9909160135 990902
PDR ADOCK 05000528
I PDR

TABLE *of* CONTENTS

ABOUT *the* COMPANY

PNM, the Public Service Company of New Mexico, is a combined electric and natural gas utility serving about 1.3 million people in New Mexico. The company also sells power on the wholesale market and offers energy-related services to a variety of customers in the U.S.

INVESTOR HIGHLIGHTS

Dollars in thousands, except per share amounts

	1998	1997	PERCENTAGE CHANGE	5-YEAR ANNUAL GROWTH RATE
Financial Data				
Operating Revenues	$1,092,445	$1,020,521	7.1%	4.6%
Operating Expenses	$ 956,796	$ 890,974	7.4%	5.3%
Operating Income	$ 135,649	$ 129,547	4.7%	0.4%
Retained Earnings	$ 186,220	$ 129,188	44.1%	N/M
Return on Average Common Equity	9.86%	10.24%	(3.7%)	N/M
Common Share Data				
Earnings (Basic)	$ 1.97	$ 1.92	2.6%	N/M
Earnings (Diluted)	$ 1.95	$ 1.91	2.1%	N/M
Book Value	$ 20.63	$ 19.26	7.1%	9.2%
Closing Price	$ 20.44	$ 23.69	(13.7%)	12.7%
Total Electric Customers	358,178	349,322	2.5%	2.7%
Total Gas Customers	419,002	410,438	2.1%	2.5%
Number of Employees	2,717	2,789	(2.6%)	0.7%

N/M = Not Meaningful

WITH SO MANY CUSTOMERS AND SHARE-HOLDERS COUNTING ON US, WE'RE DETER-MINED TO **solve** THE UNIQUE CHALLENGES WE FACE AND TO SUCCEED IN OUR CHANGING ENVIRONMENT.

9104601

To our shareholders,

employees, friends and customers:

Throughout 1998 and into 1999, PNM management has been building the framework for  a transition to customer choice in New Mexico's electric utility industry. We believe 1999 will mark a watershed between our past success as a traditional, regulated utility and our future as a competitive energy company.

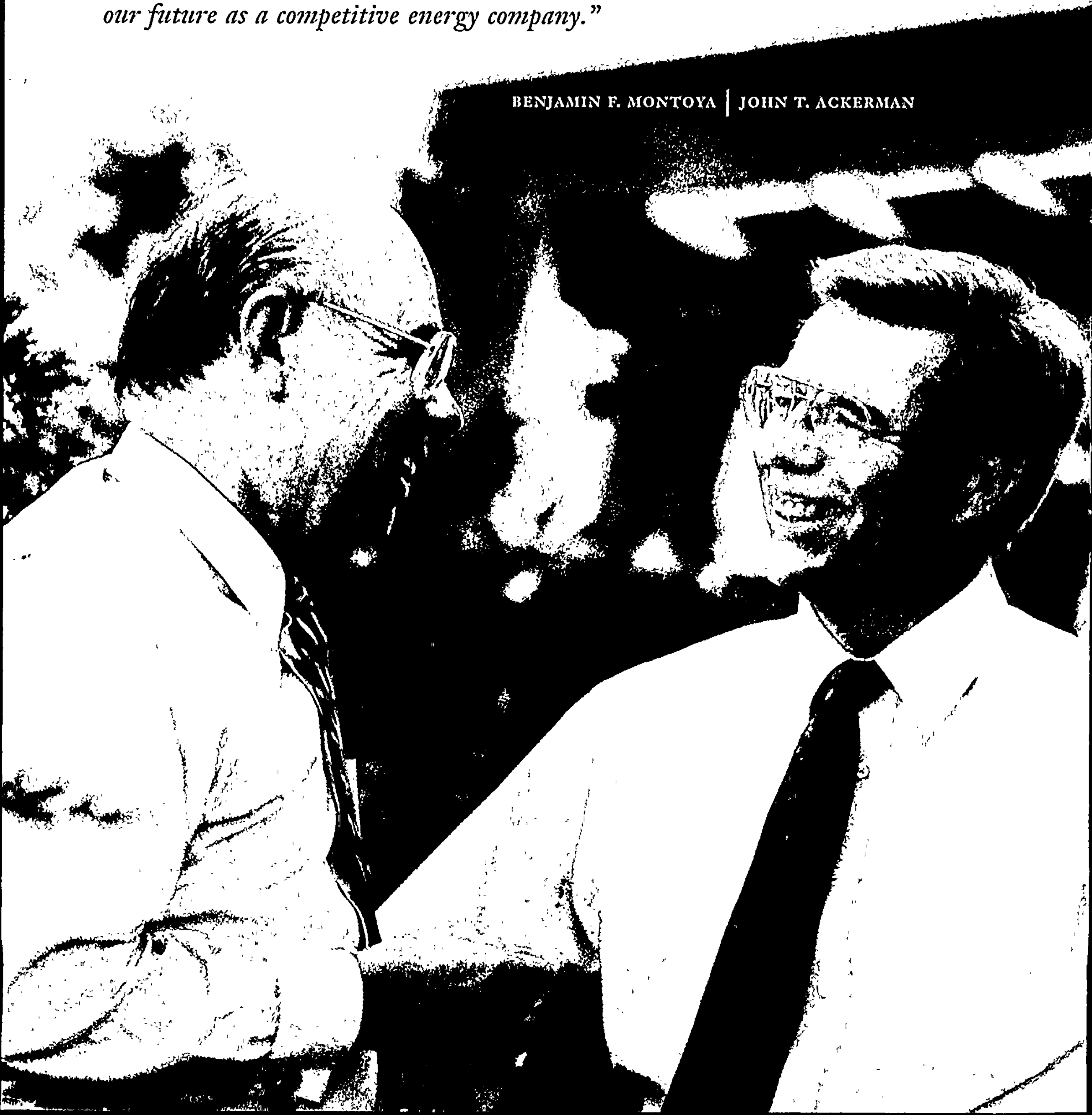
PNM revenues topped $1 billion for the second year in a row in 1998, while earnings per share of common stock increased from $1.92 in 1997 to $1.97 in 1998. Earnings from ongoing operations (not including one time or non-recurring gains or losses) rose nearly 13 percent last year, propelled by steady  growth in our service territory and increased sales in the wholesale power market. This kind of success is dependent on many factors, including weather conditions, supply and demand, and legislative and regulatory actions.

Although net earnings reached their highest level in more than a decade in 1998, PNM stock performance did not reflect the company's growing profitability. We believe this was primarily because of investors' concern over the uncertainty surrounding electric industry restructuring in New Mexico.

In 1998, PNM settled numerous gas regulatory cases pending before the state Public Utility Commission (PUC). As a result, we were able to streamline procedures, reduce operating costs, allow for the recovery of other gas service costs, and validate PNM's gas purchasing and gas measurement procedures. The progress achieved in 1998 sets the stage for collaborative development of new tariffs, rules and operating procedures to improve PNM customer services and better support competition in natural gas markets.

Unfortunately, similar progress toward customer choice in the electric power market was hindered by two decisions  issued by the PUC at the end of 1998. One of these orders would have forced a drastic cut in PNM's electric rates.

"We believe 1999 will mark a watershed between our past success as a traditional, regulated utility and our future as a competitive energy company."



BENJAMIN F. MONTOYA | JOHN T. ACKERMAN

In the second, related order, the outgoing commissioners attempted to impose their own version of competition on the state's utility industry without the necessary changes in state law.

The state Supreme Court has overturned both these ill-considered decisions. The new Public Regulation Commission, which replaced the PUC at the  beginning of 1999, is reconsidering the electric rate case. In these proceedings, we will recommend a rate reduction that benefits customers without undermining PNM's ability to continue providing reliable, efficient service.

Even more important to PNM's future is the electric industry restructuring bill passed by the New Mexico Legislature in March 1999. If signed into law by the governor, we believe this legislation can  serve as a sound basis for encouraging competition in the retail electric power market in coming years. The new law, however, only partially resolves the question of how to treat the investment shareholders have made to serve customers under the traditional regulation system. The legislation provides for recovery of at least half of these "stranded costs" and permits regulators to authorize the recovery of more if the company can meet certain criteria.

PNM will continue to vigorously advocate  fair treatment for shareholders in the transition to a competitive market. Our commitment to customer choice remains undiminished. Our resolve to defend the interests of PNM shareholders is steadfast.

Sincerely,

J. T. Ackerman

John T. Ackerman
Chairman of the Board

Benjamin F. Montoya
President & Chief Executive Officer

Answers aren't always obvious,

but they're always there.

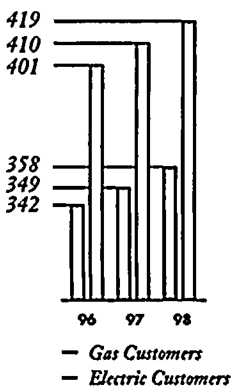
The 1990s have been a challenging decade for electric and natural gas utilities, as the industry has found the change from regulated monopoly to competition to be a slower, more complex, and less predictable process than originally anticipated. PNM has navigated the choppy seas of change in our industry by remaining true to a strategic plan that concentrates management's attention on those business activities where we enjoy a clear competitive advantage. Most of all, we have been uncompromising in our focus on growing shareholder value by controlling costs and improving productivity.

Coupled with above average growth in our home territory, the result has been an increase in both revenues and profitability over the past five years. Net earnings from continuing operations increased from $80.3 million in 1994 to $95.1 million in 1998.

STEADY GROWTH *in our* CORE BUSINESS

New Mexico has grown at about twice the national average throughout the 1990s. That growth has been reflected in PNM's sales of electricity and natural gas. In 1998, PNM added 8,101 new residential electric customers and 8,260 new residential gas customers, a growth rate of about 2.4 percent. The New Mexico economy is expected to continue to grow at a moderate pace in 1999, with job growth projected to continue at or above the national average over the next three to four years.

To accommodate that growth while keeping costs low, PNM is constantly in search of new operating efficiencies. To streamline the process of adding customers to the PNM electric and gas systems, we are combining all related service functions in a team approach that speeds the installation of new lines, saves money, and improves customer satisfaction.



TOTAL CUSTOMERS (IN THOUSANDS)

The company added about 8,800 electric and 8,500 new gas customers in 1998. PNM's customer expansion has been fueled by the growth of the economy in New Mexico.

“Trees are living structures, and we do have stewardship in mind.

We acknowledge the important balance between reliable

electric service and healthy trees in the community.”

PEGGY JELEN & THADDEUS PETZOLD | *PNM vegetation management*

"People say, 'We've always done it this way.'

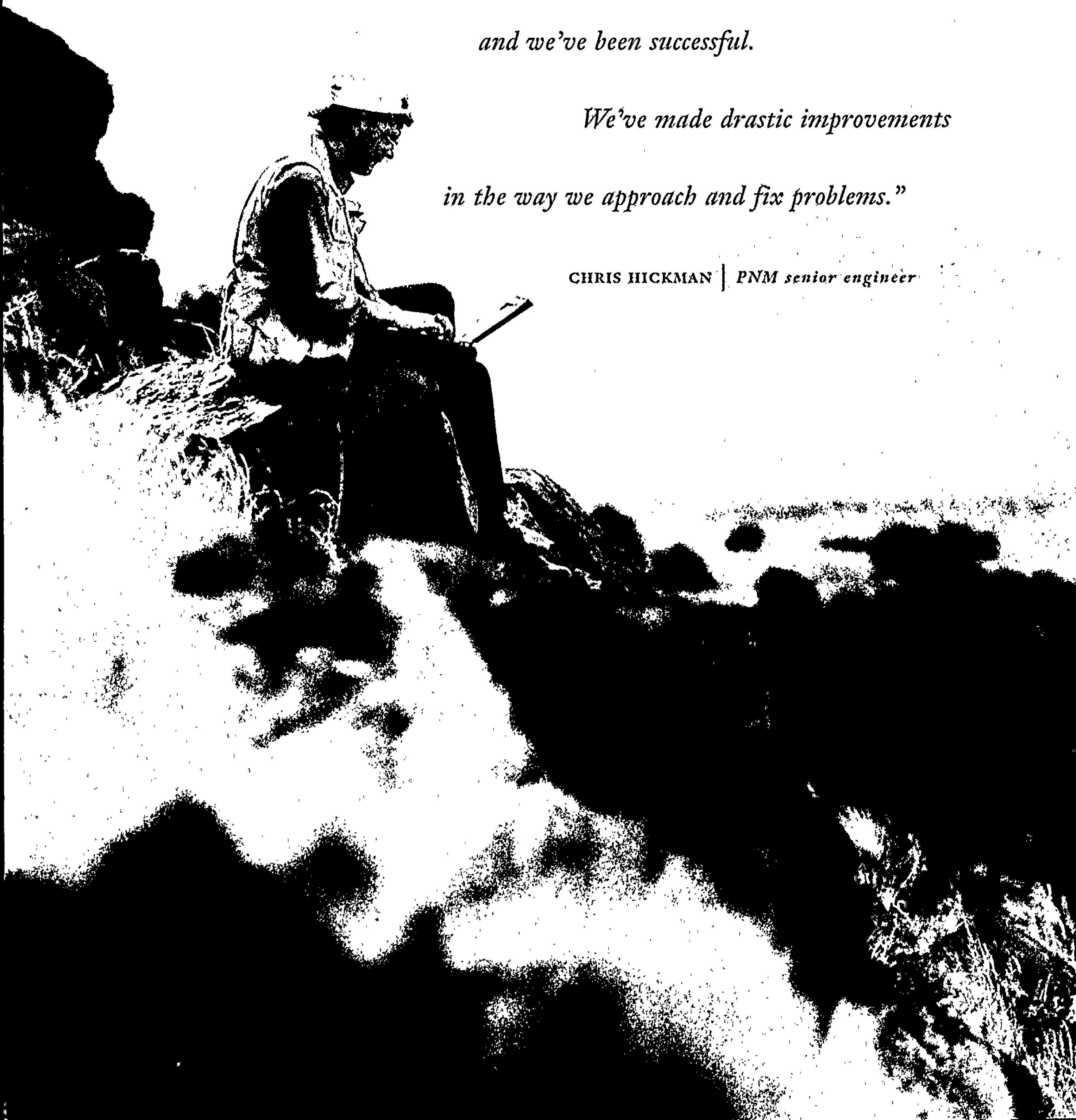
But we've shattered that mold

and we've been successful.

We've made drastic improvements

in the way we approach and fix problems."

CHRIS HICKMAN | *PNM senior engineer*



An obstacle is simply
an opportunity in work clothes.

To maintain electric reliability in coming years, PNM has committed to buying power from a new, 132-megawatt power plant now under construction in Albuquerque. That new plant is expected to be completed in May of 2000. To maintain and increase gas service reliability throughout the state, PNM invested $14 million in transmission and distribution pipeline systems in 1998.

SUCCESS *in the* WHOLESALE POWER MARKET

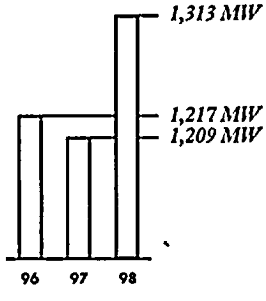
While retail power sales in PNM's home territory have grown at a compound annual rate of about 3.2 percent over the last five years, the company's wholesale power business has more than doubled. Wholesale sales were up nearly 30 percent in 1998, exceeding PNM retail electric sales for the second year in a row. Wholesale profit margins also increased, making our power trading operation an important contributor to both revenues and earnings. With strategically located power plants and more than 15 years experience in the wholesale power market, PNM is well positioned for this intensely competitive business.

Continued success in both wholesale and retail markets depends in large part upon our ability to drive down costs. Over the last several years PNM has reduced power costs through revised fuel contracts and more efficient operations at San Juan Generating Station, a 1,614 MW coal-fired plant operated by PNM. In 1998 we completed installation of a new pollution control system at San Juan that will save PNM $10 million a year. Compared to the system it replaced, the new process not only reduces sulfur dioxide emissions and cuts the plant's wastewater output by half, but also boosts available power production from the plant.

Palo Verde Nuclear Generating Station has also reported considerable progress in cutting costs and improving efficiency.

SYSTEM PEAK

The company's system peak load was 1,313 MW in 1998, the highest in PNM's 82-year history. Retail electric sales have grown nearly three times the national average over the past three years.



The power of the mind

is the greatest renewable resource.

In 1998, for the fourth consecutive year, Palo Verde shattered the U.S. power production record, producing more than 30.2 billion kilowatt-hours of electricity.

APPLYING NEW TECHNOLOGY *to* BETTER SERVE CUSTOMERS

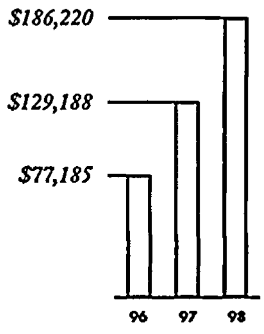
Lower costs are a key ingredient for success in competitive markets. But as choice comes to the utility industry, customers will demand more from their energy company than low prices. They will want fast, efficient service, convenience, and access to the information they need to manage their energy needs.

To meet those needs, PNM is investing in the latest information technology in the service of its customers. At the end of 1998, the company deployed a new, $35 million billing and customer service system, combining electric and gas accounts into a single integrated database capable of providing the detailed billing information customers will want in a competitive market. PNM expects the new system will be fully operational this year.

Electronic commerce will play a crucial role in the new market place, and PNM is moving to meet that demand as well. Our new Energy Net allow customers to access their billing information over the Internet. For residential customers this information includes past year usage and payment history and usage charts as well as a current online version of their bill. For commercial customers, consumption and revenue history is displayed and charted. Although the electronic bill has not yet replaced customers' paper bills, sometime this year we expect to begin accepting payments and processing transactions over the Internet.

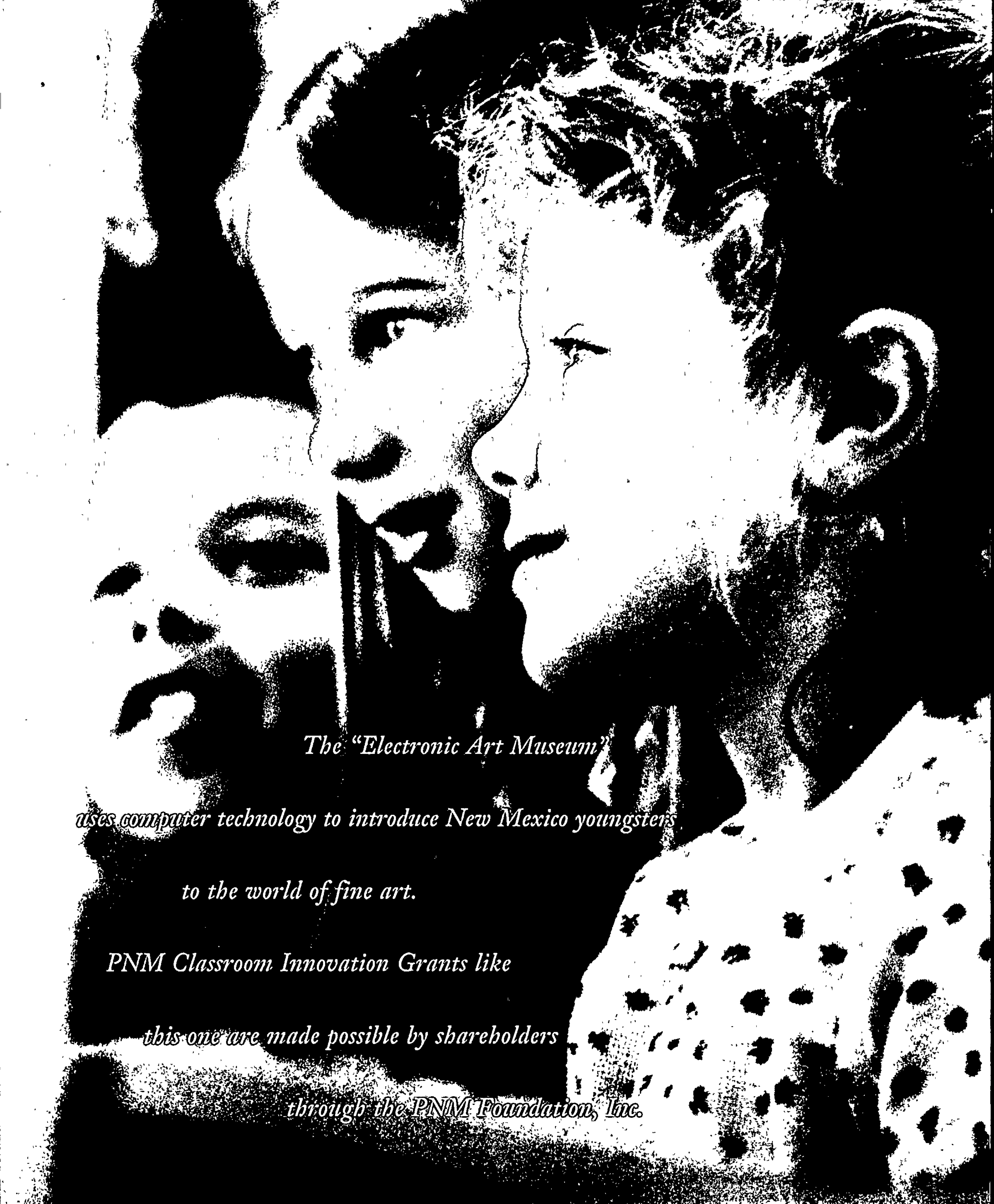
the YEAR 2000 CHALLENGE

Because today's power plants and electric and gas systems rely on computers, there is a possibility of service interruptions if critical systems are not upgraded or replaced in time for the



RETAINED EARNINGS (IN THOUSANDS)

Retained Earnings were $186,220 in 1998, the highest level in over 10 years, positioning PNM to take advantage of growth opportunities in the future.



