assets/(liabilities) of PNM Wholesale, giving an indication of when these mark-to-market amounts will settle and generate/(use) cash. The following values were determined using broker quotes:

#### Fair Value at December 31, 2005

<b>Less than 1 year</b>	<b>Maturities</b>		<b>Total</b>
	<b>1-3 Years</b>	<b>4+ Years</b>	
	(In thousands)		
\$1,964	\$194	\$227	\$2,385

As of December 31, 2005, a decrease in market pricing of PNM Wholesale's mark-to-market energy transactions by 10% would have resulted in a decrease in net earnings of less than 1%. Conversely, an increase in market pricing of these transactions by 10% would have resulted in an increase in net earnings of less than 1%.

#### *Risk Management Activities*

PNM's Wholesale Operations measure the market risk of its long-term contracts and wholesale activities using a VaR calculation to maintain the Company's total exposure within management-prescribed limits. The Company's VaR calculation reports the possible market loss for the respective transactions. This calculation is based on the transaction's fair market value on the reporting date. Accordingly, the VaR calculation is not a measure of the potential accounting mark-to-market loss. In 2005, the Company adopted the Monte Carlo simulation model of VaR. The Monte Carlo model utilizes a random generated simulation based on historical volatility to generate portfolio values. The Company continues to utilize the two-tailed confidence level at 99%. VaR models are relatively sophisticated.

The quantitative risk information, however, is limited by the parameters established in creating the model. The instruments being evaluated may trigger a potential loss in excess of calculated amounts if changes in commodity prices exceed the confidence level of the model used. The VaR methodology employs the following critical parameters: volatility estimates, market values of open positions, appropriate market-oriented holding periods and seasonally adjusted correlation estimates. The Company's VaR calculation considers the Company's forward position for the next eighteen months. The Company uses a holding period of three days as the estimate of the length of time that will be needed to liquidate the positions. The volatility and the correlation estimates measure the impact of adverse price movements both at an individual position level as

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well as at the total portfolio level. The two-tailed confidence level established is 99%. For example, if VaR is calculated at \$10.0 million, it is estimated at a 99% confidence level that if prices move against PNM's positions, the Company's pre-tax gain or loss in liquidating the portfolio would not exceed \$10.0 million in the three days that it would take to liquidate the portfolio.

In 2005, the Company revised its methodologies for calculating VaR in order to improve its ability to measure and manage risk. As a result, the Company also revised its VaR limits to be consistent with the new methodologies. As previously discussed, the Company adopted the Monte Carlo statistical simulation approach. In addition, the Company redefined the types of transactions on which it measures VaR. For PNM's wholesale operations, the Company measures VaR for all transactions that are not directly asset related and have economic risk. The VaR limit established for these transactions in February 2005 is \$5.0 million. For the year ended December 31, 2005, the average VaR amount for these transactions was \$1.7 million, with high and low VaR amounts for the period of \$7.8 million and \$0, respectively. The VaR amount for these transactions at December 31, 2005 was \$3.5 million. In late 2005, the Company discontinued its use of VaR to manage risk from its asset-backed merchant operations; therefore, the Company no longer measures a total portfolio VaR. Management believes that the limitations inherent in the VaR calculation overstates the market risk related to its generation assets.

In 2004, the Company utilized the variance/covariance model of VaR, which is a probabilistic model that measures the risk of loss to earnings in market sensitive instruments. The variance/covariance model relies on statistical relationships to analyze how changes in different markets can affect a portfolio of instruments with different characteristics and market exposure. For the year ended December 31, 2004 the Company's average total VaR amount was \$15.7 million, with high and low VaR amounts for the period of \$29.1 million and \$5.1 million, respectively. The total VaR amount at December 31, 2004 was \$20.0 million. In the prior year the Company also measured VaR for a subset of transactions that were marked-to-market in accordance with SFAS 133. The VaR limit established for these transactions was \$2.0 million. For the year ended December 31, 2004, the average VaR amount for these transactions was \$0.3 million, with high and low VaR amounts for the period of \$1.1 million and \$0, respectively. The total VaR amount for these transactions as reported at December 31, 2004 was \$0.6 million. Because of the nature of the Monte Carlo simulation method now utilized by the Company, reporting of the 2004 VaR amounts using the Company's new approach is neither practical nor representational of the Company's management of risk in 2004.

First Choice measures the market risk of its activities using an EaR calculation to maintain the Company's total exposure within management-prescribed limits. Because of its obligation to serve, First Choice must take its obligations to settlement. Accordingly, a measure that evaluates the settlement of First Choice's positions against earnings provides management with a useful tool to manage its portfolio. First Choice's EaR calculation reports the possible losses against forecasted earnings for its retail load and supply portfolio. This calculation is based on First Choice's forecasted earnings on the reporting date. The Company utilizes a Delta/Gamma approximation model of EaR. The Delta/Gamma model calculates a price change within a given time frame, correlation and volatility parameters for each price curve utilized in valuing the mark-to-market of each position to develop a change in value for any position. This process is repeated multiple times to calculate a standard deviation, which is used to arrive at an EaR amount based on a certain confidence level. The model uses the Delta/Gamma approximation to model the optionality related to price-to-beat rate resets by both the Company and the PUCT as discussed above. First Choice utilizes the one-tailed confidence level at 95%. EaR models are relatively sophisticated. The quantitative risk information, however, is limited by the parameters established in creating the model. The instruments being evaluated may trigger a potential loss in excess of calculated amounts if changes in commodity prices exceed the confidence level of the model used. The EaR calculation considers the Company's forward position for the next twelve months and holds each position to settlement. The volatility and the correlation estimates measure the impact of adverse price movements both at an individual position level as well as at the total portfolio level. For example, if EaR is calculated at \$10.0 million, it is estimated at a 95% confidence level that if prices move against First Choice's positions, the losses against the Company's forecasted earnings over the next twelve months would not exceed \$10.0 million.

For the period June 6 through December 31, 2005, the average total EaR amount was \$19.5 million, with high and low EaR amounts for the period of \$26.4 million and \$14.6 million, respectively. The total EaR amount at December 31, 2005 was \$14.6 million.

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In July 2005, the Finance Committee approved new risk measures for First Choice. These measures were designed to give First Choice management flexibility to execute its strategies to reduce the risk inherent in the portfolio and to take advantage of market opportunities in a controlled and limited fashion. The Company adopted an EaR limit of \$25.0 million. Upon successful execution of First Choice's strategy to mitigate risk by locking in its floating supply costs at favorable prices, these limits are expected to be lowered to match the new risk profile. In addition, the Company adopted two new VaR measures to monitor the market based mitigation strategies of First Choice management. The first VaR limit is based on the same total retail load and supply portfolio as the EaR measure; however, the VaR measure is intended to capture the effects of changes in market prices over a 10 day holding period. This holding period is considered appropriate given the nature of First Choice's supply portfolio and the constraints faced by First Choice in the ERCOT market. The calculation utilizes the same Monte Carlo simulation approach described above at a 95% confidence level. This VaR limit was established at \$7.5 million. The second VaR limit was established at \$1.5 million for transactions that are subject to mark-to-market accounting as defined by SFAS 133 and SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." This calculation captures the effect of changes in market prices over a three-day holding period and utilizes the same Monte Carlo simulation approach described above at a 95% confidence level.

The Company's risk measures are regularly monitored by the Company's RMC. The RMC has put in place procedures to ensure that increases in risk measures that exceed the prescribed limits are reviewed and, if deemed necessary, acted upon to reduce exposures. The VaR and EaR limits represent an estimate of the potential gains or losses that could be recognized on the Company's portfolios, subject to market risk, given current volatility in the market, and are not necessarily indicative of actual results that may occur, since actual future gains and losses will differ from those estimated. Actual gains and losses may differ due to actual fluctuations in market prices, operating exposures, and the timing thereof, as well as changes to the underlying portfolios during the year.

#### *Credit Risk*

The Company uses derivative financial instruments to manage risk as it relates to changes in natural gas and electric prices, changes in interest rates and, historically, adverse market changes for investments held by the Company's various trusts. The Company also uses certain derivative instruments for wholesale power marketing transactions in order to take advantage of favorable price movements and market timing activities in the wholesale power markets. The Company's use of derivatives and the resulting credit risk is regularly monitored by the RMC.

In addition, counterparties expose the Company to credit losses in the event of non-performance or non-payment. The Company manages credit on a consolidated basis and uses a credit management process to assess and monitor the financial conditions of counterparties. Credit exposure is regularly monitored by the RMC. The RMC has put in place procedures to ensure that increases in credit risk measures that exceed the prescribed limits are reviewed and, if deemed necessary, acted upon to reduce exposures.

The following table provides information related to PNM Wholesale's credit exposure as of December 31, 2005. The Company does not hold any credit collateral as of December 31, 2005. The table further delineates that exposure by the credit worthiness (credit rating) of the counterparties and provides guidance as to the concentration of credit risk to individual counterparties PNM Wholesale may have. Also provided is an indication of the maturity of a Company's credit risk by credit ratings of the counterparties.

**Schedule of PNM Wholesale Credit Risk Exposure  
December 31, 2005**

Rating (a)	(b) Net Credit Risk Exposure	Number of Counter- parties >10%	Net Exposure of Counter- parties >10%
		(Dollars in thousands)	
Investment grade	\$ 117,734	2	\$ 38,887
Non-investment grade	985	-	-
<b>Internal ratings</b>			
Investment grade	51	-	-
Non-investment grade	3,663	-	-
<b>Total</b>	<b>\$ 122,433</b>		<b>\$ 38,887</b>

(a) **The Rating** included in "Investment Grade" is for counterparties with a minimum S&P rating of BBB- or Moody's rating of Baa3. If the counterparty has provided a guarantee by a higher rated entity (e.g., its parent), determination is based on the rating of its guarantor. The category "Internal Ratings - Investment Grade" includes those counterparties that are internally rated as investment grade in accordance with the guidelines established in the Company's credit policy.

(b) The **Net Credit Risk Exposure** is the net credit exposure to PNM from PNM Wholesale operations. This includes long-term contracts, forward sales and short-term sales. The exposure captures the net amounts due to PNM from receivables/payables for realized transactions, delivered and unbilled revenues, and mark-to-market gains/losses (pursuant to contract terms). Exposures are offset according to legally enforceable netting arrangements and reduced by credit collateral. Credit collateral includes cash deposits, letters of credit and performance bonds received from counterparties. Amounts are presented before those reserves that are determined on a portfolio basis.

**PNM Wholesale  
Maturity of Credit Risk Exposure  
December 31, 2005**

Rating	Less than 2 Years	2-5 Years	>5 Years	Total Net Exposure
	(In thousands)			
Investment grade	\$ 100,489	\$ 13,686	\$ 3,559	\$ 117,734
Non-investment grade	985	-	-	985
<b>Internal ratings</b>				
Investment grade	51	-	-	51
Non-investment grade	3,663	-	-	3,663
<b>Total</b>	<b>\$ 105,188</b>	<b>\$ 13,686</b>	<b>\$ 3,559</b>	<b>\$ 122,433</b>

The Company provides for losses due to market and credit risk. PNM Wholesale credit risk with its largest counterparty as of December 31, 2005 and December 31, 2004 was \$20.5 million and \$26.2 million, respectively.

*First Choice*

First Choice is subject to credit risk from non-performance by its supply counterparties to the extent these contracts have a mark-to-market value in the favor of First Choice. The Constellation power supply agreement established FCPS, a bankruptcy remote special purpose entity, to hold all of First Choice's customer contracts and wholesale power and gas contracts. Constellation received a lien on accounts receivable, customer contracts, cash, and the equity of FCPS as security for FCPS's performance under the power supply agreement. The provisions of this agreement severely limit FCPS's ability to secure power from alternate sources. Additionally, the terms of the security agreement do not require Constellation to post collateral for any mark-to-market balances in FCPS's favor. At December 31, 2005, the supply contracted with Constellation was in a favorable mark-to-market position for FCPS. When netted against amounts owed to Constellation, this exposure was approximately \$8.0 million. The Constellation power supply agreement collateral provisions will continue until the expiration of the agreement on December 31, 2007. First Choice's credit exposure to other counterparties at December 31, 2005 was \$14.6 million and the tenor of these exposures was less than two years.

First Choice has continued to experience a reduction in bad debt expense from its retail customers due to reduced customer receivables resulting partially from effective disconnect policies, increased collection activity and refined consumer credit and securitization policies. Bad debt expense for the period June 6, 2005 through December 31, 2005, was \$2.5 million. First Choice expects bad debt expense to increase in 2006 due primarily to the continued increase in the price of natural gas and impacts from the Gulf Coast hurricanes, including waiver of customer deposits for hurricane victims.

*PNM Gas Supply Hedging Activities*

PNM hedges certain portions of natural gas supply contracts in order to protect its retail customers from adverse price fluctuations in the natural gas market. The financial impact of all hedge gains and losses, including the related costs of the program, is recoverable through the PGAC. As a result, earnings are not affected by gains and losses generated by these instruments.

In order to protect its natural gas customers from the risk of rising prices during the 2005-2006 heating season, in total, PNM spent approximately \$6.8 million in 2005 to purchase gas options that essentially cap the amount PNM

would pay for each volume of gas subject to the options during the winter heating season. PNM expects to recover its option premiums as a component of the PGAC during the months of October 2005 through February 2006.

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*Interest Rate Risk*

PNMR

PNMR's senior notes issued as part of the equity-linked units sold in March and October 2005 will be remarketed in 2008. If the remarketing is successful, the interest rate on the senior notes may change to a rate selected by the remarketing agent, and the maturity of the senior notes may be extended to a date selected by PNMR. If the remarketing of the senior notes is not successful, the maturity and interest rate of the senior notes will not change and holders of the equity-linked units will have the option of putting their senior notes to PNMR to satisfy their obligations under the purchase contracts. PNMR expects that the remarketing of the senior notes will be successful.

PNM

PNM has long-term debt which subjects it to the risk of loss associated with movements in market interest rates. The majority of PNM's long-term debt is fixed-rate debt, and therefore, does not expose PNM's earnings to a major risk of loss due to adverse changes in market interest rates. However, the fair value of all long-term debt instruments would increase by approximately 4.6%, or \$48.3 million, if interest rates were to decline by 50 basis points from their levels at December 31, 2005. At December 31, 2005, the fair value of PNM's long-term debt was approximately \$1.05 billion as compared to a book value of \$1.02 billion. In general, an increase in fair value would impact earnings and cash flows to the extent not recoverable in rates if PNM were to re-acquire all or a portion of its debt instruments in the open market prior to their maturity.

PNM's \$146.0 million, 2.1% pollution control bonds due in 2033 are required to be remarketed in April 2006. Following a successful remarketing, the interest rate on the pollution control bonds may change to reflect current market conditions. If for some reason, the remarketing of the pollution control bonds were not successful, PNM would be required to repurchase the bonds.

During the year ended December 31, 2005, PNM contributed cash of approximately \$9.7 million to PVNGS decommissioning, pension and other postretirement benefits for plan year 2005. The securities held by the trusts had an estimated fair value of \$631.8 million at December 31, 2005, of which approximately 26.5% were fixed-rate debt securities that subject PNM to risk of loss of fair value with movements in market interest rates. If rates were to increase by 50 basis points from their levels at December 31, 2005, the decrease in the fair value of the securities would be 2.8% or \$4.8 million. PNM does not currently recover or return through rates any losses or gains on these securities. PNM, therefore, is at risk for shortfalls in its funding of its obligations due to investment losses. PNM does not believe that long-term market returns over the period of funding will be less than required for PNM to meet its obligations. However, this belief is based on assumptions about future returns that are inherently uncertain.

TNMP

TNMP has long-term debt which subjects it to the risk of loss associated with movements in market interest rates. The majority of TNMP's long-term debt is fixed-rate debt, and therefore, does not expose TNMP's earnings to a major risk of loss due to adverse changes in market interest rates. However, the fair value of all long-term debt instruments would increase by approximately 1.2%, or \$5.3 million, if interest rates were to decline by 50 basis points from their levels at December 31, 2005. At December 31, 2005, the fair value of TNMP's long-term debt was approximately \$432.8 million as compared to a book value of \$425.0 million. In general, an increase in fair value would impact earnings and cash flows to the extent not recoverable in rates if TNMP were to re-acquire all or a portion of its debt instruments in the open market prior to their maturity.

During the year ended December 31, 2005, TNMP contributed cash of approximately \$0.9 million to other postretirement benefits for plan year 2005. The securities held by the trusts had an estimated fair value of \$88.0

million at December 31, 2005, of which approximately 28.0% were fixed-rate debt securities that subject TNMP to risk of loss of fair value with movements in market interest rates. TNMP, therefore, is at risk for shortfalls in its funding of its obligations due to investment losses. TNMP does not believe that long-term market returns over the period of funding will be less than required for TNMP to meet its obligations. However, this belief is based on assumptions about future returns that are inherently uncertain.

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*Equity Market Risk*

PNMR

Until October 2005, when the program was discontinued, PNMR had a cash management program that included a preferred stock dividend capture strategy and various absolute return strategies that had the objective of achieving returns higher than that associated with passive cash management plans and with bond-like volatility. The four investments under this program have been classified as trading securities in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS 115"). PNMR has requested and is in the process of requesting return of the cash held by investment managers under this program. At December 31, 2005, PNMR had received cash of \$3.2 million held by one investment manager and cash of \$6.7 million from two others was received in January and February 2006. As of December 31, 2005 and December 31, 2004, the total balance in this investment program was \$3.5 million and \$10.6 million, respectively.

During 2005, PNMR determined that one of its investments under this program, Wood River, had experienced a loss in market value. During the third quarter of 2005, PNMR wrote down the value of its investment in Wood River to zero and incurred a loss of approximately \$3.6 million. In the fourth quarter of 2005, the assets held in the Wood River fund were transferred into receivership as part of a civil complaint filed by the SEC against Wood River. As noted above, prior to this, the investments in Wood River were classified and accounted for as trading securities. At December 31, 2005, due to the change in circumstances surrounding Wood River, PNMR's investment was reclassified from trading to available-for-sale in accordance with SFAS 115. The fair value of PNMR's investment in Wood River was determined to be zero at December 31, 2005. PNMR cannot predict when or if it will receive a return of the cash value of its investment in Wood River.

PNM

PNM contributes to trusts established to fund its share of the decommissioning costs of PVNGS and pension and other postretirement benefits. The trusts hold certain equity securities at December 31, 2005. These equity securities also expose the Company to losses in fair value. Approximately 60.4% of the securities held by the various trusts were equity securities as of December 31, 2005. Similar to the debt securities held for funding decommissioning and certain pension and other postretirement costs, PNM does not recover or earn a return through rates on any losses or gains on these equity securities.

TNMP

TNMP contributes to trusts established to fund the pension and other postretirement benefits. The trusts hold certain equity securities at December 31, 2005. These equity securities also expose the Company to losses in fair value. Approximately 62.7% of the securities held by the various trusts were equity securities as of December 31, 2005. TNMP does not recover or earn a return through rates on any losses or gains on these equity securities.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARY**  
**TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES**

**GLOSSARY**

Afton	Afton Generating Station
ALJ	Administrative Law Judge
Altura	Altura Power L.P.
APB	Accounting Principles Board
APS	Arizona Public Service Company
ARO	Asset Retirement Obligation
Avistar	Avistar, Inc.
BLM	U.S. Department of the Interior Bureau of Land Management
BNCC	BHP Navajo Coal Company
Board	Board of Directors
BTU	British Thermal Unit
Cal PX	California Power Exchange
Cal ISO	California Independent System Operator
CCN	Certificate of Public Convenience and Necessity
Company	PNM Resources, Inc. and Subsidiaries
Congress	United States Congress
Constellation	Constellation Energy Commodities Group, Inc.
Decatherm	1,000,000 BTUs
Delta	Delta-Person Limited Partnership
DOJ	United States Department of Justice
Duke	Duke Energy Corporation
EaR	Earnings at Risk
EIP	Eastern Interconnection Project
EITF	Emerging Issues Task Force
EPE	El Paso Electric Company
EPA	United States Environmental Protection Agency
ERCOT	Electric Reliability Council of Texas
ESPP	Employee Stock Purchase Plan
FASB	Financial Accounting Standards Board
Farmington	City of Farmington, New Mexico
FCPSP	First Choice Power Special Purpose, L.P.
FERC	Federal Energy Regulatory Commission
First Choice	First Choice Power, L. P. and Subsidiaries
FIP	Federal Implementation Plan
Four Corners	Four Corners Power Plant
FPL	FPL Energy New Mexico Wind, LLC
GAAP	Generally Accepted Accounting Principles in the United



	States of America
GCT	Grand Canyon Trust

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Global Electric Agreement	Signed by PNMR and other parties in 2003; provides for a five-year rate path for New Mexico jurisdictional customers that began in September 2003
Great Southwestern	Great Southwestern Construction, Inc.
IBLA	Interior Board of Land Appeals
IRS	United States Internal Revenue Service
ISO	Independent System Operator
LIBOR	London Interbank Offered Rate
Lordsburg	Lordsburg Generating Station
Luna	Luna Energy Facility
MMBTUs	Million British Thermal Units
Moody's	Moody's Investor Services, Inc.
MW	Megawatt
MWh	Megawatt Hour
Navajo Acts	Navajo Nation Air Pollution Prevention and Control Act, the Navajo Nation Safe Drinking Water Act, and the Navajo Nation Pesticide Act
Ninth Circuit	United States Court of Appeals for the Ninth Circuit
NMED	New Mexico Environment Department
NMPRC	New Mexico Public Regulation Commission
NNHPD	Navajo Nation Historic Preservation Department
NRC	United States Nuclear Regulatory Commission
NSPS	New Source Performance Standards
NSR	New Source Review
OASIS	Open Access Same Time Information System
OATT	Open Access Transmission Tariff
O&M	Operations and Maintenance
PGAC	Purchased Gas Adjustment Clause
PG&E	Pacific Gas and Electric Co.
PNM	Public Service Company of New Mexico and Subsidiary
PNMR	PNM Resources, Inc. and Subsidiaries
PPA	Power Purchase Agreement
PRG	Power Resource Group, Inc.
PSA	Power Supply Agreement
PSD	Prevention of Significant Deterioration
PUCT	Public Utility Commission of Texas
PUHCA	The Public Utility Holding Company Act
PURPA	Public Utility Regulatory Policy Act of 1978
PVNGS	Palo Verde Nuclear Generating Station
Reeves	Reeves Generating Station
REP	Retail Electricity Provider
Restructuring Act	New Mexico Electric Utility Industry Restructuring Act of 1999, as amended
RMC	Risk Management Committee

RMRR	Routine Maintenance, Repair or Replacement
RTO	Regional Transmission Organization

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SCE	Southern California Edison Company
SCPPA	Southern California Public Power Authority
SDG&E	San Diego Gas and Electric Company
SEC	United States Securities and Exchange Commission
Sempra	Sempra Energy
Senate Bill 7	Legislation that established retail competition in Texas
SESCO	San Angelo Electric Service Company
SFAS	Statement of Financial Accounting Standards
SJCC	San Juan Coal Company
SJGS	San Juan Generating Station
SO <sub>2</sub>	Sulfur Dioxide
S&P	Standard and Poors Ratings Services
SPS	Southwestern Public Service Company
SW Acquisition	SW Acquisition, L.P.
TCEQ	Texas Commission on Environmental Quality
TECA	Texas Electric Choice Act (also known as Senate Bill 7)
TNMP	Texas-New Mexico Power Company and Subsidiaries
TNP	TNP Enterprises, Inc. and Subsidiaries
Throughput	Volumes of gas delivered, whether or not owned by the Company
Tri-State	Tri-State Generation and Transmission Association, Inc.
Tucson	Tucson Electric Power Company
Twin Oaks	Assets of Twin Oaks Power, LP and Twin Oaks Power III, LP
UAMPS	Utah Associated Municipal Power Systems
USBR	United States Bureau of Reclamation
USFS	United States Forest Service
VaR	Value at Risk
Wood River	Wood River Partners, L.P.
WSPP	Western Systems Power Pool

**PNM RESOURCES, INC. AND SUBSIDIARIES  
PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARY  
TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES**

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**Management's Annual Report on Internal Control Over Financial Reporting**

Management of PNM Resources, Inc. and subsidiaries ("the Company") is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended.

Management assessed the effectiveness of the Company's internal control over financial reporting based on the *Internal Control - Integrated Framework* set forth by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the assessment performed, management concludes that the Company's internal control over financial reporting was effective as of December 31, 2005.

Management has excluded TNP Enterprises, Inc. and its subsidiaries Texas-New Mexico Power Company and First Choice Power from their report on internal control over financial reporting. The financial statements of TNP Enterprises, Inc. and its subsidiaries reflect total assets and revenues constituting 29 and 20 percent, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2005. The Company has disclosed the material change in the Company's internal control over financial reporting due to the acquisition, which occurred June 6, 2005.

Deloitte & Touche LLP, an independent registered public accounting firm, has issued an attestation report on management's assessment of internal control over financial reporting which is included herein.

/s/ Jeffrey E. Sterba

Jeffrey E. Sterba,  
Chairman, President and  
Chief Executive Officer

/s/ Charles Eldred

Charles Eldred  
Senior Vice President and  
Chief Financial Officer

**Management's Annual Report on Internal Control Over Financial Reporting**

Management of Public Service Company of New Mexico and subsidiaries is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended.

