public service company of new mexico

PNM

1999

annual report

contents:

about our company:

More than 1.3 million people in New Mexico rely on PNM, the Public Service Company of New Mexico, for the delivery of electric power and natural gas service to their homes and businesses. PNM's 1,521 megawatts of generation capacity includes power from coal, nuclear and natural gas-fired plants. Selling electricity to other utilities is the fastest-growing part of our business. In 1999, wholesale power sales accounted for nearly a third of PNM's total operating revenues. By adding additional generation resources and expanding our trading operation, we plan to continue to expand that business.

Avistar, PNM's energy services subsidiary, is engaged in energy management and advanced metering services, as well as assisting in the development of a new, Internet-based energy auction system.

In 1999, PNM was featured in a leading industry publication as one of the five most technologically innovative utilities in the nation. Our commitment to fostering a work force that mirrors our home state's cultural diversity led *Fortune* magazine to rank PNM first on its list of the best employers for Hispanics in the U.S.

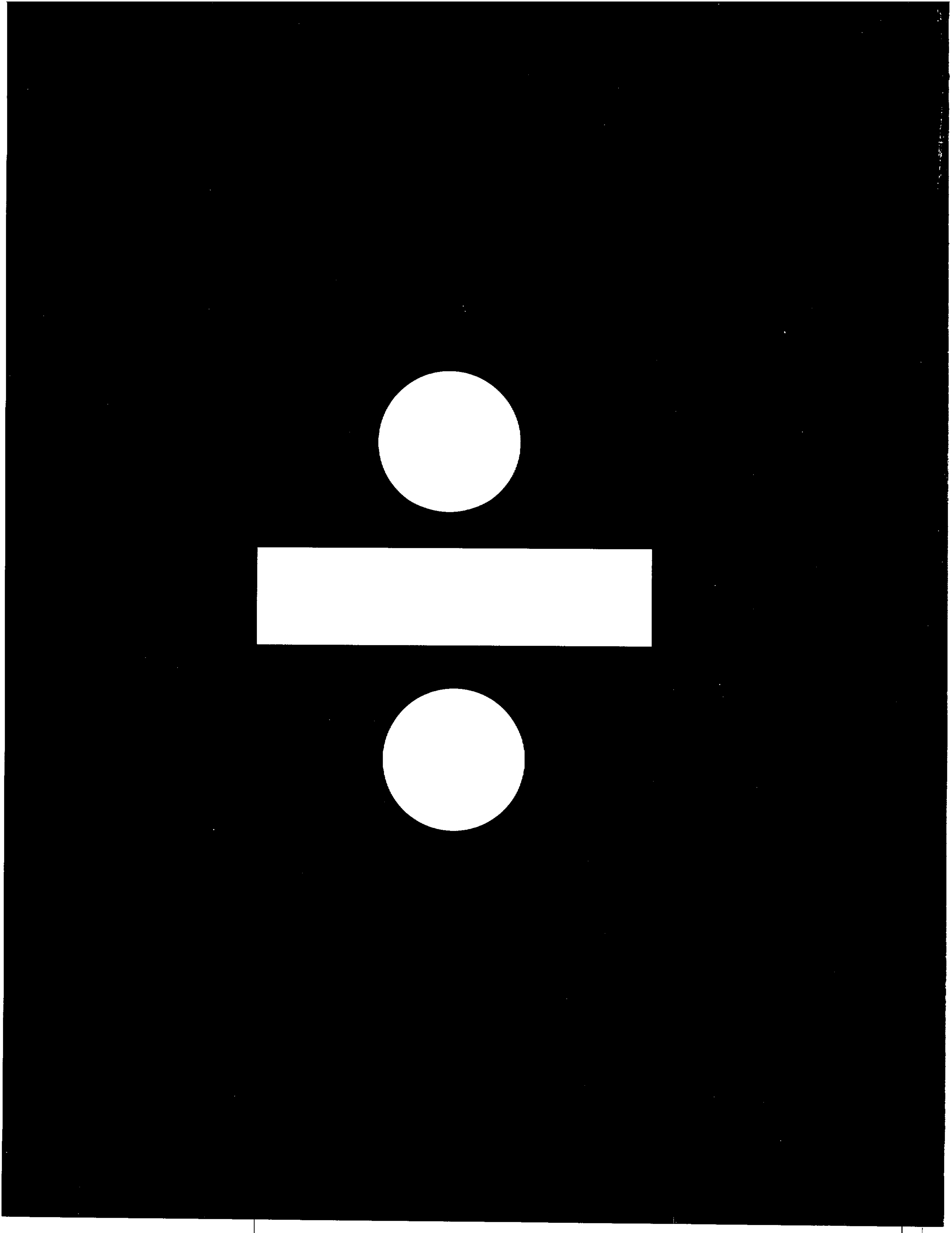
investor highlights:

dollars in thousands, except per share amounts

	1999	1998	PERCENTAGE CHANGE	5-YEAR ANNUAL GROWTH RATE
FINANCIAL DATA:				
Operating Revenues	$1,157,543	$1,092,445	5.96%	5.05%
Operating Expenses	$1,037,464	$ 956,796	8.43%	6.60%
Net Earnings Available for Common	$ 82,569	$ 82,096	0.57%	2.25%
Retained Earnings	$ 227,829	$ 186,220	22.34%	N/M
Return on Average Common Equity	9.47%	9.86%	(3.96%)	(5.25%)
COMMON SHARE DATA:				
Earnings (Basic)	$ 2.01	$ 1.97	2.03%	2.58%
Earnings (Diluted)	$ 2.01	$ 1.95	3.08%	2.58%
Book Value	$ 21.79	$ 20.63	5.62%	7.60%
Closing Price	$ 16.25	$ 20.44	(20.50%)	4.56%
Dividends Paid	$ 0.80	$ 0.77	3.90%	N/M
Average Shares Outstanding	41,038	41,774	(1.76%)	(0.35%)
NUMBER OF EMPLOYEES:	2,667	2,717	(1.84%)	(0.74%)

N/M = Not Meaningful

the *formula* for our *future* is clear. >



dividing our business
multiplies our opportunities.

As competition and customer choice revolutionize our industry, we are reshaping our company to meet new challenges and seize new opportunities. The new utility industry structure is a hybrid of competition and government regulation. While the delivery of electricity and natural gas to the customer remains subject to traditional cost-of-service ratemaking, the generation and sale of electric power is becoming a competitive business.

To succeed in those two very different environments, the PNM strategic plan envisions a holding company with two wholly-owned subsidiaries. One of those subsidiaries will remain a regulated utility, operating the PNM distribution systems in our local service territory.

The change in corporate structure will free our other subsidiary to focus on the competitive business activities where we expect the fastest growth in coming years: operating power plants, selling electricity in the open market, and expanding our new energy services business.

The combination of solid operating performance and a predictable cash flow from the regulated utility, coupled with rapid growth in revenues and earnings on the competitive side of our business, will create enhanced value for shareholders.