The "Electronic Art Museum" uses computer technology to introduce New Mexico youngsters to the world of fine art. PNM Classroom Innovation Grants like this one are made possible by shareholders through the PNM Foundation, Inc.

"With Pathways Integration,

we've been able to formulate a relationship on a personal

level to address the needs of the tribe."

BRUCE SANCHEZ | *santa ana pueblo governor*

Experience is a power line
from the past to the future.

changeover from 1999 to 2000. PNM expects to spend about $20 million to check and if necessary correct its systems. Our goal is to make all critical systems Year 2000 compliant by mid-1999. We are also working with other utilities, power providers and large customers where there is a risk that malfunction of those related systems might adversely impact PNM's operations.

NEW OPPORTUNITIES *in* NEW MARKETS

As the electric and gas utility industry moves toward open competition, new business opportunities are arising to help customers conserve energy, save money, and better manage their power consumption. Two separate PNM initiatives are aimed at entering these new markets. One is in the newly deregulated California market, where we are installing and maintaining a new generation of high-tech electric meters for utilities and larger power customers.

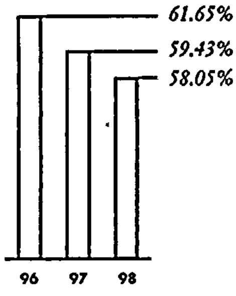
The second project builds on PNM's experience in the design, maintenance and operation of municipal water systems as well as electric and gas distribution systems. PNM Pathways Integration is now providing infrastructure development support for Native American pueblos and tribes in New Mexico.

A *stronger* PNM

Revenue growth and strong cash flow over the last several years, coupled with declining interest rates, have allowed PNM to pursue an aggressive strategy of paying down or refinancing long-term, high-cost debt. In 1998, PNM retired $140 million in mortgage debt and replaced another $463 million of mortgage debt with unsecured notes, backed by the company's overall credit. At the same time PNM arranged a new line of credit to meet short-term financing needs.

DEBT TO CAPITAL RATIO (WITH LEASES)

The company concluded a five-year debt refinancing and restructuring program that resulted in a stronger balance sheet and improved financial position. PNM's goal is reinstatement of an investment grade credit rating for all of the company's debt.



PNM, working toward
real solutions.

The new financial structure provides more flexibility in meeting future financial requirements and positions the company to respond effectively to changes in our industry in coming years.

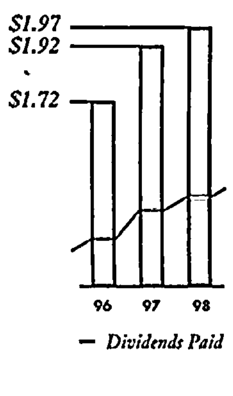
REDEFINING OUR COMPANY *and* OUR INDUSTRY

For the past five years, PNM has been preparing to succeed in a new, competitive energy industry. Our strategy is based on a realistic appraisal of our company's strengths and the opportunities before us.

As our industry moves to open markets, our experience, specialized skills, and strategic position can enable PNM to be a successful "niche player" in the wholesale power market. In distribution, there will be a continuing role for combined electric and gas utilities like PNM, capable of providing efficient, cost-effective service to customers in their local service territories. Continuing cost control and solid operating performance will also help maintain power production as a source of PNM revenues and earnings.

In all areas of our business, the ability to respond quickly to changing market conditions that distinguishes a smaller, more flexible organization will enable us to seek out new sources of revenues and earnings as the market evolves.

In 1999 and in coming years, PNM will have to continue to redefine itself, making tough economic decisions on the markets it will serve and the very shape the company takes. We will continue to serve as a leading advocate for change that benefits all customers, gives our employees the opportunity to succeed, and provides our shareholders a competitive return on their investment.



EARNINGS PER SHARE OF COMMON STOCK

Basic earnings per share were $1.97 in 1998, the highest in 10 years. Since reinstatement of the company's common stock dividend in 1996, the dividend payout ratio has grown almost 20%.

FINANCIAL SECTION - TABLE *of* CONTENTS

PNM considers this annual report to contain "forward-looking statements" under Federal securities law. It is published to assist shareholders in evaluating PNM and its securities. This report does not contain all of the information material to an evaluation and should be read in conjunction with the reports, proxy statements, and other information PNM files with the Securities and Exchange Commission. Please refer to page 28, "Disclosure Regarding Forward-Looking Statements," for a listing of the factors which could cause the Company's actual financial results to differ materially from those forecasted by the Company in forward-looking statements.

Year 2000 Readiness Disclosure

The Year 2000 statements in "The Year 2000 Challenge" section on page 8 are Year 2000 Readiness Disclosures pursuant to the Year 2000 Information and Readiness Disclosure Act, Pub. L. No. 105-271, 112 Stat. 2386 (1998).

SELECTED FINANCIAL DATA

	1998	1997	1996	1995	1994
	(In thousands except per share amounts and ratios)				
Total Operating Revenues	$1,092,445	$1,020,521	$ 873,778	$ 808,465	$ 904,711
Earnings from Continuing Operations	$ 95,119	$ 86,497	$ 72,969	$ 75,562	$ 80,318
Net Earnings	$ 82,682	$ 80,995	$ 72,580	$ 75,562	$ 80,318
Earnings per Common Share:					
Continuing Operations	$ 2.27	$ 2.05	$ 1.73	$ 1.72	$ 1.77
Basic	$ 1.97	$ 1.92	$ 1.72	$ 1.72	$ 1.77
Diluted	$ 1.95	$ 1.91	$ 1.71	$ 1.72	$ 1.77
Total Assets	$2,576,788	$2,320,555	$2,230,314	$2,035,669	$2,203,265
Preferred Stock with Mandatory Redemption Requirements	-	-	-	-	$ 17,975
Long-Term Debt, including Current Maturities	$1,008,614	$ 714,345	$ 728,889	$ 728,989	$ 900,595
Common Stock Data:					
Market price per common share at year end	$ 20.438	$ 23.688	$ 19.625	$ 17.625	$ 13.000
Book value per common share at year end	$ 20.63	$ 19.26	$ 18.06	$ 16.82	$ 15.11
Average number of common shares outstanding	41,774	41,774	41,774	41,774	41,774
Cash dividend declared per common share	$ 0.60*	$ 0.68	$ 0.48	-	-
Return on Average Common Equity	9.9%	10.2%	9.8%	10.7%	12.4%
Capitalization:					
Common stock equity	45.4%	52.6%	50.4%	48.6%	39.2%
Preferred stock:					
Without mandatory redemption requirements	0.7	0.8	0.9	0.9	3.7
With mandatory redemption requirements	-	-	-	-	1.1
Long-term debt, less current maturities	53.9	46.6	48.7	50.5	56.0
	100.0%	100.0%	100.0%	100.0%	100.0%

** On January 18, 1999, the Company's Board of Directors declared a quarterly cash dividend of 20 cents per share of common stock payable February 19, 1999, to shareholders of record as of February 1, 1999.*

Due to the discontinuance of the natural gas trading operations of its Energy Services Business Unit (see note 12 of the notes to consolidated financial statements), certain prior year amounts have been restated.

The selected financial data should be read in conjunction with the consolidated financial statements, the notes to consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

MANAGEMENT'S DISCUSSION *and* ANALYSIS *of* FINANCIAL CONDITION *and* RESULTS *of* OPERATIONS

The following is management's assessment of the Company's financial condition and the significant factors affecting the results of operations. This discussion should be read in conjunction with the Company's consolidated financial statements.

OVERVIEW

Restructuring the Electric Utility Industry

Introduction of competitive market forces and restructuring of the electric utility industry in New Mexico continue to be key issues facing the Company. During 1998, in conjunction with the electric rate case, the Company and other interested parties put significant efforts into negotiating a settlement agreement which would have resolved the rate case and produced a proposal for legislation for open access and electric competition for the Company's customers (see "Electric Rate Case" below). However, efforts failed due to various unresolved issues among the parties.

Senator Michael Sanchez, chairman of the New Mexico Legislative Interim Committee on Utilities and Telecommunications, introduced a senate bill, Electric Industry Restructuring Act of 1999, in the 1999 New Mexico Legislature on February 5, 1999. The bill includes provisions for the protection of the residential and small business customers during the transition period and also includes provisions to preserve the financial integrity of the state's electric utilities by giving reasonable opportunity to recover stranded costs. (See "ELECTRIC INDUSTRY RESTRUCTURING ACT OF 1999" below.)

At the Federal level, there are a number of proposals on electric restructuring being considered with no concrete timing for definitive actions. It is expected that previously introduced restructuring bills will be reintroduced this year. Issues such as stranded cost recovery, market power, utility regulations reform, the role of states, subsidies, consumer protections and environmental concerns are expected to be at the forefront of the Congressional debate. In addition, the Federal Energy Regulatory Commission ("FERC") has stated that if Congress mandates electric retail access, it should leave the details of the program to the states and the FERC has the authority to order the necessary transmission access for the delivery of power for the states' retail access programs.

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

Competitive Strategy

The restructuring of the electric utility industry will provide new opportunities; however, the Company anticipates that it will experience downward pressure on the Company's utility earnings from their current levels. The reasons for the downward pressure include possible limits on return on equity, disallowance of some stranded costs and the potential loss of certain customers in a competitive environment.

To better position itself for competition, the Company adopted a new internal corporate structure in January 1999. With the new corporate structure, the regulated businesses will be separated from the other business activities which the Company anticipates will be unregulated in the future. The Company's realignment of its business structure was approved by the Company's Board of Directors ("Board") in January 1999. If the Electric Industry Restructuring Act of 1999 is passed, the Company is planning to seek shareholder and other regulatory approvals to form a holding company by January 2001. Under a holding company structure, the regulated businesses (natural gas and electric transmission and distribution) will be grouped under a separate company (wires and pipes company) and would focus on the core utility business in New Mexico. The proposed unregulated businesses (power production, bulk power marketing and energy services) would

aggressively pursue their efforts to expand energy marketing and utility related businesses into carefully targeted markets in an effort to increase shareholders' value. The Company believes that successful operations of its proposed unregulated business activities under a holding company structure will better position the Company in an increasingly competitive utility environment.

The Company's bulk power operations have contributed significant earnings to the Company in recent years as a result of increased off-system sales due, in part, to favorable weather conditions experienced in the Southwest. The Company plans to expand its wholesale power trading functions which could include an expansion of its generation portfolio. The Company continuously evaluates its physical asset acquisition strategies to ensure an optimal mix of base-load generation, peaking generation and purchased power in its power portfolio. Under the proposed senate bill, the generation assets of the Company's electric operations would be separated from the regulated businesses. Depending upon the aspects of the legislation that are ultimately enacted into law, an expansion of the Company's generation assets might occur without a regulatory approval process. In addition to the continued power trading operations, the Company will further focus on opportunities in the market place where excess capacity is disappearing and mid- to long-term market demands are growing.

The Company's competitive businesses, through its Energy Services Business Unit, will continue to seek opportunities in the area of water and wastewater management services and utility related management and operations services for Federal installations and other large commercial institutions. In order to focus on profitable ventures, the Company made a decision to exit the unsuccessful natural gas trading business in August 1998 and completely disposed of its natural gas trading operations in December 1998. The Company's Energy Services Business Unit currently operates the City of Santa Fe's water system and is expanding such services to other communities, including Indian tribes. The Company is expanding its utility related services such as providing metering services, energy and process optimization solutions and energy consulting services in the deregulated energy markets in the Southwest. The Company is also pursuing business opportunities to serve mid-sized utilities, including cooperatives, municipalities and others with cost effective billing and collection services. The Company intends to move forward during the interim period to form and invest in the three wholly-owned subsidiaries to achieve competitive business strategies. The Company does not anticipate an earnings contribution from its Energy Services Business Unit over the next few years.

LIQUIDITY AND CAPITAL RESOURCES

Capital Requirements and Liquidity

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 construction program is upgrading generating systems, upgrading and expanding the electric and gas transmission and distribution systems and purchasing nuclear fuel. Total capital requirements and construction expenditures for 1998 were $161.6 million and $128.8 million, respectively. Projections for total capital requirements and construction expenditures for 1999 are $176 million and $145 million, respectively. Such projections for the years 1999 through 2003 are $769 million and $609 million, respectively. These estimates are under continuing review and subject to on-going adjustment.

The Company's construction expenditures for 1998 were entirely funded through cash generated from operations. The Company currently anticipates that internal cash generation will be sufficient to meet capital requirements for the years 1999 through 2003. 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 liquidity arrangements.

At the end of February 1999, the Company had $405 million of available liquidity arrangements, consisting of $300 million from a senior unsecured revolving credit facility ("Credit Facility"), $80 million from an accounts receivable securitization and $25 million in local lines of credit. The Credit Facility will expire in March 2003.

As of December 31, 1998, the Company had approximately $61.3 million in cash and temporary investments and $26.6 million in short-term borrowings.

Financing Capability

The Company's ability to finance its construction program at a reasonable cost and to provide for other capital needs is largely dependent upon its ability to earn a fair return on equity, results of operations, credit ratings, regulatory approvals and financial market conditions. Financing flexibility is enhanced by providing a high percentage of total capital requirements from internal sources and having the ability, if necessary, to issue long-term securities, and to obtain short-term credit. Standard & Poor's Corp. and Moody's Investors Services, Inc. currently maintain the Company's credit ratings at one level below investment grade. Duff & Phelps Credit Rating Co. currently maintains an investment grade rating for the Company's first mortgage bonds, but continues to rate all other securities of the Company below investment grade. The Company may face limited credit markets and higher financing costs as a result of its securities being rated below investment grade. As a result of the recently issued unfavorable New Mexico Public Utility Commission ("NMPUC") orders which have been appealed to the New Mexico Supreme Court ("Supreme Court") (see "Electric Rate Case" and "Residential Electric, Incorporated ("REI")" in NMPUC REGULATORY ISSUES below), the major rating agencies put the Company on a credit watch list for a possible downgrade.

Covenants in the Company's Palo Verde Nuclear Generating Station ("PVNGS") Units 1 and 2 lease agreements limit the Company'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. The Facility imposes similar restrictions regardless of credit ratings.

Financing Activities

By written consents executed in March 1998, the holders of more than 75% of the outstanding first mortgage bonds approved certain revisions to the mortgage to allow the Company more flexibility with respect to property releases, as well as with respect to covenants and administrative requirements under the mortgage. In March 1998, the Company replaced the first mortgage bonds collateralizing $463 million of tax-exempt pollution control revenue bonds ("PCBs") with senior unsecured notes ("SUNs") which were issued under a new senior unsecured note indenture. Also, in March 1998, the Company retired $140 million principal amount of first mortgage bonds. While first mortgage bonds continue to serve as collateral for PCBs in the outstanding principal amount of $111 million, the lien of the mortgage was substantially reduced to cover only the Company's ownership interest in PVNGS.

Coincident with the above transactions, the Company established a five-year, $300 million Credit Facility to replace the Company's $100 million secured revolving credit facility. Funds borrowed through this Credit Facility were used to retire the $140 million principal amount of first mortgage bonds.

In August 1998, the Company issued and sold $435 million of SUNs in two series. Approximately $420 million from the proceeds from the sale of the SUNs were loaned to PVNGS Capital Trust ("Capital Trust"), a special purpose entity established in August 1998, for the purpose of purchasing PVNGS lease debt ("Lease Debt") held by the Company as well as Lease Debt publicly held. The Capital Trust currently holds all the outstanding Lease Debt, and all the publicly-held lease obligation bonds have been retired. As a result, the Company received approximately $288 million from Capital Trust for its investment in Lease Debt and paid off its outstanding short-term debt. In addition, the Company invested approximately $13.4 million in Capital Trust in August 1998.

In 1999, the Company intends to request New Mexico Public Regulation Commission ("PRC") authority to issue $11.5 million in tax-exempt PCBs in connection with the retrofit of the pollution control facilities at the San Juan Generating Station ("SJGS").

The Company currently has no other requirements for long-term financings during the period of 1999 through 2003. However, during this period, the Company could enter into long-term financings for the purpose of strengthening its balance sheet and reducing its cost of capital. The Company continues to evaluate its investment and debt retirement options to optimize its financing strategy and earnings potential. No additional first mortgage bonds may be issued under the Company's mortgage. The amount of SUNs

that may be issued is not limited by the SUNs indenture. However, debt to capital requirements in certain of the Company's financial instruments would ultimately restrict the Company's ability to issue SUNs.

Dividends

The Company resumed the payment of cash dividends on common stock in May 1996. The Company's board of directors reviews the Company's dividend policy on a continuing basis. The declaration of common dividends is dependent upon a number of factors including earnings and financial condition of the Company, the Supreme Court's decisions on the Company's various regulatory cases currently pending (see "NMPUC REGULATORY ISSUES" below) and market conditions.

Capital Structure

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

	1998	1997	1996
Common Equity	45.4%	52.6%	50.4%
Preferred Stock	0.7	0.8	0.9
Long-term Debt	53.9*	46.6	48.7
Total Capitalization**	100.0%	100.0%	100.0%

* *Increase was due to the issuance of $435 million of SUNs in August 1998.*

** *Total capitalization does not include as debt the present value ($161 million as of December 31, 1998) of the Company's lease obligations for PVNGS Units 1 and 2 and EIP.*

RESULTS OF OPERATIONS

Basic earnings per share from continuing operations were $2.27, a 10.7 percent increase over the $2.05 earned in 1997 and a 31.2 percent increase over the $1.73 earned in 1996. Total basic earnings per share including discontinued operations were $1.97, $1.92 and $1.72 for 1998, 1997 and 1996, respectively.

Continuing Operations

Electric gross margin (operating revenues less fuel and purchased power expense) increased $38.2 million in 1998 over 1997 as a result of the success in wholesale power marketing operations. Electric gross margin for 1997 increased $20.1 million over 1996 as a result of retail load growth and increased wholesale marketing activities. Wholesale power sales exceeded retail sales for the second year in a row in 1998. Sales for resale totaled 8.8 million MWh in 1998, up approximately 2.0 million MWh over 1997 and 4.2 million MWh over 1996. An unusually hot summer in Arizona and California contributed, in part, to the profitable bulk power operations in 1998; however, the success of the Company's bulk power operation was also attributable to the location of the Company's assets in the Southwest. The favorable results of the Company's bulk power operations are not necessarily indicative of future operating results.

Gas gross margin (operating revenues less gas purchased for resale) decreased $3.8 million in 1998 from 1997 as a result of warmer weather conditions in 1998. Such margin increased $1.3 million in 1997 over 1996 due to the implementation of a higher fixed monthly customer charge (access fee) in February 1997 pursuant to a gas rate order.