Management assessed the effectiveness of the Company's internal control over financial reporting based on the *Internal Control - Integrated Framework* set forth by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the assessment performed, management concludes that the Company's internal control over financial reporting was effective as of December 31, 2005.

Deloitte & Touche LLP, an independent registered public accounting firm, has issued an attestation report on management's assessment of internal control over financial reporting which is included herein.

/s/ Jeffrey E. Sterba

Jeffrey E. Sterba,  
Chairman, President and  
Chief Executive Officer

/s/ Charles Eldred

Charles Eldred  
Senior Vice President and  
Chief Financial Officer

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
PNM Resources, Inc.  
Albuquerque, New Mexico

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting, that PNM Resources, Inc. and subsidiaries (the "Company") maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. As described in Management's Annual Report on Internal Control Over Financial Reporting, management excluded from their assessment the internal control over financial reporting at TNP Enterprises, Inc., and its subsidiaries Texas-New Mexico Power Company and First Choice Power which were acquired on June 6, 2005 and whose financial statements reflect total assets and revenues constituting 29 and 20 percent, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2005. Accordingly, our audit did not include the internal control over financial reporting at TNP Enterprises, Inc. and its subsidiaries. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing, and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2005 is fairly stated, in all material respects, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.



Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2005 of the Company and our report dated March 8, 2006 expressed an unqualified opinion on those consolidated financial statements and included an explanatory paragraph relating to the adoption of Financial Accounting Standards Board Financial

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Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* and PNM Resources, Inc.'s acquisition of TNP Enterprises, Inc. in 2005.

/s/ DELOITTE & TOUCHE LLP

Philadelphia, Pennsylvania  
March 8, 2006

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting, that Public Service Company of New Mexico and subsidiary (the "Company") maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing, and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2005 is fairly stated, in all material respects, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2005 of the Company and our

report dated March 8, 2006 expressed an unqualified opinion on those financial statements and included an explanatory paragraph relating to the adoption of Financial Accounting Standards Board Financial Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* in 2005.

/s/ DELOITTE & TOUCHE LLP

Philadelphia, Pennsylvania  
March 8, 2006

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
PNM Resources, Inc.  
Albuquerque, New Mexico

We have audited the accompanying consolidated balance sheets and consolidated statements of capitalization of PNM Resources, Inc. and subsidiaries (the "Company") as of December 31, 2005 and 2004, and the related consolidated statements of earnings, retained earnings, comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of PNM Resources, Inc. and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations*, effective January 1, 2003 and Financial Accounting Standards Board Financial Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* in 2005. As discussed in Note 12 to the consolidated financial statements, during 2003, the Company changed the actuarial valuation measurement date for the pension plan and other post-retirement benefit plans from September 30 to December 31. As discussed in Note 2 to the consolidated financial statements, the Company acquired TNP Enterprises, Inc. in 2005.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 8, 2006 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Philadelphia, Pennsylvania  
March 8, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets and statements of capitalization of Public Service Company of New Mexico and subsidiary (the "Company") as of December 31, 2005 and 2004, and the related consolidated statements of earnings, retained earnings, comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Public Service Company of New Mexico and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations*, effective January 1, 2003 and Financial Accounting Standards Board Financial Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* in 2005. As discussed in Note 12 to the consolidated financial statements, during 2003, the Company changed the actuarial valuation measurement date for the pension plan and other post-retirement benefit plans from September 30 to December 31.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 8, 2006 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Philadelphia, Pennsylvania  
March 8, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors of  
Texas-New Mexico Power Company  
Fort Worth, Texas

We have audited the accompanying consolidated balance sheets and statements of capitalization of Texas-New Mexico Power Company and subsidiaries (the "Company") as of December 31, 2005 and 2004, and the related consolidated statements of earnings, retained earnings, comprehensive income (loss), and cash flows for the periods June 6, 2005 to December 31, 2005, January 1, 2005 to June 6, 2005, and each of the years ended December 31, 2004 and 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Texas-New Mexico Power Company and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of periods June 6, 2005 to December 31, 2005, January 1, 2005 to June 6, 2005, and each of the years ended December 31, 2004 and 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, PNM Resources, Inc. acquired Texas-New Mexico Power Company and its parent TNP Enterprises, Inc. in 2005. As discussed in Note 1 to the consolidated financial statements, the Company adopted Financial Accounting Standards Board Financial Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* in 2005.

/s/ DELOITTE & TOUCHE LLP

Philadelphia, Pennsylvania  
March 8, 2006

**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF EARNINGS**

	Year Ended December 31,		
	2005	2004	2003
	(In thousands, except per share amounts)		
<b>Operating Revenues:</b>			
Electric	\$ 1,564,077	\$ 1,113,046	\$ 1,097,075
Gas	510,801	490,921	358,267
Other	1,932	825	311
Total operating revenues	2,076,810	1,604,792	1,455,653
<b>Operating Expenses:</b>			
Cost of energy sold	1,274,647	945,309	802,670
Administrative and general	217,983	168,095	158,706
Energy production costs	165,580	146,153	140,584
Depreciation and amortization	138,722	102,221	115,649
Transmission and distribution costs	70,465	59,447	60,070
Taxes, other than income taxes	52,594	34,607	31,310
Income taxes	19,450	36,062	28,072
Total operating expenses	1,939,441	1,491,894	1,337,061
Operating income	137,369	112,898	118,592
<b>Other Income and Deductions:</b>			
Interest income	42,829	38,007	41,826
Other income	17,639	10,063	10,879
Carrying charges on regulatory assets	4,376	-	-
Other deductions	(24,104)	(8,150)	(46,153)
Other income taxes	(13,411)	(13,185)	183
Net other income and deductions	27,329	26,735	6,735
Earnings before interest charges	164,698	139,633	125,327
<b>Interest Charges:</b>			
Interest on long-term debt, net	75,736	46,702	59,429
Other interest charges	17,941	4,673	6,760
Net interest charges	93,677	51,375	66,189
<b>Preferred Stock Dividend Requirements</b>			
	2,868	572	586
<b>Net Earnings Before Cumulative Effect of Changes in Accounting Principles</b>			
	68,153	87,686	58,552
<b>Cumulative Effect of Changes in Accounting Principles</b>			
<b>Net of Tax (Expense) Benefit of \$592, \$0 and \$(23,999)</b>	(926)	-	36,621
<b>Net Earnings</b>	\$ 67,227	\$ 87,686	\$ 95,173



**Net Earnings per Common Share (see Note 10):**

<b>Basic</b>	\$	1.02	\$	1.45	\$	1.60
<b>Diluted</b>	\$	1.00	\$	1.43	\$	1.58

**Dividends Declared per Common Share**

\$	0.785	\$	0.665	\$	0.600
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The accompanying notes, as they relate to PNMR, are an integral part of these financial statements.

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**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF RETAINED EARNINGS**

	2005	Year Ended December 31, 2004	2003
		(In thousands)	
<b>Balance at Beginning of Year</b>	\$ 550,566	\$ 503,069	\$ 444,651
Net earnings	67,227	87,686	95,173
Dividends:			
Common stock	(53,170)	(40,189)	(36,755)
<b>Balance at End of Year</b>	<b>\$ 564,623</b>	<b>\$ 550,566</b>	<b>\$ 503,069</b>

The accompanying notes, as they relate to PNMR, are an integral part of these financial statements.

**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

	2005	December 31, (In thousands)	2004
<b>ASSETS</b>			
<b>Utility Plant:</b>			
Electric plant in service	\$ 3,315,642		\$ 2,488,961
Gas plant in service	711,823		680,487
Common plant in service and plant held for future use	135,849		140,818
	4,163,314		3,310,266
Less accumulated depreciation and amortization	1,374,599		1,135,510
	2,788,715		2,174,756
Construction work in progress	168,195		124,381
Nuclear fuel, net of accumulated amortization of \$14,679 and \$16,448	27,182		25,449
Net utility plant	2,984,092		2,324,586
<b>Other Property and Investments:</b>			
Investment in lessor notes	286,678		308,680
Other investments	180,013		139,848
Non-utility property, net of accumulated depreciation of \$22 and \$1,773	4,214		1,437
Total other property and investments	470,905		449,965
<b>Current Assets:</b>			
Cash and cash equivalents	68,199		17,195
Special deposits	534		-
Accounts receivable, net of allowance for uncollectible accounts of \$3,653 and \$1,329	128,834		96,600
Unbilled revenues	151,773		104,708
Other receivables	64,285		48,393
Inventories	52,037		41,352
Regulatory assets	28,058		3,339
Other current assets	102,577		51,967
Total current assets	596,297		363,554
<b>Deferred charges:</b>			
Regulatory assets	347,279		217,196
Prepaid pension cost	91,444		87,336
Goodwill	499,155		-
Other intangible assets	78,512		-
Other deferred charges	57,025		44,998
Total deferred charges	1,073,415		349,530

\$	5,124,709	\$	3,487,635
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The accompanying notes, as they relate to PNMR, are an integral part of these financial statements.

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**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

	<b>2005</b>	<b>December 31,</b> (In thousands)	<b>2004</b>
<b>CAPITALIZATION AND LIABILITIES</b>			
<b>Capitalization:</b>			
Common stockholders' equity:			
Common stock outstanding (no par value, 120,000,000 shares authorized: issued 68,786,286 and 60,464,595 at December 31, 2005 and 2004, respectively)			
	\$	813,425	\$ 638,826
Accumulated other comprehensive loss, net of tax		(91,589)	(89,813)
Retained earnings		564,623	550,566
<b>Total common stockholders' equity</b>		<b>1,286,459</b>	<b>1,099,579</b>
Cumulative preferred stock of subsidiary without mandatory redemption (\$100 stated value, 10,000,000 shares authorized: issued 115,293 at December 31, 2005 and 2004)			
		11,529	11,529
Long-term debt		1,746,395	987,823
<b>Total capitalization</b>		<b>3,044,383</b>	<b>2,098,931</b>
<b>Current Liabilities:</b>			
Short-term debt		332,200	94,700
Accounts payable		206,648	117,645
Accrued interest and taxes		27,815	15,796
Other current liabilities		156,833	128,476
<b>Total current liabilities</b>		<b>723,496</b>	<b>356,617</b>
<b>Long-Term Liabilities:</b>			
Accumulated deferred income taxes		451,263	284,528
Accumulated deferred investment tax credits		33,806	35,360
Regulatory liabilities		402,253	327,419
Asset retirement obligations		55,646	50,361
Accrued pension liability and postretirement benefit cost		227,202	180,903
Other deferred credits		186,660	153,516
<b>Total long-term liabilities</b>		<b>1,356,830</b>	<b>1,032,087</b>
Commitments and Contingencies (see Note 16)		-	-
	\$	5,124,709	\$ 3,487,635

The accompanying notes, as they relate to PNMR, are an integral part of these financial statements.

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**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Year Ended December 31,		
	2005	2004	2003
	(In thousands)		
<b>Cash Flows From Operating Activities:</b>			
Net earnings	\$ 67,227	\$ 87,686	\$ 95,173
Adjustments to reconcile net earnings to net cash flows from operating activities:			
Depreciation and amortization	160,591	131,625	144,854
Allowance for equity funds used during construction	(1,892)	(1,294)	(2,589)
Accumulated deferred income tax	28,318	39,966	90,175
Transition costs write-off	-	-	16,720
Loss on reacquired debt	-	-	16,576
Cumulative effect of a changes in accounting principles	1,518	-	(60,620)
Net unrealized (gains)/losses on trading and investment securities	3,753	(1,640)	(1,360)
Realized gains on investment securities	(8,562)	(2,584)	(1,251)
Carrying charges on deferred stranded costs	(4,376)	-	-
Equity-linked units charge	11,348	-	-
Turbine impairment	14,958	-	-
Other, net	(1,384)	-	(2,433)
Changes in certain assets and liabilities, net of amounts acquired:			
Accounts receivable	(14,375)	(28,342)	(21,344)
Unbilled revenues	(13,291)	(21,809)	5,539
Accrued postretirement benefit costs	13,586	(6,089)	(14,962)
Other assets	(85,388)	(2,085)	(5,972)
Accounts payable	45,839	30,429	(7,317)
Accrued interest and taxes	20,474	(7,680)	(22,712)
Other liabilities	(27,893)	16,959	(2,562)
Net cash flows from operating activities	210,451	235,142	225,915
<b>Cash Flows From Investing Activities:</b>			
Utility plant additions	(211,160)	(135,795)	(167,701)
Nuclear fuel additions	(10,654)	(9,915)	(9,503)
Redemption of available-for-sale investments	-	-	80,291
Proceeds from sales of securities	104,623	81,218	79,624
Purchases of securities	(109,795)	(87,823)	(84,068)
Cash acquired from purchase of TNP, net of cash paid	45,965	-	-
Combustion turbine payments	-	-	(11,136)
Bond purchase	-	-	(6,675)
Return of principal PVNGS lessor notes	21,432	20,292	18,360
Luna investment	-	(13,379)	-

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Other, net	4,946	1,564	2,018
Net cash flows from investing activities	(154,643)	(143,838)	(98,790)

The accompanying notes, as they relate to PNMR, are an integral part of these financial statements.

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**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	2005	Year Ended December 31, 2004 (In thousands)	2003
<b>Cash Flows From Financing</b>			
<b>Activities:</b>			
Short-term borrowings (repayments), net	237,500	(31,218)	(24,082)
Long-term debt borrowings	339,832	-	483,882
Long-term debt repayments	(399,626)	-	(476,572)
Premium on long-term debt refinancing	-	-	(23,905)
Refund costs of pollution control bonds	-	-	(31,427)
Issuance of common stock	101,231	-	-
Redemption of TNP preferred stock	(224,564)	-	-
Retirement of preferred stock	-	(1,118)	-
Exercise of employee stock options	(9,735)	(16,430)	(9,639)
Dividends paid	(51,128)	(38,848)	(36,702)
Other, net	1,686	811	312
Net cash flows from financing activities	(4,804)	(86,803)	(118,133)
Increase in Cash and Cash Equivalents	51,004	4,501	8,992
Beginning of Year	17,195	12,694	3,702
End of Year	\$ 68,199	\$ 17,195	\$ 12,694

**Supplemental Cash Flow Disclosures:**

Interest paid, net of capitalized interest	\$ 77,066	\$ 46,469	\$ 69,046
Income taxes paid (refunded), net	\$ (4,174)	\$ 14,459	\$ (23,154)

**Supplemental schedule of noncash transactions:**

Pension contribution of PNMR common shares	\$ -	\$ -	\$ 28,950
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**Supplemental schedule of noncash investing and financing activities:**

During 2005, PNMR purchased all of the outstanding common shares of TNP for \$74.6 million in cash and \$87.4 million in PNMR common stock. In conjunction with the acquisition, liabilities were assumed as follows:

Fair value of assets acquired	\$ 1,501,114
Cash paid for transaction costs	(21,520)
Cash paid for TNP common shares	(74,648)
PNMR common stock exchanged for TNP common stock	(87,392)
Liabilities assumed	\$ 1,317,554

The accompanying notes, as they relate to PNMR, are an integral part of these financial statements.

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**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CAPITALIZATION**

	2005	December 31, (In thousands)	2004
<b>Common Stockholders' Equity:</b>			
Common Stock, no par value	\$	813,425	\$ 638,826
Accumulated other comprehensive income, net of tax		(91,589)	(89,813)
Retained earnings		564,623	550,566
Total common stockholders' equity		1,286,459	1,099,579
<b>Cumulative Preferred Stock:</b>			
Without mandatory redemption requirements:			
1965 Series, 4.58% with a stated value of \$100.00 and a current redemption price of \$102.00; outstanding shares at December 31, 2005 and 2004 were 115,293			
		11,529	11,529
<b>Long-Term Debt:</b>			
<b>Issue and Final Maturity</b>			
First Mortgage Bonds, Pollution Control Revenue Bonds:			
5.7% due 2016		65,000	65,000
Senior Unsecured Notes, Pollution Control Revenue Bonds:			
6.30% due 2016		77,045	77,045
5.75% due 2022		37,300	37,300
5.80% due 2022		100,000	100,000
6.375% due 2022		90,000	90,000
6.30% due 2026		23,000	23,000
6.60% due 2029		11,500	11,500
2.10% due 2033		46,000	46,000
2.10% due 2033		100,000	100,000
4.00% due 2038		36,000	36,000
Total Senior Unsecured Notes, Pollution Control Revenue Bonds		520,845	520,845
Senior Unsecured Notes:			
4.40% due 2008		300,000	300,000
7.50% due 2018		100,025	100,025
6.125% due 2008		248,935	-
6.25% due 2009		167,690	-
Other, including unamortized discounts		(3,350)	1,953
Total Senior Unsecured Notes		813,300	401,978
Equity-Linked Units:			

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6.75% due 2010	247,250	-
6.625% due 2010	100,000	-
Total Equity-Linked Units	347,250	-
Total long-term debt	1,746,395	987,823
Total Capitalization	\$ 3,044,383	\$ 2,098,931

The accompanying notes, as they relate to PNMR, are an integral part of these financial statements.

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**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

	2005	Year Ended December 31, 2004 (In thousands)	2003
<b>Net Earnings</b>	\$ 67,227	\$ 87,686	\$ 95,173
Other Comprehensive Income (Loss):			
<b>Unrealized gain (loss) on securities:</b>			
Unrealized holding gains arising during the period, net of tax expense of \$2,948, \$1,212 and \$1,256	4,498	1,849	1,916
Reclassification adjustment for gains included in net income, net of tax expense of \$2,925, \$745 and \$440	(4,464)	(1,137)	(672)
<b>Additional minimum pension liability adjustment, net of tax (expense) benefit of \$8,322, \$14,415 and \$(6,284)</b>	(12,701)	(21,996)	9,589
<b>Mark-to-market adjustment for certain derivative transactions:</b>			
Change in fair market value of designated cash flow hedges, net of tax expense of \$7,913, \$3,567 and \$6,816	11,844	5,443	10,401
Reclassification adjustment for gains included in net income, net of tax expense of \$624, \$318 and \$0	(953)	(485)	-
<b>Total Other Comprehensive Income (Loss)</b>	(1,776)	(16,326)	21,234
<b>Total Comprehensive Income</b>	\$ 65,451	\$ 71,360	\$ 116,407

The accompanying notes, as they relate to PNMR, are an integral part of these financial statements.

**PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARY  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONSOLIDATED STATEMENTS OF EARNINGS**

	Year Ended December 31,		
	2005	2004	2003
	(In thousands)		
<b>Operating Revenues:</b>			
Electric	\$ 1,164,656	\$ 1,113,046	\$ 1,097,075
Gas	510,801	490,921	358,267
Total operating revenues	1,675,457	1,603,967	1,455,342
<b>Operating Expenses:</b>			
Cost of energy sold	1,043,490	945,186	802,650
Administrative and general	176,641	165,942	160,200
Energy production costs	165,580	146,153	140,584
Depreciation and amortization	115,791	99,633	113,921
Transmission and distribution costs	58,231	59,447	61,169
Taxes, other than income taxes	31,175	31,270	29,670
Income taxes	8,217	37,964	28,262
Total operating expenses	1,599,125	1,485,595	1,336,456
Operating income	76,332	118,372	118,886
<b>Other Income and Deductions:</b>			
Interest income	37,919	37,721	38,918
Other income	17,211	10,006	9,837
Other deductions	(7,141)	(5,497)	(39,625)
Other income taxes	(17,077)	(14,733)	(2,328)
Net other income and deductions	30,912	27,497	6,802
Earnings before interest charges	107,244	145,869	125,688
<b>Interest Charges:</b>			
Interest on long-term debt, net	49,102	49,015	59,013
Other interest charges	5,022	4,416	6,697
Net interest charges	54,124	53,431	65,710
<b>Net Earnings Before Cumulative Effect of Changes in Accounting Principles</b>			
	53,120	92,438	59,978
<b>Cumulative Effect of Changes in Accounting Principles, Net of Tax (Expense) Benefit of \$331, \$0 and \$(23,999)</b>			
	(506)	-	36,621
<b>Net Earnings</b>	52,614	92,438	96,599
Preferred Stock Dividend Requirements	528	572	586
<b>Net Earnings Available for Common Stock</b>	\$ 52,086	\$ 91,866	\$ 96,013

The accompanying notes, as they relate to PNM, are an integral part of these financial statements.

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**PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARY  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONSOLIDATED STATEMENTS OF RETAINED EARNINGS**

	<b>2005</b>	<b>Year Ended December 31, 2004</b>	<b>2003</b>
		(In thousands)	
<b>Balance at Beginning of Year</b>	\$ 371,455	\$ 302,589	\$ 256,157
Net earnings	52,614	92,438	96,599
Dividends:			
Cumulative preferred stock	(528)	(572)	(586)
Common stock dividends paid to parent company	(90,999)	(23,000)	(49,581)
<b>Balance at End of Year</b>	<b>\$ 332,542</b>	<b>\$ 371,455</b>	<b>\$ 302,589</b>

The accompanying notes, as they relate to PNM, are an integral part of these financial statements.



**PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARY  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONSOLIDATED BALANCE SHEETS**

	<b>2005</b>	<b>December 31,</b>	<b>2004</b>
	(In thousands)		
<b>ASSETS</b>			
<b>Utility Plant:</b>			
Electric plant in service	\$ 2,576,182	\$	2,488,961
Gas plant in service	711,823		680,487
Common plant in service and plant held for future use	74,857		97,369
	3,362,862		3,266,817
Less accumulated depreciation and amortization	1,205,386		1,125,444
	2,157,476		2,141,373
Construction work in progress	137,663		110,406
Nuclear fuel, net of accumulated amortization of \$14,679 and \$16,448	27,182		25,449
Net utility plant	2,322,321		2,277,228
<b>Other Property and Investments:</b>			
Investment in lessor notes	286,678		308,680
Other investments	170,422		116,134
Non-utility property	966		966
Total other property and investments	458,066		425,780
<b>Current Assets:</b>			
Cash and cash equivalents	12,690		16,448
Special deposits	263		-
Accounts receivable, net of allowance for uncollectible accounts of \$1,435 and \$1,329	108,569		96,600
Unbilled revenues	121,453		104,708
Other receivables	53,546		45,717
Inventories	50,411		41,246
Regulatory assets	28,058		3,339
Other current assets	75,885		39,933
Total current assets	450,875		347,991
<b>Deferred charges:</b>			
Regulatory assets	223,325		217,196
Prepaid pension cost	91,444		87,336
Other deferred charges	41,720		38,199
Total deferred charges	356,489		342,731
	\$ 3,587,751	\$	3,393,730

The accompanying notes, as they relate to PNM, are an integral part of these financial statements.

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**PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARY  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONSOLIDATED BALANCE SHEETS**

	<b>2005</b>	<b>December 31,</b>	<b>2004</b>
		(In thousands)	
<b>CAPITALIZATION AND LIABILITIES</b>			
<b>Capitalization:</b>			
Common stockholder's equity:			
Common stock outstanding (no par value, 40,000,000 shares authorized: issued 39,117,799 at December 31, 2005 and 2004)			
	\$	765,500	\$ 752,350
Accumulated other comprehensive loss, net of tax		(90,515)	(89,813)
Retained earnings		332,542	371,455
<b>Total common stockholder's equity</b>		<b>1,007,527</b>	<b>1,033,992</b>
Cumulative preferred stock of subsidiary without mandatory redemption (\$100 stated value, 10,000,000 shares authorized: issued 115,293 at December 31, 2005 and 2004)			
		11,529	11,529
Long-term debt		987,068	987,676
<b>Total capitalization</b>		<b>2,006,124</b>	<b>2,033,197</b>
<b>Current Liabilities:</b>			
Short-term debt		128,200	60,400
Accounts payable		170,517	116,763
Intercompany accounts payable		50,070	38,700
Accrued interest and taxes		15,951	28,783
Other current liabilities		98,753	91,765
<b>Total current liabilities</b>		<b>463,491</b>	<b>336,411</b>
<b>Long-Term Liabilities:</b>			
Accumulated deferred income taxes		300,752	278,907
Accumulated deferred investment tax credits		32,266	35,360
Regulatory liabilities		346,007	327,419
Asset retirement obligations		54,940	50,361
Accrued pension liability and postretirement benefit cost		217,092	180,903
Other deferred credits		167,079	151,172
<b>Total long-term liabilities</b>		<b>1,118,136</b>	<b>1,024,122</b>
Commitments and Contingencies (see Note 16)		-	-
	\$	3,587,751	\$ 3,393,730

The accompanying notes, as they relate to PNM, are an integral part of these financial statements.