PNM
Electric Services

2.7

BILLION IN ASSETS

120

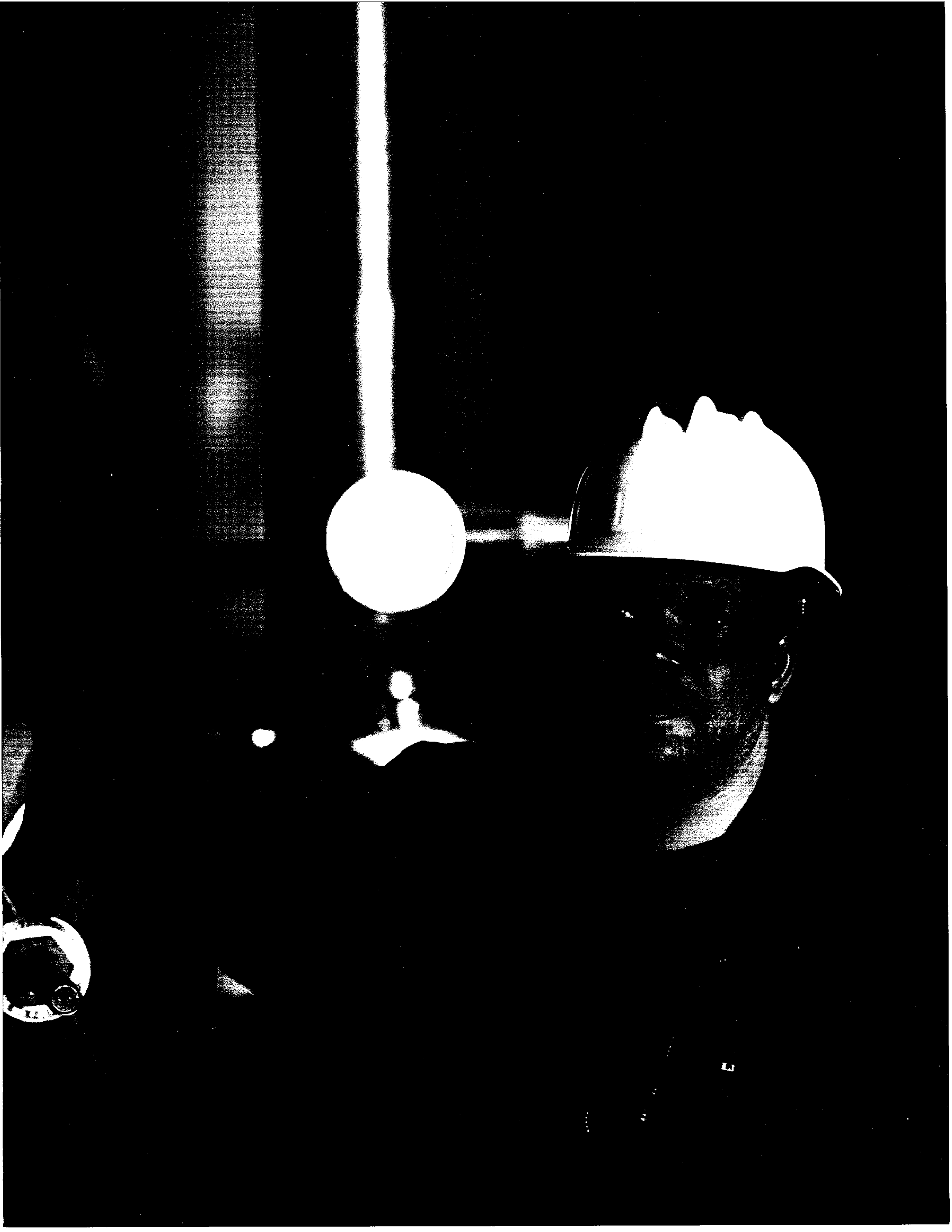
MILLION CASH ON HAND

PNM enters this new era with the financial strength and flexibility we need to expand into growing markets. Over the last decade we retired or refinanced more than $1 billion in long-term debt. Retained earnings have grown from just $25.2 million in 1995 to $227.8 million at the end of 1999. As of December 31, 1999, the PNM balance sheet showed $2.7 billion in total assets, including $120.4 million in available cash. In mid-1999 Standard & Poor's and Moody's Investors Services recognized our financial progress by raising PNM's credit rating back to investment grade. > Also during 1999 we retired 1.1 million shares of PNM stock. With the buyback of additional stock in the first quarter of 2000, we estimate that reducing the number of shares available will boost 2000 earnings by 8 cents a share.

2x generatio

3x sales

PNM wholesale power sales increased 27.2 percent in 1999. Over the past five years, our wholesale volume has been increasing at an average rate of 27.1 percent annually. Our strategy leverages PNM's 10 years' experience in the wholesale market and our unique geographic position between California and the Midwest to grow sales, protect our profit margins and manage risk in a volatile and unpredictable market. We plan to build on this success over the next five to seven years, doubling the size of our generation portfolio and tripling our sales volume.




I.B.E.W.
611

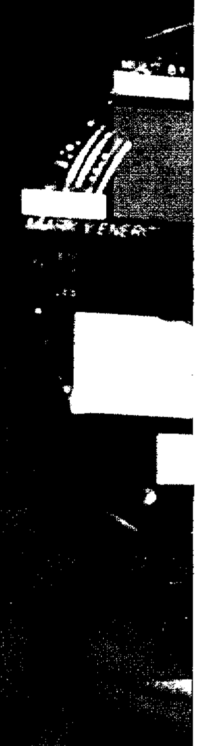
100%

satisfaction X

427,393 customers

Customer focused, reliable and efficient, the PNM electric and gas delivery systems will provide the vital link between multiple energy suppliers and customers. This core part of our business will remain regulated, with the state setting prices and terms of service for the local distribution system. Fair treatment from regulators, particularly with our state's new, elected Public Regulation Commission, will depend heavily on PNM's continued commitment to customer satisfaction. > In 1999, our systematic approach to achieving excellence in customer service and electric system reliability was recognized by Quality New Mexico, a program based on the Malcolm Baldridge National Quality Awards. > Over the past five years, PNM's local customer base has been growing at nearly double the national average rate. Given a reasonable rate of return authorized by regulators, our ability to control costs and improve productivity should provide a steady growth in revenues and earnings from the PNM electric and gas utility.

2m potential new customers



Avistar, PNM's energy services subsidiary, is expanding into new markets. Our ability to apply advanced technology to help customers conserve energy and save money has made us the dominant non-utility meter service provider in California; we see more than 2 million potential customers for this new technology in the three Western states we have targeted initially. Avistar's Total Solutions™ approach to energy conservation, infrastructure planning and utility management is tailored to meet the needs of military bases, federal installations, and other governmental clients. > In February 2000, Avistar entered into another new business through a strategic alliance with AMDAX.com, a new company that is launching an Internet-based electricity auction linking buyers and sellers together in a "virtual utility."


TransData

PNM's formula for success in today's new energy industry: a bold strategic vision, multiplied by new opportunities, equals increased shareholder value.

dear shareholders: In 1999, PNM made substantial progress toward realizing the strategic vision we first formed more than six years ago. With the passage of electric industry restructuring legislation in New Mexico, exciting new opportunities are opening up for your company.

The new law offers us not only the opportunity to continue to serve the people of New Mexico as the state's premier electric and gas utility, but also the opportunity to compete successfully in the emerging energy marketplace.

Now it is up to us to make the most of these opportunities. This year, we will be asking you to approve the formation of a holding company, Manzano Corporation. Through Manzano Corporation, shareholders will continue to own both an integrated electric and gas utility and a rapidly growing power generation and marketing business.