Other operation and maintenance ("O&M") expenses increased $23.9 million in 1998 over 1997 due to: (i) the recording of expenses associated with PVNGS spent fuel disposal costs; (ii) increased maintenance activities at SJGS; (iii) increased 401(k) benefit expense; (iv) increased O&M expense for Energy Services; and (v) increased expenses associated with the Year 2000 program. Such O&M expenses in 1997 increased $9.4 million over 1996 due to: (i) a write-off of obsolete inventory and undistributed stores expense at PVNGS; (ii) higher distribution expense for increased maintenance and service enhancement efforts; (iii) increased customer service related and sales expense; and (iv) a severance accrual at the SJGS.

Depreciation and amortization expenses increased $3.4 million in 1998 due to increased utility plant and a write-off of certain unamortized computer software costs. Such expenses increased $4.6 million in 1997 as

a result of additional utility plant and an adjustment recorded in 1996 for the over amortization of certain intangible utility plant.

Net other income and deductions increased $9.5 million over a year ago as a result of the investment income from Capital Trust, proceeds from a litigation settlement and the reversal of a gas rate case reserve. Net other income and deductions in 1997 increased $11.9 million over 1996 due to higher interest income from the investment in PVNGS Lease Obligation Bonds ("PVNGS LOBs") and a 1996 reserve for matters related to a gas rate case, offset by a curtailment gain resulting from the change in the Company's pension plan in 1996.

Net interest charges increased $7.0 million in 1998 due to the issuance of $435 million of SUNs and increased short-term borrowings for the retirement of $140 million of first mortgage bonds. Net interest charges for 1997 increased $1.5 million over 1996 due to short-term borrowings for the purchase of the $200 million of PVNGS LOBs in late 1996.

Discontinued Operations

On August 4, 1998, the Company adopted a plan to discontinue the gas trading operations in its Energy Services Business Unit. The gas trading business was completely disposed of by the end of 1998. Accordingly, the Company recorded a loss of $5.1 million, net of tax. In addition, losses from operations of the discontinued segment, net of tax were $7.4 million in 1998 compared to $5.5 million in 1997. (See note 12 of the notes to consolidated financial statements.)

OTHER ISSUES *facing the* COMPANY

ELECTRIC INDUSTRY RESTRUCTURING ACT OF 1999

Senate Bill 428, sponsored by Senator Michael Sanchez, was introduced in the 1999 New Mexico Legislature on February 5, 1999. Under the proposed bill, customer choice of power supplier would be available to schools, residential customers and small business customers in New Mexico beginning January 1, 2001, and to all customers beginning January 1, 2002. Transmission and distribution services along with related services such as meter reading and billing would remain subject to the PRC jurisdiction. This bill would not require a public utility to divest itself of any of its assets owned or leased. However, before January 1, 2001, a public utility would be required to organize into at least two corporations, dividing regulated from unregulated services through either the creation of separate affiliated companies under a holding company or through the creation of separate non-affiliated corporations.

If enacted, the bill would require all public utilities operating in New Mexico to submit a transition plan to the PRC no later than March 1, 2000, to be approved no later than December 1, 2000. The transition plan would include proposed tariffs for transmission and distribution services, together with proposed standard offer service tariffs for residential and small business customers who do not select a power supplier. The plan would also include proposals for effectively separating the utilities' regulated and non-regulated business activities.

The bill recognizes that electric utilities should be permitted a reasonable opportunity to recover an appropriate amount of the costs incurred previously in providing electric service ("stranded costs"). Stranded costs include plant decommissioning costs, regulatory assets, lease and lease-related costs and other costs recognized under cost-of-service regulation. Utilities would be allowed to recover no less than 50 percent of such costs through a nonbypassable charge on all customer bills for five years after implementation of customer choice. The PRC could authorize a utility to recover up to 100 percent of its stranded costs if the PRC finds that recovery of more than 50 percent: (i) is in the public interest; (ii) is necessary to maintain the financial integrity of the public utility; (iii) is necessary to continue adequate and reliable service; and (iv) will not cause an increase in rates to residential or small business customers during the transition period. Utilities would also be allowed to recover in full any costs incurred in implementing full open access ("transition costs"). Those transition costs would be recovered through 2007 by means of a separate wires charge. Due to uncertainties in the bill regarding the amounts of recovery and calculation of stranded costs, the Company is currently unable to determine what financial impact the bill, if enacted, will have on the Company.

Other significant provisions of the bill include: (i) customers would be allowed to prepay their allotted share of stranded costs prior to the implementation of choice for that customer class; (ii) the PRC would adopt and enforce codes of conduct to protect customer privacy and prevent such anticompetitive practices as cross-subsidization or favoritism of non-regulated energy suppliers by regulated affiliates; and (iii) a system benefit charge of $0.0003 per KWh would be added to customer bills to fund no less than $500,000 annually for low income energy assistance programs, and no more than $4 million a year for renewable energy projects, in addition to other public interest programs. The bill provides for penalties of up to $2 million for each violation of the Act. The bill also requires licensing for competitive power suppliers, which is defined to include providers of energy-related services.

The Company's primary concerns with the proposed bill revolve around the treatment of stranded cost recovery. The Company intends to work with the bill's sponsor, interested parties, and the Legislature as a whole to address its concerns and to maximize the chances for passage of restructuring legislation which is beneficial to the State as a whole. It is the Company's position that this bill goes a long way in properly balancing the interests involved; and, in that respect, provides a good vehicle for the passage of restructuring legislation in this session.

On February 28, 1999, the full Senate passed the bill with various amendments by a vote of 32-6. The Bill has been assigned to both the Business and Industry Committee and the Appropriation and Finance Committee in the State House of Representatives ("House") for consideration. The House has a similar competing bill, House Bill 865, that has been assigned to the House Judiciary Committee and the House Appropriation and Finance Committee. No hearings have been scheduled on House Bill 865. The most significant difference between the two bills is the size of the proposed subsidy for renewable energy technology. The House bill earmarks approximately $20 million a year for renewable technology, compared to $4 million designated in Senate Bill 428. However, it is likely that, like the Company, other parties will continue to seek to amend various provisions of the bill. Given the Legislature's past reluctance to implement retail competition, the Company is unable to predict whether or not legislation will pass or what its provisions are likely to be.

NMPUC REGULATORY ISSUES

Electric Rate Case

On November 30, 1998, the NMPUC issued a final order in the Company's electric rate case. In the final order, the NMPUC ordered the Company to reduce its rates for certain cost of service items and for the revaluation of its generation resources based on a so-called "market-based price" and further stated that recovery of stranded costs is illegal. The NMPUC's order would require the Company to reduce rates in 1999 by $60.2 million, by $25.6 million in 2000 and by an additional $25.6 million in 2001. If the order is implemented and the Company is required to collect its generation costs at a rate lower than its embedded cost of generation with no recovery of stranded costs, the Company could be required to record a pre-tax accounting loss of up to $540 million.

On December 14, 1998, the Company filed a notice of appeal with the Supreme Court, requesting a stay of the final order pending appeal. The Company argued that it met the standard for a stay in that there is a likelihood the Company will prevail on the merits and irreparable harm would occur to the Company if the stay were not granted and no irreparable harm would occur to opponents or the public by granting the stay. The Supreme Court granted the Company's motion for a stay of the final order on December 16, 1998, prohibiting any further actions or proceedings until further order of the Supreme Court.

On December 23, 1998, the NMPUC filed a motion with the Supreme Court, requesting the Supreme Court reverse its order so that an immediate $61 million rate cut could be granted to the Company's customers or, in the alternative, allow an immediate rate reduction of approximately $37 million, which is the amount the NMPUC said it would have ordered if it had not revalued generation assets. On January 13, 1999, the Supreme Court rejected the NMPUC's motion and affirmed the stay on the electric rate case order indefinitely until the merits of the case are decided. In addition, the Supreme Court combined the electric rate case and the REI case (see below).

On March 1, 1999, after hearing oral arguments including arguments by the PRC supporting the NMPUC order, the Supreme Court took under advisement the appeal of the NMPUC order on the Company's electric rate case and the writ petition regarding the rate case (see below). The Supreme Court continued the stay preventing implementation of the NMPUC rate reduction, pending its decision.

Residential Electric, Incorporated ("REI")

In October 1998, REI, a new entity incorporated in the state of New Mexico for the purpose of supplying electricity to retail customers, filed the following with the NMPUC: (i) an application for a certificate of convenience and necessity and an advice notice, requesting authority to provide electric services within the metropolitan areas of Albuquerque, Rio Rancho and Santa Fe; and (ii) an application and complaint seeking the unbundling of distribution and transmission facilities of the Company and the use of these facilities by REI to deliver its power supplies to retail customers. Included in the filing were a motion for a procedural and case management order and a brief discussing legal principles based on NMPUC orders in other cases.

Hearings were held at the NMPUC in November 1998. Subsequently, the NMPUC held oral arguments on November 23, 1998, in lieu of briefs, and took the matter under advisement. The NMPUC issued its order approving REI's requests on November 30, 1998.

On December 29, 1998, the Company and the New Mexico Attorney General ("AG") each filed their respective notices of appeal of the REI decision at the Supreme Court. In a related matter, a bipartisan group of legislators, the local business manager of the International Brotherhood of Electrical Workers, and a member of the Company's shareholder alliance filed a petition on December 21, 1998, at the Supreme Court seeking a writ of mandamus (the "writ proceeding") declaring the rate case order and the REI order as a violation of the separation of powers clause of the State constitution and prohibiting their enforcement, and requesting a stay of the REI order. The Supreme Court granted a stay with respect to the REI order and held a hearing on the issues on January 13, 1999. At the hearing, the Supreme Court ordered the consolidation of the Company's rate case appeal, the Company's REI appeals, and the writ proceeding, and continued the stays.

On March 1, 1999, after hearing oral arguments, the Supreme Court granted the writ of mandamus, overturning the REI order, finding that the NMPUC had overstepped its authority and departed from the principles that have guided regulatory policy in New Mexico since 1941.

City of Albuquerque ("COA") Retail Pilot Load Aggregation Program

The COA filed a petition with the NMPUC in September 1997 to institute a Retail Pilot Load Aggregation Program (the "pilot") wherein COA would serve as a load aggregator, and the pilot would consist mainly of COA facility loads. Hearings on COA's pilot proposal were held in January 1998. The Company opposed the program from the outset stating, among other things, that only the New Mexico Legislature has the authority to order retail competition or a pilot on retail access and that the pilot being proposed by COA would provide very little useful information on retail access. The NMPUC issued an order in August 1998 requiring the Company to implement a 16 MW retail pilot program for a one year period starting in December 1998. In November 1998, the NMPUC issued an order requiring the Company to begin pilot enrollment by January 12, 1999, and to implement the pilot on or before March 1, 1999. The Company filed a motion for stay with the Supreme Court, arguing that the NMPUC lacks authority to order retail competition through a pilot program. On December 15, 1998, oral arguments were held at the Supreme Court and the Supreme Court issued an order, staying the NMPUC's order on the pilot.

City of Gallup ("Gallup") Complaint

In January 1998, Gallup, Gallup Joint Utilities and the Pittsburg & Midway Coal Mining Co. ("Pitt-Midway") filed a joint complaint and petition ("Complaint") with the NMPUC for a declaratory order regarding service status and abandonment of facilities. The Complaint sought an interim declaratory order stating: (i) Pitt-Midway is no longer an obligated customer of the Company; (ii) Gallup is entitled to serve

Pitt-Midway; (iii) abandonment of the power line and related facilities by the NMPUC is not necessary; (iv) the Company must wheel power purchased by Gallup from other suppliers over the Company's transmission system; and (v) the Company must enter into an interconnection agreement with Gallup.

In September 1998, the NMPUC issued a final order without conducting a hearing, stating that Pitt-Midway is not, as a matter of law, obligated to be a customer of the Company, and ordered that the Company start on or before October 1, 1998 to: (i) wheel power on behalf of Gallup pursuant to existing contractual obligations under an agreement; (ii) deliver power to Gallup at a specified substation pursuant to a contract agreement; and (iii) transfer ownership of a specified transmission line to Pitt-Midway pursuant to a 1975 agreement.

The Company strongly disagreed with the NMPUC's decision and filed, in September 1998, a motion with the Supreme Court, requesting an emergency stay of the NMPUC order pending its appeal of the order. The Company believes that the issues are complex, that the NMPUC was premature in issuing a final order without evidentiary proceedings and that the NMPUC has exceeded its jurisdiction and has attempted to preempt FERC authority. The Supreme Court denied the Company's request and remanded the matter back to the NMPUC for consideration of matters raised by the Company. The Company also filed a petition for declaratory order at the FERC regarding several jurisdictional issues in the NMPUC's order.

The remanded issues were reheard at the NMPUC during October 1998. On November 30, 1998, the NMPUC issued its "final order on remand", which essentially reaffirmed its earlier position and order. The Company filed a supplement to its September 1998 petition for declaratory order at FERC to add the NMPUC's "final order on remand" to its previously filed information. On December 15, 1998, the Company also filed a supplement to its notice of appeal at the Supreme Court to add the "final order on remand" to the record.

The Company worked diligently with Gallup to meet obligations of the final order on remand. However, Gallup notified the Company that it was terminating negotiations until all the pending issues were resolved at the FERC and the Supreme Court.

The Company maintains its position that the FERC has exclusive jurisdiction over any wholesale transactions, including wholesale power sales to Gallup, interconnection agreements and wholesale power wheeling on behalf of Gallup. The Company also believes that the NMPUC orders disregarded New Mexico law with the respect to municipal boundary limitations. On February 17, 1999, the Company filed its brief-in-chief in this matter at the Supreme Court. The Company is currently unable to predict the ultimate outcome of this case and the effects thereof.

SAN DIEGO GAS AND ELECTRIC COMPANY ("SDG&E") COMPLAINTS

The Company has a 100 MW power sales contract with SDG&E that began in June 1988 and extends through April 2001. In 1993, 1996 and 1997, SDG&E filed three separate and similar complaints with the FERC, alleging that certain charges under the power sales agreement were unjust, unreasonable and unduly discriminatory. In each of the complaints, SDG&E requested the FERC to investigate the charges under the agreements. The Company filed responses to each of the complaints, denying the allegations made by SDG&E, and requested the FERC dismiss each complaint. The Company has estimated that if the relief sought by SDG&E is granted for all three complaints, the annual demand charges paid by SDG&E would be significantly reduced from the date of the ruling through April 2001, and could result in a refund of approximately $41.6 million as of December 31, 1998.

In December 1998, the FERC issued an order on the complaints, consolidating all three dockets, conditionally denying the Company's motion to dismiss the complaints made in 1993 and 1996, and denying the motion to dismiss the 1997 complaint. In the order, the FERC stated that it was setting the complaint for a trial-type, evidentiary hearing, but would hold the hearing in abeyance and encouraged the parties to make every effort to reach a settlement before any hearing procedures begin. The FERC indicated that this matter was a good candidate for settlement because the complaint was confined to narrow, specific rate issues.

The FERC also provided for a settlement judge to assist the parties in arriving at a settlement. In the event the parties are unable to reach a settlement, a public hearing will be held and the FERC estimated that a final decision would not be issued until October 15, 2001. On December 23, 1998, SDG&E filed a fourth complaint with the FERC, making the same allegations. The Company again filed a response denying the allegations and requesting summary dismissal. If the relief sought by the fourth complaint is granted, the Company would be required to refund an additional $12.5 million plus interest. The refund period covered by the fourth complaint is February 1999 through May 2000.

Settlement discussions with SDG&E and the FERC Staff were held with the settlement judge on March 4, 1999. However, the parties were unable to reach settlement on the issues and the complaint cases will be set for public hearing. The Company firmly believes that all four complaints are without merit and intends to vigorously defend its position. The Company cannot predict the outcome of any proceeding to be held at the FERC.

NEW CUSTOMER BILLING SYSTEM

On November 30, 1998, the Company implemented a new customer billing system. Due to a significant number of problems associated with the implementation of the new billing system, the Company has been unable to send proper bills or bills at all to approximately 10% of its accounts. Under PRC rules and PRC-approved Company rules, the Company is required to issue customer bills on a monthly basis.

On February 2, 1999, the Company filed an application for temporary variance, allowing it to send bills for more than one billing cycle and setting forth a process designed to mitigate the impact to customers who receive bills for more than one month of service. The PRC Staff recommended that the PRC grant the Company a variance under certain conditions and docket a formal investigation into the prudency of the selection, analysis, implementation, operational performance and associated costs of the new billing system.

On February 16, 1999, the PRC issued an order granting the Company a temporary variance through April 15, 1999, which will allow the Company to issue bills to customers that have been delayed from 60-120 days. The PRC's order also delayed the docketing of a prudence investigation. In accordance with the order, the Company submitted a status report on the billing system problems on March 2, 1999, and is required to continue to provide twice weekly updates to the PRC Staff. In addition, the order stated that the granting of temporary variances shall neither excuse the Company from past or ongoing violations of the New Mexico Public Utility Act ("Utility Act") or PRC rules, nor act as retroactive authorization for actions taken by the Company associated with the implementation of the new billing system. The order further provided that a hearing examiner take evidence on whether the Company has violated or is violating PRC rules, regulations, orders or the Utility Act, and if so, whether sanctions or fines should be imposed. The PRC may impose penalties for violations of the Utility Act or failure to obey any lawful order of the PRC in the amount of $100 to $100,000 for each violation.

Because of the problems associated with the Company's new customer billing system, the Company has been estimating revenues, customer accounts receivable and bad debt expense since its implementation in November 1998. The Company's financial, tax and regulatory reports reflect these estimates. The Company has been diligently working with the software manufacturer to resolve the problems in an expeditious manner; however, the Company is currently unable to predict the ultimate timing for the completion of the remediation effort or ultimate regulatory actions regarding these problems or the ultimate impact on the Company.

THE YEAR 2000 ISSUE

Background

The Year 2000 issue is a consequence of computer programs ("Information Technology Systems" or "IT Systems") being written using two digits rather than four digits to define the applicable year. As a result, computer systems could recognize the year 2000 as the year 1900. This could result in a system failure or miscalculations causing disruptions of operations. Equipment that contains embedded chips ("Embedded Systems")

may also be affected by the Year 2000 issue. Equipment affected may include such things as hand held meter reading devices, distribution and transmission control systems, elevators, routers and generator controls.

The Company has adopted a plan to address the Year 2000 issue for internal systems and external dependencies ("Year 2000 Project"). The Year 2000 Project is comprised of eight phases: (1) Awareness; (2) Inventory; (3) Assessment; (4) Planning and Scheduling; (5) Repair; (6) Testing; (7) Re-Integration/Deployment; and (8) Company-Wide Testing.

State of Readiness

In early 1998, the Company established completion date goals for each of the eight phases. Those goals were established at a point when the Company was still in the early stages of evaluating the extent of the effort required company-wide to complete the Year 2000 Project. Those goals and the estimated status of each phase as of February 28, 1999, are set out below:

YEAR 2000 PROJECT PHASE	PHASE TARGETED COMPLETION DATES	ESTIMATED STATUS OF COMPLETION*
Awareness Phase	06/01/98	Completed
Inventory Phase	06/26/98	97%
Assessment Phase	08/28/98	81%
Planning and Scheduling Phase	10/30/98	61%
Repair Phase	04/02/99	32%
Testing Phase	05/28/99	11%
Re-Integration/Deployment Phase	07/02/99	6%
Company-Wide Testing Phase	10/01/99	2%

* *The stated percentages represent the status of completion as of February 28, 1999, of all of the Company's IT Systems and Embedded Systems, including mission critical systems. For purposes of this presentation, "mission critical systems" include systems whose failures could cause an interruption in the supply of electricity or gas to the Company's customers, could interfere with the Company's ability to communicate with customers, or could interfere with the Company's cashflow.*

The estimated status of any of the eight phases may be adjusted upon completion of the Assessment Phase on the basis of information then available to the Company. However, until completion of the Assessment Phase, the Company is unable to reliably estimate the completion status of each of those phases. Work in the Company-Wide Testing Phase commences when all segments of a process have completed remediation. A segment is the portion of a process that receives input from and/or sends output to another segment of a process.