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**PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARY  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS**

	2005	Year Ended December 31, 2004 (In thousands)	2003
<b>Cash Flows From Operating Activities:</b>			
Net earnings	\$ 52,614	\$ 92,438	\$ 96,599
Adjustments to reconcile net earnings to net cash flows from operating activities:			
Depreciation and amortization	135,813	129,018	143,940
Allowance for equity funds used during construction	(1,757)	(1,228)	(2,551)
Accumulated deferred income tax	20,039	38,162	82,799
Transition costs write-off	-	-	16,720
Loss on reacquired debt	-	-	16,576
Cumulative effect of changes in accounting principles	837	-	(60,620)
Net unrealized gains on trading and investment securities	(5,749)	(1,640)	(1,360)
Realized gains on investment securities	(8,562)	(2,584)	(1,251)
Wholesale credit reserve	-	-	(2,433)
Turbine impairment	14,958	-	-
Changes in certain assets and liabilities:			
Accounts receivable	(11,969)	(28,342)	(21,344)
Unbilled revenues	(16,745)	(21,809)	5,539
Accrued postretirement benefit costs	11,556	(6,090)	(14,962)
Other assets	(84,104)	7,104	(3,716)
Accounts payable	53,754	37,388	(12,905)
Accrued interest and taxes	(12,833)	19,905	(27,572)
Other liabilities	23,691	(1,309)	(19,285)
Net cash flows from operating activities	171,543	261,013	194,174
<b>Cash Flows From Investing Activities:</b>			
Utility plant additions	(157,092)	(128,236)	(159,322)
Nuclear fuel additions	(10,654)	(9,915)	(9,503)
Proceeds from sales of securities	104,623	81,218	79,624
Purchases of securities	(109,795)	(87,823)	(84,068)
Combustion turbine payments	-	-	(11,136)
EIP buyout	-	-	(36,925)
Return of principal PVNGS lessor notes	21,432	20,292	18,360
Purchase of EIP investment	-	(12,247)	-
Other, net	213	4,942	472
Net cash flows from investing activities	(151,273)	(131,769)	(202,498)

The accompanying notes, as they relate to PNM, are an integral part of these financial statements.

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**PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARY  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS**

	2005	Year Ended December 31, 2004	2003
		(In thousands)	
<b>Cash Flows From Financing</b>			
<b>Activities:</b>			
Short-term borrowings (repayments), net	67,800	(64,500)	(25,100)
Long-term debt borrowings	-	-	483,780
Long-term debt repayments	(611)	-	(450,420)
Premium on long-term debt refinancing	-	-	(23,905)
Refund costs of pollution control bonds	-	-	(31,427)
Equity contribution from parent	-	-	126,053
Retirement of preferred stock	-	(1,118)	-
Dividends paid	(91,527)	(23,586)	(49,581)
Change in intercompany borrowings	255	(34,871)	(12,340)
Other, net	55	(328)	(223)
Net cash flows from financing activities	(24,028)	(124,403)	16,837
Increase (Decrease) in Cash and Cash			
Equivalents	(3,758)	4,841	8,513
Beginning of Year	16,448	11,607	3,094
End of Year	\$ 12,690	\$ 16,448	\$ 11,607
<b>Supplemental Cash Flow Disclosures:</b>			
Interest paid, net of capitalized interest	\$ 51,593	\$ 49,937	\$ 67,500
Income taxes paid (refunded), net	\$ 5	\$ 18,002	\$ (5,084)

The accompanying notes, as they relate to PNM, are an integral part of these financial statements.

**PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARY  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONSOLIDATED STATEMENTS OF CAPITALIZATION**

	2005	December 31, (In thousands)	2004
<b>Common Stockholder's Equity:</b>			
Common stock outstanding, no par value	\$ 765,500		\$ 752,350
Accumulated other comprehensive income, net of tax	(90,515)		(89,813)
Retained earnings	332,542		371,455
Total common stockholder's equity	1,007,527		1,033,992
<b>Cumulative Preferred Stock:</b>			
Without mandatory redemption requirements:			
1965 Series, 4.58% with a stated value of \$100.00 and a current redemption price of \$102.00; outstanding shares at December 31, 2005 and 2004 of 115,293	11,529		11,529
<b>Long-Term Debt:</b>			
<b><u>Issue and Final Maturity</u></b>			
First Mortgage Bonds, Pollution Control Revenue Bonds:			
5.7% due 2016	65,000		65,000
Senior Unsecured Notes, Pollution Control Revenue Bonds:			
6.30% due 2016	77,045		77,045
5.75% due 2022	37,300		37,300
5.80% due 2022	100,000		100,000
6.375% due 2022	90,000		90,000
6.30% due 2026	23,000		23,000
6.60% due 2029	11,500		11,500
2.10% due 2033	46,000		46,000
2.10% due 2033	100,000		100,000
4.00% due 2038	36,000		36,000
Total Senior Unsecured Notes, Pollution Control Revenue Bonds	520,845		520,845
Senior Unsecured Notes:			
4.40% due 2008	300,000		300,000
7.50% due 2018	100,025		100,025
Other, including unamortized discounts	1,198		1,806
Total Senior Unsecured Notes	401,223		401,831
Total long-term debt	987,068		987,676
Total Capitalization	\$ 2,006,124		\$ 2,033,197



The accompanying notes, as they relate to PNM, are an integral part of these financial statements.

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**PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARY  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

	2005	Year Ended December 31, 2004	2003
	(In thousands)		
<b>Net Earnings Available for Common Stock</b>	\$ 52,086	\$ 91,866	\$ 96,013
Other Comprehensive Income (Loss):			
<b>Unrealized gain (loss) on securities:</b>			
Unrealized holding gains arising from the period, net of tax expense of \$2,948, \$1,212 and \$1,545	4,498	1,849	2,357
Reclassification adjustment for gains included in net income, net of tax expense of \$2,925, \$745 and \$440	(4,464)	(1,137)	(672)
<b>Additional minimum pension liability adjustment, net of tax (expense) benefit of \$8,304, \$14,415 and \$(6,284)</b>	(12,672)	(21,996)	9,589
<b>Mark-to-market adjustment for certain derivative transactions:</b>			
Change in fair market value of designated cash flow hedges, net of tax expense of \$8,447, \$3,567 and \$6,140	12,889	5,443	9,369
Reclassification adjustment for gains included in net income, net of tax expense of \$624, \$318 and \$0	(953)	(485)	-
<b>Total Other Comprehensive Income (Loss)</b>	(702)	(16,326)	20,643
<b>Total Comprehensive Income</b>	\$ 51,384	\$ 75,540	\$ 116,656

The accompanying notes, as they relate to PNM, are an integral part of these financial statements.

**TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES**  
**A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.**  
**CONSOLIDATED STATEMENTS OF EARNINGS**

	Post-Acquisition For the Period June 6- December 31, 2005	Pre-Acquisition For the Period January 1- June 6, 2005	Pre-Acquisition Year Ended December 31, 2004 (In thousands)	Pre-Acquisition Year Ended December 31, 2003
<b>Operating Revenues:</b>				
Electric	\$ 154,350	\$ 112,820	\$ 269,665	\$ 249,488
Total operating revenues	154,350	112,820	269,665	249,488
<b>Operating Expenses:</b>				
Cost of energy sold	58,014	43,885	101,361	89,818
Administrative and general	14,165	11,048	27,963	23,715
Depreciation and amortization	17,596	12,954	29,691	28,631
Transmission and distribution costs	12,403	9,111	19,314	20,289
Taxes, other than income taxes	14,261	9,228	22,884	21,227
Income taxes	7,965	5,055	13,680	13,044
Total operating expenses	124,404	91,281	214,893	196,724
Operating income	29,946	21,539	54,772	52,764
<b>Other Income and Deductions:</b>				
Interest income	1,001	650	677	364
Other income	528	523	844	1,750
Carrying charges on regulatory assets	4,376	(1,407)	32,006	-
Other deductions	(74)	(79)	(254)	(35)
Other income taxes	(2,071)	154	(12,711)	(661)
Net other income and deductions	3,760	(159)	20,562	1,418
<b>Interest Charges:</b>				
Interest on long-term debt, net	14,650	11,077	25,855	25,279
Other interest charges	1,225	1,043	2,836	3,621
Net interest charges	15,875	12,120	28,691	28,900
<b>Net Earnings Before Extraordinary Item and Cumulative Effect of Change in Accounting Principle</b>				
	17,831	9,260	46,643	25,282

<b>Extraordinary Item - Disallowance of Stranded Costs, Net of Tax Benefit of \$57,317</b>					
	-		-	(97,836)	-
<b>Cumulative Effect of Change in Accounting Principle, Net of Tax Benefit of \$234</b>					
	(381)		-	-	-
<b>Net Earnings (Loss)</b>	\$ 17,450		\$ 9,260	\$ (51,193)	\$ 25,282

The accompanying notes, as they relate to TNMP, are an integral part of these financial statements.

**TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES**  
**A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.**  
**CONSOLIDATED STATEMENTS OF RETAINED EARNINGS**

	Post-Acquisition For the Period June 6- December 31, 2005	Pre-Acquisition For the Period January 1- June 6, 2005	Pre-Acquisition Year Ended December 31, 2004	Pre-Acquisition Year Ended December 31, 2003
			(In thousands)	
<b>Balance at Beginning of Period</b>	\$ -	\$ (6,795)	\$ 50,398	\$ 54,516
Net earnings	17,450	9,260	(51,193)	25,282
Dividends:				
Common stock dividends paid to parent company	(12,000)	-	(6,000)	(29,400)
<b>Balance at End of Period</b>	<b>\$ 5,450</b>	<b>\$ 2,465</b>	<b>\$ (6,795)</b>	<b>\$ 50,398</b>

The accompanying notes, as they relate to TNMP, are an integral part of these financial statements.

**TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES**  
**A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.**  
**CONSOLIDATED BALANCE SHEETS**

	2005	December 31, (In thousands)	2004
<b>ASSETS</b>			
<b>Utility Plant:</b>			
Electric plant in service	\$ 877,893		\$ 845,900
Construction work in progress	7,138		4,261
Common plant in service and plant held for future use	589		589
	885,620		850,750
Less accumulated depreciation and amortization	296,611		276,081
Net utility plant	589,009		574,669
<b>Other Property and Investments:</b>			
Other investments	548		530
Non-utility property, net of accumulated depreciation of \$3 and \$3	2,120		343
Total other property and investments	2,668		873
<b>Current Assets:</b>			
Cash and cash equivalents	16,228		65,759
Special deposits	-		3,086
Accounts receivable, net of allowance for uncollectible accounts of \$100 and \$191	13,191		12,739
Federal income tax refund	36,392		22,912
Unbilled revenues	6,679		7,576
Other receivables	6,087		10,083
Inventories	1,478		1,505
Other current assets	1,211		7,526
Total current assets	81,266		131,186
<b>Deferred charges:</b>			
Stranded costs	87,316		87,316
Carrying charges on stranded costs	33,918		48,130
Other regulatory assets	2,720		8,105
Goodwill	456,088		-
Other deferred charges	4,948		22,227
Total deferred charges	584,990		165,778
	\$ 1,257,933		\$ 872,506

The accompanying notes, as they relate to TNMP, are an integral part of these financial statements.

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**TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES**  
**A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.**  
**CONSOLIDATED BALANCE SHEETS**

	2005	December 31, (In thousands)	2004
<b>CAPITALIZATION AND LIABILITIES</b>			
<b>Capitalization:</b>			
Common stockholder's equity:			
Common stock outstanding (\$10 par value, 12,000,000 shares authorized: issued 9,615 and 10,705 at December 31, 2005 and 2004, respectively)			
	\$ 96		\$ 107
Paid-in-capital	583,130		197,751
Accumulated other comprehensive loss, net of tax	(29)		(1,761)
Retained earnings	5,450		(6,795)
<b>Total common stockholder's equity</b>	<b>588,647</b>		<b>189,302</b>
Long-term debt	415,864		415,569
<b>Total capitalization</b>	<b>1,004,511</b>		<b>604,871</b>
<b>Current Liabilities:</b>			
Accounts payable	11,913		15,649
Accrued interest and taxes	24,250		22,647
Accrued payroll and benefits	3,268		1,583
Other current liabilities	5,516		5,155
<b>Total current liabilities</b>	<b>44,947</b>		<b>45,034</b>
<b>Long-Term Liabilities:</b>			
Accumulated deferred income taxes	139,405		138,249
Accumulated deferred investment tax credits	1,540		2,326
Regulatory liabilities	56,246		40,729
Accrued pension liability	3,585		4,844
Accrued postretirement benefit cost	6,525		2,693
Other deferred credits	1,174		33,760
<b>Total long-term liabilities</b>	<b>208,475</b>		<b>222,601</b>
Commitments and Contingencies (see Note 16)	-		-
	<b>\$ 1,257,933</b>		<b>\$ 872,506</b>

The accompanying notes, as they relate to TNMP, are an integral part of these financial statements.



**TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES**  
**A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Post-Acquisition For the Period June 6- December 31, 2005	Pre-Acquisition For the Period January 1- June 6, 2005 (In thousands)	Pre-Acquisition Year Ended December 31, 2004	Pre-Acquisition Year Ended December 31, 2003
<b>Cash Flows From Operating Activities:</b>				
Net earnings (loss)	\$ 17,450	\$ 9,260	\$ (51,193)	\$ 25,282
Adjustments to reconcile net earnings to net cash flows from operating activities:				
Depreciation and amortization	18,619	14,042	32,279	31,472
Allowance for equity funds used during construction	(112)	(60)	(384)	(584)
Accumulated deferred income tax	9,870	(1,267)	43,135	2,179
Carrying charges on regulatory assets	(4,376)	1,407	(32,006)	-
Cumulative effect of change in accounting principle	615	-	-	-
Disallowance of stranded costs, net of tax benefit	-	-	97,836	-
Deferred purchased power and fuel costs	-	-	(511)	18,373
Changes in certain assets and liabilities:				
Accounts receivable	(481)	29	820	3,131
Unbilled revenues	1,003	(106)	1,225	(1,896)
Accounts payable	86	(5,379)	2,347	3,758
Accrued interest and taxes	8,799	(7,314)	(16,621)	1,088
Interest rate lock on issuance of senior notes	-	-	-	(4,162)
Acquisition related benefit programs	(2,604)	-	-	-
Payments for stranded/fuel costs	(4,284)	-	-	-
Receipt for retail competition transition obligation	16,336	-	-	-
Other assets and liabilities	(9,347)	4,741	(9,520)	(6,927)
Net cash flows from				

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operating activities	51,574		15,353	67,407	71,714
<b>Cash Flows From Investing Activities:</b>					
Utility plant additions	(27,801)		(17,822)	(42,817)	(44,548)
Other, net	3,111		(242)	(356)	(2,909)
Net cash flows from investing activities	(24,690)		(18,064)	(43,173)	(47,457)

The accompanying notes, as they relate to TNMP, are an integral part of these financial statements.

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**TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES**  
**A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Post-Acquisition For the Period June 6- December 31, 2005</b>	<b>Pre-Acquisition For the Period January 1- June 6, 2005 (In thousands)</b>	<b>Pre-Acquisition Year Ended December 31, 2004</b>	<b>Pre-Acquisition Year Ended December 31, 2003</b>
<b>Cash Flows From Financing Activities:</b>				
Long-term debt costs and repayments	-	-	(9,382)	(172,600)
Redemption of common stock	(62,000)	-	-	-
Repayments to affiliate	-	-	-	(14,557)
Issuance of senior notes, net of discount	-	-	-	248,923
Dividends paid	(12,000)	-	(6,000)	(29,400)
Other	169	127	-	-
Net cash flows from financing activities	(73,831)	127	(15,382)	32,366
Increase (Decrease) in Cash and Cash				
Equivalents	(46,947)	(2,584)	8,852	56,623
Beginning of Period	63,175	65,759	56,907	284
End of Period	\$ 16,228	\$ 63,175	\$ 65,759	\$ 56,907
<b>Supplemental Cash Flow Disclosures:</b>				
Interest paid, net of capitalized interest	\$ (609)	\$ 12,868	\$ 26,145	\$ 27,424
Income taxes paid, net	\$ (20,014)	\$ 2,456	\$ 8,434	\$ 14,000

The accompanying notes, as they relate to TNMP, are an integral part of these financial statements.

**TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES**  
**A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.**  
**CONSOLIDATED STATEMENTS OF CAPITALIZATION**

	2005	December 31, 2005	2004
	(In thousands)		
<b>Common Stockholder's Equity:</b>			
Common stock outstanding, par value \$10 per share	\$ 96		\$ 107
Paid-in-capital	583,130		197,751
Accumulated other comprehensive loss, net of tax	(29)		(1,761)
Retained earnings	5,450		(6,795)
Total common stockholder's equity	588,647		189,302
<b>Long-Term Debt:</b>			
<b><u>Issue and Final Maturity</u></b>			
Senior Notes:			
6.125% due 2008	248,935		248,935
6.25% due 2009	167,690		167,690
Other, including unamortized discounts	(761)		(1,056)
Total long-term debt	415,864		415,569
Total Capitalization	\$ 1,004,511		\$ 604,871

The accompanying notes, as they relate to TNMP, are an integral part of these financial statements.

**TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES  
A WHOLLY OWNED SUBSIDIARY OF PNM RESOURCES, INC.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

	<b>Post-Acquisition For the Period June 6- December 31, 2005</b>	<b>Pre-Acquisition For the Period January 1- June 6, 2005</b>	<b>Pre-Acquisition Year Ended December 31, 2004</b>	<b>Pre-Acquisition Year Ended December 31, 2003</b>
		<b>June 6, 2005</b>		
		<b>(In thousands)</b>		
<b>Net Earnings (Loss)</b>	\$ 17,450	\$ 9,260	\$ (51,193)	\$ 25,282
Other Comprehensive Income (Loss):				
Interest rate hedge net of reclassification adjustment, net of income tax benefit (expense) of \$0, \$1,084, \$317 and \$(685)	-	1,761	516	(1,111)
Additional minimum pension liability adjustment, net of tax (expense) benefit of \$18, \$0, \$0 and \$(132)	(29)	-	-	214
<b>Total Comprehensive Income (Loss)</b>	\$ 17,421	\$ 11,021	\$ (50,677)	\$ 24,385

In conjunction with the acquisition of TNP by PNMR, the interest rate hedge was fair valued at zero. The acquired book value was \$1.7 million.

The accompanying notes, as they relate to TNMP, are an integral part of these financial statements.

**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARY**  
**TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2005, 2004 and 2003**

**(1) Summary of the Business and Significant Accounting Policies**

*Nature of Business*

PNMR or the “Company” is an investor-owned holding company of energy and energy-related businesses. The Company’s three primary subsidiaries are PNM, TNMP and First Choice. PNM is an integrated public utility with regulated operations primarily engaged in the generation, transmission and distribution of electricity, transmission, distribution and sale of natural gas within New Mexico, and unregulated operations primarily focused on the sale and marketing of electricity in the western United States. TNMP is a regulated utility operating in Texas and New Mexico. In Texas, TNMP provides regulated transmission and distribution services. In New Mexico, TNMP provides integrated electric services that include the transmission, distribution, purchase and sale of electricity to its New Mexico customers. First Choice is a competitive retail electric provider operating in Texas. In addition, PNMR provides energy and technology related services through its wholly owned subsidiary, Avistar. The Company’s common stock trades on the New York Stock Exchange under the symbol PNM.

*TNP Acquisition*

As discussed in Note 2, on June 6, 2005, PNMR completed the previously announced acquisition of TNP effective at 8:00 AM Central Daylight Time. Prior to the consummation of the acquisition, TNP was a privately owned holding company based in Fort Worth, Texas. TNP’s principal subsidiaries are TNMP and First Choice.

The acquisition was accounted for using the purchase method of accounting. Under this method, the purchase price was allocated and fair market value adjustments were made to the assets acquired and the liabilities assumed. The excess of the purchase price over net assets acquired was allocated to goodwill in the amount of \$499.2 million. Other intangible assets of \$79.3 million were also recorded. Adjustments to goodwill and intangible assets were recorded in the third and fourth quarters of 2005 (see “*Goodwill and Intangible Assets*” below in this Note 1 and see also Note 2).

The purchase accounting entries are reflected on PNMR’s financial statements as of the purchase date. PNMR “pushed down” the effects of purchase accounting to the financial statements of TNMP and First Choice. Accordingly, TNMP’s post-acquisition financial statements reflect a new basis of accounting, and separate financial statements and footnote amounts in tabular format are presented for pre-acquisition and post-acquisition periods, separated by a heavy black line.

*Presentation*

The Notes to Consolidated Financial Statements include disclosures for PNMR, PNM and TNMP. For discussion purposes, this report will use the term “Company” when discussing matters of common applicability to PNMR, PNM and TNMP. Discussions regarding only PNMR, PNM or TNMP will be clearly indicated as such.

PNMR was established as a holding company in 2001. On December 30, 2004, PNMR became a registered holding company under PUHCA. As a result of the requirement to register as a holding company, PNMR created PNMR Services Company, a wholly owned services company, which began operation on January 1, 2005.

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**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARY**  
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**December 31, 2005, 2004 and 2003**

PNMR performed substantially all of the corporate activities of PNM from 2001 to 2004. These activities were billed to PNM on a cost basis and were allocated to the business units. The service functions previously performed by PNMR were assumed by PNMR Services Company effective January 1, 2005.

Until June 6, 2005, TNMP provided First Choice and TNP with corporate support services, including accounting, finance, information services, legal and human resources, under a shared services agreement with First Choice and a similar agreement with TNP. These services were billed at TNMP's cost and, in return, TNP and First Choice compensated TNMP for the services provided. These agreements were in effect through June 6, 2005 when they were replaced by a new shared services arrangement with PNMR Services Company.

Effective with the close of the acquisition of TNP on June 6, 2005, all TNMP employees who were providing corporate support to TNP and First Choice became employees of PNMR Services Company. PNMR Services Company provides corporate services to all of PNMR's business units, including PNM, Avistar, TNP, TNMP and First Choice based on shared services agreements. These services are billed at cost on a monthly basis and allocated to the business units.

The Company maintains its accounting records in accordance with the uniform system of accounts prescribed by the FERC and the National Association of Regulatory Utility Commissioners, and adopted by the NMPRC.

The Company's accounting policies conform to the provisions of SFAS No. 71, as amended, "*Accounting for the Effects of Certain Types of Regulation*," ("SFAS 71"), as applicable. In accordance with SFAS 71, the Company has deferred certain costs and recorded certain liabilities pursuant to the rate actions of the FERC, the NMPRC and the PUCT. These "regulatory assets" and "regulatory liabilities" are enumerated and discussed in Note 4.

PNM discontinued the application of SFAS 71 as of December 31, 1999, for the generation portion of its business effective with the passage of the Restructuring Act in accordance with SFAS No. 101, "*Accounting for the Discontinuation of Application of FASB Statement No. 71*." As a result of repeal of the Restructuring Act, the Company re-applied SFAS 71 to its generation portion of its business during the first quarter of 2003 as a result of NMPRC approval of the Global Electric Agreement (see Note 17) in January 2003.

*Principles of Consolidation*

The Consolidated Financial Statements include the accounts of the Company and subsidiaries in which it owns a majority voting interest. Corporate administrative and general expenses, which represent costs that are driven primarily by corporate level activities, are allocated to the business segments. Other significant intercompany transactions between PNMR, PNM, TNP and TNMP in 2005 or 2004 include energy purchases and sales, dividends paid on common stock, the redemption of common stock by TNMP from its parent company, TNP, and consolidation of PVNGS capital trust. All significant intercompany transactions and balances have been eliminated. See Note 20.

PNM adopted SFAS No. 150 "*Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*" ("SFAS 150") effective in May 2005. SFAS 150 established standards for classifying and measuring certain financial instruments with characteristics of both liabilities and equity. Under SFAS 150, issuers are required to classify as liabilities a financial instrument that is within its scope as a liability because that financial instrument embodies an obligation of the issuer. SFAS 150 is effective for financial instruments entered into or modified after



May 31, 2003. Upon adoption, the Company reclassified approximately \$10.0 million from minority interest to other deferred credits on its Consolidated Balance Sheets.

*Financial Statement Preparation*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual recorded amounts could differ from those estimated.

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**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARY**  
**TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**December 31, 2005, 2004 and 2003**

### *Cash and Cash Equivalents*

Investments in highly liquid investments with maturities of three months or less at the date of purchase are considered cash equivalents.

### *Utility Plant*

Utility plant is stated at cost, which includes capitalized payroll-related costs such as taxes, pension and other fringe benefits, administrative costs and allowance for funds used during construction as deemed appropriate.

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

### *Allowance For Funds Used During Construction*

As provided by the FERC uniform systems of accounts, allowance for funds used during construction is charged to utility plant. This allowance is a non-cash item designed to enable a utility to capitalize financing costs during periods of construction of property subject to rate regulation. It 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 calculation of allowance for funds used during construction should be performed if its subsequent inclusion in allowable costs for rate-making purposes is probable. In 2005, 2004 and 2003, PNM recorded \$4.3 million, \$3.0 million and \$3.9 million, respectively, of allowance for funds used during construction on certain projects. In 2005, 2004 and 2003, TNMP recorded \$0.4 million, \$0.8 million and \$1.0 million, respectively, of allowance for funds used during construction.

### *Capitalized Interest*

In accordance with SFAS No. 34, "*Capitalization of Interest Costs*" ("SFAS 34"), PNM capitalizes interest on its construction projects not included in rate base because there were no specific charges and software costs. Interest was capitalized at the overall weighted average borrowing rate of 5.0%, 5.2% and 6.4% for 2005, 2004 and 2003, respectively. PNM's capitalized interest was \$1.4 million, \$1.0 million and \$1.2 million in 2005, 2004 and 2003, respectively.

### *Carrying Charges on Stranded Costs*

TNMP's estimate of allowable carrying charges on stranded costs that it may recover from its transmission and distribution customers is based on a United States Supreme Court ruling, and the PUCT's application of that ruling. As of December 31, 2005, the accrual for carrying costs was \$33.9 million (see Note 16).

### *Inventories*

Inventory consists principally of materials and supplies, natural gas held in storage for eventual resale, and coal held for use in electric generation.

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**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARY**  
**TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**December 31, 2005, 2004 and 2003**

Generally, materials and supplies include the costs of transmission, distribution and generating plant materials. Materials and supplies are charged to inventory when purchased and are expensed or capitalized as appropriate when issued. Materials and supplies are valued using an average costing method. Obsolete materials and supplies are immediately expensed when identified.