Dividing regulated and competitive activities into separate subsidiaries recognizes that these are *two complementary but very different businesses.* The familiar, trusted PNM name will stay with the electric and gas utility, where management focus will remain on efficiently delivering energy to retail customers by deploying the latest technology to further reduce costs, boost system reliability and improve service.

On the competitive side of the business, we will continue to build on our success in power generation, wholesale power marketing and energy services. We anticipate that these businesses will provide *the lion's share of growth in revenues and earnings* in the years to come.

In 1999, PNM earned $83.2 million, or $2.01 per share, up 2.0 percent over the previous year, on revenues of $1.16 billion. Several factors contributed to the relatively small increase in earnings last year. The $37 million electric rate cut we implemented in the third quarter, together with moderate summer temperatures, reduced 1999 revenues significantly. And although I am proud to report that PNM's many complex computer systems rolled over into 2000 without a single glitch, the $20.7 million we spent to assure that smooth Y2K transition also trimmed earnings last year.

Cash flow from operations remained strong, up to $214.5 million in 1999 from $211.0 million in 1998, and retained earnings grew to $227.8 million by year-end, a 22.3 percent increase over the previous year. In mid-August, the credit rating agencies rewarded six years of effort to rebuild the company's finances by raising PNM debt back to investment grade.

PNM 1999 stock performance did not reflect our solid financial performance for the year, or the substantial progress we have made toward resolving the regulatory issues surrounding industry restructuring in New Mexico. Although our total return to shareholders of minus 16.8% was disappointing, PNM was not as badly battered as many other utility stocks, with the electric utilities index down 18.6% for the year.

To signal our confidence in your company's future, since March 1999 the Board has approved the repurchase of more than 2 million shares of common stock.

PNM's primary objective in 2000 is to resolve the remaining regulatory and legal questions surrounding industry restructuring in New Mexico. We are seeking the necessary regulatory approvals to create the new holding company, and cooperating closely with the Public Regulation Commission in setting the new rules to facilitate electric competition.

In making the transition to a competitive market, we will insist on fair treatment for PNM shareholders.

Fortunately, I believe we are approaching these critical issues in a much more constructive environment than was the case in past years. *Today, customers, regulators, and legislators all recognize the vital contribution PNM, its employees and its shareholders make to the New Mexico economy.*

Finally, I am pleased to report that PNM's former Chief Operating Officer, Jeff Sterba, has rejoined the company as President. Jeff has also been elected to the Board of Directors to finish the term of Mr. Larry Lattman, who reached retirement age and provided 7 years of admirable service. Jeff will assume the duties of Chief Executive Officer at this year's annual meeting, and is expected to succeed me as Chairman when I retire.

Since I joined PNM nearly seven years ago, our management team has made tremendous progress in returning our company to financial health and preparing for the great leap from traditional utility to competitive energy company. Finding the right person to continue that progress was a major goal of the Board and myself over this past year. I can think of no other individual more qualified to lead PNM in the coming years than Jeff Sterba.

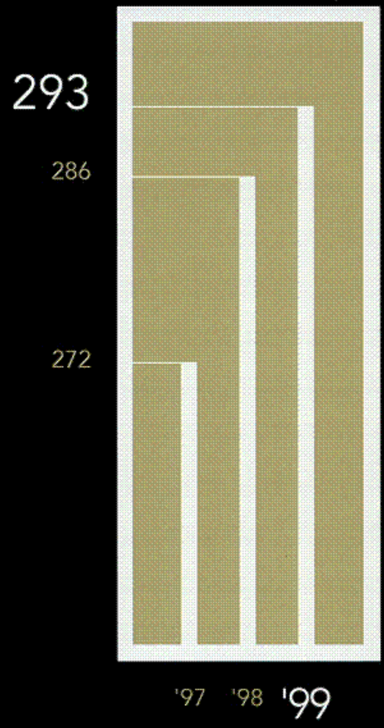
We welcome the year 2000 with anticipation, optimism and confidence.