At the inception of the Year 2000 Project, there were several projects then underway to upgrade and replace some IT Systems and Embedded Systems. One result of those projects was to make the systems Year 2000 compliant. Due, in part, to the status of those projects and the fact that the Year 2000 issue affects each area of the Company in different ways, the Year 2000 Project is at varying stages of completion throughout the Company.

Several IT Systems known to be noncompliant have already been remediated. Other IT Systems that are determined to be noncompliant will be remediated according to schedules established during the Planning and Scheduling Phase of the Year 2000 Project. Most of the Company's mission critical systems are in the operations areas and are a combination of both IT Systems and Embedded Systems. While the Company can, in many instances, perform the necessary test and remediation functions on the IT portion of these systems, the Company does not generally possess the required equipment and skills necessary to test and remediate the embedded portion of these systems at the microchip level and must, therefore, rely upon manufacturers or suppliers to assist in remediating noncompliant systems. Where necessary, the Company has contracted with vendors to assist with the assessment, remediation and testing work required in this area.

The Company is participating in the Year 2000 program sponsored by the Electric Power Research Institute ("EPRI"). The program involves utilities sharing Year 2000 compliance information about specific embedded systems, test protocols, data and results and project management ideas. EPRI is also assisting in coordinating communications between the electric power industry and manufacturers and suppliers.

Costs

The Company currently estimates that during 1999, the Year 2000 Project will generate incremental expenditures of approximately $12.6 million. An additional $2.7 million of payroll cost will be transferred from other operations and maintenance expenses. In the year 2000, the Company will incur additional expenditures associated with the steps necessary to finalize the Year 2000 Project and document results. The estimate does not include the cost of upgrades and replacements of the systems that were undertaken independent of the Year 2000 issue where the projects have not been accelerated to address the Year 2000 issue, even though one result is that those systems will be Year 2000 compliant. The Company's estimate is under continuous review as the Year 2000 Project proceeds. During 1998, the Company incurred approximately $5.3 million of costs for the Year 2000 Project.

Risks

The Company is connected to one of the three major electric grids for North America. That electric grid known as the Western Interconnection connects utilities throughout the western portion of North America. The stability and reliability of the operations of each utility on any of the electric grids is, to a certain extent, dependent upon these interconnections. A major disturbance within a grid can have an immediate effect throughout the grid. Even though the Company addresses the Year 2000 issue for its systems, it could still encounter difficulties due to the state of readiness of another utility on the Western Interconnection. There is a likelihood of at least minor disruptions on the grid as a result of the Year 2000 issue. The Company is working with the Western Systems Coordinating Council ("WSCC"), as well as with the utilities with which the Company is directly connected on the grid. The Company will participate in the initiatives of WSCC in connection with grid stability.

The Company's natural gas operations rely upon timely receipt of natural gas from gas transporters and suppliers. The ability of those transporters and suppliers to continue to provide an uninterrupted and adequate supply of gas also may be dependent upon their Year 2000 readiness and is critical to the operations of the Company's gas operations. The Company is working with each of its primary transporters and suppliers to determine their Year 2000 readiness and to jointly develop contingency plans.

The continuation of the Company's operations is also dependent upon a number of significant suppliers and service providers. The Company is working with these parties to determine their Year 2000 readiness and to jointly develop contingency plans. The Company is working with its fuel suppliers to ensure that an uninterrupted and adequate fuel supply exists for its power generation operations. Disruption in the services from third party telecommunications providers would impair the Company's ability to operate its electric transmission and distribution and natural gas distribution operations. The Company is working on how to assess the Year 2000 readiness of these third party telecommunications providers.

The goal of the Company has been to make its mission critical systems Year 2000 compliant by mid-1999. However, because the Company must rely on outside vendors for the remediation of a portion of its mission critical systems, there is a probability that remediation and testing will not be completed on some of these systems until after this date. If a delay past mid-1999 is anticipated, then specific contingency plans will be developed. The Company anticipates that the conversion of certain non-critical systems may not be completed until late 1999. The Company believes that if remediation of its mission critical IT Systems and Embedded Systems is not completed timely, the Year 2000 issue could have a material adverse impact on the Company's operations.

Contingency Plans

The Company is in the process of reviewing its existing contingency and business continuity plans for applicability to the Year 2000 Project and will enhance or replace these plans as required. New plans specific to the Year 2000 Project will be developed if these issues have not been previously addressed. The Company has begun developing high level contingency plans that respond to problems unique to the Year 2000 issue.

The Company currently expects that the most reasonably likely worst case scenario in connection with its electric operations will be voltage variations and some frequency variations around the time of the date rollover to January 1, 2000, and in the following several days. The volume of these events is expected to be greater than during normal operations. The result will be that the Company will not be able to control these variations and maintain system stability to the usual degree. The Company currently believes that existing contingency plans should adequately address this scenario. The operations of only a small number of customers would be sensitive to such variations. The Company does not expect these variations to have a material adverse impact on the Company's operations. It is also possible, but less likely, that there may be intermittent, short duration electric outages occurring during the several days following the date rollover to January 1, 2000.

The Company is, nevertheless, developing contingency plans intended to further improve the probability that no interruptions in the delivery of electricity to its customers will occur. These plans are being developed both internally and in conjunction with the WSCC. The WSCC has made certain recommendations for electric operations around the date rollover to January 1, 2000. The Company's contingency plans are consistent with those recommendations. The Company will be establishing a company-wide emergency operations center that will be staffed prior to the date rollover to January 1, 2000, until it is decided that the center is no longer required for Year 2000 contingency planning purposes. The Company will have additional staff present at its power plants and mission critical substations and switching facilities in case there is a need to manually operate any systems or make any repairs. Remote facilities will have backup communications systems in place.

The Company currently expects that the most reasonably likely worst case scenario in connection with its gas operations is the loss of electric supply to certain compression and processing facilities belonging to the Company's gas suppliers and transporters. However, the suppliers and transporters have provided the Company with information that indicates that there is adequate natural gas fired compression on their systems to maintain main line pressures. Further they have represented that the primary processing facilities have adequate backup sources of electric generation to operate without interruption. If these facilities incur other unexpected Year 2000 problems, they can bypass the processing facilities and run the gas through dehydrators to dry the gas prior to delivery to the main pipelines.

The Company is developing contingency plans intended to further improve the probability that no interruptions of gas supply will occur. In addition to the company-wide emergency operations center, the Company will have employees stationed at mission critical gas interchange points to allow for manual operation if required. Backup communications systems will be in place for remote facilities. Alternate operating procedures will be in place in order to maintain pipeline pressures if any problems are experienced with the backup communications systems. The Company will have additional supply contracts in place to allow for delivery of gas from multiple points in case one or more transporters are unable to deliver the full contracted quantity of gas.

Year 2000 Readiness Disclosure

The Year 2000 statements in "The Year 2000 Issues" section are Year 2000 Readiness Disclosures pursuant to the Year 2000 Information and Readiness Disclosure Act, Pub. L. No. 105-271, 112 Stat. 2386 (1998).

COAL FUEL SUPPLY

The coal requirements for the SJGS are being supplied by San Juan Coal Company ("SJCC"), a wholly owned subsidiary of BHP Minerals International, Inc. ("BHP"), from certain Federal, state and private coal leases under a Coal Sales Agreement, pursuant to which SJCC will supply processed coal for operation of the SJGS

until 2017. The primary sources of coal for current operations are a mine adjacent to the SJGS and a mine located approximately 25 miles northeast of the SJGS in the La Plata area of northwestern New Mexico.

In 1997, the Company was notified by SJCC of certain audit exceptions identified by the Federal Minerals Management Service ("MMS") for the period 1986 through 1997, These exceptions pertain to the valuation of coal for purposes of calculating the Federal coal royalty. Primary issues include whether coal processing and transportation costs should be included in the base value of La Plata coal for royalty determination. Administrative appeals of the MMS claims are pending.

The Company was notified during the fourth quarter of 1998 that the MMS agreed to a mediation of the claims. It is the Company's understanding that the mediation will occur during 1999. The Company is unable to predict the outcome of this matter and the Company's exposures have not yet been assessed.

The Company was also notified of claims by a private royaltyholder involving royalty valuation at the La Plata Mine. During the fourth quarter of 1998, the Company was notified that settlement discussions with the private royaltyholder resulted in potential agreement on all claims. Based on the Company's understanding of the proposed settlement, it does not believe that a material impact will result.

In 1996, the Company was notified by SJCC that the Navajo Nation has proposed to select certain properties within the San Juan and La Plata Mines (the "mining properties") pursuant to the Navajo-Hopi Land Settlement Act of 1974 (the "Act"). The mining properties are operated by SJCC under leases from the Bureau of Land Management ("BLM") and comprise a portion of the fuel supply for the SJGS. An administrative appeal by SJCC is pending. In the appeal, SJCC expressed concern that transfer of the mining properties to the Navajo Nation may subject the mining operations to taxation and additional regulation by the Navajo Nation, both of which could increase the price of coal that might potentially be passed on to the SJGS through the existing coal sales agreement. The Company is monitoring closely the appeal and other developments on this issue and will continue to assess potential impacts to the SJGS and the Company's operations. The Company is unable to predict the ultimate outcome of this matter.

ACCOUNTING STANDARDS

Decommissioning: The Staff of the Securities and Exchange Commission ("SEC") has questioned certain of the current accounting practices of the electric industry regarding the recognition, measurement and classification of decommissioning costs for nuclear generating stations in financial statements of electric utilities. In response to these questions, the Financial Accounting Standards Board ("FASB") has a project on its agenda to review the accounting for closure and removal costs, including decommissioning of nuclear power plants. If current electric industry accounting practices for nuclear power plant decommissioning are changed, the estimated cost for decommissioning could be recorded as a liability with recognition of an increase in the cost of the related nuclear power plant. The Company does not believe that such changes, if required, would have a material adverse effect on results of operations.

Accounting for Derivative Instruments and Hedging Activities, Statement of Financial Accounting Standards ("SFAS") No. 133; SFAS No. 133 establishes accounting and reporting standards requiring that every derivative instrument be recorded in the balance sheet as either an asset or liability measured at its fair value. The Statement requires that changes in the derivatives' fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows derivative gains and losses to offset related results on the hedged item in the income statement, and requires that a company must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. This statement is effective for fiscal years beginning after June 15, 1999, and cannot be applied retroactively. The Company has not yet fully quantified the impacts of adopting SFAS No. 133 on the financial statements. However, it is anticipated that SFAS No. 133 could increase volatility in earnings and other comprehensive income.

Accounting for Contracts Involved in Energy Trading and Risk Management Activities (EITF Issue 98-10): In December 1998, the Emerging Issues Task Force ("EITF") of the FASB reached consensus on EITF Issue 98-10. EITF Issue 98-10 requires that energy trading contracts should be marked to market (measured at fair value determined as of the balance sheet date) with the gains and losses included in earnings and separately disclosed in the financial statements or footnotes thereto. EITF Issue 98-10 is effective for fiscal years beginning after December 15, 1998. The effects of initial application of EITF Issue 98-10 will be reported as a cumulative effect of a change in accounting principle. Financial statements for periods prior to initial adoption of EITF Issue 98-10 may not be allowed to be restated. The Company is currently evaluating the Company's energy portfolio to determine which contracts and activities should be considered trading activities. As a result, the Company has not fully quantified potential gains or losses related to these activities. The Company does not believe that the adoption of EITF Issue 98-10 will have a material adverse effect on the results of operations.

DISCLOSURE REGARDING FORWARD LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 (the "Act") provides a "safe harbor" for forward-looking statements to encourage companies to provide prospective information about their companies without fear of litigation so long as those statements are identified as forward-looking and are accompanied by meaningful, cautionary statements identifying important factors that could cause actual results to differ materially from those projected in the statement. Words such as "estimates," "expects," "anticipates," "plans," "believes," "projects," and similar expressions identify forward-looking statements. Accordingly, the Company hereby identifies the following important factors which could cause the Company's actual financial results to differ materially from any such results which might be projected, forecasted, estimated or budgeted by the Company in forward-looking statements: (i) adverse actions of utility regulatory commissions; (ii) utility industry restructuring; (iii) failure to recover stranded costs; (iv) the inability of the Company to successfully compete outside its traditional regulated market; (v) regional economic conditions, which could affect customer growth; (vi) adverse impacts resulting from environmental regulations; (vii) loss of favorable fuel supply contracts; (viii) failure to obtain water rights and rights-of-way; (ix) operational and environmental problems at generating stations; (x) the cost of debt and equity capital; (xi) weather conditions; and (xii) technical developments in the utility industry.

The costs of the Company's Year 2000 Project and the dates on which the Company believes it will complete the phases of the Project are based upon management's best estimates, which were derived using numerous assumptions regarding future events, including the continued availability of certain resources, third-party remediation plans, and other factors. There can be no assurance that these estimates will prove to be accurate and actual results could differ materially from those currently anticipated. Specific factors that could cause such material differences include, but are not limited to, the availability and cost of personnel trained in Year 2000 issues, the ability to identify, assess, remediate and test all relevant computer codes and embedded technology, and similar uncertainties.

QUANTITATIVE *and* QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The following discussion regarding the Company's market risk sensitive instruments contains forward-looking information involving risks and uncertainties. The statements regarding potential gains and losses are only estimates of what may occur in the future. Actual future results may differ materially from those estimates presented due to the model characteristics and the risks and uncertainties involved.

The Company is potentially exposed to market risk due to changes in interest rates, equity and other investment returns and commodity prices. All of the Company's derivative commodity instruments described below are held for purposes other than trading. The Company's other financial instruments are held both for trading and for other purposes.

Interest Rate Risk

The Company's interest rate exposure relates primarily to debt financing issued to fund capital requirements including refund of maturing debt securities. Except for the proposed issuance of pollution control revenue bonds of $11.5 million, the Company currently does not have a plan to issue long-term debt within the next five years. The Company's long-term debt obligations are all fixed rate obligations with varying maturities. The Company managed its interest rate risk through the issuance of fixed-rate debt with varying maturities. The table below presents principal cash flows, estimated market values at December 31, 1998, and related weighted average interest rates of the Company's long-term debt by expected maturity dates.

	DECEMBER 31,							
	1998	1999	2000	2001	2002	THEREAFTER	TOTAL	ESTIMATED MARKET VALUE
				(Dollars in Millions)				
Pollution Control Revenue Bonds	$0	$0	$0	$0	$0	$574.3	$574.3	$594.6
Weighted-Average Interest Rate	-	-	-	-	-	6.15%	6.15%	
Senior Unsecured Notes	$0	$0	$0	$0	$0	$435.0	$435.0	$447.9
Weighted-Average Interest Rate	-	-	-	-	-	7.22%	7.22%	
Total	$0	$0	$0	$0	$0	$1,009.3	$1,009.3	$1,042.5

Equity and Other Investment Return Risk

At December 31, 1998, the Company's equity and other investment return exposure related primarily to corporate owned life insurance ("COLI") policies and equity investments held within the Company's non-qualified and qualified nuclear decommissioning trusts. In January 1999, the COLI policies were surrendered for approximately $42.1 million. After repayment of a related bank loan for $26.7 million incurred by the decommissioning trust for the payments of COLI policy premiums and interest charges, the Company invested the remaining $15.4 million in temporary investments within the non-qualified trust. This investment is carried at its market value of $15.4 million. Neither the fair value of these investments nor near-term investment losses from reasonably possible near-term changes in market prices were material to the financial position, results of operations or liquidity of the Company.

As of December 31, 1998, the fair value of equity investments held within the trusts was approximately $24.7 million. The Company records the gains or losses resulting from the market changes in those investments. Neither the fair value of these investments nor near-term investment losses from reasonably possible near-term changes in market prices were material to the financial position, results of operations or liquidity of the Company.

The Company also has other investment return exposure related to $50 million invested in temporary investments. Neither the fair value of these investments nor the near-term investment losses from reasonably possible near-term changes in market prices are material to the financial position, results of operations or liquidity of the Company.

Commodity Price Risk

At December 31, 1998, the Company's derivative commodity price exposure relates to "swap" agreements entered into by the Company to hedge the price risks associated with a portion of anticipated 1998-1999 winter-heating season natural gas purchases. These instruments are settled in cash at or prior to expiration. Under

these instruments, payments are made or received based on the difference between a fixed and a variable product price. The Company defers the impact of changes in the market value of these instruments until the related transaction is completed. As of December 31, 1998, the Company had outstanding basis swap agreements covering approximately 3 million decatherms of natural gas purchases through March 1999. The Company had unrealized losses of $3.1 million at December 31, 1998, related to the outstanding agreements. Neither the fair value of the derivatives outstanding nor potential, near-term derivative losses from reasonably possible near-term changes in market prices were material to the financial position, results of operations or liquidity of the Company. The risk of gas cost variations under the swap agreements should be mitigated by the Company's Gas Services Purchased Gas Adjustment Clause ("PGAC") in New Mexico. The Company is evaluating the use of swap agreements for the 1999-2000 winter heating season.

Other Commodity Price Risks

The Company also has commodity price exposure related to agreements other than derivative financial and commodity instruments and other financial instruments. The Company utilizes contracts of various duration for the forward sale and purchase of natural gas to effectively manage its available natural gas supply portfolio. These agreements contain fixed-priced and variable-price provisions and are settled in physical delivery. The contracts with variable pricing provisions are exposed to fluctuations in prices of natural gas due to unpredictable factors, such as weather, which impacts supply and demand. To reduce price risk caused by market fluctuations, the Company hedges a portion of its purchases as discussed under Commodity Price Risk above. The risk of gas cost variations under the these agreements is mitigated by the PGAC in New Mexico.

The Company utilizes contracts of various duration for the forward purchases of coal and uranium to effectively manage its available coal and uranium supply portfolio for the generation of electricity. These agreements contain fixed-price and variable-price provisions and are settled by physical delivery of the commodity.

In the normal course of business, the Company utilizes contracts of various duration for the forward sale and purchase of electricity to effectively manage its available generating capacity. Such contracts include forward contracts for wholesale sales of generating capacity and energy during periods when the Company's available power resources are expected to exceed the requirements of its native load customers. It may also include forward contracts for the purchase of wholesale capacity and energy during periods when the anticipated market price of electricity is below the Company's expected incremental power production cost. In addition, for trading purposes, the Company routinely buys and sells electricity in the wholesale market and also writes and purchases option contracts on a limited basis. These forward and option contracts require physical delivery of electricity. The use of these types of physical commodity instruments is designed to allow the Company to manage and hedge its contractual commitments, reduce its exposure relative to the volatility of market prices, and take advantage of selected arbitrage opportunities.

The Company structures and modifies its net resource position to capture expected changes in future demand, seasonal market pricing characteristics, overall market sentiment, and price relationships between different time periods. The Company is exposed to the risk that fluctuating market prices of electric power may potentially impact its financial condition, or results of operations. The Company is not currently using mark-to-market accounting. Actual gains and losses are recorded for financial statement purposes after physical delivery. As previously discussed, the requirements of EITF Issue 98-10 are currently being evaluated and will be adopted in the first quarter of 1999.

The Company's Risk Management Committee (the "Committee") established policies, procedures, and limits designed to minimize the Company's exposure to electricity commodity price risk. The Committee periodically reviews these policies to ensure they are responsive to changing business conditions. The Company uses a value-at-risk methodology and mark-to-market gains and losses to assess the market risk of the anticipated excess capacity and electricity trading portfolio. These exposures are revalued and reported to the Committee daily.