Gas in underground storage is valued using a weighted average inventory method. Withdrawals are charged to sales service customers through the PGAC.

Coal is valued using a rolling weighted average costing method that is updated based on the current period cost per ton. Periodic aerial surveys are performed and any material adjustments would be recorded as identified.

Inventories consisted of the following at December 31:

	PNMR		PNM		TNMP	
	2005	2004	2005	2004	2005	2004
	(In thousands)					
Coal	\$ 11,410	\$ 9,802	\$ 11,410	\$ 9,802	\$ -	\$ -
Gas in underground storage	12,487	5,324	12,487	5,324	-	-
Materials and supplies	28,140	26,226	26,514	26,120	1,478	1,505
	\$ 52,037	\$ 41,352	\$ 50,411	\$ 41,246	\$ 1,478	\$ 1,505

#### *Investments*

The Company's investments are comprised of United States, state, and municipal government obligations and corporate securities. Investments with maturities of less than one year are considered short-term and are carried at fair value. All investments are held in the Company's name and are in the custody of major financial institutions. The specific identification method is used to determine the cost of securities disposed of, with realized gains and losses reflected in other income and deductions. At December 31, 2005 and 2004, substantially all of the Company's investments were classified as available for sale. Unrealized gains and losses on these investments are included in other comprehensive income, net of any related tax effect.

PNMR also has investments in equity securities that are primarily classified as trading. The investment balance is included in other current assets and unrealized gains and losses on these investments are recorded in other income and deductions (see Note 8).

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**PNM RESOURCES, INC. AND SUBSIDIARIES**  
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**December 31, 2005, 2004 and 2003**

*Goodwill and Other Intangible Assets*

The excess purchase price over the fair value of the assets acquired and the liabilities assumed by PNMR for its June 6, 2005 acquisition of TNP was recorded as goodwill. Under the provisions of SFAS No. 142, “*Goodwill and Other Intangible Assets*” (“SFAS 142”), the Company does not amortize goodwill. Certain intangible assets are amortized over their estimated useful lives. Goodwill and unamortized intangible assets are evaluated for impairment at least annually, or more frequently if events and circumstances indicate that the goodwill and intangible assets might be impaired. Amortized other intangible assets are evaluated for impairment in accordance with SFAS No. 144 “*Accounting for the Impairment or Disposal of Long-Lived Assets*” (“SFAS 144”) when events and circumstances indicate that the assets might be impaired.

The changes in the carrying amount of goodwill by reportable segment (see Note 3) for the year ended December 31, 2005 were as follows:

	<b>TNMP Electric</b>	<b>First Choice</b> (In thousands)	<b>Total PNMR</b>
Balance as of January 1, 2005	\$ -	\$ -	\$ -
Purchase of TNP during 2005	456,088	43,067	499,155
Balance as of December 31, 2005	\$ 456,088	\$ 43,067	\$ 499,155

Of the \$79.3 million of acquired intangible assets, \$68.8 million relates to the trade name “First Choice.” The trade name has an indefinite useful life; therefore, no amortization will be recognized, but the asset will be evaluated for impairment each reporting period. The other \$10.5 million intangible asset relates to the First Choice customer list. The useful life of the customer list is estimated to be approximately eight years; therefore the asset will be amortized on a straight-line basis over an eight-year period.

The components of PNMR’s identifiable intangible assets at December 31, 2005 are as follows:

	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>
	(In thousands)	
Amortized intangible asset:		
First Choice customer list	\$ 10,480	\$ 742
Unamortized intangible asset:		
First Choice trade name	\$ 68,774	\$ -

Expected future amortization expense for this intangible asset is \$1.3 million annually through 2010.

*Asset Impairment*

Tangible long-lived assets are evaluated in relation to the future undiscounted cash flows to assess recoverability in accordance with SFAS 144 when events and circumstances indicate that the assets might be impaired. Impairment testing of power generation assets excluded from jurisdictional rates is performed periodically in response to changes in market conditions. TNMP did not have any impairment on its long-lived assets for the years 2003 through 2005.

PNM had planned to convert its Afton plant from a combustion turbine to a combined-cycle unit using a turbine in storage. As part of a stipulation that will allow PNM to convert Afton to a combined cycle plant and include it as a jurisdictional resource, with 50% of Afton's capacity designated to serve PNM's customers and 50% designated to

serve TNMP's New Mexico customers, an alternative equipment configuration will be used for Afton instead of the turbine in storage. In the fourth quarter of 2005, PNM management determined that it would make the

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**PNM RESOURCES, INC. AND SUBSIDIARIES**  
**PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARY**  
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**December 31, 2005, 2004 and 2003**



turbine available for sale. Based on its market survey, PNM recorded an impairment charge of approximately \$15.0 million, included in energy production costs on the Consolidated Statement of Earnings for the year ended December 31, 2005. The impairment charge is recorded in the Corporate and Other segment (see Note 3).

### *Revenue Recognition*

First Choice, PNM and TNMP record electric and gas operating revenues, as applicable, in the period of delivery, which includes estimated amounts for service rendered but unbilled at the end of each accounting period.

The determination of the energy sales by PNM, TNMP and First Choice to individual customers is based on the reading of their meters, which occurs on a systematic basis throughout the month. At the end of each month, amounts of energy delivered to customers since the date of the last meter reading are estimated and the corresponding unbilled revenue is estimated. Unbilled electric revenue is estimated based on the daily generation volumes, estimated customer usage by class, weather factors, line losses and applicable customer rates based on regression analyses reflecting historical trends and experience.

PNM purchases gas on behalf of sales-service customers while other marketers or producers purchase gas on behalf of transportation-service customers. PNM collects a cost of service revenue for the transportation, delivery, and customer service provided to these customers. Sales-service tariffs are subject to the terms of the PGAC and billed under a cycle-bill basis. Transportation service customers are metered and billed on the last day of the month. Therefore, PNM estimates unbilled decatherms and records cost of service and PGAC revenues for sales-service customers only.

PNM wholesale revenues are recognized in the month the energy is delivered to the customer and are based on the actual amounts supplied to the customer. However, in accordance with the WSPP contract, these revenues are billed in the month subsequent to their delivery. Consequently, wholesale revenues for the last month in any reporting period are unbilled when reported.

PNM's wholesale electricity sales are recorded as operating revenues and the wholesale electricity purchases are recorded as costs of energy sold. In accordance with EITF Issue 03-11, "*Reporting Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, and Not Held for Trading Purposes*" ("EITF 03-11"), non-normal derivative contracts that are net settled or "booked-out" are recorded net in earnings. A book-out is the planned or unplanned netting of off-setting purchase and sale transactions. A book-out is a transmission mechanism to reduce congestion on the transmission system or administrative burden (see further discussion below in "Financial Instruments" in this Note 1). For accounting purposes, a book-out, as referred to above, is the recording of net revenues upon the settlement of a non-normal derivative contract.

PNM enters into merchant energy contracts to take advantage of market opportunities associated with the purchase and sale of electricity. Unrealized gains and losses resulting from the impact of price movements on PNM's derivative energy contracts that are not designated normal purchases and sales or hedges are recognized as adjustments to operating revenues. The market prices used to value these transactions reflect Company management's best estimate considering various factors including closing exchange and over-the-counter quotations, time value and volatility factors underlying the commitments.

**PNM RESOURCES, INC. AND SUBSIDIARIES**  
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**TEXAS-NEW MEXICO POWER COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**December 31, 2005, 2004 and 2003**

*Depreciation and Amortization*

PNM's provision for depreciation and amortization of utility plant is made based upon rates approved by the NMPRC. PNM's average rates used are as follows:

	<b>2005</b>	<b>2004</b>	<b>2003</b>
Electric plant	3.10%	3.07%	3.33%
Gas plant	2.93%	2.87%	2.96%
Common plant	8.65%	8.08%	8.38%

TNMP's provision for depreciation and amortization of utility plant is made based upon rates approved by the NMPRC and the PUCT. TNMP's electric and common plant assets rates are both regulated rates and are depreciated on a straight-line basis. TNMP's average rates used are as follows:

	<b>2005</b>	<b>2004</b>	<b>2003</b>
Electric plant and common plant	3.34%	3.62%	3.66%

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

*Amortization of Debt Acquisition Costs*

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

*Financial Instruments*

The Company follows the provisions set forth under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), as amended. SFAS 133 establishes accounting and reporting standards requiring derivative instruments to be recorded in the balance sheet as either an asset or liability measured at their fair value. SFAS 133 also requires that changes in the derivatives' fair value be recognized currently in earnings unless specific hedge accounting or normal purchase and sale criteria are met. Special accounting for qualifying hedges allows derivative gains and losses to offset related results on the hedged item in the statement of earnings, and requires that a company must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. SFAS 133 provides that the effective portion of the gain or loss on a derivative instrument designated and qualifying as a cash flow hedging instrument be reported as a component of other comprehensive income and be reclassified into earnings in the period during which the hedged forecasted transaction affects earnings. The results of hedge ineffectiveness and the change in fair value of a derivative that an entity has chosen to exclude from hedge

effectiveness are required to be presented in current earnings.

SFAS No. 149, “*Amendment of Statement 133 on Derivative Instruments and Hedging Activities*” (“SFAS 149”) was effective for all derivative contracts entered into by the Company or modified after June 30, 2003. Under SFAS 149, the Company treats all forward electric purchases and sales contracts subject to unplanned netting or book-out by the transmission provider as derivative instruments subject to mark-to-market accounting, unless the contract qualifies for the normal exception by meeting the definition in SFAS 149 of a capacity contract. Under this definition, the contract cannot permit net settlement, the seller must have the resources to serve the contract and the buyer must be a load serving entity. Upon adoption, SFAS 149 did not have a material impact on the Company’s financial condition or results of operations.

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In addition, the Company follows the provisions of EITF 02-3, "*Issues Related to Accounting for Contracts Involved in Energy Trading and Risk Management Activities.*" Under EITF 02-3 all energy contracts held for trading purposes are presented on a net margin basis in the statement of earnings. Energy contracts that do not meet the definition of a derivative under SFAS 133 are recognized in current earnings and are not marked to market.

EITF 03-11 was effective for PNM on October 1, 2003. EITF 03-11 gives guidance on whether realized gains and losses on derivative contracts not held for trading purposes should be reported on a net or gross basis and concludes such classification is a matter of judgment that depends on the relevant facts and circumstances. PNM nets all realized gains and losses on non-normal derivative transactions that do not physically deliver and that are offset by similar transactions during settlement. For the years ended December 31, 2005, 2004 and 2003, wholesale purchases of \$30.9 million, \$33.6 million and \$15.0 million, respectively, were netted with electric revenues in the Consolidated Statements of Earnings (see Note 3).

*Decommissioning Costs*

Accounting for decommissioning costs for nuclear and fossil-fuel generation involves significant estimates related to costs to be incurred many years in the future after plant closure. Changes in these estimates could significantly impact PNM's and PNM's financial position, results of operations and cash flows. PNM owns and leases nuclear and fossil-fuel facilities that are within and outside of its retail service areas. In accordance with SFAS No. 143, "*Accounting for Asset Retirement Obligations*" ("SFAS 143"), PNM is only required to recognize and measure decommissioning liabilities for tangible long-lived assets for which a legal obligation exists (see Note 15). Adoption of the statement changed the method of accounting for both nuclear generation decommissioning and fossil-fuel generation decommissioning. Nuclear decommissioning costs are based on site-specific estimates of the costs for removing all radioactive and other structures at the site. PVNGS Unit 3 is excluded from PNM's retail rates while PVNGS Units 1 and 2 are included. PNM collects a provision for ultimate decommissioning of PVNGS Units 1 and 2 in its rates and recognizes a corresponding expense and liability for these amounts. PNM believes that it will continue to be able to collect in rates for its legal asset retirement obligations for nuclear generation activities included in the ratemaking process.

In addition, PNM has a contractual obligation with the PVNGS participants to fund separately the nuclear decommissioning cost at a level in excess of what PNM has identified as its legal asset retirement obligation under SFAS 143. The contractual funding obligation is based on a site-specific estimate prepared by a third party. PNM's most recent site-specific estimates for nuclear decommissioning costs were developed in 2004, using 2004 cost factors, and are based on prompt dismantlement decommissioning, reflecting the costs of removal discussed above, with such removal occurring shortly after operating license expiration. PNM's share of the contractual funding obligation through the end of the licensing terms is approximately \$216.7 million (measured in 2004 dollars). The estimates are subject to change based on a variety of factors, including cost escalation, changes in technology applicable to nuclear decommissioning and changes in federal, state or local regulations. The operating licenses for PVNGS Units 1, 2 and 3 will expire in 2025, 2026, and 2027, respectively. PNM does not have a similar contractual funding obligation related to its fossil-fuel plants.

*Pension and Other Postretirement Benefits*

See Note 12 for a comprehensive discussion of pension and postretirement benefits expense, including a discussion of the actuarial assumptions.

*Stock Based Compensation*

PNMR accounts for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "*Accounting for Stock Issued to Employee*" ("APB 25"). Compensation cost for

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stock options, if any, is measured as the excess of the quoted market price of PNMR's stock at the date of grant over the exercise price of the granted stock option. Compensation cost for restricted stock awards are recorded over the requisite vesting period based on the market value on the date of grant. Compensation cost for performance shares are recorded on the measurement date. All stock-based compensation is granted through stock-based employee compensation plans maintained by PNMR. Although certain PNM and TNMP employees participate in the PNMR plans, PNM and TNMP do not have separate employee stock-based compensation plans.

At December 31, 2005, PNMR had three stock-based employee compensation plans. Stock options continue to be granted under only one of the plans. Had compensation expense for PNMR's stock options been recognized based on the fair value on the grant date under the methodology prescribed by SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), the effect on PNMR's pro forma net earnings and pro forma diluted earnings per share would be as follows:

	<b>Year Ended December 31,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	(In thousands, except per share data)		
PNMR net earnings:	\$ 67,227	\$ 87,686	\$ 95,173
Add: Stock compensation expense included in reported net income, net of related tax effects	761	1,362	-
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(3,072)	(4,177)	(2,200)
PNMR pro forma net earnings	\$ 64,916	\$ 84,871	\$ 92,973
PNMR earnings per share:			
Basic - as reported	\$ 1.02	\$ 1.45	\$ 1.60
Basic - pro forma	\$ 0.98	\$ 1.40	\$ 1.56
Diluted - as reported	\$ 1.00	\$ 1.43	\$ 1.58
Diluted - pro forma	\$ 0.97	\$ 1.38	\$ 1.54

SFAS No. 123 (revised 2004), "Share Based Payment" ("SFAS 123R"), supersedes APB 25. SFAS 123R requires the recognition of compensation expense, over the requisite service period, in an amount equal to the fair value of share-based payments granted to employees. The fair value of the share-based payments, excluding liability awards, is computed at the date of grant and will not be remeasured. The fair value of liability awards will be remeasured at each reporting date through the settlement date with the change in fair value recognized as compensation expense over that period. SFAS No. 123R also requires the benefits of tax deductions in excess of recognized compensation costs to be reported as financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. PNMR does not believe this reclassification will have a material impact on its Consolidated Statements of Cash



Flows.

SFAS 123R was effective for PNMR beginning January 1, 2006. PNMR adopted SFAS 123R using the modified prospective application transition method. PNMR estimates that 2006 compensation expense related to employee stock options is expected to be in the range of \$4.0 million to \$6.0 million. PNMR estimates that total 2006 expense for all of its stock-based compensation is expected to be in the range of \$6.0 million to \$9.0 million.

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*Income Taxes*

Income taxes are accounted for in accordance with the provisions of SFAS No. 109, “*Accounting for Income Taxes*” (“SFAS 109”), which uses the asset and liability method for accounting for income taxes. Under SFAS 109, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying value of existing assets and liabilities and their respective tax basis. Current NMPRC and PUCT approved rates include the tax effects of the majority of these differences. SFAS 109 requires that rate-regulated enterprises record deferred income taxes for temporary differences accorded flow-through treatment at the direction of a regulatory commission. The resulting deferred tax assets and liabilities are recorded at the expected cash flow to be reflected in future rates. Because the NMPRC and the PUCT have consistently permitted the recovery of tax effects previously flowed-through earnings, the Company has established regulatory liabilities and assets offsetting such deferred tax assets and liabilities. Items accorded flow-through treatment under rate orders, deferred income taxes and the future ratemaking effects of such taxes, as well as corresponding regulatory assets and liabilities, are recorded in the financial statements.

*Excise Taxes*

The Company pays certain fees or taxes which are either considered to be an excise tax or similar to an excise tax. These excise and excise-type taxes are recorded on both a net basis and a gross basis.

*Cumulative Effect of Changes in Accounting Principles*

In 2005, PNMR, PNM and TNMP adopted FASB Interpretation No. 47, “*Accounting for Conditional Asset Retirement Obligations*” (“FIN 47”), and recognized a cumulative effect of a change in accounting principle that decreased 2005 earnings. The amount is net of amounts expensed in prior years for cost of removal included in depreciation. FIN 47 requires the accrual of costs associated with conditional retirement obligations. PNMR, PNM and TNMP 2005 earnings were decreased \$0.9 million, \$0.5 million and \$0.4 million, respectively, net of income tax benefits. PNMR’s 2005 net earnings per diluted common share was decreased \$0.01.

In 2003, the Company changed the actuarial valuation measurement date for its pension plan and other postretirement benefits plan from September 30 to December 31 to better reflect the actual plan balances as of the year end balance sheet date. PNMR and PNM recognized a cumulative effect of a change in accounting principle that decreased 2003 earnings by \$0.8 million, net of income tax benefit, or, for PNMR, \$0.01 per diluted common share.

Also, in 2003, PNM adopted SFAS 143 and PNMR and PNM recognized a cumulative effect of a change in accounting principle that increased 2003 earnings by \$37.4 million, net of income tax expense, or, for PNMR, \$0.62 per diluted common share, representing amounts expensed in prior years for PNM’s asset retirement obligations in excess of the actual legal obligations as established under the new accounting standard.

*Extraordinary Item*

During 2004, TNMP recorded a loss of \$97.8 million related to the PUCT true-up proceeding regarding TNMP’s stranded costs. The purpose of the true-up proceeding was to quantify and reconcile the amount of stranded costs that TNMP may recover from its transmission and distribution customers. The PUCT decision established \$128.4 million

as TNMP's stranded costs and allowed TNMP to recover \$87.3 million of the \$266.5 million that TNMP requested for its true-up balance. This decision resulted in a loss of \$155.2 million before tax (\$97.8 million after tax). TNMP recorded the \$97.8 million after tax loss as an extraordinary item in accordance with the requirements of SFAS No. 101, "*Regulated Enterprises - Accounting for the Discontinuance of the Application of FASB Statement No. 71.*"

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*Change in Presentation*

Certain amounts in the 2004 and 2003 Consolidated Financial Statements and Notes thereto for PNMR, PNM and TNMP have been reclassified to conform to the 2005 financial statement presentation. Specifically, certain amounts in the 2004 and 2003 Consolidated Financial Statements and Notes thereto of TNMP have been reclassified to conform to PNMR's presentation for comparability.

**(2) TNP Acquisition**

On June 6, 2005, PNMR acquired all of the outstanding common shares of TNP, including its principal subsidiaries, TNMP and First Choice. The results of TNP's operations have been included in the Consolidated Financial Statements of PNMR from that date. PNMR acquired TNP in order to complement its existing New Mexico electric operations and to expand into the retail and wholesale markets in Texas.

The aggregate purchase price was \$1,221 million, including a net payment to the previous owner of \$162.0 million consisting of \$74.6 million of cash and common stock valued at \$87.4 million. The value of the 4,326,337 common shares issued was determined based on \$20.20 per common share as provided for in the Stock Purchase Agreement, dated as of July 24, 2004, by and between PNMR and SW Acquisition. In addition, the aggregate purchase price included \$1,037 million of TNP debt and preferred stock and incurred transaction and other costs of \$21.5 million. During the fourth quarter of 2005, PNMR completed the valuations of acquired property and intangible assets.

Pursuant to the Stock Purchase Agreement, PNMR provided SW Acquisition its proposed final purchase price, reflecting a reduction from the estimated purchase price of approximately \$37.0 million. SW Acquisition filed a lawsuit that disputed PNMR's proposed final purchase price. In November 2005, the parties reached a settlement of the lawsuit resulting in a reduction of approximately \$13.0 million to the original purchase price based on working capital adjustments from the closing of the second-quarter financial statements and stranded cost recovery payments. PNMR received the \$13.0 million payment from SW Acquisition in the fourth quarter of 2005. The net cash paid and purchase price stated above reflect this reduction.

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The following table presents the estimated fair values of the assets acquired and liabilities assumed at June 6, 2005, updated for subsequent adjustments to the purchase price.

(In thousands)

Net utility plant	\$	580,427
Other property and investments		3,785
Current assets		213,229
Goodwill		499,155
Other intangible assets		79,254
Deferred assets		125,264
Total assets acquired	\$	1,501,114
Current liabilities	\$	70,815
Long-term debt		814,725
Preferred stock		222,224
Deferred liabilities		209,790
Total liabilities assumed	\$	1,317,554
Net assets acquired	\$	183,560

As part of the acquisition of TNP, PNMR determined the fair value of a First Choice contractual obligation to purchase power. In comparing the pricing terms of the contractual obligation against the forward price of electricity in the relevant market, First Choice concluded that the contract was above market. In accordance with SFAS No. 141, as amended, “*Business Combinations*” (“SFAS 141”), the contract was recorded at fair value and a deferred liability of \$3.8 million was recorded that will be amortized as a reduction in cost of energy over the contract life, or approximately three years. The amortization matches the difference between the forward price curve and the contractual obligation for each month in accordance with the contract as of the acquisition date.

PNMR also determined the fair value of a First Choice contractual obligation to sell power to certain commercial and industrial customers. The valuation was based on the difference between the current market rates charged by First Choice for these customers compared to the contractual rate embedded in the customer agreement. As a result of the analysis, First Choice determined that its rates for these contractual customers are below market rates and recorded a deferred liability of \$3.5 million that will be amortized into revenues over the contract life, or approximately three years. The amortization matches the difference between the retail market rate and the contractual obligation for each month as of the date of acquisition.

TNP’s largest subsidiary, TNMP, is a regulated utility; therefore, in accordance with SFAS 71, the valuations of the majority of the assets and liabilities did not change significantly.

The \$499.2 million of goodwill was allocated to the TNMP and First Choice segments in the amounts of \$456.1 million and \$43.1 million, respectively. Of that total goodwill amount, none is expected to be deductible under Section 197 of the Internal Revenue Code.

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The following unaudited pro forma financial information presents a summary of PNMR's consolidated results of operations for the years ended December 31, 2005 and 2004, assuming the acquisition of TNP had been completed as of January 1, 2004. The pro forma financial information does not include other items or synergy savings that may result from the business combination and is not necessarily indicative of the results of operations if the acquisition had been effective as January 1, 2004. Specifically, it does not include a charge of \$11.3 million (\$7.3 million net of tax) that was recorded during 2005 in conjunction with the issuance of equity-linked units in connection with the acquisition (see Note 6).

	<b>For the Year Ended December 31,</b>	
	<b>2005</b>	<b>2004</b>
	(In thousands, except per share amounts)	
Operating revenues	\$ 2,301,333	\$ 2,286,680
Operating expenses	\$ 2,141,382	\$ 2,094,219
Earnings before extraordinary item and cumulative effect of change in accounting principle	\$ 81,077	\$ 147,565
Net earnings	\$ 80,151	\$ 49,729
Net earnings per common share before extraordinary item and cumulative effect of change in accounting principle:		
Basic	\$ 1.18	\$ 2.15
Diluted	\$ 1.16	\$ 2.12
Net earnings per common share:		
Basic	\$ 1.17	\$ 0.72
Diluted	\$ 1.15	\$ 0.71

### (3) Segment Information

The following segment presentation is based on the methodology that the Company's management uses for making operating decisions and assessing performance of its various business activities. The following presentation reports operating results without regard to the effect of accounting or regulatory changes and similar other items not related to normal operations. A reconciliation from the segment presentation to the GAAP financial statements is provided.

## REGULATED OPERATIONS

### PNM Electric

PNM Electric is an integrated electric utility that consists of the generation, transmission and distribution of electricity for retail electric customers in New Mexico and the sale of transmission to third parties as well as to PNM Wholesale and TNMP Electric. PNM Electric provides retail electric service to a large area of north central New Mexico, including the cities of Albuquerque and Santa Fe, and certain other areas of New Mexico. Customer rates for retail electric service are set by the NMPRC based on the provisions of the Global Electric Agreement (see Note 17). PNM Electric owns or leases transmission lines, interconnected with other utilities in New Mexico, and south and east into Texas, west into Arizona, and north into Colorado and Utah.

**TNMP Electric**

TNMP Electric consists of the operations of TNMP. TNMP is a regulated utility operating in Texas and New Mexico. In Texas, TNMP provides regulated transmission and distribution services under the provisions of TECA. In New Mexico, TNMP provides integrated electricity services that include the transmission, distribution, purchase and sale of electricity to its New Mexico customers as well as transmission to third parties and to PNM. TNMP's Texas and New Mexico operations are subject to traditional cost-of-service regulation.