Sincerely,

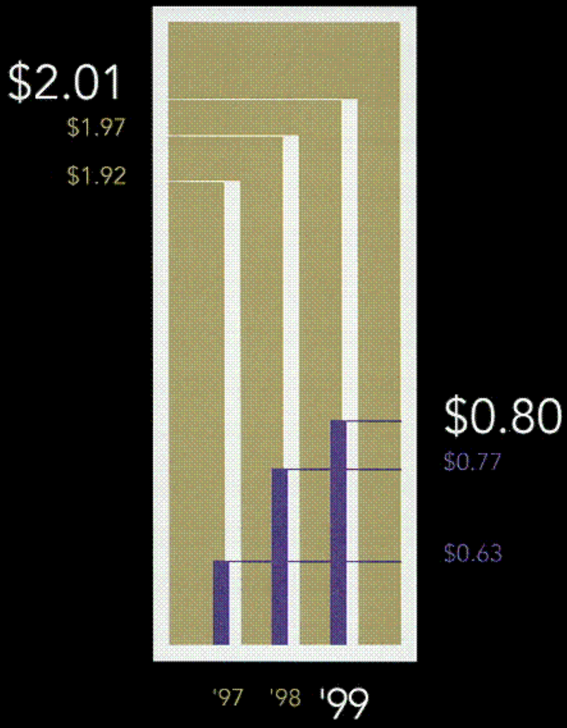
Benjamin F. Montoya

Benjamin F. Montoya

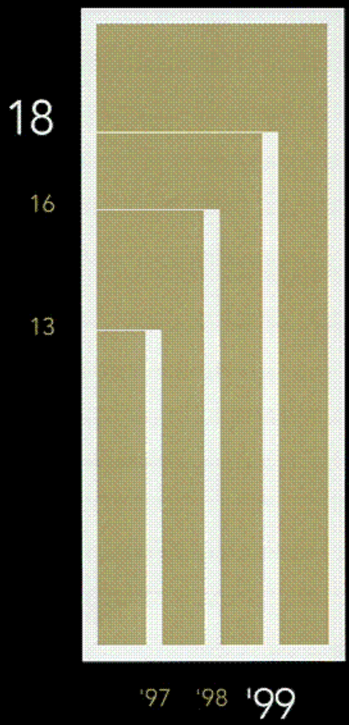
Chairman and Chief Executive Officer



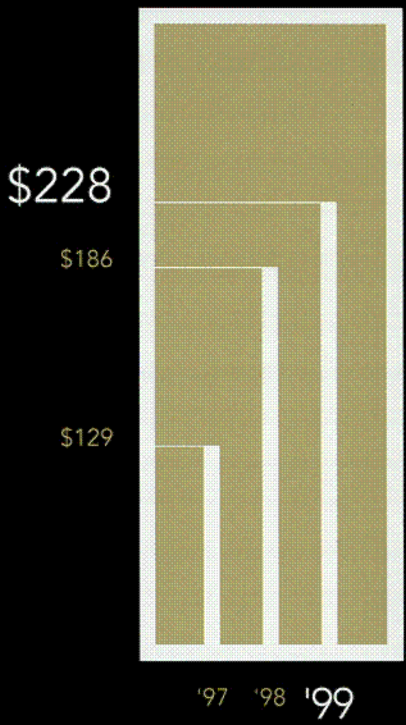
PRODUCTIVITY
(customers per employee)



EARNINGS AND DIVIDENDS
basic earnings per share of common stock
dividends paid per share of common stock



SALES
(total KWh in millions)



FINANCIAL STRENGTH
(retained earnings in millions)

table of contents for financial section:

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 its periodic reports, proxy statement and other information PNM files with the Securities and Exchange Commission. Please refer to page 35, "Disclosure Regarding Forward-Looking Statements," for a listing of the factors which could cause the Company's actual financial results to differ materially from the prospective information provided by the Company in forward-looking statements.

selected financial data:

(in thousands except per share amounts and ratios)	1999	1998	1997	1996	1995
Total Operating Revenues	$ 1,157,543	$ 1,092,445	$ 1,020,521	$ 873,778	$ 808,465
Earnings from Continuing Operations	$ 79,614	$ 95,119	$ 86,497	$ 72,969	$ 75,562
Net Earnings	$ 83,155	$ 82,682	$ 80,995	$ 72,580	$ 75,562
Earnings per Common Share:					
Continuing Operations	$ 1.93	$ 2.27	$ 2.05	$ 1.73	$ 1.72
Basic	$ 2.01	$ 1.97	$ 1.92	$ 1.72	$ 1.72
Diluted	$ 2.01	$ 1.95	$ 1.91	$ 1.71	$ 1.72
Total Assets	$ 2,723,268	$ 2,668,603	$ 2,407,410	$ 2,313,334	$ 2,107,908
Long-Term Debt, including Current Maturities	$ 988,489	$ 1,008,614	$ 714,345	$ 728,889	$ 728,989
Common Stock Data:					
Market price per common share at year end	$ 16.250	$ 20.438	$ 23.688	$ 19.625	$ 17.625
Book value per common share at year end	$ 21.790	$ 20.630	$ 19.260	$ 18.060	$ 16.820
Average number of common shares outstanding	41,038	41,774	41,774	41,774	41,774
Cash dividend declared per common share	$ 1.00	$ 0.60	$ 0.68	$ 0.48	-
Return on Average Common Equity	9.5%	9.9%	10.2%	9.8%	10.7%
Capitalization:					
Common stock equity	46.7%	45.4%	52.6%	50.4%	48.6
Preferred stock without mandatory redemption requirements	0.7	0.7	0.8	0.9	0.9
Long-term debt, less current maturities	52.6	53.9	46.6	48.7	50.5
	100.0%	100.0%	100.0%	100.0%	100.0%

Due to the discontinuance of the natural gas trading operations of the Energy Services Business Unit (see note 13 of the notes to consolidated financial statements), certain prior year amounts have been reclassified as discontinued operations.