FINANCIAL STATEMENTS *and* SUPPLEMENTARY DATA

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The management of Public Service Company of New Mexico (the "Company") is responsible for the preparation and presentation of the accompanying consolidated financial statements. The consolidated financial statements have been prepared in conformity with generally accepted accounting principles and include amounts that are based on informed estimates and judgments of management. Management maintains a system of internal accounting controls which it believes is adequate to provide reasonable assurance that assets are safeguarded, transactions are executed in accordance with management authorization and the financial records are reliable for preparing the consolidated financial statements. The system of internal accounting controls is supported by written policies and procedures, by a staff of internal auditors who conduct comprehensive internal audits and by the selection and training of qualified personnel. The board of directors, through its audit committee comprised entirely of outside directors, meets periodically with management, internal auditors and the Company's independent auditors to discuss auditing, internal control and financial reporting matters. To ensure their independence, both the internal auditors and independent auditors have full and free access to the audit committee. The independent auditors, Arthur Andersen LLP, are engaged to audit the Company's consolidated financial statements in accordance with generally accepted auditing standards.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

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

We have audited the accompanying consolidated balance sheets and statements of capitalization of Public Service Company of New Mexico (a New Mexico corporation) and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of earnings, comprehensive income, retained earnings, and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Public Service Company of New Mexico and subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998 in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

Albuquerque, New Mexico
March 2, 1999

CONSOLIDATED STATEMENTS of EARNINGS

	YEAR ENDED DECEMBER 31,		
	1998	1997	1996
	(In thousands except per share amounts)		
Operating Revenues:			
Electric	$ 835,204	$ 722,438	$645,639
Gas	255,975	294,769	227,301
Energy Services	1,266	3,314	838
Total operating revenues	1,092,445	1,020,521	873,778
Operating Expenses:			
Fuel and purchased power	310,098	235,508	178,807
Gas purchased for resale.	134,755	169,758	103,574
Cost of sales and projects - Energy Services	936	2,631	110
Other operation expenses	293,902	269,013	262,584
Maintenance and repairs	51,666	52,626	49,693
Depreciation and amortization	86,141	82,694	78,115
Taxes, other than income taxes	37,992	36,803	34,837
Income taxes	41,306	41,941	39,650
Total operating expenses	956,796	890,974	747,370
Operating income	135,649	129,547	126,408
Other Income and Deductions:			
Other	37,672	21,548	2,367
Income tax expense	(14,985)	(8,384)	(1,099)
Net other income and deductions	22,687	13,164	1,268
Income before interest charges	158,336	142,711	127,676
Interest Charges:			
Interest on long-term debt	50,929	46,670	49,009
Other interest charges	12,288	9,544	5,698
Net interest charges	63,217	56,214	54,707
Net Earnings from Continuing Operations	95,119	86,497	72,969
Discontinued Operations, net of tax:			
Loss from operations of gas marketing	(7,386)	(5,502)	(389)
Estimated loss on disposal of gas marketing, including provision for operating losses during phase-out period	(5,051)	-	-
Net Earnings	82,682	80,995	72,580
Preferred Stock Dividend Requirements	586	586	586
Net Earnings Available for Common Stock	$ 82,096	$ 80,409	$ 71,994
Average Number of Common Shares Outstanding	41,774	41,774	41,774
Net Earnings (Loss) per Common Share:			
Earnings from continuing operations	$ 2.27	$ 2.05	$ 1.73
Loss from discontinued operations	(0.18)	(0.13)	(0.01)
Estimated loss on disposal of gas marketing	(0.12)	-	-
Net Earnings per Common Share (Basic)	$ 1.97	$ 1.92	$ 1.72
Net Earnings per Common Share (Diluted)	$ 1.95	$ 1.91	$ 1.71
Dividends Paid per Share of Common Stock	$ 0.77	$ 0.63	$ 0.36

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

CONSOLIDATED STATEMENTS of COMPREHENSIVE INCOME

	YEAR ENDED DECEMBER 31,		
	1998	1997	1996
		(In thousands)	
Net Earnings	$ 82,682	$ 80,995	$ 72,580
Other Comprehensive Income, net of tax:			
Unrealized gain (loss) on securities:			
Unrealized holding gains arising from the period	1,519	1,529	1,176
Less reclassification adjustment for gains included in net income	(673)	(672)	(347)
Minimum pension liability adjustment	(205)	(626)	(478)
Total Other Comprehensive Income	641	231	351
Total Comprehensive Income	$ 83,323	$ 81,226	$ 72,931

Note: Tax expense for Total Other Comprehensive Income for 1998, 1997 and 1996 was $420, $151, and $230, respectively.

CONSOLIDATED STATEMENTS of RETAINED EARNINGS

	YEAR ENDED DECEMBER 31,		
	1998	1997	1996
		(In thousands)	
Balance at Beginning of Year	$ 129,188	$ 77,185	$ 25,243
Net earnings	82,682	80,995	72,580
Dividends:			
Cumulative preferred stock	(586)	(586)	(586)
Common stock	(25,064)	(28,406)	(20,052)
Balance at End of Year	$ 186,220	$ 129,188	$ 77,185

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

CONSOLIDATED BALANCE SHEETS

	AS OF DECEMBER 31, 1998	1997
	(In thousands)	
ASSETS		
Utility Plant, at original cost except PVNGS:		
Electric plant in service	$ 1,966,277	$ 1,958,912
Gas plant in service	467,758	441,045
Common plant in service	63,245	43,415
Plant held for future use	551	551
	2,497,831	2,443,923
Less accumulated depreciation and amortization	998,175	1,003,086
	1,499,656	1,440,837
Construction work in progress	66,677	104,497
Nuclear fuel, net of accumulated amortization of $21,898 and $21,263	27,426	27,816
Net utility plant	1,593,759	1,573,150
Other Property and Investments:		
Non-utility property, net of accumulated depreciation of $1,129 and $2,146	4,875	4,502
Other investments	518,959	307,261
Total other property and investments	523,834	311,763
Current Assets:		
Cash	2,573	8,705
Temporary investments, at cost	58,707	9,490
Receivables, net of allowance for uncollectible accounts of $836 and $783	197,906	216,305
Income taxes receivable	8,266	-
Fuel, materials and supplies, at average cost	33,137	33,664
Gas in underground storage, at average cost	2,537	13,158
Other current assets	4,666	4,509
Total current assets	307,792	285,831
Deferred charges	151,403	149,811
	$ 2,576,788	$ 2,320,555
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Common stock equity:		
Common stock outstanding – 41,774 shares	$ 208,870	$ 208,870
Additional paid-in capital	465,386	469,073
Accumulated other comprehensive income, net of tax	1,127	486
Retained earnings since January 1, 1989	186,220	129,188
Total common stock equity	861,603	807,617
Minority interest	13,405	-
Cumulative preferred stock without mandatory redemption requirements	12,800	12,800
Long-term debt, less current maturities	1,008,614	713,995
Total capitalization	1,896,422	1,534,412
Current Liabilities:		
Short-term debt	26,620	114,100
Accounts payable	113,975	154,501
Dividends payable	147	7,248
Current maturities of long-term debt	-	350
Accrued interest and taxes	34,289	24,161
Other current liabilities	28,308	26,102
Total current liabilities	203,339	326,462
Deferred Credits:		
Accumulated deferred investment tax credits	54,404	57,823
Accumulated deferred income taxes	144,277	124,054
Other deferred credits	278,346	277,804
Total deferred credits	477,027	459,681
Commitments and Contingencies		
	$ 2,576,788	$ 2,320,555

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

CONSOLIDATED STATEMENTS of CASH FLOWS

	YEAR ENDED DECEMBER 31,		
	1998	1997	1996
	(In thousands)		
Cash Flows From Operating Activities:			
Net earnings	$ 82,682	$ 80,995	$ 72,580
Adjustments to reconcile net earnings to net cash flows from operating activities:			
Depreciation and amortization	98,154	94,924	90,458
Accumulated deferred investment tax credit	(3,418)	(4,436)	(4,476)
Accumulated deferred income taxes	18,292	11,080	31,436
Changes in certain assets and liabilities:			
Receivables	17,009	4,554	(83,416)
Fuel, materials and supplies	11,148	(2,883)	5,795
Deferred charges	8,509	(11,190)	5,190
Accounts payable	(40,490)	23,808	36,930
Accrued interest and taxes	10,128	805	(3,500)
Deferred credits	(1,938)	2,455	12,655
Other	(1,676)	(371)	(9,279)
Other, net	12,587	13,381	11,528
Net cash flows from operating activities	210,987	213,122	165,901
Cash Flows From Investing Activities:			
Utility plant additions	(128,784)	(128,371)	(103,087)
Purchase of PVNGS lease debt	(215,701)	-	-
Increase in nuclear decommissioning trust	(3,620)	(23,000)	-
Return of principal of PVNGS lease obligation bonds	11,337	5,018	-
Utility plant sales	-	-	333
Other property sales	-	-	702
Net increase in other property and investments	(4,224)	(6,814)	(14,706)
Escrow for purchase of PVNGS lease obligation bonds	-	(28,900)	(208,446)
Decrease (increase) in temporary investments, net	(49,216)	(363)	86,844
Net cash flows from investing activities	(390,208)	(182,430)	(238,360)
Cash Flows From Financing Activities:			
Proceeds from issuance of senior unsecured notes	892,728	-	-
Redemption of pollution control revenue bonds	(463,345)	-	-
Redemption of first mortgage bonds	(140,206)	-	-
Short-term borrowings for redemption of first mortgage bonds	140,206	-	-
Proceeds from minority interest in Capital Trust	13,405	-	-
Bond redemption premium and costs	(5,537)	(3,693)	(5,158)
Proceeds from (repayments of) asset securitization	-	(13,900)	100,400
Repayments of long-term debt	-	(14,970)	(326)
Trust borrowing for nuclear decommissioning	3,620	23,000	-
Increase (decrease) in short-term debt	(231,306)	4,600	-
Exercise of employee stock options	(3,687)	(1,285)	-
Dividends paid	(32,789)	(26,864)	(15,560)
Net cash flows from financing activities	173,089	(33,112)	79,356
Increase (Decrease) in Cash	(6,132)	(2,420)	6,897
Cash at Beginning of Year	8,705	11,125	4,228
Cash at End of Year	$ 2,573	$ 8,705	$ 11,125
Supplemental cash flow disclosures:			
Interest paid	$ 50,109	$ 57,302	$ 55,480
Income taxes paid, net of refunds	$ 49,048	$ 20,175	$ 31,617

Cash consists of currency on hand and demand deposits.

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

CONSOLIDATED STATEMENTS of CAPITALIZATION

	DECEMBER 31, 1998	DECEMBER 31, 1997
	(In thousands)	
Common Stock Equity:		
Common Stock, par value $5 per share	$ 208,870	$ 208,870
Additional paid-in capital	465,386	469,073
Accumulated other comprehensive income, net of tax	1,127	486
Retained earnings since January 1, 1989	186,220	129,188
Total common stock equity	861,603	807,617
Minority Interest	13,405	-
Cumulative Preferred Stock:		
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, 1998 were 128,000.	12,800	12,800
Long-Term Debt:		
Issue and Final Maturity		
First Mortgage Bonds (taxable)	-	140,206
First Mortgage Bonds, Pollution Control Revenue Bonds:		
5.7% due 2016	65,000	65,000
5.75% to 6.4% due 2016 through 2026	-	463,345
6.375% due 2022	46,000	46,000
Total First Mortgage Bonds	111,000	714,551
Senior Unsecured Notes, Pollution Control Revenue Bonds:		
6.30% due 2016	77,045	-
5.75% due 2022	37,300	-
5.80% due 2022	100,000	-
6.375% due 2022	90,000	-
6.375% due 2023	36,000	-
6.40% due 2023	100,000	-
6.30% due 2026	23,000	-
Total Senior Unsecured Notes, Pollution Control Revenue Bonds	463,345	-
Senior Unsecured Notes:		
7.10% due 2005	300,000	-
7.50% due 2018	135,000	-
Other, including unamortized premium and (discounted), net	(731)	(206)
Total long-term debt	1,008,614	714,345
Less current maturities	-	350
Long-term debt, less current maturities	1,008,614	713,995
Total Capitalization	$1,896,422	$1,534,412

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

NOTES *to* CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1998, 1997 and 1996

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Public Service Company of New Mexico (the "Company") is an investor-owned utility company engaged in the generation, transmission, distribution and sale of electricity. The Company provides retail electric service to a large area of north central New Mexico, including the cities of Albuquerque, Santa Fe, Rio Rancho, Las Vegas, Belen and Bernalillo. The Company also provides retail electric service to Deming in southwestern New Mexico and to Clayton in northeastern New Mexico. The Company is also engaged in the transmission, distribution and sale of natural gas within the State of New Mexico. The Company distributes natural gas to most of the major communities in New Mexico, including Albuquerque and Santa Fe. In addition, the Company provides energy and utility related services under its Energy Services Business Unit. These activities include energy management services, management services for water and wastewater systems and utility related management and operation services. The Company is also operating the City of Santa Fe's water system.

Systems of Accounts

The Company maintains its accounts for utility operations primarily in accordance with the uniform systems of accounts prescribed by the Federal Energy Regulatory Commission ("FERC") and the National Association of Regulatory Utility Commissioners, and adopted by the New Mexico Public Regulation Commission ("PRC"), the successor of the New Mexico Public Utility Commission ("NMPUC"), effective January 1, 1999.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and subsidiaries in which it owns a majority voting interest. All significant intercompany transactions and balances have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual recorded amounts could differ from those estimated.

Utility Plant

Utility plant, with the exception of Palo Verde Nuclear Generating Station ("PVNGS") Unit 3 and the Company's owned interests in PVNGS Units 1 and 2, is stated at original cost, which includes capitalized payroll-related costs such as taxes, pension and other fringe benefits, administrative costs and an allowance for funds used during construction. Utility plant includes certain electric assets not subject to regulation. The results of operations of such electric assets are included in operating income.

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

Depreciation and Amortization

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

	1998	1997	1996
Electric plant	3.32%	3.33%	3.32%
Gas plant	3.06%	3.23%	3.27%
Common plant	7.34%	7.60%	7.00%

The provision for depreciation of certain equipment is charged to clearing accounts and subsequently allocated to operating expenses or construction projects based on the use of the equipment. Depreciation of non-utility property is computed on the straight-line method. Amortization of nuclear fuel is computed based on the units of production method.

Nuclear Decommissioning

The Company accounts for nuclear decommissioning costs on a straight-line basis over the estimated useful life of the facilities. Such amounts are based on the present value of expenditures estimated to be required to decommission the plant.

Fuel and Purchased Power Cost Adjustment Clause ("FPPCAC")

The Company uses the deferral method of accounting for fuel and purchased power costs for its firm-requirements wholesale customers. Such amounts are reflected in subsequent periods under a FPPCAC approved by the FERC.

Purchased Gas Adjustment Clause ("PGAC")

The Company uses the deferral method of accounting for gas purchase costs which are settled in subsequent periods under gas adjustment clauses. Future recovery of these costs is subject to approval by the PRC.

Amortization of Debt Discount, Premium and Expense

Discount, premium and expense related to the issuance of long-term debt are amortized over the lives of the respective issues. In connection with the retirement of long-term debt, such amounts associated with resources subject to PRC regulation are amortized over the lives of the respective issues. Amounts associated with the Company's firm-requirements wholesale customers and its resources excluded from PRC retail rates are recognized immediately as expense or income as they are incurred.

Income Taxes

The Company reports income tax expense in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, Accounting for Income Taxes. SFAS No. 109 requires that deferred income taxes for temporary differences between financial and income tax reporting be recorded using the liability method. Therefore, deferred income taxes are computed using the statutory tax rates scheduled to be in effect when temporary differences reverse. Current PRC jurisdictional rates include the tax effects of the majority of these temporary differences (normalization). Recovery of reversing temporary differences previously accounted for under the flow-through method is also included in rates charged to customers. For regulated operations, any changes in tax rates applied to accumulated deferred income taxes may not be immediately recognized because of ratemaking and tax accounting provisions required by the Internal Revenue Code. Items accorded flow-through treatment under PRC 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.

New Accounting Standards

The Financial Accounting Standards Board ("FASB") issued SFAS No. 130, Reporting Comprehensive Income, SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information and SFAS No. 132, Employers' Disclosures about Pensions and Other Postretirement Benefits, all of which were adopted in 1998.

SFAS No. 130 establishes standards for reporting and display of comprehensive income and its components in financial statements. The objective of this standard is to report a measure of all changes in equity that result from transactions and other economic events of the period other than transactions with owners.

SFAS No. 131 requires a public company to report selected information about its reportable operating segments in annual and interim financial statements. Operating segments are components of an enterprise that engage in business activities that earn revenues and incur expenses, and are evaluated regularly by the chief operating decision maker within a company for making operating decisions and assessing performance.

SFAS No. 132 standardizes the disclosure requirements for pensions and other postretirement benefits other than pensions. This statement requires additional information on changes in the benefit obligations and fair values of plan assets and eliminates certain disclosures that are no longer useful.

Nuclear Decommissioning Costs
The Staff of the Securities and Exchange Commission ("SEC") has questioned certain of the current accounting practices of the electric industry regarding the recognition, measurement and classification of decommissioning costs for nuclear generating stations in financial statements of electric utilities. In response to these questions, the FASB has a project on its agenda to review the accounting for closure and removal costs, including decommissioning of nuclear power plants. If current electric industry accounting practices for nuclear power plant decommissioning are changed, estimated cost for decommissioning could be recorded as a liability with recognition of an increase in the cost of the related nuclear power plant. The Company does not believe that such changes, if required, would have a material adverse effect on results of operations.

Performance Stock Plan
The Company continues to apply Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for its plan. Accordingly, no compensation cost has been recognized for this plan.

(2) RISKS AND UNCERTAINTIES

Electric Rate Case
On November 30, 1998, the NMPUC issued a final order in the Company's electric rate case. In the final order, the NMPUC ordered the Company to reduce its rates for certain cost of service items and for the revaluation of its generation resources based on a so-called "market-based price" and further stated that recovery of stranded costs is illegal. The NMPUC's order would require the Company to reduce rates in 1999 by $60.2 million, by $25.6 million in each year 2000 and by an additional $25.6 million in 2001. If the order is implemented and the Company is required to collect its generation costs at a rate lower than its embedded cost of generation with no recovery of stranded costs, the Company could be required to record a pre-tax accounting loss of up to $540 million.

On December 14, 1998, the Company filed a notice of appeal with the New Mexico Supreme Court ("Supreme Court"), requesting a stay of the final order pending appeal. The Company argued that it met the standard for a stay in that there is a likelihood the Company will prevail on the merits and irreparable harm that would occur to the Company if the stay were not granted and no irreparable harm would occur to opponents or the public by granting the stay. The Supreme Court granted the Company's motion for a stay of the final order on December 16, 1998, prohibiting any further actions or proceedings until further order of the Supreme Court.

On December 23, 1998, the NMPUC filed a motion with the Supreme Court, requesting the Supreme Court reverse its order so that an immediate $61 million rate cut could be granted to the Company's customers or, in the alternative, allow an immediate rate reduction of approximately $37 million, which is the amount the NMPUC said it would have ordered if it had not revalued generation assets. On January 13, 1999, the Supreme Court rejected the NMPUC's motion and affirmed the stay on the electric rate case order indefinitely until the merits of the case are decided.

On March 1, 1999, after hearing oral arguments including arguments by the PRC supporting the NMPUC order, the Supreme Court took under advisement the appeal of the NMPUC order on the Company's electric rate case and the writ petition regarding the rate case. The Supreme Court continued the stay preventing implementation of the NMPUC rate reduction, pending its decision.

Electric Industry Restructuring Act of 1999

Senate Bill 428, sponsored by Senator Michael Sanchez, was introduced in the 1999 New Mexico Legislature on February 5, 1999. Under the proposed bill, customer choice of power supplier would be available to schools, residential customers and small business customers in New Mexico beginning January 1, 2001, and to all customers beginning January 1, 2002. Transmission and distribution services along with related services such as meter reading and billing would remain subject to the PRC jurisdiction. This bill would not require a public utility to divest itself of any of its assets owned or leased. However, before January 1, 2001, a public utility would be required to organize into at least two corporations, dividing regulated from unregulated services through either the creation of separate affiliated companies under a holding company or through the creation of separate non-affiliated corporations.

If enacted, the bill would require all public utilities operating in New Mexico to submit a transition plan to the PRC no later than March 1, 2000, to be approved no later than December 1, 2000. The transition plan would include proposed tariffs for transmission and distribution services, together with proposed standard offer service tariffs for residential and small business customers who do not select a power supplier. The plan would also include proposals for effectively separating the utilities' regulated and non-regulated business activities.