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**PNM Gas**

PNM Gas distributes natural gas to most of the major communities in New Mexico, including two of New Mexico's three largest metropolitan areas, Albuquerque and Santa Fe. The customer base of PNM Gas includes both sales-service customers and transportation-service customers. PNM Gas purchases natural gas in the open market and resells it at cost to its distribution customers. As a result, increases or decreases in gas revenues resulting from wholesale gas price fluctuations do not impact PNM's or PNM's consolidated gross margin or earnings.

**UNREGULATED OPERATIONS**

**PNM Wholesale**

PNM Wholesale consists of the generation and sale of electricity into the wholesale market. PNM Wholesale sells the unused capacity of PNM's jurisdictional assets as well as the capacity of PNM's wholesale plants excluded from retail rates. Both regulated and unregulated generation is jointly dispatched in order to improve reliability, provide the most economic power to retail customers, and maximize profits on any wholesale transactions. Although the FERC has jurisdiction over the rates of PNM Wholesale, the Company includes PNM Wholesale in the unregulated portion of its business because PNM Wholesale is not subject to traditional rate of return regulation.

Long-term contracts include sales to firm-requirements and other wholesale customers with multi-year arrangements. Short-term sales generally include transactions entered into for up to two years. They also include spot market, hour ahead, day ahead, week ahead and forward market opportunities in which PNM Wholesale utilizes its asset backed strategy. Also included in short-term sales are sales of any excess generation not required to fulfill PNM Electric's retail load and contractual commitments.

Adjustments related to EITF Issue 03-11, "*Reporting Realized Gains and Losses on Derivative Instruments that are subject to FASB statement No. 133 and Not Held for Trading Purposes,*" are included in Corporate and Other. This requires a net presentation of trading gains and losses and realized gains and losses for certain non-trading derivatives. Management evaluates PNM Wholesale operations on a gross presentation basis due to its primarily net asset-backed marketing strategy and the importance it places on the Company's ability to repurchase and remarket previously sold capacity.

**First Choice**

First Choice is a certified retail electric provider operating in Texas, which allows it to provide electricity to residential, small and large commercial, industrial and institutional customers. First Choice performs all activities for its Texas retail customers, including acquiring new retail customers, setting up retail accounts, handling customer inquiries and complaints, and acting as a liaison between the transmission and distribution companies and retail customers. First Choice was organized in 2000 to act as TNMP's affiliated retail electric provider, as required by TECA. Although First Choice is regulated in certain respects by the PUCT under ERCOT, the Company includes First Choice in the unregulated portion of its business because First Choice is not subject to traditional rate of return regulation.

**CORPORATE AND OTHER**

On December 30, 2004, PNMR became a registered holding company under PUHCA. As a result of the requirement to register as a holding company, PNMR created PNMR Services Company, a services company, which began operation on January 1, 2005. The comprehensive energy legislation enacted in August 2005 resulted in the repeal of PUHCA effective February 2006. PNMR is in the process of evaluating the effects of that repeal, along with the other provisions of the legislation (see Note 17).

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PNMR provides energy and technology related services through its wholly owned subsidiary, Avistar and those results are included in the Corporate and Other segment.

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PNMR Segment Information

Summarized financial information for PNMR by business segment for the year ended December 31, 2005 is as follows (in thousands):

Segments of Business	Regulated		Unregulated				Consolidated
	PNM Electric	TNMP Electric *	PNM Gas	PNM Wholesale	First Choice *	Corporate & Other	
<b>2005:</b>							
Operating revenues	\$ 567,270	\$ 108,475	\$ 510,801	\$ 602,939	\$ 316,330	\$ (29,005) (a)	\$ 2,076,810
Intersegment revenues	6,706	45,875	641	25,089	-	(78,311)	-
<b>Total revenues</b>	<b>573,976</b>	<b>154,350</b>	<b>511,442</b>	<b>628,028</b>	<b>316,330</b>	<b>(107,316)</b>	<b>2,076,810</b>
Less: Cost of energy	210,169	58,014	364,205	506,935	243,053	(107,729) (a)	1,274,647
Intersegment energy transfer	(35,829)	-	-	35,829	-	-	-
<b>Gross margin</b>	<b>399,636</b>	<b>96,336</b>	<b>147,237</b>	<b>85,264</b>	<b>73,277</b>	<b>413</b>	<b>802,163</b>
Operating expenses	263,446	39,576	98,402	44,827	27,897	32,474 (b)	506,622
Depreciation and amortization	69,798	17,596	22,548	15,669	1,094	12,017 (c)	138,722
Income taxes	13,065	8,442	5,853	3,612	15,450	(26,972) (b,c,e)	19,450
<b>Operating income</b>	<b>53,327</b>	<b>30,722</b>	<b>20,434</b>	<b>21,156</b>	<b>28,836</b>	<b>(17,106)</b>	<b>137,369</b>
Interest Income	27,459	1,001	3,769	5,249	1,545	3,806	42,829
Other income/(deductions)	6,859	4,829	689	2,856	(79)	(20,111) (d)	(4,957)
Other income taxes	(13,586)	(2,071)	(1,765)	(3,209)	(528)	7,748 (d)	(13,411)
Interest charges	(33,392)	(15,875)	(11,503)	(15,644)	(905)	(16,358) (e)	(93,677)
<b>Segment net income (loss)**</b>	<b>\$ 40,667</b>	<b>\$ 18,606</b>	<b>\$ 11,624</b>	<b>\$ 10,408</b>	<b>\$ 28,869</b>	<b>\$ (42,021)</b>	<b>\$ 68,153</b>
<b>Total assets at</b>							
<b>December 31, 2005</b>	<b>\$ 1,937,811</b>	<b>\$ 1,257,933</b>	<b>\$ 721,021</b>	<b>\$ 421,377</b>	<b>\$ 229,977</b>	<b>\$ 556,590</b>	<b>\$ 5,124,709</b>
<b>Goodwill</b>	<b>\$ -</b>	<b>\$ 456,088</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 43,067</b>	<b>\$ -</b>	<b>\$ 499,155</b>
<b>Gross property additions</b>	<b>\$ 135,632</b>	<b>\$ 27,801</b>	<b>\$ 31,019</b>	<b>\$ 14,595</b>	<b>\$ 482</b>	<b>\$ 12,285</b>	<b>\$ 221,814</b>

- (a) Reflects EITF 03-11 impact, under which wholesale revenues and the associated cost of energy of \$30.9 million are reclassified to a net margin basis in accordance with GAAP.
- (b) Includes the impairment of a turbine of \$15.0 million, TNP acquisition related costs of \$17.0 million and regulatory costs associated with the NMPRC's approval of the acquisition of \$2.3 million in operating expense and an income tax benefit of \$13.5 million in income taxes.
- (c) Includes a write-off of software costs of \$4.5 million in depreciation and amortization and an income tax benefit of \$1.8 million in income taxes.
- (d)

Includes an \$11.3 million charge related to the issuance of equity-linked units in October 2005, TNP debt refinancing costs of \$1.0 million in other income/(deductions) and an income tax benefit of \$3.5 million in other income taxes.

(e) Includes TNP debt refinancing costs of \$5.3 million in interest charges and an income tax benefit of \$2.0 million in income taxes.

\* Includes results from June 6 through December 31, 2005.

\*\* Net earnings before cumulative effect of change in accounting principle.

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Summarized financial information for PNMR by business segment for the year ended December 31, 2004 is as follows (in thousands):

Segments of Business	PNM Electric	Regulated TNMP Electric	PNM Gas	Unregulated PNM Wholesale	First Choice	Corporate & Other	Consolidated
<b>2004:</b>							
Operating revenues	\$ 552,563	\$ -	\$ 489,767	\$ 588,243	\$ -	\$ (32,784)(a)	\$1,597,789
Intersegment revenues	5,849	-	1,154	-	-	-	7,003
<b>Total revenues</b>	<b>558,412</b>	<b>-</b>	<b>490,921</b>	<b>588,243</b>	<b>-</b>	<b>(32,784)</b>	<b>1,604,792</b>
Less: Cost of energy	186,517	-	343,219	449,059	-	(33,486)(a)	945,309
Intersegment energy transfer	(42,769)	-	-	42,769	-	-	-
<b>Gross margin</b>	<b>414,664</b>	<b>-</b>	<b>147,702</b>	<b>96,415</b>	<b>-</b>	<b>702</b>	<b>659,483</b>
Operating expenses	258,182	-	97,412	46,442	-	6,266	408,302
Depreciation and amortization	63,050	-	18,894	14,809	-	5,468	102,221
Income taxes	23,141	-	8,063	8,537	-	(3,679)	36,062
<b>Operating income</b>	<b>70,291</b>	<b>-</b>	<b>23,333</b>	<b>26,627</b>	<b>-</b>	<b>(7,353)</b>	<b>112,898</b>
Interest Income	28,445	-	2,253	5,468	-	1,841	38,007
Other income/(deductions)	2,045	-	190	1,640	-	(2,534)	1,341
Other income taxes	(12,072)	-	(967)	(2,814)	-	2,668	(13,185)
Interest charges	(34,981)	-	(11,029)	(13,601)	-	8,236	(51,375)
<b>Segment net income (loss)</b>	<b>\$ 53,728</b>	<b>\$ -</b>	<b>\$ 13,780</b>	<b>\$ 17,320</b>	<b>\$ -</b>	<b>\$ 2,858</b>	<b>\$ 87,686</b>
<b>Total assets at December 31, 2004</b>	<b>\$1,764,032</b>	<b>\$ -</b>	<b>\$ 512,538</b>	<b>\$ 430,493</b>	<b>\$ -</b>	<b>\$ 780,572</b>	<b>\$3,487,635</b>
<b>Gross property additions</b>	<b>\$ 89,124</b>	<b>\$ -</b>	<b>\$ 35,547</b>	<b>\$ 8,023</b>	<b>\$ -</b>	<b>\$ 13,016</b>	<b>\$ 145,710</b>

(a) Reflects EITF 03-11 impact, under which wholesale revenues and the associated cost of energy of \$33.6 million are reclassified to a net margin basis in accordance with GAAP.

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Summarized financial information for PNMR by business segment for the year ended December 31, 2003 is as follows (in thousands):

Segments of Business	PNM Electric	Regulated TNMP Electric	PNM Gas	Unregulated PNM Wholesale	First Choice	Corporate & Other	Consolidated
<b>2003:</b>							
Operating revenues	\$ 553,979	\$ -	\$ 356,872	\$ 551,625	\$ -	\$ (14,703)(a)	\$1,447,773
Intersegment revenues	6,485	-	1,395	1,535	-	(1,535)	7,880
<b>Total revenues</b>	<b>560,464</b>	<b>-</b>	<b>358,267</b>	<b>553,160</b>	<b>-</b>	<b>(16,238)</b>	<b>1,455,653</b>
Less: Cost of energy	177,767	-	228,345	413,089	-	(16,531)(a)	802,670
Intersegment energy transfer	(34,760)	-	-	34,760	-	-	-
<b>Gross margin</b>	<b>417,457</b>	<b>-</b>	<b>129,922</b>	<b>105,311</b>	<b>-</b>	<b>293</b>	<b>652,983</b>
Operating expenses	252,634	-	96,746	44,928	-	(3,638)	390,670
Depreciation and amortization	73,532	-	22,186	14,230	-	5,701	115,649
Income taxes	23,750	-	(956)	12,111	-	(6,833)	28,072
<b>Operating income</b>	<b>67,541</b>	<b>-</b>	<b>11,946</b>	<b>34,042</b>	<b>-</b>	<b>5,063</b>	<b>118,592</b>
Interest Income	28,669	-	2,437	5,493	-	5,227	41,826
Other income/(deductions)	4,828	-	587	1,097	-	(42,372)	(35,860)
Other income taxes	(13,830)	-	(1,197)	(2,609)	-	17,819(b)	183
Interest charges	(31,303)	-	(13,406)	(15,562)	-	(5,918)	(66,189)
<b>Segment net income (loss)</b>	<b>\$ 55,905</b>	<b>\$ -</b>	<b>\$ 367</b>	<b>\$ 22,461</b>	<b>\$ -</b>	<b>\$ (20,181)(b)</b>	<b>\$ 58,552</b>
<b>Total assets at December 31, 2003</b>	<b>\$1,704,592</b>	<b>\$ -</b>	<b>\$ 509,111</b>	<b>\$ 425,372</b>	<b>\$ -</b>	<b>\$ 739,554</b>	<b>\$3,378,629</b>
<b>Gross property additions</b>	<b>\$ 108,823</b>	<b>\$ -</b>	<b>\$ 45,616</b>	<b>\$ 14,620</b>	<b>\$ -</b>	<b>\$ 8,145</b>	<b>\$ 177,204</b>

(a)Reflects EITF 03-11 impact, under which certain wholesale revenues and the associated cost of energy of \$15.0 million are reclassified to a net margin basis in accordance with GAAP.

(b)Includes \$9.5 million write-off of transition costs, net of tax benefit of \$7.2 million, due to the repeal of deregulation in New Mexico, and the \$10.0 million write-off related to refinancing of long-term debt, net of tax benefit of \$6.6 million, that reduced consolidated net earnings.

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PNM Segment Information

Summarized financial information for PNM by business segment for the year ended December 31, 2005 is as follows (in thousands):

Segments of Business	PNM Electric	PNM Gas	PNM Wholesale	Other	Consolidated
<b>2005:</b>					
Operating revenues	\$ 567,270	\$ 510,801	\$ 602,939	\$ (34,228) (a)	\$1,646,782
Intersegment revenues	6,706	641	25,089	(3,761)	28,675
<b>Total revenues</b>	<b>573,976</b>	<b>511,442</b>	<b>628,028</b>	<b>(37,989)</b>	<b>1,675,457</b>
Less: Cost of energy	210,169	364,205	506,935	(37,819) (a)	1,043,490
Intersegment energy transfer	(35,829)	-	35,829	-	-
<b>Gross margin</b>	<b>399,636</b>	<b>147,237</b>	<b>85,264</b>	<b>(170)</b>	<b>631,967</b>
Operating expenses	263,446	98,402	44,827	24,952 (b)	431,627
Depreciation and amortization	69,798	22,548	15,669	7,776 (c)	115,791
Income taxes	13,065	5,853	3,612	(14,313)(b,c)	8,217
<b>Operating income</b>	<b>53,327</b>	<b>20,434</b>	<b>21,156</b>	<b>(18,585)</b>	<b>76,332</b>
Interest Income	27,459	3,769	5,249	1,442	37,919
Other income/(deductions)	6,859	689	2,856	(862)	9,542
Other income taxes	(13,586)	(1,765)	(3,209)	1,483	(17,077)
Interest charges	(33,392)	(11,503)	(15,644)	6,415	(54,124)
<b>Segment net income (loss) *</b>	<b>\$ 40,667</b>	<b>\$ 11,624</b>	<b>\$ 10,408</b>	<b>\$ (10,107)</b>	<b>\$ 52,592</b>
<b>Total assets at</b>					
<b>December 31, 2005</b>	<b>\$1,937,811</b>	<b>\$ 721,021</b>	<b>\$ 421,377</b>	<b>\$ 507,542</b>	<b>\$3,587,751</b>
<b>Gross property additions</b>	<b>\$ 135,632</b>	<b>\$ 31,019</b>	<b>\$ 14,595</b>	<b>\$ (13,500)</b>	<b>\$ 167,746</b>

(a) Reflects EITF 03-11 impact, under which wholesale revenues and the associated cost of energy of \$30.9 million are reclassified to a net margin basis in accordance with GAAP.

(b) Includes the impairment of a turbine of \$15.0 million, TNP acquisition related costs of \$8.7 million and regulatory costs associated with the NMPRC's approval of the acquisition of \$2.3 million in operating expenses and an income tax benefit of \$10.3 million in income taxes.

(c) Includes a write-off of software costs of \$4.5 million in depreciation and amortization and an income tax benefit of \$1.8 million in income taxes.

\* Net earnings available for common stock before cumulative effect of change in accounting principle.



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Summarized financial information for PNM by business segment for the year ended December 31, 2004 is as follows (in thousands):

Segments of Business	PNM Electric	PNM Gas	PNM Wholesale	Other	Consolidated
<b>2004:</b>					
Operating revenues	\$ 552,563	\$ 489,767	\$ 588,243	\$ (33,609)(a)	\$1,596,964
Intersegment revenues	5,849	1,154	-	-	7,003
<b>Total revenues</b>	<b>558,412</b>	<b>490,921</b>	<b>588,243</b>	<b>(33,609)</b>	<b>1,603,967</b>
Less: Cost of energy	186,517	343,219	449,059	(33,609)(a)	945,186
Intersegment energy transfer	(42,769)	-	42,769	-	-
<b>Gross margin</b>	<b>414,664</b>	<b>147,702</b>	<b>96,415</b>	<b>-</b>	<b>658,781</b>
Operating expenses	258,182	97,412	46,442	776	402,812
Depreciation and amortization	63,050	18,894	14,809	2,880	99,633
Income taxes	23,141	8,063	8,537	(1,777)	37,964
<b>Operating income</b>	<b>70,291</b>	<b>23,333</b>	<b>26,627</b>	<b>(1,879)</b>	<b>118,372</b>
Interest Income	28,445	2,253	5,468	1,555	37,721
Other income/(deductions)	2,045	190	1,640	62	3,937
Other income taxes	(12,072)	(967)	(2,814)	1,120	(14,733)
Interest charges	(34,981)	(11,029)	(13,601)	6,180	(53,431)
<b>Segment net income (loss)</b>	<b>\$ 53,728</b>	<b>\$ 13,780</b>	<b>\$ 17,320</b>	<b>\$ 7,038</b>	<b>\$ 91,866</b>
<b>Total assets at</b>					
<b>December 31, 2004</b>	<b>\$1,764,032</b>	<b>\$ 512,538</b>	<b>\$ 430,493</b>	<b>\$ 686,667</b>	<b>\$3,393,730</b>
<b>Gross property additions</b>	<b>\$ 89,124</b>	<b>\$ 35,547</b>	<b>\$ 8,023</b>	<b>\$ 5,457</b>	<b>\$ 138,151</b>

(a) Reflects EITF 03-11 impact, under which wholesale revenues and the associated cost of energy of \$33.6 million are reclassified to a net margin basis in accordance with GAAP.

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Summarized financial information for PNM by business segment for the year ended December 31, 2003 is as follows (in thousands):

Segments of Business	PNM Electric	PNM Gas	PNM Wholesale	Other	Consolidated
<b>2003:</b>					
Operating revenues	\$ 553,979	\$ 356,872	\$ 551,625	\$ (15,014)(a)	\$1,447,462
Intersegment revenues	6,485	1,395	1,535	(1,535)	7,880
<b>Total revenues</b>	<b>560,464</b>	<b>358,267</b>	<b>553,160</b>	<b>(16,549)</b>	<b>1,455,342</b>
Less: Cost of energy	177,767	228,345	413,089	(16,551)(a)	802,650
Intersegment energy transfer	(34,760)	-	34,760	-	-
<b>Gross margin</b>	<b>417,457</b>	<b>129,922</b>	<b>105,311</b>	<b>2</b>	<b>652,692</b>
Operating expenses	252,634	96,746	44,928	(2,685)	391,623
Depreciation and amortization	73,532	22,186	14,230	3,973	113,921
Income taxes	23,750	(956)	12,111	(6,643)	28,262
<b>Operating income</b>	<b>67,541</b>	<b>11,946</b>	<b>34,042</b>	<b>5,357</b>	<b>118,886</b>
Interest Income	28,669	2,437	5,493	2,319	38,918
Other income/(deductions)	4,828	587	1,097	(36,886)	(30,374)
Other income taxes	(13,830)	(1,197)	(2,609)	15,308(b)	(2,328)
Interest charges	(31,303)	(13,406)	(15,562)	(5,439)	(65,710)
<b>Segment net income (loss)</b>	<b>\$ 55,905</b>	<b>\$ 367</b>	<b>\$ 22,461</b>	<b>\$ (19,341)(b)</b>	<b>\$ 59,392</b>
<b>Total assets at</b>					
<b>December 31, 2003</b>	<b>\$1,704,592</b>	<b>\$ 509,111</b>	<b>\$ 425,372</b>	<b>\$ 660,229</b>	<b>\$3,299,304</b>
<b>Gross property additions</b>	<b>\$ 108,823</b>	<b>\$ 45,616</b>	<b>\$ 14,620</b>	<b>(234)</b>	<b>\$ 168,825</b>

(a) Reflects EITF 03-11 impact, under which certain wholesale revenues and the associated cost of energy of \$15.0 million are reclassified to a net margin basis in accordance with GAAP.

(b) Includes \$9.5 million write-off of transition costs, net of tax benefit of \$7.2 million, due to the repeal of deregulation in New Mexico, and the \$10.0 million write-off related to refinancing of long-term debt, net of tax benefit of \$6.6 million, that reduced consolidated net earnings.

**TNMP**

TNMP operates in only one reportable segment; therefore tabular presentation of segment data is not required.

**(4) Regulatory Assets and Liabilities**

The Company's operations are regulated by the NMPRC, PUCT and the FERC and the Company applies the provisions of SFAS 71 to its regulated operations as applicable. Regulatory assets represent probable future recovery of previously incurred costs, which will be collected from customers through the ratemaking process. Regulatory liabilities represent probable future reductions in revenues associated with amounts that are to be credited to customers through the ratemaking process. Regulatory assets and liabilities reflected in the Consolidated Balance Sheets are presented below.

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PNMR

	2005	December 31, (In thousands)	2004
<b>Assets:</b>			
Current:			
PGAC	\$ 24,885		\$ -
Gas Take-or-Pay Costs	1,065		3,339
Underground Rate	790		-
Gas Mark-to-Market - Off System Sales	1,318		-
Subtotal	28,058		3,339
Non-Current:			
Mine Reclamation Costs	94,758		90,587
Deferred Income Taxes	78,671		71,471
Financing Costs	25,362		26,253
Loss on Reacquired Debt	17,398		19,044
Renewable Energy Certificates	5,739		3,448
Stranded Costs	87,316		-
Carrying Charges on Stranded Costs	33,918		-
Other	4,117		6,393
Subtotal	347,279		217,196
Total Regulatory Assets	375,337		220,535
<b>Liabilities:</b>			
Current:			
PGAC	-		(657)
Gas Mark-to-Market - PGAC	(7,085)		-
Subtotal	(7,085)		(657)
Non-Current:			
Cost of Removal	(298,307)		(247,350)
Retail competition transition obligation	(16,621)		-
Deferred Income Taxes	(30,070)		(33,020)
Asset Retirement Obligation	(33,367)		(30,702)
Unrealized Gain on PVNGS Decommissioning Trust	(7,251)		(8,153)
PVNGS Prudence Audit	(3,555)		(3,931)
Settlement Due Customers	(1,075)		(1,158)
Gain on Reacquired Debt	(692)		(1,012)
Gas Mark-to-Market - PGAC	(5,564)		-
TNP Acquisition - Settlement Due Customers	(2,448)		-
Other	(3,303)		(2,093)
Subtotal	(402,253)		(327,419)
Total Regulatory Liabilities	(409,338)		(328,076)

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**PNM RESOURCES, INC. AND SUBSIDIARIES**  
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**December 31, 2005, 2004 and 2003**

PNM

	2005	December 31, 2004
	(In thousands)	
<b>Assets:</b>		
Current:		
PGAC	\$ 24,885	\$ -
Gas Take-or-Pay Costs	1,065	3,339
Underground Rate	790	-
Gas Mark-to-Market - Off System Sales	1,318	-
Subtotal	28,058	3,339
Non-Current:		
Mine Reclamation Costs	94,758	90,587
Deferred Income Taxes	75,951	71,471
Financing Costs	25,362	26,253
Loss on Reacquired Debt	17,398	19,044
Renewable Energy Certificates	5,739	3,448
Other	4,117	6,393
Subtotal	223,325	217,196
Total Regulatory Assets	251,383	220,535
<b>Liabilities:</b>		
Current:		
PGAC	-	(657)
Gas Mark-to-Market - PGAC	(7,085)	-
Subtotal	(7,085)	(657)
Non-Current:		
Cost of Removal	(258,682)	(247,350)
Deferred Income Taxes	(30,070)	(33,020)
Asset Retirement Obligation	(33,367)	(30,702)
Unrealized Gain on PVNGS Decommissioning Trust	(7,251)	(8,153)
PVNGS Prudence Audit	(3,555)	(3,931)
Settlement Due Customers	(1,075)	(1,158)
Gain on Reacquired Debt	(692)	(1,012)
Gas Mark-to-Market - PGAC	(5,564)	-
TNP Acquisition - Settlement Due Customers	(2,448)	-
Other	(3,303)	(2,093)
Subtotal	(346,007)	(327,419)
Total Regulatory Liabilities	(353,092)	(328,076)

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**PNM RESOURCES, INC. AND SUBSIDIARIES**  
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TNMP

	2005	December 31, (In thousands)	2004
<b>Assets:</b>			
Non-Current:			
Stranded Costs	\$ 87,316		\$ 87,316
Carrying Charges on Stranded Costs	33,918		48,130
Deferred Income Taxes	2,720		2,484
Texas System Benefit Fund	-		4,006
Other	-		1,615
Subtotal	123,954		143,551
Total Regulatory Assets	123,954		143,551
<b>Liabilities:</b>			
Non-Current:			
Cost of Removal	(39,625)		(40,729)
Retail competition transition obligation	(16,621)		-
Total Regulatory Liabilities	(56,246)		(40,729)

Substantially all of the Company's regulatory assets and regulatory liabilities are reflected in rates charged to customers or have been addressed in a regulatory proceeding. The Company receives or pays a rate of return on these regulatory assets and regulatory liabilities, except for mine reclamation costs and financing costs. Recovery of mine reclamation costs is provided for up to \$100.0 million with a remaining recovery period of 15 years. Financing costs are amortized over the life of the debt, with the remaining amortization periods ranging from 3 to 30 years.