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 Public Service Company of New Mexico ("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 that follow and PART I, ITEM 3. - LEGAL PROCEEDINGS as filed in the Company's 1999 annual report on Form 10-K. Trends and contingencies of a material nature are discussed to the extent known and considered relevant.

overview

The Company is a public utility primarily engaged in the generation, transmission, distribution and sale of electricity and in the transmission, distribution and sale of natural gas within the State of New Mexico. In addition, in pursuing new business opportunities, the Company provides energy and utility related activities under its wholly owned subsidiary, Avistar, Inc. ("Avistar").

ELECTRIC OPERATIONS

The Company's electric operations serve four principal markets. Sales to retail customers and sales to firm-requirements wholesale customers, sometimes referred to collectively as "system" sales, comprise two of these markets. The third market consists of other contracted sales to utilities for which the Company commits to deliver a specified amount of capacity (measured in megawatts-MW) or energy (measured in megawatt hours-MWh) over a given period of time. The fourth market consists of economy energy sales made on an hourly basis at fluctuating, spot-market rates. Sales to the third and fourth markets are sometimes referred to collectively as "off-system" sales.

The Company provides retail electric service to a large area of north central New Mexico, including the cities of Albuquerque and Santa Fe, and certain other areas of New Mexico. As of December 31, 1999, 1998 and 1997, approximately 361,000, 358,000 and 349,000, respectively, retail electric customers were served by the Company.

electric sales by market:

(thousands of dollars)	1999	1998	1997
Retail	$ 522,523	$ 536,417	$ 519,504
Firm-requirements wholesale	7,046	10,708	10,690
Other contracted off-system sales	226,773	142,115	118,876
Economy Energy Sales	131,549	122,156	55,768
Other	24,086	23,808	17,600
	$ 911,977	$ 835,204	$ 722,438

electric sales by market:

(megawatt hours)	1999	1998	1997
Retail	6,803,853	6,739,874	6,534,899
Firm-requirements wholesale	179,249	278,615	278,727
Other contracted off-system sales	6,196,499	4,033,931	3,790,081
Economy energy sales	4,795,873	4,469,769	2,716,835
	17,975,474	15,522,189	13,320,542

The Company has ownership interests in certain generating facilities located in New Mexico, including Four Corners Power Plant ("Four Corners"), a coal fired unit and the San Juan Generating Station ("SJGS"), a coal fired unit. In addition, the Company has ownership and leasehold interests in the Palo Verde Nuclear Generating Station ("PVNGS") located in Arizona. These generation assets are used to supply retail and wholesale customers. The Company also owns Reeves Generating Station ("Reeves"), a gas and oil fired unit and Las Vegas Generating Station ("Las Vegas"), a gas and oil fired unit that are used solely for reliability purposes or to generate electricity for the wholesale market during peak demand periods in the Company's wholesale power markets. As of December 31, 1999, the total net generation capacity of facilities owned or leased by the Company was 1,521 MW. In addition to generation capacity, the Company purchases power in the open market. The Company is also interconnected with various utilities for economy interchanges and the 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 purchase agreements to accommodate its trading activity.

NATURAL GAS OPERATIONS

The Company's gas operating division, Public Service Company of New Mexico Gas Services ("PNMGS"), distributes natural gas to most of the major communities in New Mexico, including Albuquerque and Santa Fe, serving approximately 426,000, 419,000 and 410,438 customers as of December 31, 1999, 1998 and 1997, respectively. PNMGS' customer base includes both sales-service customers and transportation-service customers. Sales-service customers purchase natural gas and receive transportation and delivery services from PNMGS for which PNMGS receives both cost-of-gas and cost-of-service revenues. Additionally, PNMGS makes occasional gas sales to off-system customers. Off-system sales deliveries generally occur at interstate pipeline interconnects with PNMGS' system. Transportation-service customers, who procure gas independently of PNMGS and contract with PNMGS for transportation and related services, provide PNMGS with cost-of-service revenues only.

PNMGS obtains its supply of natural gas primarily from sources within New Mexico pursuant to contracts with producers and marketers. These contracts are generally sufficient to meet PNMGS' peak-day demand. PNMGS serves certain cities which depend on El Paso Natural Gas Company ("EPNG") or Transwestern Pipeline Company for transportation of gas supplies. Because these cities are not directly connected to PNMGS transmission facilities, gas transported by these companies is the sole supply source for those cities. Such transportation is regulated by the Federal Energy Regulatory Commission ("FERC").

The following table shows gas throughput by customer class:

gas throughput:

(millions of decatherms)	1999	1998	1997
Residential	29.3	30.3	30.7
Commercial	10.1	10.4	10.6
Industrial	2.3	1.5	1.3
Public authorities	2.9	3.4	4.2
Irrigation	1.4	1.9	1.6
Sales for resale	1.2	1.2	1.2
Unbilled	3.8	(1.3)	(0.2)
Transportation*	40.2	36.4	34.0
Off-system sales	1.1	1.9	1.2
	92.3	85.7	84.6

*Customer-owned gas.