The bill recognizes that electric utilities should be permitted a reasonable opportunity to recover an appropriate amount of the costs incurred previously in providing electric service ("stranded costs"). Stranded costs include plant decommissioning costs, regulatory assets, lease and lease-related costs and other costs recognized under cost-of-service regulation. Utilities would be allowed to recover no less than 50 percent of such costs through a nonbypassable charge on all customer bills for five years after implementation of customer choice. The PRC could authorize a utility to recover up to 100 percent of its stranded costs if the PRC finds that recovery of more than 50 percent: (i) is in the public interest; (ii) is necessary to maintain the financial integrity of the public utility; (iii) is necessary to continue adequate and reliable service; and (iv) will not cause an increase in rates to residential or small business customers during the transition period. Utilities would also be allowed to recover in full any costs incurred in implementing full open access ("transition costs"). Those transition costs would be recovered through 2007 by means of a separate wires charge. Due to uncertainties in the bill regarding the amounts of recovery and calculation of stranded costs, the Company is currently unable to determine what financial impact the bill, if enacted, will have on the Company.

Other significant provisions of the bill include: (i) customers would be allowed to prepay their allotted share of stranded costs prior to the implementation of choice for that customer class; (ii) the PRC would adopt and enforce codes of conduct to protect customer privacy and prevent such anticompetitive practices as cross-subsidization or favoritism of non-regulated energy suppliers by regulated affiliates; and (iii) a system benefit charge of $0.0003 per KWh would be added to customer bills to fund no less than $500,000 annually for low income energy assistance programs, and no more than $4 million a year for renewable energy projects, in addition to other public interest programs. The bill provides for penalties of up to $2 million for each violation of the Act. The bill also requires licensing for competitive power suppliers, which is defined to include providers of energy-related services.

The Company's primary concerns with the proposed bill revolve around the treatment of stranded cost recovery. The Company intends to work with the bill's sponsor, interested parties, and the Legislature as a whole to address its concerns and to maximize the chances for passage of restructuring legislation which is beneficial to the State as a whole. It is the Company's position that this bill goes a long way in properly balancing the interests involved, and, in that respect, provides a good vehicle for the passage of restructuring legislation in this session.

On February 28, 1999, the full Senate passed the bill with various amendments by a vote of 32-6. The Bill has been assigned to both the Business and Industry Committee and the Appropriation and Finance Committee in the State House of Representatives ("House") for consideration. The House has a similar com-

peting bill, House Bill 865, that has been assigned to the House Judiciary Committee and the House Appropriation and Finance Committee. No hearings have been scheduled on House Bill 865. The most significant difference between the two bills is the size of the proposed subsidy for renewable energy technology. The House bill earmarks approximately $20 million a year for renewable technology, compared to $4 million designated in Senate Bill 428. However, it is likely that, like the Company, other parties will continue to seek to amend various provisions of the bill. Given the Legislature's past reluctance to implement retail competition, the Company is unable to predict whether or not legislation will pass or what its provisions are likely to be.

(3) REGULATORY ASSETS AND LIABILITIES

The Company is subject to the provisions of SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*, on operations regulated by the PRC. Regulatory assets represent probable future revenue to the Company associated with certain costs which will be recovered from customers through the ratemaking process. Regulatory liabilities represent probable future reductions in revenues associated with amounts that are to be credited to customers through the ratemaking process. Regulatory assets and liabilities reflected in the Consolidated Balance Sheets as of December 31 relate to the following:

	1998	1997
	(In thousands)	
Deferred Income Taxes	$71,653	$70,968
Loss on Reacquired Debt	11,108	8,869
Gas Take-or-Pay Costs	10,740	19,953
Gas Reservation Fees	7,029	7,029
Gas Imputed Revenues	6,726	12,823
PGAC	5,294	16,006
Deferred Customer Expense on Gas Assets Sale	5,260	5,260
Gas Retirees' Health Care Costs	4,804	6,345
Proposed Transmission Line Costs	2,660	2,903
Gas Rate Case Costs	1,571	1,571
Other	471	118
Subtotal	127,316	151,845
Deferred Income Taxes	(49,971)	(53,132)
Gas Regulatory Reserve	(21,308)	(27,881)
Customer Gain on Gas Assets Sale	(7,643)	(11,856)
PVNGS Prudence Audit	(6,185)	(6,561)
Settlement Due Customers	(3,564)	(3,743)
Gain on Reacquired Debt	(531)	(546)
Other	(773)	(723)
Subtotal	(89,975)	(104,442)
Net Regulatory Assets	$37,341	$47,403

As of December 31, 1998, substantially all of the Company's regulatory assets and regulatory liabilities are being recovered in rates charged to customers or have been addressed in a regulatory proceeding. If a portion of the Company's operations under the PRC jurisdiction becomes no longer subject to the provisions of SFAS No. 71, a write off of related regulatory assets and liabilities would be required, unless some form of transition cost recovery (refund) continues through rates established and collected for the Company's remaining

regulated operations. The enactment of the Electric Industry Restructuring Act of 1999 would require the Company to discontinue the application of SFAS No. 71 to certain of the Company's operations; however, discontinuance of the application of SFAS No. 71 would not result in a material adverse impact to the Company. Based on a current evaluation of the various factors and conditions that are expected to impact future cost recovery, the Company believes that its net regulatory assets are probable of future recovery.

(4) CAPITALIZATION

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

	COMMON STOCK			CUMULATIVE PREFERRED STOCK WITHOUT MANDATORY REDEMPTION REQUIREMENTS	
	NUMBER OF SHARES	AGGREGATE PAR VALUE	ADDITIONAL PAID-IN CAPITAL	NUMBER OF SHARES	AGGREGATE STATED VALUE
			(Dollars in thousands)		
Balance at December 31, 1996	41,774,083	$ 208,870	$ 470,358	128,000	$ 12,800
Exercise of stock options	-	-	(1,285)	-	-
Balance at December 31, 1997	41,774,083	208,870	469,073	128,000	12,800
Exercise of stock options	-	-	(3,687)	-	-
Balance at December 31, 1998	41,774,083	$ 208,870	$ 465,386	128,000	$ 12,800

Common Stock

The number of authorized shares of common stock with par value of $5 per share is 80 million shares. The declaration of common dividends is dependent upon a number of factors including earnings and financial condition of the Company, the Supreme Court decisions on the Company's various regulatory cases and market conditions.

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

Cumulative Preferred Stock

The number of authorized shares of cumulative preferred stock is 10 million shares. The Company has 128,000 shares, 1965 Series, 4.58%, stated value of $100 per share, of cumulative preferred stock outstanding. The 1965 Series does not have a mandatory redemption requirement but may be redeemable at 102% of the par value with accrued dividends. The holders of the 1965 Series are entitled to payment before holders of common stock in the event of any liquidation or dissolution or distribution of assets of the Company. In addition, the 1965 Series is not entitled to a sinking fund and cannot be converted into any other class of stock of the Company. The Company's restated articles of incorporation limit the amount of preferred stock which may be issued. The earnings test in the Company's restated articles of incorporation currently allows for the issuance of additional preferred stock.

Long-Term Debt

On March 11, 1998, the Company modified its 1947 Indenture of Mortgage and Deed of Trust; no future bonds can be issued under the mortgage. The first mortgage bonds continue to serve as collateral for the tax-exempt pollution control revenue bonds ("PCBs") in the outstanding principal amount of $111 million.

The Company has no long-term debt that matures from 1999 through 2003.

In March 1998, the Company replaced the first mortgage bonds collateralizing $463 million of PCBs with senior unsecured notes ("SUNs") which were issued under a new senior unsecured note indenture. Also, in March 1998, the Company retired $140 million principal amount of first mortgage bonds. While first mortgage bonds continue to serve as collateral for PCBs in the outstanding principal amount of $111 million, the lien of the mortgage was substantially reduced to cover only the Company's ownership interest in PVNGS. With the exception of the $111 million of PCBs secured by first mortgage bonds, the SUNs are and will be the senior debt of the Company.

In August 1998, the Company issued and sold $435 million of SUNs in two series, the 7.10% Series A due August 1, 2005, in the principal amount of $300 million, and the 7.50% Series B due August 1, 2018, in the principal amount of $135 million. These SUNs were issued under an indenture similar to the indenture under which the SUNs were issued in March 1998, and it is expected that future long-term debt financings will be similarly issued.

Revolving Credit Facility and Other Credit Facilities

At December 31, 1998, the Company has a $300 million unsecured revolving credit facility (the "Facility") with an expiration date of March 31, 2003. The Company must pay commitment fees of .200% per year on the total amount of the Facility. The Company also has a $100 million credit facility, which expires on May 20, 2001, and is collateralized by the Company's electric and gas customer accounts receivable and certain amounts being recovered from gas customers relating to certain gas contract settlements. In addition, the Company has $25 million in local lines of credit.

Fair Value of Financial Instruments

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

	1998		1997	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
	(In thousands)			
Long-Term Debt	$1,008,614	$1,042,557	$714,345	$743,524
Decommissioning Trust Debt	$ 26,620	$ 26,620	$ 23,000	$ 23,000
Investment in PVNGS Lessors' Notes	$ 443,748	$ 459,167	$ -	$ -
Investment in PVNGS LOBs	$ -	$ -	$237,774	$236,049
Decommissioning Trust	$ 59,803	$ 64,509	$ 51,857	$ 53,900
Fossil-Fueled Plant Decommissioning Trust	$ 7,676	$ 7,676	$ 7,245	$ 7,273
Rabbi Trust	$ 9,804	$ 17,012	$ 10,080	$ 15,218

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

The carrying amounts reflected on the consolidated balance sheets approximate fair value for cash, temporary investments, and receivables and payables due to the short period of maturity.

(5) 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. The following reconciliation illustrates the impact on the share amounts of potential common shares and the earnings per share amounts:

	INCOME	SHARES	PER-SHARE AMOUNT
	(In thousands except per share amounts)		
December 31, 1998			
Net Earnings	$82,682		
Less: Preferred stock dividends	(586)		
Basic Earnings per Share			
Net earnings available for common stock	82,096	41,774	$1.97
Options issued	-	298	
Diluted Earnings per Share			
Net earnings available for common stock	$82,096	42,072	$1.95
December 31, 1997			
Net Earnings	$80,995		
Less: Preferred stock dividends	(586)		
Basic Earnings per Share			
Net earnings available for common stock	80,409	41,774	$1.92
Options issued	-	217	
Diluted Earnings per Share			
Net earnings available for common stock	$80,409	41,991	$1.91
December 31, 1996			
Net Earnings	$72,580		
Less: Preferred stock dividends	(586)		
Basic Earnings per Share			
Net earnings available for common stock	71,994	41,774	$1.72
Options issued	-	332	
Diluted Earnings per Share			
Net earnings available for common stock	$71,994	42,106	$1.71

(6) INCOME TAXES

Income taxes consist of the following components:

	1998	1997	1996
		(In thousands)	
Current Federal income tax	$ 26,824	$ 32,911	$ 14,815
Current state income tax	10,157	9,859	2,847
Deferred Federal income tax	15,062	8,781	22,372
Deferred state income tax	(484)	(397)	4,936
Amortization of accumulated investment tax credits	(3,418)	(4,436)	(4,476)
Total income taxes	$ 48,141	$ 46,718	$ 40,494
Charged to operating expenses	$ 41,306	$ 41,941	$ 39,650
Charged to other income and deductions	6,835	4,777	844
Total income taxes	$ 48,141	$ 46,718	$ 40,494

The Company's provision for income taxes differed from the Federal income tax computed at the statutory rate for each of the years shown. The differences are attributable to the following factors:

	1998	1997	1996
		(In thousands)	
Federal income tax at statutory rates	$ 45,788	$ 44,700	$ 39,576
Investment tax credits	(3,418)	(4,436)	(4,476)
Depreciation of flow-through items	531	519	519
Gains on the sale and leaseback of PVNGS Units 1 and 2	(527)	(527)	(527)
State income tax	6,129	5,963	5,192
Other	(362)	499	210
Total income taxes	$ 48,141	$ 46,718	$ 40,494

Deferred income taxes result from certain temporary differences between the recognition of income and expense for tax and financial reporting purposes, as described in note 1. The major sources of these differences for which deferred taxes have been provided and the tax effects of each are as follows:

	1998	1997	1996
		(In thousands)	
Deferred fuel costs	$(11,097)	$ (9,133)	$ 8,234
Depreciation and cost recovery	7,526	6,390	18,048
Contributions in aid of construction	(2,826)	(3,185)	(4,053)
Alternative minimum tax in excess of regular tax	21,144	12,482	(1,052)
PVNGS decommissioning	(618)	(1,512)	537
Contribution to 401(h) plan	(763)	3,181	(510)
Regulatory liability	-	-	(6,651)
Curtailment gain	-	-	5,272
Transmission project cost	-	-	4,898
Other	1,212	161	2,585
Net deferred taxes provided	$ 14,578	$ 8,384	$ 27,308

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

	1998	1997
	(In thousands)	
Deferred Tax Assets:		
Alternative minimum tax credit carryforward	$ 34,055	$ 55,198
Nuclear decommissioning	20,062	18,226
Regulatory liabilities	47,615	50,689
Other	45,480	46,079
Total deferred tax assets	$147,212	$170,192
Deferred Tax Liabilities:		
Depreciation	$184,462	$182,641
Investment tax credit	54,404	57,823
Fuel costs	12,808	23,905
Regulatory assets	69,298	68,524
Other	24,921	19,176
Total deferred tax liabilities	345,893	352,369
Accumulated deferred income taxes, net	$198,681	$181,877

45

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

Net change in deferred income tax liability per above table	$16,804
Change in tax effects of income tax related regulatory assets and liabilities	(3,848)
Tax effect of excess pension liability	134
Tax effect of mark-to-market on investments available for sale	(1,930)
Deferred income tax expense for the period	$11,160

The Company has no net operating loss carryforwards as of December 31, 1998.

(7) EMPLOYEE AND OTHER POSTRETIREMENT BENEFITS

Pension Plan

The Company and its subsidiaries have a pension plan covering substantially all of their employees, including officers. The plan is non-contributory and provides for benefits to be paid to eligible employees at retirement based primarily upon years of service with the Company and the average of their highest annual base salary for three consecutive years. The Company's policy is to fund actuarially-determined contributions. Contributions to the plan reflect benefits attributed to employees' years of service to date and also for services expected to be provided in the future. Plan assets primarily consist of common stock, fixed income securities, cash equivalents and real estate.

In December 1996, the Company's Board approved changes to the Company's defined benefit pension plan and the implementation of a defined contribution plan effective January 1, 1998. As a result, the Company recorded a curtailment gain of approximately $13.3 million in the consolidated financial statements for the year ended December 31, 1996.

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

	PENSION BENEFITS 1998	1997
Change in Benefit Obligation:		
Benefit obligation at beginning of year	$297,679	$259,051
Service cost	6,660	6,535
Interest cost	20,101	19,592
Actuarial loss	19,380	25,001
Benefits paid	(13,772)	(12,500)
Benefit obligation at end of period	330,048	297,679
Change in Plan Assets:		
Fair value of plan assets at beginning of year	330,550	273,981
Actual return on plan assets	13,593	69,069
Employer contribution	185	2,000
Benefits paid	(13,772)	(12,500)
Fair value of plan assets at end of year	330,556	332,550
Funded Status	508	34,871
Unamortized transition assets	(3,486)	(4,650)
Unrecognized net actuarial loss	19,714	(12,828)
Unrecognized prior service cost	112	146
Prepaid benefit cost	$ 16,848	$ 17,539
Weighted - Average Assumptions as of December 31,		
Discount rate	6.75%	7.25%
Expected return on plan assets	8.50%	8.25%
Rate of compensation increase	N/A	N/A

	PENSION BENEFITS 1998	1997	1996
Components of Net Periodic Benefit Cost:			
Service cost	$ 6,660	$ 6,535	$ 8,540
Interest cost	20,101	19,592	20,546
Expected return on plan assets	(26,755)	(23,426)	(31,211)
Amortization of prior service cost	(1,130)	(1,130)	9,577
Net periodic benefit cost	(1,124)	1,571	7,452
Curtailment gain	-	-	(13,317)
Total pension expense (benefit)	$ (1,124)	$ 1,571	$ (5,865)

Other Postretirement Benefits

The Company provides medical and dental benefits to eligible retirees. Currently, retirees are offered the same benefits as active employees after reflecting Medicare coordination. The following sets forth the plan's funded status, components of net periodic benefit cost (in thousands) at December 31:

	OTHER BENEFITS 1998	1997	1996
Change in Benefit Obligation:			
Benefit obligation at beginning of year	$ 59,084	$ 58,399	
Service cost	1,292	1,300	
Interest cost	4,501	4,452	
Actuarial loss (gain)	9,662	(5,067)	
Benefit obligation at end of period	74,539	59,084	
Change in Plan Assets:			
Fair value of plan assets at beginning of year	33,158	20,930	
Actual return on plan assets	4,444	6,076	
Employer contribution	-	6,152	
Fair value of plan assets at end of year	$ 37,602	$ 33,158	
Funded Status	$(36,937)	$(25,926)	
Unamortized transition assets	6,826	(4,033)	
Unrecognized prior service cost	25,440	27,257	
Accrued benefit cost	$ (4,671)	$ (2,702)	
Weighted - Average Assumptions as of December 31,			
Discount rate	6.75%	7.25%	
Expected return on plan assets	8.75%	8.75%	
Rate of compensation increase	N/A	N/A	
Components of Net Periodic Benefit Cost:			
Service cost	$ 1,292	$ 1,300	$ 1,449
Interest cost	4,501	4,452	4,478
Expected return on plan assets	(2,943)	(1,884)	(1,367)
Amortization of prior service cost	1,817	1,817	1,817
Net periodic benefit cost	$ 4,667	$ 5,685	$ 6,377

The effect of a 1% increase in the health care trend rate assumption would increase the accumulated postretirement benefit obligation as of December 31, 1998, by approximately $13.6 million and the aggregate service and interest cost components of net periodic postretirement benefit cost for 1998 by approximately $1.2 million. The health care cost trend rate is expected to decrease to 5.0% by 2010 and to remain at that level thereafter.

Executive Retirement Program

The Company has an executive retirement program for a group of management employees. The program was intended to attract, motivate and retain key management employees. The Company's projected benefit obligation for this program, as of December 31, 1998, was \$19.5 million, of which the accumulated and vested benefit obligation was \$19.5 million. As of December 31, 1998, the Company has recognized an additional liability of \$5.8 million for the amount of unfunded accumulated benefits in excess of accrued pension costs. The net periodic pension cost for 1998, 1997 and 1996 was \$2.3 million, \$2.2 million and \$2.1 million, respectively. In 1989, the Company established an irrevocable grantor trust in connection with the executive retirement program. Under the terms of the trust, the Company may, but is not obligated to, provide funds to the trust, which was established with an independent trustee, to aid it in meeting its obligations under such program. Marketable securities in the amount of approximately \$9.8 million (fair market value of \$17.0 million) are presently in trust. No additional funds have been provided to the trust since 1989.

Stock Option Plans

The Company's Performance Stock Plan ("PSP") is a non-qualified stock option plan, covering a group of management employees. Options are granted at the fair market value of the shares on the date of the grant. Options granted through December 31, 1995, vested on June 30, 1996, have an exercise term of up to 10 years. All subsequent awards granted after December 31, 1995, vest three years from the grant date of the awards. The maximum number of options authorized are five million shares through December 31, 2000.

In addition, the Company has a Director Retainer Plan ("DRP") which provides for payment of the Directors' annual retainer in the form of cash, restricted stock or stock options. The number of options granted in 1998 under the DRP was 10,000 shares with an exercise price of \$12.75. The number of options exercised during 1998 under the DRP was 5,000. The number of options outstanding as of December 31, 1998, was 21,000.

The fair value of each option grant is determined on the date of grant using the Black-Scholes option-pricing model with the following average assumptions used for grants in 1996, 1997 and 1998, respectively: dividend yield of 2.4%, 3.0% and 3.75%; expected volatility of 18%, 20% and 26.78%, risk-free interest rates of 5.59%, 5.69% and 4.65%; and expected lives of four years.

A summary of the status of the Company's stock option plans at December 31, and changes during the years then ended is presented below. Prior periods have been restated for comparability purposes.