The Company is permitted, under rate regulations, to accrue and record a regulatory liability for the estimated cost of removal and salvage associated with certain of its assets through depreciation expense.

In 2004, the PUCT issued its first order in TNMP's stranded cost true-up proceeding. The purpose of the true-up proceeding was to quantify and reconcile the amount of stranded costs that TNMP may recover from its transmission and distribution customers. See Note 17.

PNM records a regulatory asset for renewable energy certificates at \$0.005 per KWh. A renewable energy certificate represents one KWh of energy produced from a renewable energy source as defined by the New Mexico Renewable Energy Act. The source of the renewable energy certificates is PNM's PPA to purchase renewable energy from the New Mexico Wind Energy Center.

PNM's cost-of-gas revenues collected from sales-service customers are recovered in accordance with NMPRC regulations through the PGAC and represent a pass-through of the cost of natural gas to the customer. An order was issued by the NMPRC in 2001 that approved an agreement regarding the hedging strategy of PNM and the implementation of a price management fund program which includes a continuous monthly balancing account with a



carrying charge. This carrying charge has the effect of keeping PNM whole on purchases of gas since it is compensated for the time value of money that exists due to any delay in collections from customers.

Five forward starting interest rate swaps were terminated in May 2003 for a cash settlement of \$27.1 million. This amount has been capitalized by PNM as a financing cost and will be amortized over the life of the bonds.

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**PNM RESOURCES, INC. AND SUBSIDIARIES**  
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Based on a current evaluation of the various factors and conditions that are expected to impact future cost recovery, the Company believes that its regulatory assets are probable of future recovery.

**(5) Stockholders' Equity**

PNMR

*Stock Split*

In May 2004, the Board of PNMR approved a 3-for-2 stock split for shareholders of record on June 1, 2004. All references in the accompanying Consolidated Financial Statements and Notes thereto to PNMR's shares outstanding and per share amounts have been restated to reflect the stock split.

Changes in common stock for PNMR are as follows:

	<b>Common Stock</b>	
	<b>Number of Shares</b>	<b>Aggregate Value</b>
	(Dollars in thousands)	
<b>Balance at December 31, 2003</b>	60,388,496	\$ 647,722
Exercise of stock options	-	(16,430)
Tax benefit from exercise of stock options	-	6,246
Stock split costs	-	(142)
Retirement of preferred stock	-	153
ESPP purchase	76,099	1,277
<b>Balance at December 31, 2004</b>	60,464,595	\$ 638,826
Exercise of stock options	-	(16,261)
Tax benefit from exercise of stock options	-	6,527
Issuance of equity-linked units	-	(18,769)
Other charge - equity-linked units	-	11,348
Restricted stock	-	1,259
Sale of common stock	3,910,000	101,231
Common stock issued for TNP acquisition	4,326,337	87,392
ESPP purchase	85,354	1,872
<b>Balance at December 31, 2005</b>	68,786,286	\$ 813,425

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PNM

Changes in common stock for PNM are as follows:

	<b>Common Stock</b>	
	<b>Number of Shares</b>	<b>Aggregate Value</b>
	(Dollars in thousands)	
<b>Balance at December 31, 2003</b>	39,117,799	\$ 752,197
Retirement of preferred stock	-	153
<b>Balance at December 31, 2004</b>	39,117,799	\$ 752,350
Equity from parent	-	13,150
<b>Balance at December 31, 2005</b>	39,117,799	\$ 765,500

TNMP

Changes in common stock and additional paid-in capital for TNMP are as follows:

	<b>Common Stock</b>		<b>Additional Paid-In Capital</b>
	<b>Number of Shares</b>	<b>Aggregate Par Value</b>	
	(Dollars in thousands)		
<b>Pre-Acquisition:</b>			
<b>Balance at December 31, 2003</b>	10,705	\$ 107	\$ 197,751
<b>Balance at December 31, 2004</b>	10,705	\$ 107	\$ 197,751
<b>Post-Acquisition:</b>			
<b>Balance at June 6, 2005</b>	10,705	\$ 107	\$ -
Purchase accounting adjustments	-	-	645,130
Stock redemption	(1,090)	(11)	(62,000)
<b>Balance at December 31, 2005</b>	9,615	\$ 96	\$ 583,130

*Dividends*

The declaration of common dividends by PNMR is dependent upon a number of factors including the ability of PNMR's subsidiaries to pay dividends. PNMR's primary sources of dividends are PNM and TNMP.

PNM paid cash dividends of \$91.0 million, \$23.0 million and \$49.6 million to PNMR for the years ended December 31, 2005, 2004 and 2003, respectively. TNMP paid cash dividends of \$12.0 million to PNMR for the year ended December 31, 2005.

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As part of the order approving the formation of PNMR, the NMPRC placed certain restrictions on the ability of PNM and TNMP to pay dividends to PNMR. The NMPRC order imposed the following conditions regarding dividends paid by PNM and TNMP to PNMR: PNM or TNMP cannot pay dividends which cause its debt rating to fall below investment grade; and neither PNM nor TNMP can pay dividends in any year, as determined on a rolling four quarter basis, in excess of net earnings without prior NMPRC approval. The Global Electric Agreement (see Note 17) modified the PNM dividend restriction to allow PNM to pay dividends from earnings to PNMR as well as equity contributions made by PNMR. Additionally, PNM has various financial covenants that limit the transfer of assets, through dividends or other means.

In addition, the ability of PNMR to declare dividends is dependent upon the extent to which cash flows will support dividends, the availability of retained earnings, the financial circumstances and performance, the NMPRC's and PUCT's decisions in various regulatory cases currently pending and which may be docketed in the future, the effect of federal regulatory decisions, Congressional and legislative acts and economic conditions in the United States. Conditions imposed by the NMPRC or PUCT, future growth plans and the related capital requirements and business considerations may also affect PNMR's ability to pay dividends.

In February 2004, the Board of PNMR approved a 4.3% increase in the common stock dividend for an indicated annual dividend of \$0.64 per share. In December 2004, the Board of PNMR approved a 15.6% increase in the common stock dividend for an indicated annual dividend of \$0.74 per share. In July 2005, the Board of PNMR approved an 8.0% increase in the common stock dividend for an indicated annual dividend of \$0.80 per share. In February 2006, the Board of PNMR approved a 10.0% increase in the common stock dividend for an indicated annual dividend of \$0.88 per share.

*Cumulative Preferred Stock*

PNMR has no preferred stock outstanding. PNMR's restated articles of incorporation authorize 10 million shares of preferred stock, which may be issued without restriction.

The number of authorized shares of PNM cumulative preferred stock is 10 million shares. During 2004, PNM retired 12,707 shares for \$1.1 million. PNM preferred stock does not have a mandatory redemption requirement but may be redeemed at 102% of the stated value with accrued dividends. The holders of the preferred stock are entitled to payment before the holders of common stock in the event of any liquidation or dissolution or distribution of assets of PNM. In addition, PNM's preferred stock is not entitled to a sinking fund and cannot be converted into any other class of stock of PNM.

TNMP has no preferred stock outstanding. The number of authorized shares of TNMP cumulative preferred stock is 1 million shares.

*PNMR Equity-Linked Units and Common Stock*

See Note 6 below for details about PNMR's issuance of equity-linked units and common stock and the other charge related to this transaction.

*TNMP Common Stock*

In September 2005, as part of the TNP acquisition financing, TNMP redeemed and cancelled 1,090 shares of its privately held stock held by TNP at the book value of \$56,888.91 per share, for a total of \$62.0 million. TNP subsequently paid a cash dividend of \$62.0 million to PNMR.

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**(6) Financing**

PNMR

*Long-Term Debt*

During 2005, PNMR issued senior notes in conjunction with private and public offerings (see “Equity-Linked Units Offerings” below).

*Revolving and Other Credit Facilities*

In August 2005, PNMR completed arrangements to expand the size, extend the maturity and modify certain terms and conditions of its previous unsecured revolving credit facility and executed an amended and restated credit agreement (the “PNMR Facility”). The PNMR Facility expands the size of its previous revolving credit facility from \$400.0 million to \$600.0 million. Under the PNMR Facility, the borrowing availability of First Choice was increased from \$100.0 million to \$300.0 million to support First Choice’s future business activities. The PNMR Facility has an expiration date of August 15, 2010 and includes two one-year extension options that are subject to approval by a majority of the lenders. At December 31, 2005, \$10.0 million was outstanding under the PNMR Facility (see First Choice below).

At December 31, 2005, PNMR also had \$15.0 million in local lines of credit. There were no outstanding borrowings under the local lines of credit at December 31, 2005.

In June 2005, PNMR established a commercial paper program under which it may issue up to \$400.0 million in commercial paper for up to 270 days. The commercial paper is unsecured and the proceeds are used for short-term cash management needs. The PNMR Facility serves as a backstop for the outstanding commercial paper. At December 31, 2005, PNMR had \$190.1 million of commercial paper outstanding.

At December 31, 2005, First Choice had up to \$300.0 million of borrowing capacity under the PNMR Facility. Any borrowings made by First Choice under this sublimit are guaranteed by PNMR. At December 31, 2005, First Choice had \$10.0 million outstanding under the PNMR Facility; however, First Choice had \$15.6 million of letters of credit outstanding, which reduces the available capacity under the PNMR Facility. TNMP is also a borrower under the PNMR Facility (see “TNMP” below).

*Financing Activities*

PNMR has a universal shelf registration statement filed with the SEC for the issuance of debt securities and equity securities, preferred stock, purchase contracts, purchase contract units and warrants. As of December 31, 2005, PNMR had approximately \$400.9 million of remaining unissued securities under this registration statement.

PNMR has entered into three fixed-to-floating interest rate swaps with an aggregate notional principal amount of \$150.0 million. Under these swaps, PNMR receives a 4.40% fixed interest payment on the notional principal amount on a semi-annual basis and pays a floating rate equal to the six month LIBOR plus 58.15 basis points (0.5815%) on the notional amount through September 15, 2008. The initial floating rate was 1.91% and will be reset every six months. The floating rate was reset on September 15, 2005, to 4.60%. The swap is accounted for as a fair-value hedge

with a liability position of approximately \$3.9 million as of December 31, 2005.

During October 2004, PNMR entered into two forward starting floating-to-fixed rate interest rate swaps with an aggregate notional principal amount of \$100.0 million. These swaps became effective August 1, 2005 and terminate November 15, 2009. Under these swaps, PNMR receives a floating rate equal to the three month LIBOR rate on the notional principal amount and pays a fixed interest rate of 3.975% on the notional principal amount on a quarterly basis. The initial floating rate was set on August 1, 2005, at 3.693% and will be reset every three months. From November 2004 through June 30, 2005, the swaps were accounted for as a cash flow hedge against

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borrowings under a five-year \$400.0 million PNMR revolving credit agreement dated November 15, 2004. The PNMR Facility replaced the November 2004 credit agreement in August 2005. Effective June 30, 2005, the swaps were de-designated as cash flow hedges due to a change in the underlying borrowings being hedged from the November 2004 credit agreement at the inception of the hedge to commercial paper. The mark-to-market change in the fair value of these swaps was subsequently recognized on PNMR's Consolidated Statement of Earnings. At December 31, 2005, the increase in fair value related to these swaps was \$2.8 million. Of this increase, \$0.4 million was recorded in accumulated other comprehensive income on PNMR's Consolidated Balance Sheet and \$2.4 million was recognized in other income on PNMR's Consolidated Statement of Earnings for the year ended December 31, 2005.

In conjunction with the acquisition of TNP, on June 6, 2005, PNMR made an equity investment of approximately \$110.5 million in TNP, which TNP used to repay in full amounts owing under TNP's credit agreement. In addition, pursuant to PNMR's acquisition of TNP, PNMR agreed to provide funds to TNP to enable TNP to redeem (a) TNP's 14.5% Senior Redeemable Preferred Stock, Series C, (b) TNP's 14.5% Senior Redeemable Preferred Stock, Series D (collectively, "Preferred Stock"), and (c) TNP's 10.25% Senior Subordinated Notes due 2010, Series B ("Senior Notes"). On July 6, 2005, TNP redeemed the Preferred Stock by tendering \$224.6 million to the holders of the Preferred Stock and redeemed the Senior Notes by tendering \$296.5 million to holders of the Senior Notes (tendered amounts include interest, as applicable). In order to fund a portion of the cost of redemption of TNP's Preferred Stock and Senior Notes, PNMR issued \$370.0 million of commercial paper short-term notes under the PNMR commercial paper program. The balance of the funds necessary for the redemption came from other cash available to PNMR and the total redemption amount was an equity investment by PNMR in TNP.

*Equity-Linked Units Offering - Private*

In October 2005, PNMR completed a private offering of 4,000,000 equity-linked units at 6.625%. PNMR received \$100.0 million in proceeds from this transaction and there were no underwriting discounts or commissions. PNMR used the proceeds to repay short-term borrowings, which included borrowings for the acquisition of TNP.

Each equity-linked unit consists of a purchase contract and a 2.5% undivided beneficial ownership interest in one of PNMR's senior notes with a stated amount of \$1,000, which corresponds to a \$25.00 stated amount of PNMR's senior notes. The ownership interest in the senior notes is initially pledged to secure the purchaser's obligation to purchase PNMR common stock under the related purchase contract. The senior notes are scheduled to mature in August 2010 (subject to the remarketing described below) and bear interest initially at the annual rate of 5.1%. The purchase contracts entitle the purchaser to quarterly contract adjustment payments of 1.525% per year on the stated amount of \$25.00.

Each purchase contract contains a mandatory obligation for the holder to purchase, and PNMR to sell, at a purchase price of \$25.00 in cash, shares of PNMR's common stock (or preferred stock under certain circumstances in a ratio of 1/10 of a preferred share for each share of common stock) on or before November 16, 2008. Generally, the number of shares the purchaser is obligated to purchase depends on the average closing price per share of PNMR's common stock over a 20-day trading period ending on the third trading day immediately preceding November 16, 2008, subject to anti-dilution adjustments. If the average closing price for the 20-day trading period is equal to or greater than approximately \$25.116 per share, the settlement rate will be 0.9954 shares of common stock. If the average closing price for the trading period is less than approximately \$25.116 per share but greater than \$20.93 per share, the

settlement rate is equal to \$25.00 divided by the average closing price of PNMR's common stock for the trading period. If the average closing price for the trading period is less than or equal to \$20.93 per share, the settlement rate will be 1.1945 shares of common stock. The purchaser has the option to settle its obligations under the purchase contracts at any time on or prior to the fifth business day immediately preceding November 16, 2008. Prior to November 16, 2008, the senior notes will be remarketed. If the remarketing is successful, the interest rate on the senior notes may change to a rate selected by the remarketing agent, and the maturity of the senior notes may be extended to a date selected by PNMR, but no later than November 2011. If the remarketing of the senior notes is not successful, the maturity and interest rate of the senior notes will not change and holders of the equity-linked units will have the option of putting their senior notes to PNMR to satisfy their obligations under the purchase contracts. PNMR expects that the remarketing of the senior notes will be successful.

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The purchase contracts are forward transactions in PNMR's common stock. Upon issuance in October 2005, a liability for the present value of the purchase contract adjustment payments of \$4.6 million was recorded as a reduction to stockholders' equity, with an offsetting increase to other long-term liabilities. Subsequent contract adjustment payments will reduce this liability. In addition, other charges of \$11.3 million was recorded based on the increase in PNMR's stock price from August 2004, when the agreement was signed, to October 2005, when the equity-linked units were issued. Upon settlement of each purchase contract, PNMR will receive the stated amount of \$25.00 on the purchase contract and will issue the requisite number of shares of common stock (or preferred stock under certain circumstances in a ratio of 1/10 of a preferred share for each share of common stock). The stated amount received will be recorded as an increase to stockholders' equity.

Before the issuance of common stock (or preferred stock under certain circumstances in a ratio of 1/10 of a preferred share for each share of common stock) upon settlement of the purchase contracts, the equity-linked units will be reflected in diluted earnings per share calculations using the treasury stock method as defined by SFAS No. 128, "Earnings per Share" ("SFAS 128"). Under this method, the number of shares of common stock used in calculating diluted earnings per share (based on the settlement formula applied at the end of the reporting period) is deemed to be increased by the excess, if any, of the number of shares that would be issued upon settlement of the purchase contracts less the number of shares that could be purchased by PNMR in the market at the average market price during the period, using the proceeds to be received upon settlement. Therefore, dilution will occur for periods when the average market price of PNMR's common stock for the reporting period is above approximately \$25.116, and will potentially occur when the average price of PNMR's common stock for the 20-day trading period preceding the end of the reporting period is lower than the average price of PNMR's common stock for the full reporting period. The dilution effect for the year ended December 31, 2005 was approximately 317,600 shares.

*Common Stock Offering*

In March 2005, PNMR issued 3,910,000 shares of its common stock at \$26.76 per share. PNMR received net proceeds from this offering, after deducting underwriting discounts and commissions and estimated expenses, of approximately \$101.0 million. PNMR used the net proceeds to retire high cost TNP debt and preferred stock and to complete the construction of Luna, a partially constructed, combined-cycle power plant near Deming, New Mexico and for other general corporate purposes.

*Equity-Linked Units Offering - Public*

In March 2005, PNMR completed a public offering of 4,945,000 6.75% equity-linked units, yielding net proceeds after fees of \$239.6 million. PNMR used the net proceeds to retire high cost TNP debt and preferred stock, to complete the construction of Luna and for other general corporate purposes.

Each equity-linked unit consists of a purchase contract and a 5.0% undivided beneficial ownership interest in one of PNMR's senior notes with a stated amount of \$1,000, which corresponds to a \$50.00 stated amount of PNMR's senior notes. The ownership interest in the senior notes is initially pledged to secure the corporate unit holder's obligation to purchase PNMR common stock under the related purchase contract. The senior notes are scheduled to mature in May 2010 (subject to the remarketing described below) and bear interest at a rate of 4.8% per year. The purchase contracts entitle their holders to contract adjustment payments of 1.95% per year on the stated amount of \$50.00.

Each purchase contract contains a mandatory obligation for the holder to purchase, and PNMR to sell, at a purchase price of \$50.00 in cash, shares of PNMR's common stock on or before May 16, 2008. Generally, the number of shares each holder of the equity-linked units is obligated to purchase depends on the average closing price per share of PNMR's common stock over a 20-day trading period ending on the third trading day immediately preceding May 16, 2008, subject to anti-dilution adjustments. If the average closing price for the 20-day trading

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period is equal to or greater than approximately \$32.65 per share, the settlement rate will be 1.5315 shares of common stock. If the average closing price for the trading period is less than approximately \$32.65 per share but greater than \$26.76 per share, the settlement rate is equal to \$50.00 divided by the average closing price of the Company's common stock for the trading period. If the average closing price for the trading period is less than or equal to \$26.76 per share, the settlement rate will be 1.8685 shares of common stock. The holders of equity-linked units have the option to settle their obligations under the purchase contracts at any time on or prior to the seventh business day immediately preceding May 16, 2008. Prior to May 16, 2008, the senior notes will be remarketed. If the remarketing is successful, the interest rate on the senior notes may change to a rate selected by the remarketing agent, and the maturity of the senior notes may be extended to a date selected by PNMR, but no later than May 2038. If the remarketing of the senior notes is not successful, the maturity and interest rate of the senior notes will not change and holders of the equity-linked units will have the option of putting their senior notes to PNMR to satisfy their obligations under the purchase contracts. PNMR expects that the remarketing of the senior notes will be successful.

The purchase contracts are forward transactions in PNMR's common stock. Upon issuance, a liability for the present value of the purchase contract adjustment payments of \$13.9 million was recorded as a reduction to stockholders' equity, with an offsetting increase to other long-term liabilities. Subsequent contract adjustment payments will reduce this liability. Upon settlement of each purchase contract, PNMR will receive the stated amount of \$50.00 on the purchase contract and will issue the requisite number of shares of common stock. The stated amount received will be recorded as an increase to stockholders' equity. PNMR has reserved 10 million shares of its common stock for issuance pursuant to the purchase contracts.

Before the issuance of common stock upon settlement of the purchase contracts, the equity-linked units will be reflected in diluted earnings per share calculations using the treasury stock method as defined by SFAS 128. Dilution will occur for periods when the average market price of PNMR's common stock for the reporting period is above approximately \$32.65, and will potentially occur when the average price of PNMR's common stock for the 20-day trading period preceding the end of the reporting period is lower than the average price of PNMR's common stock for the full reporting period. The dilution effect for the year ended December 31, 2005 was approximately 122,636 shares.

## PNM

### *Long-Term Debt*

Under PNM's modified 1947 Indenture of Mortgage and Deed of Trust, no future bonds can be issued under the mortgage. While first mortgage bonds continue to serve as collateral for pollution control bonds in the outstanding principal amount of \$65.0 million, the lien of the mortgage covers only PNM's ownership interest in PVNGS. Senior unsecured notes, which were issued under a senior unsecured note indenture, serve as collateral for the pollution control bonds in the outstanding principal amount of \$520.8 million. With the exception of the \$65.0 million of pollution control bonds secured by first mortgage bonds, the senior unsecured notes are the senior debt of PNM.

### *Revolving and Other Credit Facilities*

In August 2005, PNM entered into a new \$400.0 million unsecured credit agreement (the "PNM Facility") to replace its existing \$300.0 million facility. The PNM Facility is for a one-year term and expires August 17, 2006. Upon receiving approval by the NMPRC, it is expected that the term will be extended through August 17, 2010. The PNM Facility

also includes two one-year extension options, subject to regulatory approval and approval by a majority of the lenders. In connection with entering into the new PNM Facility, PNM simultaneously terminated the previously existing \$300.0 million facility, which would otherwise have terminated on November 21, 2006. Many of the same lenders were parties to the prior agreement. The terms and conditions of the new PNM Facility are generally similar to, or improvements over, the terms and conditions in the terminated agreement. At the time the previous credit facility was terminated, there was no balance on the facility and there were no fees or penalties related to the termination.

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At December 31, 2005, PNM also had \$23.5 million in local lines of credit and a \$20.0 million borrowing arrangement with PNMR. There were no outstanding borrowings under the PNM Facility, the local lines of credit or the borrowing arrangement with PNMR at December 31, 2005; however, \$4.5 million of letters of credit were outstanding, which reduces the available capacity under the PNM Facility.

PNM has a commercial paper program under which PNM may issue up to \$300.0 million in commercial paper for up to 365 days. The commercial paper is unsecured and the proceeds are used for short-term cash management needs. The PNM Facility serves as a backstop for the outstanding commercial paper. As of December 31, 2005, PNM had \$127.9 million in commercial paper outstanding.

*Financing Activities*

PNM has a universal shelf registration statement filed with the SEC for the issuance of debt securities, equity securities, preferred stock, purchase contracts, purchase contract units and warrants. As of December 31, 2005, PNM had approximately \$200.0 million of remaining unissued securities registered under its shelf registration statement.

*Asset Securitization*

PNM has an accounts receivable securitization program with a maximum borrowing capacity of \$70.0 million. This program provides for the securitization of PNM's retail electric service accounts receivable and retail gas service accounts receivable. Under the securitization program, PNM will periodically sell its accounts receivable, principally retail receivables, to a bankruptcy remote subsidiary, PNM Receivables Corporation, which in turn pledges an undivided interest in the receivables to an unaffiliated conduit commercial paper issuer. As of December 31, 2005 and 2004, PNM had no outstanding borrowings under the accounts receivable securitization program, which was secured by \$129.5 million and \$143.7 million of accounts receivable, respectively. PNM Receivables Corporation is consolidated in PNM's financial statements. The accounts receivable program expires in April 2006.

TNMP

*Long-Term Debt*

In 1999 and 2003, respectively, TNMP issued \$175.0 million, 6.25% senior unsecured notes that mature in 2009 and \$250.0 million, 6.125% senior notes that mature in 2008. On or after May 1, 2005, TNMP will be required to redeem the 6.125% senior notes to the extent that it receives proceeds from the securitization of stranded costs.

*Revolving and Other Credit Facilities*

In July 2005, the NMPRC approved TNMP's application to become a borrower and issue notes of up to \$100.0 million under the PNMR Facility. SEC approval was received in September 2005 and TNMP was added as a borrower under the PNMR Facility in September 2005. Any borrowings made by TNMP under this sublimit are not guaranteed by PNMR. At December 31, 2005, TNMP had no outstanding borrowings under the PNMR Facility. However, TNMP had \$2.4 million letters of credit outstanding, which reduces the available capacity under the PNMR facility.





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*Financing Activities*

In June 2003, TNMP issued \$250.0 million of 6.125% senior notes due in 2008. In May 2003, TNMP executed a \$250.0 million Treasury rate lock transaction designed to manage interest rate risk associated with the issuance of the senior notes. TNMP paid \$4.2 million upon the issuance of senior notes in June 2003 to settle the rate lock. Through the date of the acquisition, the cost of the rate lock was recorded in accumulated other comprehensive income and was amortized to interest expense over the life of the senior notes. The book value of the rate lock acquired was \$1.7 million. In conjunction with the acquisition of TNP by PNMR on June 6, 2005, the balance for the rate lock remaining in accumulated other comprehensive income was recorded at fair market value as of the date of acquisition, which was zero.