The following table shows gas revenues by customer:

gas revenues:

(thousands of dollars)	1999	1998	1997
Residential	$148,968	$161,153	$187,563
Commercial	36,528	42,680	50,502
Industrial	8,550	4,887	4,536
Public authorities	9,782	12,610	17,577
Irrigation	4,229	5,780	5,041
Sales for resale	2,530	3,596	4,465
Unbilled	4,107	(955)	(2,172)
Transportation*	12,390	13,464	14,172
Liquids	1,867	1,463	4,451
Off-system sales	2,357	3,816	1,926
Other	5,403	7,481	6,708
	$236,711	$255,975	$294,769

*Customer-owned gas.

AVISTAR

The Company's wholly-owned subsidiary, Avistar, was formed in August 1999 as a New Mexico corporation and is currently engaged in certain unregulated, non-utility businesses, including energy and utility-related services previously operated by the Company. The New Mexico Public Regulation Commission ("PRC"), predecessor of the New Mexico Public Utility Commission ("NMPUC"), authorized the Company to invest $50 million in equity in Avistar and to enter into a reciprocal loan agreement for up to $30 million. The Company has currently invested $25 million in Avistar. In February 2000, Avistar invested $3 million in AMDAX.com, a start-up company which will provide an on line auction service to bring together electricity buyers and sellers in the deregulated electric power market. In addition, Avistar entered into an agreement with Sandia Corporation to jointly develop and market new risk and reliability software for private industry. Avistar also operates and manages the City of Santa Fe's water system.

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. The Electric Utility Industry Restructuring Act of 1999 ("The Restructuring Act") was enacted into law on April 8, 1999, opening the state's electric power market to customer choice beginning in 2001. The law gives schools, residential and small business customers the opportunity to choose among competing power suppliers beginning in January 2001. Competition will be expanded to include all customers starting in January 2002. The PRC, however, can extend these dates by one year if necessary. Rural electric cooperatives and municipal electric systems have the option not to participate in the competitive market.

Residential and small business customers who do not select a power supplier in the open market can buy their electricity through their local utility through a "standard offer" whereby the local distribution utility will purchase power supplies through a competitive process approved by the PRC. The local distribution utility system and related services such as billing and metering will continue to be regulated by the PRC, while the interstate transmission system will remain subject to Federal regulation.

The law does not require utilities to divest their generating plants, but requires unregulated activities to be separated from the regulated activities through creation of at least two separate corporations.

The law also provides for sharing of stranded costs between utility shareholders and customers, allowing utilities to recover at least half of such stranded costs. Stranded costs are defined in the law to include nuclear decommissioning costs, regulatory assets, leases and other costs recognized under existing regulation. Utilities could be allowed to recover more than half of their stranded costs if they meet the criteria specified in the law. Stranded costs will be recovered from customers over a five-year period. Utilities will also be allowed to recover through 2007 all transition costs reasonably incurred to comply with the new law.

The law, however, does not provide a guaranteed rate cut for residential customers. Electric rates during the transition to competition will be set by the PRC. The Company received a recent rate case order, which did result in a rate reduction. (See *"Electric Rate Case"* below.)

The Company is required to file a transition plan with the PRC by June 1, 2000. The transition plan must include proposals for: (i) implementing customer choice and open access to the Company's transmission and distribution system; (ii) separating regulated and non-regulated business activities; (iii) recommended rates for distribution, transmission and related services; (iv) competitive procurement process for standard offer; and (v) recovery of stranded costs and transition costs. The Company plans to reorganize its operations by forming a holding company structure as a means of achieving the corporate and asset separation required by the Restructuring Act. The proposed holding company will be called Manzano Corporation ("Manzano"). On February 15, 2000, the PRC approved the Company's request to form a wholly-owned shell subsidiary which will become the holding company. The Company's plan for a holding company structure will separate the Company into two subsidiaries. Shareholders will be asked to approve the holding company structure. If the Company receives all necessary regulatory and other approvals, pursuant to the Restructuring Act, all of the Company's electric and gas distribution and transmission assets and related liabilities will be transferred to a newly created subsidiary. After this asset transfer, this subsidiary will acquire the name "Public Service Company of New Mexico" (for purposes of this discussion, the subsidiary will be referred to as "UtilityCo") and the corporation formerly named Public Service Company of New Mexico will be renamed Manzano Energy Corporation (for purposes of this discussion, the subsidiary will be referred to as "Energy"). Energy will continue to own the Company's existing electric generation and unregulated, competitive assets after completion of the transfer of the regulated business to the newly created utility subsidiary. UtilityCo and Energy will be wholly-owned subsidiaries of Manzano. (See "*Formation Of Holding Company*" below.)

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.