	1998		1997		1996	
FIXED OPTIONS	SHARES	WEIGHTED AVERAGE EXERCISE PRICE	SHARES	WEIGHTED AVERAGE EXERCISE PRICE	SHARES	WEIGHTED AVERAGE EXERCISE PRICES
Outstanding at beginning of year	1,539,214	\$17.704	1,619,406	\$15.905	1,652,977	\$14.457
Granted	10,000	\$12.750	312,707	\$23.033	390,228	\$19.480
Exercised	473,063	\$14.663	379,833	\$14.453	408,822	\$13.691
Forfeited	79,976	\$21.194	13,066	\$19.450	14,977	\$19.625
Outstanding at end of year	996,175	\$18.819	1,539,214	\$17.704	1,619,406	\$15.905
Options exercisable at year-end	400,158		861,221		1,244,155	
Weighted-average fair value of options granted during the year:						
PSP	N/A		\$ 4.21		\$ 3.56	
DRP	\$7.32		\$15.69		\$11.50	

The following table summarizes information about stock options outstanding at December 31, 1998:

	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING AT 12/31/98	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED AVERAGE EXERCISE PRICES	NUMBER EXERCISABLE AT 12/31/98	WEIGHTED AVERAGE EXERCISE PRICES
\$ 5.50 - \$ 12.75	21,000	9.33 years	\$ 9.381	11,000	\$ 6.318
\$ 11.50 - \$ 23.6875	975,175	7.62 years	\$ 19.022	389,158	\$15.298
\$ 5.50 - \$23.6875	996,175	7.65 years	\$ 18.819	400,158	\$15,051

Had compensation cost for the Company's performance stock plan been determined consistent with SFAS No. 123, Accounting for Stock-Based Compensation, the effect on the Company's pro forma net earnings and pro forma earnings per share would be as follows:

		1998	1997	1996
		(In thousands except per share amounts)		
Net Earnings:				
(Available for common)	As Reported	\$ 82,096	\$ 80,409	\$ 71,994
	Pro Forma	\$ 81,554	\$ 80,018	\$ 70,952
Basic EPS:	As Reported	\$ 1.97	\$ 1.92	\$ 1.72
	Pro Forma	\$ 1.95	\$ 1.92	\$ 1.70
Diluted EPS:	As Reported	\$ 1.95	\$ 1.91	\$ 1.71
	Pro Forma	\$ 1.95	\$ 1.90	\$ 1.70

(8) CONSTRUCTION PROGRAM AND JOINTLY-OWNED PLANTS

The Company's construction expenditures for 1998 were approximately \$128.8 million, including expenditures on jointly-owned projects. The Company's proportionate share of expenses for the jointly-owned plants is included in operating expenses in the consolidated statements of earnings.

At December 31, 1998, the Company's interests and investments in jointly-owned generating facilities are:

STATION (FUEL TYPE)	PLANT IN SERVICE	ACCUMULATED DEPRECIATION	CONSTRUCTION WORK IN PROGRESS	COMPOSITE INTEREST
	(In thousands)			
San Juan Generating Station (Coal)	\$ 704,890	\$310,678	\$ 15,310	46.3%
Palo Verde Nuclear Generating Station (Nuclear)	\$ 197,369*	\$ 43,822*	\$ 12,156*	10.2%
Four Corners Power Plant Units 4 and 5 (Coal)	\$ 120,492	\$ 62,494	\$ 1,690	13.0%

** Includes the Company's interest in PVNGS Unit 3, the Company's interest in common facilities for all PVNGS units and the Company's owned interests in PVNGS Units 1 and 2.*

San Juan Generating Station ("SJGS")

The Company operates and jointly owns SJGS. At December 31, 1998, SJGS Units 1 and 2 are owned on a 50% shared basis with Tucson Electric Power Company, Unit 3 is owned 50% by the Company, 41.8% by Southern California Public Power Authority ("SCPPA") and 8.2% by Tri-State Generation and Transmission Association, Inc. Unit 4 is owned 38.457% by the Company, 28.8% by M-S-R Public Power Agency, California public power agency ("M-S-R"), 10.04% by the City of Anaheim, California, 8.475% by the City of Farmington, 7.2% by the County of Los Alamos, and 7.028% by Utah Associated Municipal Power Systems.

Palo Verde Nuclear Generating Station

The Company is participating in the three 1,270 MW units of PVNGS, also known as the Arizona Nuclear Power Project, with Arizona Public Service Company ("APS") (the operating agent), Salt River Project, El Paso Electric Company ("El Paso"), Southern California Edison Company, SCPPA and The Department of Water and Power of the City of Los Angeles. The Company has a 10.2% undivided interest in PVNGS, with portions of its interests in Units 1 and 2 held under leases. During 1998, PVNGS was operated at a capacity factor of 92.5% which was the highest yearly capacity factor attained at the plant. This capacity factor was primarily attributable to record setting low refueling outage days.

PVNGS Liability and Insurance Matters

The PVNGS participants have insurance for public liability resulting from nuclear energy hazards to the full limit of liability under Federal law. This potential liability is covered by primary liability insurance provided by commercial insurance carriers in the amount of $200 million and the balance by an industry-wide retrospective assessment program. If losses at any nuclear power plant covered by the programs exceed the accumulated funds, the Company could be assessed retrospective premium adjustments. The maximum assessment per reactor under the program for each nuclear incident is approximately $88 million, subject to an annual limit of $10 million per incident. Based upon the Company's 10.2% interest in the three PVNGS units, the Company's maximum potential assessment per incident for all three units is approximately $26.9 million, with an annual payment limitation of $3 million per incident. The insureds under this liability insurance include the PVNGS participants and "any other person or organization with respect to his legal responsibility for damage caused by the nuclear energy hazard". If the funds provided by this retrospective assessment program prove to be insufficient, Congress could impose revenue raising measures on the nuclear industry to pay claims.

The United States Nuclear Regulatory Commission ("NRC") has also recently announced that it has provided a report to Congress, making certain recommendations, with respect to the Federal law referred to above, which provides for payment of public liability claims in case of a catastrophic accident involving a nuclear power plant. One of the recommendations by the NRC would be that Congress consider amending the law to provide that the maximum a nuclear utility can be assessed per reactor per incident per year be doubled to $20 million. The $88 million maximum retrospective assessment per reactor per incident would be unchanged under the NRC proposal. The NRC also recommended that Congress investigate whether the $200 million now available from the private insurance market for liability claims per reactor can be increased to keep pace with inflation. The Company cannot predict whether or not Congress will act on the NRC's recommendations. However, if adopted, certain of the recommendations could possibly trigger "Deemed Loss Events" under the Company's PVNGS leases, absent waiver by the lessors.

The PVNGS participants maintain "all-risk" (including nuclear hazards) insurance for nuclear property damage to, and decontamination of, property at PVNGS in the aggregate amount of $2.75 billion as of January 1, 1999, a substantial portion of which must be applied to stabilization and decontamination. The Company has also secured insurance against portions of the increased cost of generation or purchased power and business interruption resulting from certain accidental outages of any of the three units if the outages exceeds 17 weeks. The insurance coverage discussed in this section is subject to certain policy conditions and exclusions. The Company is a member of an industry mutual insurer. This mutual insurer provides both the "all-risk" and increased cost of generation insurance to the Company. In the event of adverse losses experienced by this insurer, the Company is subject to an assessment. The Company's maximum share of any assessment is approximately $3.3 million per year.

PVNGS Decommissioning Funding

The Company has a program for funding its share of decommissioning costs for PVNGS. Under a portion of this program, the Company made a series of annual deposits under agreements approved by the NMPUC to an external non-qualified trust which were applied pursuant to a split dollar agreement between the Company

and its employees towards an investment in whole life insurance policies on certain current and former employees. The program for investment in life insurance policies has been terminated. The remaining portion of the nuclear decommissioning funding program is invested in equities in qualified and non-qualified trusts. The results of the 1998 decommissioning cost study indicated that the Company's share of the PVNGS decommissioning costs excluding spent fuel disposal will be approximately $155.4 million (in 1998 dollars).

Pursuant to NMPUC approval, the Company funded an additional $3.0 million, $2.1 million and $12.5 million in 1998, 1997 and 1996, respectively, into the qualified and non-qualified trust funds. The estimated market value of the trusts, including the net cash value of the life insurance policies, at the end of 1998 was approximately $40 million.

The NRC has recently amended its rules on financial assurance requirements for the decommissioning of nuclear power plants. The amended rules became effective on November 23, 1998. The NRC has indicated that the amendments respond to the potential rate deregulation in the power generating industry and NRC concerns regarding whether decommissioning funding assurance requirements will need to be modified. The amended rules provide that a licensee may use an external sinking fund as the exclusive financial assurance mechanism if the licensee recovers estimated total decommissioning costs through cost of service rates or through a "non-bypassable charge". Other mechanisms are prescribed, including prepayment, if the requirements for exclusive reliance on the external sinking fund mechanism are not met. The Company currently relies on the external sinking fund mechanism to meet the NRC financial assurance requirements for its interests in PVNGS Units 1, 2 and 3. The costs of PVNGS Units 1 and 2 are currently included in PRC jurisdictional rates, but the costs of PVNGS Unit 3 are excluded from PRC jurisdictional rates. The Company will be filing a report with the NRC through APS, the operating agent of PVNGS, at the end of March 1999, concerning decommissioning funding assurance, and believes that it will continue to be allowed to use the external sinking fund method as the sole financial assurance method for Unit 3.

Nuclear Spent Fuel and Waste Disposal

Pursuant to the Nuclear Waste Policy Act of 1982, as amended in 1987 (the "Waste Act"), United States Department of Energy ("DOE") is obligated to accept and dispose of all spent nuclear fuel and other high-level radioactive wastes generated by all domestic power reactors. The NRC, pursuant to the Waste Act, requires operators of nuclear power reactors to enter into spent fuel disposal contracts with DOE. APS, on its own behalf and on behalf of the other PVNGS participants, executed a spent fuel disposal contract with DOE. Under the Waste Act, DOE was to develop the facilities necessary for the storage and disposal of spent nuclear fuel and to have the first such facility in operation by 1998. That facility was to be a permanent repository. DOE announced that such a repository now cannot be completed before 2010.

In response to lawsuits filed over DOE's obligation to accept used nuclear fuel, the United States Court of Appeals for the D.C. Circuit ("D.C. Circuit") has ruled that DOE had an obligation to begin accepting used nuclear fuel in 1998. However, the D.C. Circuit refused to issue an order compelling DOE to begin moving used fuel. Instead, the D.C. Circuit ruled that any damages to utilities should be sought under the standard contract signed between DOE and utilities, including APS, the operating agent of PVNGS. The United States Supreme Court has refused to grant review of the D.C. Circuit's decisions. In July 1998, APS filed a petition for review regarding DOE's obligation to begin accepting spent nuclear fuel.

APS has capacity in existing fuel storage pools at PVNGS which, with certain modifications, could accommodate all fuel expected to be discharged from normal operation of PVNGS through 2002, and believes it could augment that wet storage with the new facilities for on-site dry storage of spent fuel for an indeterminate period of operation beyond 2002, subject to obtaining any required governmental approvals. The Company currently estimates that it will incur approximately $41 million (in 1998 dollars) over the life of PVNGS for its share of the costs related to the on-site interim storage of spent nuclear fuel. The Company accrues these costs as a component of fuel expense, meaning the charges are accrued as the fuel is burned.

During 1998, the Company expensed approximately $12 million for on-site interim nuclear fuel storage costs related to nuclear fuel burned prior to 1999. APS currently believes that spent fuel storage or disposal methods will be available for use by PVNGS to allow its continued operation beyond 2002.

A low-level radioactive waste facility built in 1995 at the PVNGS site could store an amount of waste equivalent to 10 years of normal operation of PVNGS. Although some low-level waste has been stored on-site, APS is currently shipping low-level waste to off-site facilities. APS currently believes that interim low-level waste storage methods are or will be available for use by PVNGS to allow its continued operation and to safely store low-level waste until a permanent facility is available.

While believing that scientific and financial aspects of the issues of spent fuel and low-level waste storage and disposal can be resolved satisfactorily, the Company acknowledges that their ultimate resolution in a timely fashion will require political resolution and action on national and regional scales which it is less able to predict.

(9) LONG-TERM POWER CONTRACTS

The Company has a power purchase contract with Southwestern Public Service Company ("SPS") which originally provided for the purchase of up to 200 MW, expiring in May 2011. The Company may reduce its purchases from SPS by 25 MW annually upon three years' notice. The Company provided such notice to reduce the purchase by 25 MW in 1999 and by an additional 25 MW in 2000. The Company has 39 MW of contingent capacity obtained from El Paso under a transmission capacity for generation capacity trade arrangement that increases up to 70 MW from 1999 through 2003. In addition, the Company is interconnected with various utilities for economy interchanges and mutual assistance in emergencies. The Company has been actively trading in the wholesale power market and has entered into and anticipates that it will continue to enter into power purchases to accommodate its trading activity.

The Company anticipates the need for approximately 100 to 200 MW of additional capacity in the 1999 through 2000 timeframe. To meet projected capacity needs, in 1996, the Company entered into a long-term power purchase agreement ("PPA") with Cobisa-Person Limited Partnership ("PLP") to purchase approximately 100 MW of unit contingent peaking capacity from a gas turbine generating unit for a period of 20 years, with an option to renew for an additional five years. In September 1997, the NMPUC approved the Company's and PLP's applications for the project. In December 1997, PLP also received FERC approval for "exempt wholesale generator" status with respect to the gas turbine generating unit. In March 1998, the Company and PLP executed amendments to the PPA and to the associated site lease and interconnection agreement, and executed a new water use lease. The PPA was amended to change the maximum capacity the Company was obligated to take to 132 MW and to change the commercial operation date from May 1999 to May 2000. The gas turbine generating unit will be constructed and operated by PLP and will be located on the Company's retired Person Generating Station site in Albuquerque, New Mexico. The site for the generating unit was chosen, in part, to provide needed benefits to the Company's constrained transmission system. Primary fuel for the gas turbine generating unit will be natural gas, which will be provided by the Company. In addition, the unit will have the capability to utilize low sulfur fuel oil in the event natural gas is not available.

In the September 1997 NMPUC order, the NMPUC approved the project application and a stipulated settlement agreement ("Stipulation") which had been entered into earlier among the Company, PLP and the NMPUC staff to resolve certain issues raised in this proceeding. The Stipulation included, among other things, a provision wherein the Company committed, in cooperation with the NMPUC staff, to the development and evaluation of a request for proposal ("RFP") for the purchase of approximately 5 MW of capacity from solar generation resources. The Company was not obligated to build such a unit or commit to such a solar power purchase agreement prior to the NMPUC approval of a full-cost recovery mechanism.

By order dated October 27, 1998, the NMPUC approved the Company's implementation of a rate rider to collect a 0.5 percent surcharge on all retail electric bills to pay for solar and other renewable resource projects. Under the NMPUC's order, one-half of the monies collected under the rider will be used to purchase

or acquire resources the Company had pursued through the solar RFP process, while the other half of the monies will be used for other renewable resource projects.

In November 1998, the NMPUC adopted a rule that establishes a "renewable energy development program" and requires New Mexico utilities to collect voluntary contributions to a renewable energy fund from their customers. The stated purpose of the rule is to support research, development, demonstration and deployment of renewable energy resources. Funds collected by each utility are to be spent by it on projects approved by the PRC based upon the recommendations of a Renewable Energy Advisory Board which will be appointed by the PRC. The Company has requested the PRC to exempt it from the rule on the grounds that the rule is more than satisfied by the renewable resource program and 0.5 percent surcharge specifically approved for the Company by the NMPUC in October 1998. The Company's request is pending.

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

(10) LEASE COMMITMENTS

The Company leases interests in Units 1 and 2 of PVNGS, certain transmission facilities, office buildings and other equipment under operating leases. The lease expense for PVNGS is $66.3 million per year over base lease terms expiring in 2015 and 2016. Prior to 1992, the aggregate lease expense for the PVNGS leases was $84.6 million per year over the base lease terms; however, this amount was reduced by the purchase of approximately 22% of the beneficial interests in the PVNGS Units 1 and 2 leases (see note 8). The Company has since reacquired the ownership of those specific interests in PVNGS Units 1 and 2. Each PVNGS lease contains renewal and fair market value purchase options at the end of the base lease term. Covenants in the Company's PVNGS Units 1 and 2 lease agreements limit the Company's ability, without consent of the owner participants and bondholders in the lease transactions, (i) to enter into any merger or consolidation, or (ii) except in connection with normal dividend policy, to convey, transfer, lease or dividend more than 5% of its assets in any single transaction or series of related transactions.

Future minimum operating lease payments (in thousands) at December 31, 1998 are:

1999	$79,805
2000	78,974
2001	78,779
2002	78,666
2003	78,663
Later years	875,088
Total minimum lease payments	$1,269,975

Operating lease expense, inclusive of PVNGS leases, was approximately $82.6 million in 1998, $80.8 million in 1997 and $80.3 million in 1996. Aggregate minimum payments to be received in future periods under noncancelable subleases are approximately $5.3 million.

(11) ENVIRONMENTAL ISSUES

The Company is committed to complying with all applicable environmental regulations. Environmental issues have presented and will continue to present a challenge to the Company. The Company has evaluated the potential impacts of the following environmental issues and believes, after consideration of established reserves, that the ultimate outcome of these environmental issues will not have a material adverse effect on the Company's financial condition or results of operations.

Electric Operations

Santa Fe Generating Station ("Santa Fe Station")

The Company and the New Mexico Environment Department ("NMED") have conducted investigations of the gasoline and chlorinated solvent groundwater contamination detected beneath the former Santa Fe Station site to determine the source of the contamination pursuant to a 1992 Settlement Agreement ("Settlement Agreement") between the Company and the NMED. In June 1996, the Company received a letter from the NMED, indicating that the NMED believes the Company is the source of gasoline contamination in a municipal well supplying the City of Santa Fe and of groundwater underlying the Santa Fe Station site. Further, the NMED letter stated that the Company was required to proceed with interim remediation of the contamination pursuant to the New Mexico Water Quality Control Commission regulations.

In October 1996, the Company and the NMED signed an amendment to the Settlement Agreement concerning the groundwater contamination underlying the site. As part of the amendment, the Company agreed to spend approximately $1.2 million for certain costs related to sampling, monitoring, and the development and implementation of a remediation plan.

The amended Settlement Agreement does not, however, provide the Company with a full and complete release from potential further liability for remediation of the groundwater contamination. After the Company has expended the settlement amount, if the NMED can establish through binding arbitration that the Santa Fe Station is the source of the contamination, the Company could be required to perform further remediation that is determined to be necessary. The Company continues to dispute any contention that the Santa Fe Station is the source of the groundwater contamination and believes that insufficient data exists to identify the sources of groundwater contamination. The Company's aquifer characterization and groundwater quality reports complied from 1996 to 1999 strongly suggest the groundwater contamination does not originate from the Santa Fe Station site and has been drawn under the site by the pumping of the Santa Fe supply well.

The Company and the NMED, with the cooperation of the City of Santa Fe, jointly selected a remediation plan proposed by a remediation contractor. The City of Santa Fe, the Company and the NMED entered into a memorandum of understanding concerning the selected remediation plan and the operation of the municipal well adjacent to the Santa Fe Station site in connection with carrying out that plan. Construction of a new Santa Fe well and booster station has been completed. The new system began operation on October 5, 1998, to treat groundwater produced by the Santa Fe well to drinking water standards for municipal distribution and the stimulation of naturally occurring bioremediation of groundwater contamination beneath the Santa Fe Station site.

Person Station

The Company, in compliance with a Corrective Action Directive issued by the NMED, determined that groundwater contamination exists in the deep and shallow groundwater at the Person Station site. The Company is required to delineate the extent of the contamination and remediate the contaminants in the groundwater at the Person Station site. The extent of shallow and deep groundwater contamination was assessed and the results were reported to the NMED. The Company currently is involved with the process to renew the Resource Conservation and Recovery Act ("RCRA") post-closure care permit for the facility. Remedial actions for the shallow and deep groundwater will be incorporated into the new permit. The Company has installed and is operating a pump and treat system for the shallow groundwater. The Company has proposed a monitoring program in conjunction with natural attenuation processes as the most cost effective approach for the deep groundwater remediation. The Company's current estimate to decommission its retired fossil-fueled plants includes approximately $5.0 million in additional expenses to complete the groundwater remediation program at Person Station. As part of the financial assurance requirement of the Person Station Hazardous Waste Permit, the Company established a trust fund. The current value of the trust fund at December 31, 1998, was $7.7 million. The remediation program continues on schedule.