**(7) Lease Commitments**

PNMR

PNMR's operating lease expense, including TNP lease expense from June 6, 2005 through December 31, 2005, was approximately \$36.7 million in 2005, \$33.0 million in 2004 and \$33.4 million in 2003. Aggregate minimum payments to be received in future periods under non-cancelable subleases are approximately \$1.2 million.

PNMR's future minimum operating lease payments at December 31, 2005 are:

	(In thousands)
2006	\$ 34,363
2007	34,634
2008	34,371
2009	31,478
2010	31,271
Later years	214,476
<b>Total minimum lease payments</b>	<b>\$ 380,593</b>

PNM

PNM leases interests in Units 1 and 2 of PVNGS, certain transmission facilities, office buildings and other equipment under operating leases. Covenants in PNM's PVNGS Units 1 and 2 lease agreements, expiring in 2015 and 2016, limit PNM's ability, without consent of the owner participants in the lease transactions, (i) to enter into any merger or consolidation, or (ii) except in connection with normal dividend policy, to convey, transfer, lease or dividend more than 5% of its assets in any single transaction or series of related transactions.

PNM's other significant operating lease obligations include a leased interest in the EIP transmission line with annual lease payments of \$2.8 million and a PPA for the entire output of Delta, a gas-fired generating plant in Albuquerque, New Mexico, with imputed annual lease payments of \$6.0 million. See Note 9 and Note 16 for additional information about the Delta operating lease. PNM's operating lease expense was approximately \$28.5 million in 2005, \$27.6

million in 2004 and \$28.0 million in 2003. Aggregate minimum payments to be received in future periods under non-cancelable subleases are approximately \$1.2 million.

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PNM has several capital leases for certain fleet vehicles. At December 31, 2005 and 2004, \$1.5 million and \$2.2 million of these capital leases were recorded in long-term debt.

PNM's future minimum operating lease payments at December 31, 2005 are:

	(In thousands)
2006	\$ 29,322
2007	30,206
2008	31,147
2009	28,995
2010	28,995
Later years	204,765
<b>Total minimum lease payments</b>	<b>\$ 353,430</b>

**TNMP**

TNMP's operating lease expense was approximately \$1.4 million in 2005, \$1.1 million in 2004 and \$1.0 million in 2003.

TNMP's future minimum operating lease payments at December 31, 2005 are:

	(In thousands)
2006	\$ 3,159
2007	2,545
2008	1,342
2009	600
2010	393
Later years	454
<b>Total minimum lease payments</b>	<b>\$ 8,493</b>

**(8) Fair Value of Financial Instruments**

**PNMR and PNM**

*Interest Rate Management*

The Company may enter into agreements for derivative instruments, including options and swaps, to manage risks related to changes in interest rates. At the inception of any such transaction, the Company documents relationships between the hedging instruments and the items being hedged. This documentation includes the strategy that supports executing the specific transaction. See Note 6 for details regarding interest rate swaps PNMR has entered into.

GAAP defines the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation. Although management uses its best judgment in estimating the fair value of these financial instruments, there are inherent limitations in any estimation technique. Therefore, the fair value estimates presented herein are not necessarily indicative of the amounts that the Company could realize in a current transaction. Fair value is based on market quotes provided by the Company's investment bankers and trust advisors. The market prices used to value PNM's mark-to-market energy portfolio are based on closing exchange prices and over-the-counter quotations.

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PNMR*Carrying Amount/Fair Value*

The carrying amounts reflected on PNMR's Consolidated Balance Sheets approximate fair value for cash, temporary investments, receivables, and payables due to the short period of maturity. The carrying amount and fair value of PNMR's financial instruments (including current maturities) are:

	<b>December 31, 2005</b>		<b>December 31, 2004</b>	
	<b>Carrying Amount</b>	<b>Fair Value</b>	<b>Carrying Amount</b>	<b>Fair Value</b>
		(In thousands)		
Long-term debt	\$ 1,746,395	\$ 1,828,990	\$ 987,823	\$ 1,026,131
Investment in PVNGS lessors' notes	\$ 286,678	\$ 331,961	\$ 308,680	\$ 390,244

PNMR's available-for-sale securities consist solely of PNM assets held in trust for its share of decommissioning costs of PVNGS and PNM's executive retirement program. The trusts hold equity and fixed income securities. These amounts are included in other investments on the Consolidated Balance Sheets. The carrying value, gross unrealized gains and losses and estimated fair value of investments in available-for-sale securities are as follows:

	<b>At and For the Year Ended December 31, 2005</b>		
	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>
Available-for-sale:			
Equity securities	\$ 19,155	\$ (459)	\$ 73,562
Municipal bonds	932	(58)	24,621
U.S. Government securities	163	(76)	6,786
Corporate bonds	10	(72)	2,569
Other investments	30	(5)	3,569
	\$ 20,290	\$ (670)	\$ 111,107

**PNM RESOURCES, INC. AND SUBSIDIARIES**  
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**December 31, 2005, 2004 and 2003**

	<b>At and For the Year Ended December 31, 2004</b>		
	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>
Available-for-sale:			
Equity securities	\$ 20,089	\$ (186)	\$ 62,873
Municipal bonds	1,220	(52)	24,103
U.S. Government securities	226	(18)	6,592
Corporate bonds	31	(18)	2,508
Other investments	6	(2)	4,410
	\$ 21,572	\$ (276)	\$ 100,486

At December 31, 2005, the available-for-sale securities held by PNMR had the following maturities:

	<b>Fair Value</b> (In thousands)
Within 1 year	\$ 2,923
After 1 year through 5 years	4,938
After 5 years through 10 years	5,285
Over 10 years	20,830
Equity securities	73,562
Other investments	3,569
	\$ 111,107

The proceeds and gross realized gains and losses on the disposition of available-for-sale investments for PNMR and PNM are shown in the following table. Realized gains and losses are determined by specific identification of costs of securities sold.

	<b>Year Ended December 31,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	(In thousands)		
Proceeds from sales	\$ 106,624	\$ 51,213	\$ 123,030
Gross realized gains	\$ 11,825	\$ 6,737	\$ 7,685
Gross realized losses	\$ (3,176)	\$ (4,068)	\$ (5,694)

During 2005, PNMR determined that one of its investments, Wood River, had experienced a loss in market value. During the third quarter of 2005, PNMR wrote down the value of its investment in Wood River to zero and incurred a loss of approximately \$3.6 million. In the fourth quarter of 2005, the assets held in the Wood River fund were transferred into receivership as part of a civil complaint filed by the SEC against Wood River. As noted above, prior to this, the investments in Wood River were classified and accounted for as trading securities. At December 31, 2005, due to the change in circumstances surrounding Wood River, PNMR's investment was reclassified from trading to available-for-sale in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity

*Securities*” (“SFAS 115”). The fair value of PNMR’s investment in Wood River was determined to be zero at December 31, 2005. PNMR cannot predict when or if it will receive a return of the cash value of its investment in Wood River.

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*First Choice Natural Gas Contracts*

During July 2005, First Choice began entering into various gas contracts. These contracts are marked to market in accordance with GAAP. The change in mark-to-market valuation is recognized in earnings each period and is recorded in operating revenues if a sales position, and cost of energy if a purchase position, as applicable. For the year ended December 31, 2005, First Choice had a net settled gain of \$0.7 million related to natural gas contracts. As of December 31, 2005, First Choice had a net mark-to-market liability loss of \$2.8 million recorded in other current liabilities for these contracts.

*First Choice Energy Contracts*

During July 2005, First Choice also began entering into various forward physical contracts for the purchase and sale of electricity with the intent of optimizing market opportunities. These contracts, which are derivatives, do not qualify for normal purchase and sale designation pursuant to GAAP, and are marked to market. For the year ended December 31, 2005, First Choice had a net settled gain of \$88,879 related to these forward energy contracts. As of December 31, 2005, First Choice had a net mark-to-market asset gain of \$4.1 million recorded in other current assets for these contracts.

*First Choice Natural Gas Hedges*

First Choice also enters into natural gas transactions to hedge the variable component of certain heat-rate based power products used to serve customer load. These products are priced based on gas to power conversion rates using the spot price for natural gas. The hedges are effective in offsetting future cash flow volatility caused by increases in natural gas prices. The fair value of the natural gas hedges as of December 31, 2005, was a liability of \$0.5 million, which is recorded on PNMR's Consolidated Balance Sheet as a current liability. There was no hedge ineffectiveness on these transactions because the hedges and the underlying contracts are both indexed to New York Mercantile Exchange rates and movement in the hedge offsets movement in the contract. For the year ended December 31, 2005, (after June 6, 2005) First Choice's cost of energy includes gains of \$6.0 million related to the settlement of natural gas hedges.

**PNM**

*Carrying Amount/Fair Value*

The carrying amounts reflected on PNM's Consolidated Balance Sheets approximate fair value for cash, temporary investments, receivables, and payables due to the short period of maturity. The carrying amount and fair value of PNM's financial instruments (including current maturities) are:

	<b>December 31, 2005</b>		<b>December 31, 2004</b>	
	<b>Carrying Amount</b>	<b>Fair Value</b>	<b>Carrying Amount</b>	<b>Fair Value</b>
	(In thousands)			
Long-term debt	\$ 987,068	\$ 1,052,736	\$ 987,676	\$ 1,025,983
Investment in PVNGS lessors' notes	\$ 286,678	\$ 331,961	\$ 308,680	\$ 390,244



PNM's investment in the EIP transmission line and related facilities includes a 60% ownership and a 10.25% note investment maturing in 2012. It is carried at cost on the Consolidated Balance Sheet in other investments. The balance as of December 31, 2005 and 2004 was \$12.0 million and \$12.2 million, respectively.

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**PNM RESOURCES, INC. AND SUBSIDIARIES**  
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**December 31, 2005, 2004 and 2003**

*Retail Natural Gas Contracts*

The NMPRC has authorized PNM to hedge certain portions of natural gas supply contracts to protect PNM's natural gas customers from the risk of adverse price fluctuations in the natural gas market. Hedge gains and losses are recoverable through PNM's PGAC if deemed prudently incurred by the NMPRC. As a result, earnings are not affected by gains or losses generated by these instruments.

PNM purchased \$6.8 million and \$7.8 million of natural gas options during the year ended December 31, 2005 and 2004, respectively, to protect its natural gas customers from the risk of rising prices during the 2005-2006 and 2004-2005 heating seasons. These gas options cap the amount PNM would pay for each volume of gas subject to the options during the winter heating season. At December 31, 2005 and 2004, PNM had \$3.4 million and \$3.1 million of unrecovered premium costs included in other current assets on its Consolidated Balance Sheet. Expense of \$3.4 million and \$4.7 million is included on PNM's Consolidated Statement of Earnings for the year ended December 31, 2005 and 2004, respectively. PNM recovered \$3.1 million of its option premiums as a component of the PGAC during January 2005 through February 2005.

PNM entered into fixed-for-float financial transactions to hedge a portion of its winter gas purchase portfolio and has applied hedge accounting to these transactions. PNM has hedged 10.9 million MMBTUs utilizing the fixed-for-float strategy for 2005-2006 and the 2006-2007 winter heating seasons.

*Wholesale Electricity Contracts*

PNM Wholesale has entered into various forward physical contracts for the purchase and sale of electricity with the intent to optimize its net generation position. These contracts, which are derivatives, do not qualify for normal purchase and sale designation pursuant to GAAP, and are marked to market.

For the year ended December 31, 2005, PNM Wholesale settled derivative forward contracts for the sale of electricity that generated \$168.1 million of electric revenues by delivering 2.9 million MWh. For the year ended December 31, 2005, PNM Wholesale settled derivative forward contracts for the purchase of electricity of \$168.2 million or 2.8 million MWh to support these contractual sales and other open market sales opportunities. For the year ended December 31, 2004, PNM Wholesale settled derivative forward contracts for the sale of electricity that generated \$159.3 million of electric revenues by delivering 3.0 million MWh. PNM Wholesale settled derivative forward contracts for the purchase of electricity of \$143.0 million or 2.8 million MWh to support these contractual sales and other open market sales opportunities.

As of December 31, 2005, PNM Wholesale had open derivative forward contract positions to buy \$52.6 million and to sell \$72.4 million of electricity. At December 31, 2005, PNM Wholesale had a gross mark-to-market gain (asset position) on these derivative forward contracts of \$17.1 million and a gross mark-to-market loss (liability position) of \$16.7 million, recorded in other assets and liabilities, respectively. As of December 31, 2004, PNM Wholesale had open derivative forward contract positions to buy \$35.2 million and to sell \$39.2 million of electricity. At December 31, 2004, PNM Wholesale had a gross mark-to-market gain (asset position) on these derivative forward contracts of \$6.5 million and a gross mark-to-market loss (liability position) of \$5.3 million, recorded in other assets and liabilities, respectively. The change in mark-to-market valuation is recognized in earnings each period and is recorded in operating revenues if a sales position, and cost of energy if a purchase position, as applicable. There is no hedge

ineffectiveness on these transactions because the hedged transactions and the hedged item are based on the same forward curve.

PNM Wholesale also entered into forward physical contracts for the sale of PNM's electric capacity in excess of its retail and wholesale firm requirement needs, including reserves. In addition, PNM Wholesale entered into forward physical contracts for the purchase of retail needs, including reserves, when resource shortfalls exist. PNM Wholesale generally accounts for these as normal sales and purchases as defined by SFAS 133. From time to time PNM Wholesale makes forward purchases to serve its retail needs when the cost of purchased power is less than the incremental cost of its generation. At December 31, 2005, PNM Wholesale had open forward positions classified as normal sales of electricity of \$138.9 million and normal purchases of electricity of \$11.2 million, which will be reflected in the financial statements upon physical delivery.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
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The operations of PNM Wholesale, including both firm commitments and other wholesale sale activities, are managed primarily through a net asset-backed strategy, whereby PNM Wholesale's aggregate net open position is covered by its own excess generation capabilities. PNM Wholesale is exposed to market risk if its generation capabilities were disrupted or if its retail load requirements were greater than anticipated. If PNM Wholesale were required to cover all or a portion of its net open contract position, it would have to meet its commitments through market purchases.

Counterparties to its financial and physical derivative instruments expose PNM Wholesale to credit risk in the event of non-performance or non-payment. PNM Wholesale uses a credit management process to assess and monitor the financial conditions of counterparties. PNM Wholesale's credit risk with its largest counterparty as of December 31, 2005 and December 31, 2004 was \$20.5 million and \$26.2 million, respectively.

*Wholesale Gas Contracts*

PNM Wholesale enters into various fixed-for-float price swaps to manage the price risk of certain forward sales of power. These contracts, along with the underlying power sales, are marked to market in accordance with GAAP.

For the year ended December 31, 2005, PNM Wholesale settled derivative forward contracts for the sale of gas that generated \$26.5 million of revenues and settled derivative forward contracts for the purchase of gas of \$25.3 million. For the year ended December 31, 2004, PNM Wholesale settled derivative forward contracts for the sale of gas that generated \$24.5 million of revenues and settled derivative forward contracts for the purchase of gas of \$22.9 million.

As of December 31, 2005, PNM Wholesale had open derivative forward contract positions to sell \$26.7 million of natural gas and to purchase \$1.9 million of natural gas. At December 31, 2005, PNM Wholesale had a gross mark-to-market gain (asset position) on these derivative forward contracts of \$14.5 million and a gross mark-to-market loss (liability position) of \$12.6 million, recorded in other current assets and liabilities, respectively. As of December 31, 2004, PNM Wholesale had open derivative forward contract positions to sell \$13.3 million of gas. At December 31, 2004, PNM Wholesale had a gross mark-to-market gain (asset position) on these derivative forward contracts of \$0.9 million and a gross mark-to-market loss (liability position) of \$0.3 million, recorded in other assets and liabilities, respectively. The change in mark-to-market valuation is recognized in earnings each period and is recorded in operating revenues, if a sales position, and cost of energy, if a purchase position, as applicable. There is no hedge ineffectiveness on these transactions because the hedged transactions and the hedged item are based on the same forward curve.

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TNMP*Carrying Amount/Fair Value*

The carrying amounts reflected on TNMP's Consolidated Balance Sheets approximate fair value for cash, temporary investments, receivables, and payables due to the short period of maturity. The carrying value for these items reflects the fair value recorded at the date of acquisition, June 6, 2005, in accordance with SFAS 71. The carrying amount and fair value of TNMP's financial instruments (including current maturities) are:

	<b>December 31, 2005</b>		<b>December 31, 2004</b>	
	<b>Carrying Amount</b>	<b>Fair Value</b>	<b>Carrying Amount</b>	<b>Fair Value</b>
	(In thousands)			
Long-term debt	\$ 415,864	\$ 432,792	\$ 415,569	\$ 434,773

*Normal Purchases and Sales*

In the normal course of business, TNMP enters into commodity contracts, which include components for additional purchases or sales of electricity, in order to meet customer requirements. Criteria by which option-type and forward contracts for electricity can qualify for the normal purchase and sales exception has been defined by SFAS 133. In accordance with these GAAP pronouncements, management has determined that its contracts for electricity qualify for the normal purchases and sales exception. Accordingly, TNMP does not account for its electricity contracts as derivatives.

**(9) Variable Interest Entities**

FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" (Revised December 2003) ("FIN 46R"), became effective January 1, 2004 for those entities considered to be special purpose entities, and March 31, 2004 for others. Under the model for consolidation promulgated by FIN 46R, a PPA may qualify as a variable interest if its terms expose the purchaser to variability in supply or operating costs and the contract is for a significant portion of the entity's generating capacity. PNM evaluated its PPAs under the provisions of FIN 46R and determined that one purchase contract entered into prior to December 31, 2003 qualifies as a variable interest. Although PNM has continued to make ongoing efforts to obtain information, PNM was unable to obtain the necessary information needed to determine if PNM was the primary beneficiary and if consolidation was needed despite efforts including a formal written request to the operator of the entity supplying power under the PPA. The operator cited legal and competitive reasons for refusing to provide the information.

This variable interest PPA is a contract under an operating lease to purchase 132 MW of capacity and energy expiring in June 2020. See Note 7 and Note 16 for more information about the Delta operating lease. The contract contains a fixed capacity charge, a fixed O&M charge, and a variable energy charge that subjects PNM to the changes in the cost of fuel and O&M. For the year ended December 31, 2005, the capacity and O&M charge was \$6.4 million and the energy charges were \$1.1 million. For the year ended December 31, 2004, the capacity and O&M charge was \$6.0 million and the energy charges were \$0.9 million. The contract is for the full output of a specific gas generating plant

and is currently accounted for as an operating lease by PNM. Under this contract PNM is exposed to changes in the costs to produce energy and operate the plant.

PNM also has interests in other variable interest entities created before January 31, 2003, for which PNM is not the primary beneficiary. These arrangements include PNM's investment in a limited partnership and certain PNM leases. The aggregate maximum loss exposure at December 31, 2005 that PNM could be required to record in its Consolidated Statement of Earnings as a result of these arrangements totals approximately \$5.3 million. The creditors of these variable interest entities do not have recourse to the general credit of PNMR in excess of the aggregate maximum loss exposure.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
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**(10) Earnings Per Share**

In accordance with SFAS No. 128, "Earnings per Share," dual presentation of basic and diluted earnings per share has been presented in the Consolidated Statements of Earnings. Prior years' share amounts have been adjusted to reflect the effects of 2004 stock split. The following reconciliation illustrates the impact on the share amounts of potential common shares and the earnings per share amounts:

	Year Ended December 31,		
	2005	2004	2003
	(In thousands, except per share amounts)		
<b>Basic:</b>			
Net Earnings Before Cumulative Effect of Changes in Accounting Principle	\$ 68,153	\$ 87,686	\$ 58,552
Cumulative Effect of Changes in Accounting Principle, net of tax of \$592 and \$23,999	(926)	-	36,621
<b>Net Earnings</b>	<b>\$ 67,227</b>	<b>\$ 87,686</b>	<b>\$ 95,173</b>
Average Number of Common Shares Outstanding	65,928	60,414	59,620
<b>Net Earnings per Share of Common Stock (Basic)</b>	<b>\$ 1.02</b>	<b>\$ 1.45</b>	<b>\$ 1.60</b>
Earnings Before Cumulative Effect of Changes in Accounting Principles	1.03	1.45	0.99
Cumulative Effect of Changes in Accounting Principles, net of tax	(0.01)	-	0.61
<b>Net Earnings per Share of Common Stock (Basic)</b>	<b>\$ 1.02</b>	<b>\$ 1.45</b>	<b>\$ 1.60</b>
<b>Diluted:</b>			
Net Earnings Before Cumulative Effect of Changes in Accounting Principle	\$ 68,153	\$ 87,686	\$ 58,552
Cumulative Effect of Changes in Accounting Principle, net of tax of \$592 and \$23,999	(926)	-	36,621
<b>Net Earnings</b>	<b>\$ 67,227</b>	<b>\$ 87,686</b>	<b>\$ 95,173</b>
Average Number of Common Shares Outstanding	65,928	60,414	59,620
Diluted Effect of Common Stock Equivalents (a)	1,152	926	585
Average Common and Common Equivalent Shares Outstanding	67,080	61,340	60,205
<b>Net Earnings per Share of Common Stock (Diluted)</b>	<b>\$ 1.00</b>	<b>\$ 1.43</b>	<b>\$ 1.58</b>
Earnings Before Cumulative Effect of Changes in Accounting Principles	1.01	1.43	0.97
Cumulative Effect of Changes in Accounting Principles, net of tax	(0.01)	-	0.61
<b>Net Earnings per Share of Common Stock (Diluted)</b>	<b>\$ 1.00</b>	<b>\$ 1.43</b>	<b>\$ 1.58</b>

(a) Excludes the effect of average anti-dilutive common stock equivalents related to out-of-the-money options of 433,957 shares, 5,883 shares and 871,493 shares for the years ended December 31, 2005, 2004 and 2003, respectively.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**December 31, 2005, 2004 and 2003**

**(11) Income Taxes**PNMR

PNMR's income taxes before cumulative effect of changes in accounting principles consist of the following components:

	Year Ended December 31,		
	2005	2004	2003
	(In thousands)		
Current federal income tax	\$ 4,390	\$ 10,634	\$ (27,621)
Current state income tax	81	2,495	(6,169)
Deferred federal income tax	28,070	31,725	52,154
Deferred state income tax	3,872	7,495	12,646
Amortization of accumulated investment tax credits	(3,552)	(3,102)	(3,121)
<b>Total income taxes</b>	<b>\$ 32,861</b>	<b>\$ 49,247</b>	<b>\$ 27,889</b>
Charged to operating expenses	\$ 19,450	\$ 36,062	\$ 28,072
Charged to other income and deductions	13,411	13,185	(183)
<b>Total income taxes</b>	<b>\$ 32,861</b>	<b>\$ 49,247</b>	<b>\$ 27,889</b>

PNMR's provision for income taxes, before cumulative effect of changes in accounting principles, differed from the federal income tax computed at the statutory rate for each of the years shown. The differences are attributable to the following factors:

	Year Ended December 31,		
	2005	2004	2003
	(In thousands)		
Federal income tax at statutory rates	\$ 36,362	\$ 48,127	\$ 30,459
Investment tax credits	(3,552)	(3,102)	(3,121)
Flow-through of depreciation items	1,903	2,091	2,033
Gains on the sale and leaseback of PVNGS Units 1 and 2	(527)	(527)	(527)
Annual reversal of deferred income taxes accrued at prior tax rates	(2,086)	(1,963)	(1,963)
Research and development credit	-	-	(966)
Affordable housing credit	(750)	(789)	(969)
Allowance for funds used during construction	(623)	(453)	(906)
Charitable contribution of appreciated property	-	(960)	-
State income tax	3,356	6,357	4,161
Other	(1,222)	466	(312)

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Total income taxes	\$	32,861	\$	49,247	\$	27,889
Effective tax rate		31.63%		35.81%		32.05%

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The components of PNMR's net accumulated deferred income tax liability were:

	<b>2005</b>	<b>December 31,</b>	<b>2004</b>
	(In thousands)		
<b>Deferred Tax Assets:</b>			
Nuclear decommissioning costs	\$ 27,610	\$	31,632
Regulatory liabilities related to income taxes	38,331		31,805
Minimum pension liability	72,443		64,139
Other	58,863		43,526
<b>Total deferred tax assets</b>	<b>197,247</b>		<b>171,102</b>
<b>Deferred Tax Liabilities:</b>			
Depreciation	(346,693)		(263,542)
Investment tax credit	(33,806)		(35,360)
Regulatory assets related to income taxes	(86,931)		(70,256)
Asset retirement obligations	(16,213)		(24,524)
Deferred charges	(10,745)		-
Other intangibles	(26,861)		-
Recoverable stranded costs	(46,585)		-
Other	(114,482)		(97,308)
<b>Total deferred tax liabilities</b>	<b>(682,316)</b>		<b>(490,990)</b>
<b>Net Accumulated deferred income tax liabilities</b>	<b>\$ (485,069)</b>	<b>\$</b>	<b>(319,888)</b>

The following table reconciles the change in PNMR's net accumulated deferred income tax liability to the deferred income tax expense included in the Consolidated Statement of Earnings:

	<b>Year Ended</b>
	<b>December 31,</b>
	<b>2005</b>
	(In thousands)
Net change in deferred income tax liability per above table	\$ 165,181
Inclusion of TNP deferred tax liabilities	(124,947)
Change in tax effects of income tax related regulatory assets and liabilities	(7,725)
Tax effect of mark-to-market on investments available for sale	(6,999)
Tax effect of excess pension liability	8,304
Tax effect of cumulative effect of change in accounting principle	591
Other	(6,015)
<b>Deferred income tax expense</b>	<b>\$ 28,390</b>

The Company defers investment tax credits related to rate regulated assets and amortizes them over the estimated useful lives of those assets.

PNMR's tax years 2001 through 2004 and TNP's tax years 2002 and 2003 are currently under examination by the IRS. Although the Company does not expect any significant adjustments to the tax provision as a result of the IRS examination, management is unable to determine the final outcome of the IRS examination at this time.

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PNM

PNM's income taxes before cumulative effect of changes in accounting principles consist of the following components:

	<b>Year Ended December 31,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	(In thousands)		
Current federal income tax	\$ 10,070	\$ 15,057	\$ (19,824)
Current state income tax	2,289	3,327	(4,123)
Deferred federal income tax	12,792	30,252	46,761
Deferred state income tax	3,237	7,163	10,897
Amortization of accumulated investment tax credits	(3,094)	(3,102)	(3,121)
<b>Total income taxes</b>	<b>\$ 25,294</b>	<b>\$ 52,697</b>	<b>\$ 30,590</b>
Charged to operating expenses	8,217	37,964	28,262
Charged to other income and deductions	17,077	14,733	2,328
<b>Total income taxes</b>	<b>\$ 25,294</b>	<b>\$ 52,697</b>	<b>\$ 30,590</b>

PNM's provision for income taxes, before cumulative effect of changes in accounting principles, differed from the federal income tax computed at the statutory rate for each of the years shown. The differences are attributable to the following factors:

	<b>Year Ended December 31,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	(In thousands)		
Federal income tax at statutory rates	\$ 27,445	\$ 50,797	\$ 31,699
Investment tax credits	(3,094)	(3,102)	(3,121)
Flow-through of depreciation items	1,903	2,091	2,033
Gains on the sale and leaseback of PVNGS Units 1 and 2	(527)	(527)	(527)
Annual reversal of deferred income taxes accrued at prior tax rates	(1,963)	(1,963)	(1,963)
Research and development credit	-	-	(966)
Allowance for funds used during construction	(615)	(430)	(893)
Charitable contribution of appreciated property	-	(960)	-
State income tax	3,694	6,682	4,300
Other	(1,549)	109	28
<b>Total income taxes</b>	<b>\$ 25,294</b>	<b>\$ 52,697</b>	<b>\$ 30,590</b>

Effective tax rate	32.26%	36.31%	33.78%
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**PNM RESOURCES, INC. AND SUBSIDIARIES**  
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The components of PNM's net accumulated deferred income tax liability were:

	<b>2005</b>	<b>December 31,</b>	<b>2004</b>
	(In thousands)		
<b>Deferred Tax Assets:</b>			
Nuclear decommissioning costs	\$ 27,610	\$	31,632
Regulatory liabilities related to income taxes	28,351		31,805
Minimum pension liability	72,443		64,139
Other	40,105		47,252
<b>Total deferred tax assets</b>	<b>168,509</b>		<b>174,828</b>
<b>Deferred Tax Liabilities:</b>			
Depreciation	(264,437)		(262,039)
Investment tax credit	(32,266)		(35,360)
Regulatory assets related to income taxes	(74,231)		(70,256)
Asset retirement obligations	(16,222)		(24,524)
Other	(114,371)		(96,916)
<b>Total deferred tax liabilities</b>	<b>(501,527)</b>		<b>(489,095)</b>
<b>Net Accumulated deferred income tax liabilities</b>	<b>\$ (333,018)</b>	<b>\$</b>	<b>(314,267)</b>

The following table reconciles the change in PNM's net accumulated deferred income tax liability to the deferred income tax expense included in the Consolidated Statement of Earnings:

	<b>Year Ended</b>
	<b>December 31,</b>
	<b>2005</b>
	(In thousands)
Net change in deferred income tax liability per above table	\$ 18,751
Change in tax effects of income tax related regulatory assets and liabilities	(7,429)
Tax effect of mark-to-market on investments available for sale	(6,999)
Tax effect of excess pension liability	8,304
Tax effect of cumulative effect of change in accounting principle	331
Other	(23)
<b>Deferred income tax expense</b>	<b>\$ 12,935</b>

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TNMP

TNMP's income taxes before extraordinary item and cumulative effect of change in accounting principle consist of the following components:

	<b>Post- Acquisition June 6- December 31, 2005</b>	<b>Pre- Acquisition January 1- June 6, 2005</b>	<b>Pre- Acquisition Year Ended December 31, 2004</b>	<b>Pre- Acquisition Year Ended December 31, 2003</b>
		(In thousands)		
Current federal income tax	\$ 958	\$ 5,634	\$ 6,364	\$ 13,619
Current state income tax	(60)	676	3,048	1,354
Deferred federal income tax	8,328	(954)	15,049	(388)
Deferred state income tax	1,268	(127)	2,652	(6)
Amortization of accumulated investment tax credits	(458)	(328)	(722)	(874)
<b>Total income taxes</b>	<b>\$ 10,036</b>	<b>\$ 4,901</b>	<b>\$ 26,391</b>	<b>\$ 13,705</b>
Charged to operating expenses	\$ 7,965	\$ 5,055	\$ 13,680	\$ 13,044
Charged to other income and deductions	2,071	(154)	12,711	661
<b>Total income taxes</b>	<b>\$ 10,036</b>	<b>\$ 4,901</b>	<b>\$ 26,391</b>	<b>\$ 13,705</b>

TNMP's provision for income taxes, before extraordinary item and cumulative effect of change in accounting principle, differed from the federal income tax computed at the statutory rate for each of the periods shown. The differences are attributable to the following factors:

	<b>Post- Acquisition June 6- December 31, 2005</b>	<b>Pre- Acquisition January 1- June 6, 2005</b>	<b>Pre- Acquisition Year Ended December 31, 2004</b>	<b>Pre- Acquisition Year Ended December 31, 2003</b>
		(In thousands)		
Federal income tax at statutory rates	\$ 9,753	\$ 4,956	\$ 24,342	\$ 13,451
Investment tax credits	(458)	(328)	(722)	(874)
Annual reversal of deferred income taxes accrued at prior tax rates	(123)	(93)	(216)	(198)



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State income tax	1,208		549	3,048	1,354
Other	(344)		(183)	(61)	(28)
Total income taxes	\$ 10,036	\$	4,901	\$ 26,391	\$ 13,705
Effective tax rate	36.01%		34.61%	36.14%	35.15%

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The components of TNMP's net accumulated deferred income tax liability at December 31 were:

	2005	December 31, (In thousands)	2004
<b>Deferred Tax Assets:</b>			
Regulatory liabilities related to income taxes	\$ 9,980		\$ 10,602
Other	2,753		2,658
<b>Total deferred tax assets</b>	<b>12,733</b>		<b>13,260</b>
<b>Deferred Tax Liabilities:</b>			
Utility plant, principally due to depreciation and basis differences, including TNP One recoverable stranded cost	(82,108)		(86,606)
Deferred charges	(10,745)		(5,232)
Investment tax credit	(1,540)		(2,326)
Other recoverable stranded costs (non-current)	(46,585)		(46,585)
Regulatory assets related to income taxes	(12,700)		(13,086)
<b>Total deferred tax liabilities</b>	<b>(153,678)</b>		<b>(153,835)</b>
<b>Net Accumulated deferred income tax liabilities</b>	<b>\$ (140,945)</b>		<b>\$ (140,575)</b>

The following table reconciles the change in TNMP's net accumulated deferred income tax liability to the deferred income tax expense included in the Consolidated Statement of Earnings:

	Post- Acquisition June 6- December 31, 2005	(In thousands)	Pre- Acquisition January 1- June 6, 2005
Net change in deferred income tax liability per above table	\$ 1,636		\$ (1,266)
Change in tax effects of income tax related regulatory assets and liabilities	(296)		60
Other	7,798		(203)
<b>Deferred income tax expense</b>	<b>\$ 9,138</b>		<b>\$ (1,409)</b>

**(12) Pension and Other Postretirement Benefits**

PNMR and its subsidiaries maintain a qualified defined benefit pension plan, a plan providing medical and dental benefits to eligible retirees, and an executive retirement program ("PNM Plans"). PNMR maintains the legal obligation for the benefits owed to participants under these plans. TNMP also maintains a qualified defined benefit pension plan covering substantially all of its employees, a plan providing medical and death benefits to eligible retirees and an

executive retirement program (“TNMP Plans”).

Participants in the PNM Plans include eligible employees and retirees of PNMR and other subsidiaries of PNMR. Participants in the TNMP Plans include eligible employees and retirees of TNMP, First Choice and other subsidiaries of TNP. The PNM pension plan was frozen at the end of 1997 with regard to new participants, salary levels and benefits. Additional credited service can be accrued under the PNM pension plan up to a limit determined by age and service. The TNMP pension plan was frozen at December 31, 2005 with regard to new participants, salary levels and benefits.

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The total net periodic benefit cost or income from the PNM Plans, in addition to the net periodic benefit cost from the TNMP Plans from the date of PNMR's acquisition of TNP, or June 6, 2005 through December 31, 2005, is included in the Consolidated Statement of Earnings of PNMR. The TNMP Plan amounts included in the results of PNMR are as follows: pension plan income of approximately \$0.3 million, other postretirement benefit expense of approximately \$0.4 million and executive retirement plan expense of less than \$0.1 million.

The Company has in place, for the PNM and TNMP pension plans and postretirement benefits plans, a policy that defines the investment objectives, establishes performance goals of the asset managers and provides procedures for the manner in which investments are to be reviewed. The plans implement investment strategies to achieve the following objectives:

- Maximize the return on assets, commensurate with the risk that the Corporate Investment Committee deem appropriate to: meet the obligations of the pension plans and other postretirement benefits plans; minimize the volatility of expense; and account for contingencies; and
- Generate a rate of return for the total portfolio that equals or exceeds the actuarial investment rate assumption.

Management is responsible for the determination of the asset target mix and the expected rate of return. Under SFAS No. 87, "*Employers' Accounting for Pensions*" ("SFAS 87") and SFAS No. 106, "*Employers' Accounting for Postretirement Benefits Other Than Pensions*" ("SFAS 106"), the expected long-term rate of return on pension and postretirement plan assets is calculated on the market-related value of assets. SFAS 87 and SFAS 106 require that actual gains and losses on pension and postretirement plan assets be recognized in the market-related value of assets equally over a period of not more than five years, which reduces year-to-year volatility. For the PNM Plans and TNMP Plans, the market-related value of assets is equal to the prior years' market related value of assets adjusted for contributions, benefit payments and investment gains and losses that lie within a corridor of plus or minus 4.0% around the expected return on market value. Gains and losses that lie outside the corridor are amortized over five years, i.e., if investment return is outside a range of 5.0% to 13.0% (expected long-term rate of return plus or minus 4.0%), this market-related valuation recognizes the portion of return that is outside the range over a five-year period from the year in which the return occurs. As such, the future value of assets will be impacted as previously deferred returns are recorded. A December 31 measurement date is used for calculating the values reported for plan assets and benefit obligations.

In 2003, PNM changed the actuarial valuation measurement date for its pension plan and other postretirement benefits from September 30 to December 31 to better reflect the actual pension balances as of PNM's balance sheet dates and recognized a cumulative effect of a change in accounting principle of \$0.8 million, net of taxes at \$0.5 million.

*Pension Plans*

For defined benefit pension plans, the benefit obligation is the "projected benefit obligation," the actuarial present value, as of the measurement date, of all benefits attributed by the pension benefit formula to employee service rendered to that date.



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**December 31, 2005, 2004 and 2003**

The following tables present a reconciliation of the beginning and ending balances of the projected benefit obligation and show the change in the benefit obligation:

	<b>PNM Plan</b>	
	<b>Year Ended December 31,</b>	<b>2004</b>
	<b>2005</b>	<b>2004</b>
	(In thousands)	
Benefit obligation at beginning of year	\$ 517,225	\$ 463,794
Service cost	1,907	3,524
Interest cost	30,267	29,891
Actuarial loss	26,453	44,691
Benefits paid	(25,927)	(24,675)
Benefit obligation at end of year	\$ 549,925	\$ 517,225

	<b>Post- Acquisition June 6- December 31, 2005</b>	<b>TNMP Plan Pre- Acquisition January 1- June 6, 2005</b>	<b>Pre- Acquisition Year Ended December 31, 2004</b>
	(In thousands)		
Benefit obligation at beginning of period	\$ 85,083	\$ 81,290	\$ 81,833
Service cost	1,353	848	1,876
Interest cost	2,499	1,875	4,590
Actuarial loss	(2,691)	3,708	304
Benefits paid	(4,501)	(2,638)	(7,313)
Amendments	(2,419)	-	-
Benefit obligation at end of period	\$ 79,324	\$ 85,083	\$ 81,290

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**December 31, 2005, 2004 and 2003**

The following tables present the change in the value of pension plan assets and the pension plans' funded status:

	<b>PNM Plan</b>	
	<b>Year Ended December 31,</b>	
	<b>2005</b>	<b>2004</b>
	(In thousands)	
Fair value of plan assets at beginning of year	\$ 445,101	\$ 425,654
Actual return on plan assets	40,911	44,122
Benefits paid	(25,927)	(24,675)
Fair value of plan assets at end of year	460,085	445,101
Funded status	(89,840)	(72,124)
Unrecognized net actuarial loss	178,991	156,850
Unrecognized prior service cost	2,293	2,610
Prepaid pension cost	\$ 91,444	\$ 87,336

	<b>TNMP Plan</b>		
	<b>Post- Acquisition June 6- December 31, 2005</b>	<b>Pre- Acquisition January 1- June 6, 2005</b>	<b>Pre- Acquisition Year Ended December 31, 2004</b>
	(In thousands)		
Fair value of plan assets at beginning of period	\$ 80,176	\$ 82,364	\$ 85,052
Actual return on plan assets	6,162	450	4,625
Benefits paid	(4,501)	(2,638)	(7,313)
Fair value of plan assets at end of period	81,837	80,176	82,364
Funded status	2,513	(4,907)	1,074
Unrecognized net actuarial loss	(4,697)	4,284	(1,361)
Unrecognized prior service cost	-	(791)	(840)
Accrued pension liability	\$ (2,184)	\$ (1,414)	\$ (1,127)

The following table presents the amounts recognized in the Consolidated Balance Sheets:

	<b>PNM Plan</b>		<b>TNMP Plan</b>	
	<b>December 31,</b>		<b>December 31,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	(In thousands)			
Prepaid pension cost/(Accrued pension liability)	\$ 91,444	\$ 87,336	\$ (2,184)	\$ (1,127)
Additional minimum pension liability	(181,284)	(159,460)	-	-

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Intangible asset	2,293	2,610	-	-
Deferred tax asset	70,863	62,096	-	-
Additional minimum pension liability adjustment *	108,128	94,754	-	-
Net amount recognized	\$ 91,444	\$ 87,336	\$ (2,184)	\$ (1,127)

\* Included in accumulated other comprehensive income (loss).

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**December 31, 2005, 2004 and 2003**

The following table presents the components of PNM net pension cost/(income) recognized in the Consolidated Statements of Earnings:

<b>PNM Plan</b>	<b>Pension Benefits</b>		
	<b>Year Ended December 31,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	(In thousands)		
Service cost	\$ 1,907	\$ 3,524	\$ 5,189
Interest cost	30,267	29,891	28,089
Expected long-term rate of return on plan assets	(40,168)	(39,037)	(35,109)
Amortization of net loss	3,569	3,956	3,910
Amortization of prior service cost	317	317	317
Net pension cost/(income)	\$ (4,108)	\$ (1,349)	\$ 2,396

The following significant weighted-average assumptions were used to determine the PNM projected benefit obligation and net pension cost/(income):

<b>PNM Plan</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
Discount rate for determining projected benefit obligation at December 31	5.75%	6.00%	6.50%
Discount rate for determining net pension cost/(income)	6.00%	6.50%	6.75%
Expected long-term rate of return on plan assets	9.00%	9.00%	9.00%
Rate of compensation increase	N/A	N/A	N/A

The assumed discount rate for determining the projected benefit obligation of 5.75% at December 31, 2005 was determined based on a review of long-term high-grade bonds and management's expectations. The discount rate was reduced at December 31, 2005 and 2004 by 0.25% and 0.50% respectively, resulting in an increase in the PNM pension benefit obligation of approximately \$16.5 million and \$31.0 million at December 31, 2005 and 2004. Should actual experience differ from actuarial assumptions, the projected benefit obligation and net pension cost/(income) would be affected.

The expected long-term rate of return on plan assets of 9.0% at December 31, 2005 reflects the average rate of earnings expected on the funds invested, or to be invested, to provide for the benefits included in the PNM projected benefit obligations. Factors that are considered include, but are not limited to, historic returns on plan assets, current market information on long-term returns (e.g., long-term bond rates) and current and target asset allocations between asset categories. The target asset allocation is determined based on consultations with external investment advisors. The expected long-term rate of return assumption for the PNM pension plan compares to the actual return of 9.7% for the year ended December 31, 2005. If all other factors were to remain unchanged, it is expected that a 1% decrease in the expected long-term rate of return would cause PNM's 2006 net pension income to decrease approximately \$4.5 million (analogous change would result from a 1% increase).

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**December 31, 2005, 2004 and 2003**

The following table presents the components of TNMP net pension cost/(income) recognized in the Consolidated Statements of Earnings:

**TNMP Plan**

	Post- Acquisition June 6- December 31, 2005	Pension Benefits		
		Pre- Acquisition January 1- June 6, 2005	Pre- Acquisition Year Ended December 31, 2004	Pre- Acquisition Year Ended December 31, 2003
		(In thousands)		
Service cost	\$ 1,353	\$ 848	\$ 1,876	\$ 1,784
Interest cost	2,499	1,875	4,590	4,897
Expected long-term rate of return on plan assets	(4,155)	(2,387)	(6,040)	(6,960)
Amortization of prior service cost	-	(49)	(116)	(116)
Net pension benefit cost/(income)	\$ (303)	\$ 287	\$ 310	\$ (395)

The following significant weighted-average assumptions were used to determine the TNMP projected benefit obligation and net pension cost/(income):

**TNMP Plan**

	Post- Acquisition June 6- December 31, 2005	Pre- Acquisition January 1- June 6, 2005	Pre- Acquisition Year Ended December 31, 2004	Pre- Acquisition Year Ended December 31, 2003
Discount rate for determining projected benefit obligation at the end of the period	5.75%	5.25%	5.75%	6.00%
Discount rate for determining net pension cost/(income)	5.25%	5.75%	6.00%	6.50%
Expected long-term rate of return on plan assets	9.00%	7.80%	7.80%	8.50%
Rate of compensation increase	3.50%	3.50%	3.50%	3.50%

The assumed discount rate for determining the projected benefit obligation of 5.75% at December 31, 2005 was determined based on a review of long-term high-grade bonds and management's expectations. The discount rate was increased by 0.50% at December 31, 2005 over June 6, 2005, resulting in a decrease in the TNMP pension benefit obligation of approximately \$3.3 million at December 31, 2005. The discount rate was reduced at December 31 2004 by 0.25%, resulting in an increase in the TNMP pension benefit obligation of approximately \$1.7 million at December

31, 2004. Should actual experience differ from actuarial assumptions, the projected benefit obligation and net pension cost/(income) would be affected.

The expected long-term rate of return on plan assets of 9.0% at December 31, 2005 reflects the average rate of earnings expected on the funds invested, or to be invested, to provide for the benefits included in the TNMP projected benefit obligations. Factors that are considered include, but are not limited to, historic returns on plan assets, current market information on long-term returns (e.g., long-term bond rates) and current and target asset allocations between asset categories. The target asset allocation is determined based on consultations with external investment advisors. The expected long-term rate of return assumption for the TNMP pension plan compares to the actual return of 8.4% for the year ended December 31, 2005. If all other factors were to remain unchanged, it is expected that a 1% decrease in the expected long-term rate of return would cause TNMP's 2006 net pension income to decrease approximately \$0.8 million (analogous change would result from a 1% increase).

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At December 31, 2005 and 2004, the projected and accumulated benefit obligation for the PNM pension plan are the same, as the PNM pension plan was frozen in 1997, as discussed above. At December 31, 2005, the projected and accumulated benefit obligation for the TNMP pension plan are the same, as the TNMP pension plan was frozen in 2005. The following sets forth the pension plans' projected and accumulated benefit obligation and the fair value of plan assets at the pension plans' measurement date:

	<b>PNM Plan</b>		<b>TNMP Plan</b>	
	<b>December 31,</b>		<b>December 31,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	(In thousands)			
Projected benefit obligation	\$ 549,925	\$ 517,225	\$ 79,324	\$ 81,290
Accumulated benefit obligation	\$ 549,925	\$ 517,225	\$ 79,324	\$ 79,126
Fair value of plan assets	\$ 460,085	\$ 445,101	\$ 81,837	\$ 82,634

The following tables set forth the increase (decrease) in minimum liability, net of tax, included in other comprehensive income:

	<b>PNM Plan</b>		
	<b>Year Ended December 31,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	(In thousands)		
Included in other comprehensive income	\$ 13,376	\$ 21,539	\$ (13,972)

There were no amounts included in other comprehensive income for the TNMP plan for the years ended December 31, 2005, 2004 or 2003.

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**December 31, 2005, 2004 and 2003**

The following table outlines the asset allocations for the pension plans:

	<b>PNM Plan</b>		<b>TNMP Plan</b>	
	<b>December 31,</b>		<b>December 31,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Equity securities	60%	60%	66%	23%
Debt securities	23%	23%	24%	-
Real estate	6%	7%	-	-
Other	11%	10%	10%	77%
	100%	100%	100%	100%

The pension plans are currently targeting the following asset allocations for the year ended December 31, 2006:

	<b>PNM Plan</b>	<b>TNMP Plan</b>
Domestic equity	47.5%	47.5%
Non-US equity	10.0%	10.0%
Fixed income	22.5%	22.5%
Real estate	5.0%	5.0%
Private equity	5.0%	5.0%
Absolute return	10.0%	10.0%
	100%	100%

The following pension benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	<b>PNM Plan</b>	<b>TNMP Plan</b>
	(In thousands)	
2006	\$ 27,096	\$ 7,724
2007	\$ 27,939	\$ 7,346
2008	\$ 29,077	\$ 7,500
2009	\$ 30,507	\$ 7,901
2010	\$ 32,275	\$ 7,415
Years 2011 - 2015	\$ 188,000	\$ 35,957

*Other Postretirement Benefits*

For postretirement benefit plans, the benefit obligation is the “accumulated postretirement benefit obligation,” the actuarial present value as of a date of all future benefits attributed under the terms of the postretirement benefit plan to employee service rendered to that date.

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The following table presents a reconciliation of the beginning and ending balances of the accumulated postretirement benefit obligation and shows the change in the obligation:

	<b>PNM Plan</b>	
	<b>Year Ended December 31,</b>	
	<b>2005</b>	<b>2004</b>
	(In thousands)	
Benefit obligation at beginning of year	\$ 112,592	\$ 114,812
Service cost	2,764	2,286
Interest cost	6,765	6,941
Participant contributions	1,240	1,179
Amendments	8,641	(17,621)
Unrecognized actuarial loss	7,605	12,031
Benefits paid	(7,918)	(7,036)
Benefit obligation at end of year	\$ 131,689	\$ 112,592

	<b>TNMP Plan</b>		
	<b>Post- Acquisition June 6- December 31, 2005</b>	<b>Pre- Acquisition January 1- June 6, 2005</b>	<b>Pre- Acquisition Year Ended December 31, 2004</b>
	(In thousands)		
Benefit obligation at beginning of period	\$ 12,864	\$ 12,209	\$ 10,864
Service cost	290	195	411
Interest cost	376	282	679
Participant contributions	505	438	857
Amendments	517	-	-
Unrecognized actuarial loss	(817)	514	1,465
Benefits paid	(928)	(774)	(2,067)
Benefit obligation at end of period	\$ 12,807	\$ 12,864	\$ 12,209



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The following table sets forth the change in the value of plan assets for the years ended December 31, the plans' funded status and the accrued postretirement benefit obligation liability recognized in the Consolidated Balance Sheets:

	<b>PNM Plan</b>	
	<b>Year Ended December 31, 2005</b>	<b>2004</b>
	(In thousands)	
Fair value of plan assets at beginning of year	\$ 56,689	\$ 50,957
Actual return on plan assets	2,063	5,187
Employer contributions	6,410	6,402
Participant contributions	1,240	1,179
Benefits paid	(7,918)	(7,036)
Fair value of plan assets at end of year	58,484	56,689
Funded status	(73,205)	(55,902)
Unrecognized net actuarial loss	84,511	79,773
Unrecognized prior service cost	(27,993)	(42,924)
Accrued postretirement benefit obligation	\$ (16,687)	\$ (19,053)

	<b>TNMP Plan</b>		
	<b>Post- Acquisition June 6- December 31, 2005</b>	<b>Pre- Acquisition January 1- June 6, 2005</b>	<b>Pre- Acquisition Year Ended December 31, 2004</b>
	(In thousands)		
Fair value of plan assets at beginning of period	\$ 5,979	\$ 5,956	\$ 5,689
Actual return on plan assets	120	15	369
Employer contributions	786	344	1,099
Participant contributions	505	438	853
Benefits paid	(928)	(774)	(2,054)