Gas Operations

Pit Closure and Remediation

In 1995, the Jicarilla Apache Tribe ("Jicarilla") enacted an ordinance directing that unlined surface impoundments located within environmentally sensitive areas be remediated and closed by December 1996, and that all other unlined surface impoundments on Jicarilla lands be remediated and closed by December 1998. In 1995, the Company received a claim for indemnification by Williams Gas Processing-Blanco, Inc. ("Williams"), the purchaser of the Company's gas gathering and processing assets, for the environmental work required to comply with the Jicarilla ordinance. The Company submitted a closure/remediation plan to the Jicarillas' environmental protection office, which was approved. The Company's remediation work pursuant to the plan commenced in 1996, and the costs of remediation are being charged against the $10.6 million indemnification cap contained in the purchase and sale agreement between the Company and Williams. The Company completed remediation and closed pits within the environmentally sensitive area in 1996, and completed remediation and closure of all other pits on the Jicarilla Apache Reservation associated with the sale of gas gathering and processing assets by the December 1998 deadline specified in the ordinance.

(12) DISCONTINUED OPERATIONS

On August 4, 1998, the Company adopted a plan to discontinue the gas trading operations of its Energy Services Business Unit. Accordingly, the gas marketing operations of its Energy Services Business Unit are reported as discontinued operations. Estimated losses on the disposal of the gas marketing segment was $5.1 million (net of income tax benefit of $3.3 million), which includes a provision for anticipated operating losses prior to disposal.

Operating results of the discontinued operations prior to the date of discontinuation are shown separately in the accompanying consolidated statements of earnings. Such amounts include income tax benefits related to the losses from discontinued operations of $4.8 million in 1998, $3.6 million in 1997 and $.3 million in 1996. Total sales from the discontinued operations were $159.2 million, $114.7 million and $9.6 million in 1998, 1997 and 1996, respectively. Prior to the decision to discontinue non-utility operations, such total sales and income tax benefits were included in operating revenues and operating expenses in the consolidated statement of earnings.

(13) SEGMENT INFORMATION

In 1998, the Company adopted SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. The Company's principal business segments are the four regulated business units: Electric Service Business Unit ("Distribution"), Transmission Service Business Unit ("Transmission"), Bulk Power Business Unit ("Generation") and Gas Services Business Unit ("Gas"). The Company's non operating subsidiaries and Energy Services Business Unit are not reportable segments and are included in "Other" for reconciliation purposes. Intersegment revenues are determined based on a formula mutually agreed upon between affected segments and are not based on market rates. Such intersegment items are eliminated for consolidation purposes.

Summarized financial information by business segment for 1998, 1997 and 1996 is as follows:

	ELECTRIC					
	DISTRIBUTION	TRANSMISSION	GENERATION	GAS	OTHER	TOTAL
	(In thousands)					
1998:						
Operating revenues:						
External customers	$539,972	$ 15,596	$ 279,636	$255,975	$ 1,266	$1,092,445
Intersegment revenues	$ -	$ 29,091	$ 362,722	$ -	$ -	$ 391,813
Depreciation and amortization	$ 23,396	$ 8,527	$ 38,292	$ 15,863	$ 63	$ 86,141
Interest income	$ 9,200	$ 4,286	$ 15,001	$ 6,130	$ 424	$ 35,041
Net interest charges	$ 16,057	$ 7,547	$ 26,179	$ 13,784	$ (350)	$ 63,217
Operating income tax expense (benefit)	$ 10,217	$ 2,518	$ 27,632	$ 4,597	$ (3,658)	$ 41,306
Segment net income (loss)	$ 22,317	$ 6,828	$ 61,949	$ 11,056	$(19,468)	$ 82,682
Total assets	$583,104	$197,085	$1,328,691	$443,750	$ 24,158	$2,576,788
Gross property additions	$ 50,399	$ 9,156	$ 30,969	$ 38,260	$ -	$ 128,784
1997:						
Operating revenues:						
External customers	$522,835	-	$ 199,603	$294,769	$ 3,314	$1,020,521
Intersegment revenues	$ -	-	$ 370,019	-	$ -	$ 370,019
Depreciation and amortization	$ 21,754	-	$ 46,335	$ 14,587	$ 18	$ 82,694
Interest income	$ 6,715	-	$ 12,714	$ 4,313	$ 34	$ 23,776
Net interest charges	$ 15,900	-	$ 27,613	$ 12,701	$ -	$ 56,214
Operating income tax expense (benefit)	$ 13,890	-	$ 22,556	$ 7,587	$ (2,092)	$ 41,941
Segment net income (loss)	$ 24,496	-	$ 51,260	$ 14,602	$ (9,363)	$ 80,995
Total assets	$607,898	-	$1,178,036	$479,320	$ 55,301	$2,320,555
Gross property additions	$ 45,302	-	$ 51,661	$ 31,408	$ -	$ 128,371
1996:						
Operating revenues:						
External customers	$510,936	-	$ 134,703	$227,301	$ 838	$ 873,778
Intersegment revenues	$ -	-	$ 380,000	$ -	$ -	$ 380,000
Depreciation and amortization	$ 19,883	-	$ 44,934	$ 13,122	$ 176	$ 78,115
Interest income	$ 2,386	-	$ 5,700	$ 4,420	$ -	$ 12,506
Net interest charges	$ 12,346	-	$ 30,817	$ 11,544	$ -	$ 54,707
Operating income tax expense (benefit)	$ 8,559	-	$ 23,863	$ 8,927	$ (1,699)	$ 39,650
Segment net income (loss)	$ 16,800	-	$ 52,237	$ 8,909	$ (5,366)	$ 72,580
Total assets	$579,793	-	$1,139,827	$484,073	$ 26,621	$2,230,314
Gross property additions	$ 49,221	-	$ 27,351	$ 26,497	$ 18	$ 103,087

The Transmission Service Business Unit was established in 1998. Prior to 1998, it was combined with the Bulk Power Business Unit. Prior periods information for the Transmission Service Business Unit is not available.

On August 4, 1998, the Company adopted a plan to discontinue the gas trading operations of its Energy Services Business Unit (see note 12). Included in the line item Segment net income (loss) under Other are losses of $18,501, $9,050 and $5,058 for the discontinued operations for 1998, 1997 and 1996, respectively.

QUARTERLY *operating* RESULTS

The unaudited operating results by quarters for 1998 and 1997 are as follows:

	QUARTER ENDED			
	MARCH 31	JUNE 30	SEPTEMBER 30	DECEMBER 31
	(In thousands except per share amounts)			
1998:				
Operating Revenues	$282,560	$230,478	$320,438	$258,969
Operating Income	$ 36,626	$ 26,042	$ 47,446	$ 25,535
Earnings Before Discontinued Operations	$ 25,561	$ 16,497	$ 34,656	$ 18,405
Net Earnings (1)	$ 21,214	$ 14,778	$ 31,989	$ 14,701
Net Earnings per share before Discontinued Operations	$ 0.61	$ 0.39	$ 0.83	$ 0.44
Net Earnings per share (basic)	$ 0.50	$ 0.35	$ 0.77	$ 0.35
Net Earnings per share (diluted)	$ 0.50	$ 0.35	$ 0.76	$ 0.34
1997:				
Operating Revenues	$285,290	$219,435	$254,600	$261,196
Operating Income	$ 36,893	$ 26,781	$ 35,152	$ 30,721
Earnings before Discontinued Operations	$ 25,096	$ 16,354	$ 24,586	$ 20,461
Net Earnings	$ 24,896	$ 15,567	$ 24,319	$ 16,213
Net Earnings per share before Discontinued Operations	$ 0.60	$ 0.39	$ 0.59	$ 0.48
Net Earnings per share (basic)	$ 0.59	$ 0.37	$ 0.58	$ 0.38
Net Earnings per share (diluted)	$ 0.59	$ 0.37	$ 0.57	$ 0.38

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

(1) On August 4, 1998, the Company adopted a plan to discontinue the gas trading operations of its Energy Services Business Unit. As a result, estimated losses of $1.4 million ($0.03 per common share) and $3.7 million ($0.09 per common share) for the third quarter and the fourth quarter, respectively, were recognized. (See note 12 of the notes to consolidated financial statements.) In addition, certain prior periods amounts have been restated.

COMPARATIVE OPERATING STATISTICS

	1998	1997	1996	1995	1994
Electric Service					
Energy Sales - KWh (in thousands):					
Residential	2,007,852	1,976,434	1,892,290	1,795,371	1,786,292
Commercial	2,888,539	2,841,831	2,698,087	2,578,243	2,534,507
Industrial	1,571,824	1,556,264	1,505,801	1,434,974	1,268,208
Other ultimate customers	271,659	160,370	310,118	220,777	364,144
Total sales to ultimate customers	6,739,874	6,534,899	6,406,296	6,029,365	5,953,151
Sales for resale	8,782,315	6,785,643	4,575,220	2,590,513	3,361,933
Total KWh sales	15,522,189	13,320,542	10,981,516	8,619,878	9,315,084
Electric Revenues (in thousands):					
Residential	$ 187,681	$ 184,813	$ 177,220	$ 168,633	$ 172,559
Commercial	241,968	237,629	226,146	218,222	229,851
Industrial	88,644	86,927	83,651	79,964	79,729
Other ultimate customers	18,124	10,135	20,804	18,749	24,147
Total revenues to ultimate customers	536,417	519,504	507,821	485,568	506,286
Sales for resale	274,979	185,334	121,329	80,949*	96,821*
Total revenues from energy sales	811,396	704,838	629,150	566,517	603,107
Miscellaneous electric revenues	23,808	17,600	16,489	17,767	18,687
Total electric revenues	$ 835,204	$ 722,438	$ 645,639	$ 584,284	$ 621,794
Customers at Year End:					
Residential	319,415	311,314	304,900	296,821	287,369
Commercial	37,652	36,942	36,292	35,390	34,336
Industrial	363	363	375	374	384
Other ultimate customers	665	637	632	598	599
Total ultimate customers	358,095	349,256	342,199	333,183	322,688
Sales for Resale	83	66	56	37	42
Total customers	358,178	349,322	342,255	333,220	322,730
Reliable Net Capability - KW	1,506,000	1,506,000	1,506,000	1,506,000	1,506,000
Coincidental Peak Demand - KW	1,313,000	1,209,000	1,217,000	1,247,000	1,189,000
Average Fuel Cost per Million BTU	$ 1.2433	$ 1.2319	$ 1.2735	$ 1.3177	$ 1.3488
BTU per KWh of Net Generation	10,784	10,927	10,768	10,811	10,817
Water Service **					
Water Sales - Gallon (in thousands)	-	-	-	1,616,544	3,366,388
Revenues (in thousands)	-	-	-	$ 6,196	$ 13,407
Customers at Year End	-	-	-	23,752	23,452

* Due to the provision for the loss associated with the M-S-R contingent power purchase contract recognized in 1992, operating revenues were reduced by $7.3 million and $25.0 million for 1995 and 1994, respectively

** On July 3, 1995, the Company sold its water utility division. Water Service's comparative operating statistics for 1995 are through this date.

COMPARATIVE OPERATING STATISTICS

	1998	1997	1996	1995	1994
Gas Throughput - Decatherms (in thousands)					
PNMGS:					
Residential	30,258	30,755	27,387	25,865	27,139
Commercial	10,387	10,644	9,310	8,864	9,767
Industrial	1,553	1,280	2,136	661	831
Public authorities	3,427	4,153	2,591	2,411	2,465
Irrigation	1,869	1,593	1,418	1,245	1,272
Sales for resale	1,205	1,233	3,094	1,266	680
Off-system sales	1,889	1,179	5,745	1,176	-
Unbilled	(1,343)	(202)	1,405	(1,764)	(309)
PNMGS sales	49,245	50,635	53,086	39,724	41,845
Transportation throughput	36,413	33,975	47,010	49,136	43,135
PNMGS throughput	85,658	84,610	100,096	88,860	84,980
Gathering Company:					
Spot market sales	-	-	-	39	-
Transportation throughput	-	-	-	20,695	47,091
Total throughput	85,658	84,610	100,096	109,594	132,071
Gas Revenues (in thousands)					
PNMGS:					
Residential	$161,153	$187,563	$129,911	$125,290	$149,439
Commercial	42,680	50,502	33,022	32,328	42,725
Industrial	4,887	4,536	5,179	1,873	2,905
Public authorities	12,610	17,577	8,018	7,939	9,969
Irrigation	5,780	5,041	3,252	3,077	4,061
Sales for resale	3,596	4,465	2,106	3,114	2,462
Off-system sales	3,816	1,926	14,352	1,885	-
Imbalance penalties	1,416	1,273	1,231	1,786	944
Unbilled	(955)	(2,172)	2,678	(2,430)	267
Revenues from gas sales	234,983	270,711	199,749	174,862	212,772
Transportation	13,464	14,172	17,215	18,532	19,742
Liquids	1,463	4,451	7,608	12,782	14,551
Other	6,065	5,435	2,729	3,606	4,705
PNMGS operating revenues	255,975	294,769	227,301	209,782	251,770
Gathering Company:					
Spot market sales	-	-	-	42	-
Transportation	-	-	-	3,640	7,850
Imbalance penalties	-	-	-	418	26
Processing Company:					
Liquids revenue	-	-	-	632	(621)
Processing fees	-	-	-	3,471	10,485
Total operating revenues	$255,975	$294,769	$227,301	$217,985	$269,510
Customers at Year End					
PNMGS:					
Residential	383,292	375,032	367,025	358,822	348,715
Commercial	32,004	31,560	30,757	30,493	30,139
Industrial	55	50	54	59	57
Public authorities	2,429	2,735	2,462	2,444	2,463
Irrigation	1,078	1,027	1,076	886	899
Sales for resale	3	3	3	2	3
Gas choice	112	-	-	-	-
Transportation	29	31	36	38	43
PNMGS customers	419,002	410,438	401,413	392,744	382,319
Gathering Company:					
Transportation	-	-	-	-	-
Processing Company	-	-	-	-	32
Total customers	419,002	410,438	401,413	392,744	382,372

On June 30, 1995, the Company sold substantially all of the gas gathering and processing assets of the Company and its gas subsidiaries. Comparative operating statistics for Gathering Company and Processing Company are through this date.

INVESTOR INFORMATION

COMMON STOCK PRICES AND DIVIDENDS PAID

	1998			1997		
QUARTER	DIVIDEND	HIGH	LOW	DIVIDEND	HIGH	LOW
1	$0.17	24 11/16	22 1/8	$0.12	20 1/2	17 1/4
2	$0.20	24 3/4	20 15/16	$0.17	18 5/8	15 3/4
3	$0.20	23 3/16	19 1/16	$0.17	19 9/16	17 3/4
4	$0.20	23 5/16	17 3/8	$0.17	23 15/16	18 7/8

Corporate Headquarters
Public Service Company of New Mexico, Alvarado Square, Albuquerque, NM 87158, (505) 241-2700

Annual Meeting
The 1999 annual meeting of shareholders will be held on Tuesday, June 8, 1999, at the South Broadway Cultural Center, 1025 Broadway SE, Albuquerque, NM. The meeting will begin at 9:30 a.m. (MDT).

Business and Financial Information
PNM business and financial information is available around the clock by phone and on the Internet.
PNM by Phone: Shareholders can access PNM from anywhere in the United States or abroad by calling our automated investor communications system at (800) 840-0PNM.
PNM on the Internet: You can visit PNM online at http://www.pnm.com/

Security Analyst Contact
Security analysts and others requesting information about PNM should contact Barbara L. Barsky, Senior Vice President and Secretary at (505) 241-2662. E-Mail: bbarsky@mail.pnm.com

Shareholder Records
Shareholders with questions about dividend payments, address changes, missing certificates, ownership changes, other account information, or PNM Direct Plan should contact our Shareholder Records Department at (800) 545-4425.

Transfer Agent and Registrar
PNM Shareholder Records Department, Alvarado Square - 1104, Albuquerque, NM 87158 Telephone: (800) 545-4425; Fax: (505) 241-4311; E-Mail: yjohnso@mail.pnm.com

Common Stock Listing
PNM's common stock is listed under the symbol PNM and primarily traded on the New York Stock Exchange. As of December 31, 1998, there were 16,486 common shareholders of record.

Requests for Annual Reports or Form 10-K
To obtain an additional copy of this annual report or a copy of the annual Form 10-K filed with the Securities and Exchange Commission, call (800) 545-4425, or write to Barbara Barsky at the corporate headquarters address.

PNM Direct Plan
PNM offers a direct stock purchase plan (PNM Direct Plan) as a service to all interested participants. Features of the Plan include: direct cash investments ranging from $50 to $5,000 as often as once a month, dividend reinvestment, direct deposit of dividends, and safekeeping of stock certificates. Information regarding the Plan can be obtained by completing the enclosed card or by contacting Shareholder Records.

BOARD *of* DIRECTORS

John T. Ackerman, 57 (1990) ✱
Chairman of the Board of PNM,
Retired President & Chief Executive Officer of PNM

Robert G. Armstrong, 52 (1991) ✦ ✱ +
President of Armstrong Energy Corporation

Joyce A. Godwin, 55 (1989) ★ ✱ + ✻
Retired Vice President and Secretary of Presbyterian Healthcare Services and retired Chairman and President of Southwest Business Ventures, Inc.

Laurence H. Lattman, 75 (1993) ✦ ★ ✻
Retired President of New Mexico Institute of Mining and Technology

Manuel Lujan, Jr. 70 (1994) ✦ ★
Former U.S. Secretary of the Interior, consultant on U.S. governmental matters and insurance agent with Manuel Lujan Insurance, Inc.

Benjamin F. Montoya, 63 (1993) ●
President and Chief Executive Officer of PNM

Reynaldo ("Reynie") U. Ortiz, 52 (1992) ✦ ★
International telecommunications consultant

Robert M. Price, 68 (1992) ✱ ● +
President of PSV, Inc., a technology consulting business

Paul F. Roth, 66 (1991) ✱ ● + ✻
Retired President of the Texas Division of Southwestern Bell Telephone Company

---

✦ Audit Committee

★ Customer and Public Policy Committee

✱ Executive Committee

● Finance Committee

+ Compensation and Human Resources Committee

✻ Nominating and Governance Committee

( ) Year elected PNM Board Member

These lists are effective as of 2/12/99

OFFICERS *of the* COMPANY

Benjamin F. Montoya, 63
President & Chief Executive Officer

Roger J. Flynn, 56
Executive Vice President, Electric and Gas Services

William J. Real, 50
Executive Vice President,
Energy Services and Power Production

Barbara L. Barsky, 54
Senior Vice President and Secretary

Marc D. Christensen, 50
Senior Vice President, Consumer Services

Max H. Maerki, 58
Senior Vice President and Chief Financial Officer

Patrick T. Ortiz, 49
Senior Vice President and General Counsel

R. Blake Ridgeway, 40
Senior Vice President, Energy Services

Donna M. Burnett, 44
Vice President, Corporate Controller and Chief Accounting Officer

Ernest T. C'de Baca, 45
Vice President, Governmental Affairs

Melvin J. Christopher, 38
Vice President, Gas Operations

Patrick J. Goodman, 49
Vice President, Power Production

Terry R. Horn, 46
Vice President and Treasurer

Sarita P. Loehr, 41
Vice President, Human Resources

Cindy E. McGill, 42
Vice President, Regulatory Affairs

John H. Myers, 41
Vice President, Electric Operations

Edward Padilla, Jr., 45
Vice President, Bulk Power Marketing & Development

Lawrence D. Ratliff, 52
Vice President, Engineering and Technical Services

Terry D. Rister, 47
Vice President, Customer Service

-NOTICE-

THE ATTACHED FILES ARE OFFICAL RECORDS OF THE OCIO/INFORMATION MANAGEMENT DIVISION. THEY HAVE BEEN CHARGED TO YOU FOR A LIMITED TIME PERIOD AND MUST BE RETURNED TO THE RECORDS AND ARCHIVES SERVICES SECTION, T-5C3. PLEASE DO NOT SEND DOCUMENTS CHARGED OUT THROUGH THE MAIL. REMOVAL OF ANY PAGE(S) FROM DOCUMENTS FOR REPRODUCTION MUST BE REFERRED TO FILE PERSONNEL.

-NOTICE-

50-528 9909160126 9/2/99