Under a holding company structure, the regulated businesses (natural gas and electric transmission and distribution) will be grouped under a separate company and would focus on the core utility business in New Mexico. The unregulated businesses under the Restructuring Act (power production, bulk power marketing and energy services) would aggressively pursue 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. 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. 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 current business plan includes a 300% increase in sales and a doubling of its generating capacity through the construction or acquisition of additional power generation assets in its surrounding region of operations. Such growth will be dependent upon the Company's ability to generate $400 to $600 million to fund the Company's expansion. There can be no assurance that these competitive businesses, particularly the generation business, will be successful or, if unsuccessful, that they will not have a direct or indirect adverse effect on the Company.

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 re-introduced 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 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 retail competition in New Mexico, 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.

RESULTS OF OPERATIONS

The following discussion is based on the financial information presented in Footnote 1 of the Consolidated Financial Statements - Nature of Business and Segment Information. The table below sets forth the operating results as percentages of total operating revenues for each business segment.

year ended December 31, 1999:

	ELECTRIC	GAS	OTHER	COSOLIDATED
Operating Revenues	100.00%	100.00%	100.00%	100.00%
Cost of energy sold	45.95%	47.71%	0.00%	45.96%
Cost of sales and projects	0.00%	0.00%	91.35%	0.70%
Gross Margin	54.05%	52.29%	8.65%	53.35%
Administrative and other costs	9.23%	22.15%	101.82%	12.58%
Energy production costs	15.27%	0.63%	0.00%	12.16%
Depreciation and amortization	7.99%	8.35%	0.00%	8.00%
Transmission and distribution costs	3.40%	11.92%	0.00%	5.12%
Taxes other than income taxes	3.12%	2.98%	(15.90)%	2.94%
Income taxes	3.03%	(0.14)%	(25.53)%	2.16%
Total non-fuel operating expenses	42.04%	45.90%	60.38%	42.97%
Operating Income	12.01%	6.39%	(51.73)%	10.37%

year ended December 31, 1998:

	ELECTRIC	GAS	OTHER	COSOLIDATED
Operating Revenues	100.00%	100.00%	100.00%	100.00%
Cost of energy sold	37.68%	52.64%	0.00%	41.14%
Cost of sales and projects	0.00%	0.00%	73.93%	0.09%
Gross Margin	62.32%	47.36%	26.07%	58.77%
Administrative and other costs	9.12%	19.13%	760.66%	12.34%
Energy production costs	17.90%	0.09%	0.00%	13.71%
Depreciation and amortization	8.41%	6.20%	4.98%	7.89%
Transmission and distribution costs	3.85%	9.51%	0.00%	5.17%
Taxes other than income taxes	3.67%	2.78%	20.22%	3.48%
Income taxes	4.83%	1.80%	(288.94)%	3.78%
Total non-fuel operating expenses	47.78%	39.50%	496.92%	46.36%
Operating Income	14.55%	7.85%	(470.85)%	12.42%

year ended December 31, 1997:

	ELECTRIC	GAS	OTHER	COSOLIDATED
Operating Revenues	100.00%	100.00%	100.00%	100.00%
Cost of energy sold	33.22%	57.59%	0.00%	40.15%
Cost of sales and projects	0.00%	0.00%	79.39%	0.26%
Gross Margin	66.78%	42.41%	20.61%	59.59%
Administrative and other costs	9.48%	16.10%	180.21%	11.95%
Energy production costs	19.10%	0.10%	0.00%	13.55%
Depreciation and amortization	9.42%	4.95%	0.54%	8.10%
Transmission and distribution costs	4.41%	8.53%	0.00%	5.58%
Taxes other than income taxes	4.17%	2.21%	4.62%	3.61%
Income taxes	5.04%	2.57%	(63.13)%	4.11%
Total non-fuel operating expenses	51.63%	34.46%	122.24%	46.90%
Operating Income	15.15%	7.95%	(101.63)%	12.69%

Year Ended December 31, 1999 Compared to Year Ended December 31, 1998

Electric Operations

Operating revenues grew $76.8 million (9.2%) for the year to $912.0 million as a 32.9% improvement in wholesale electricity sales volume was only partially offset by the implementation of a new rate order in late July 1999 (which lowered rates by $18 million and will lower rates by $37 million annually based on expected customer growth). The Company delivered wholesale (bulk) power of 11.17 million MWh of electricity this year compared to 8.78 million MWh delivered last year, an increase of 27.2%. Retail electricity delivery was 6.8 million MWh compared to 6.7 million MWh delivered last year, a 1.5% improvement while revenues declined 2.6% as a result of the new rate order. Revenue growth for both the retail and wholesale businesses was negatively impacted by cooler temperatures in the southwest during the summer months and the availability of abundant hydro power which competes with the Company's wholesale business.

The gross margin or operating revenues minus cost of energy decreased $27.6 million reflecting a decrease in gross margin as a percentage of revenues of 8.3%. This decline reflects the rate reduction discussed above and higher fuel and purchased power costs.

Administrative and general increased $7.9 million (10.4%) for the year. This increase is due to Year 2000 ("Y2K") compliance costs (see "*The Year 2000 Issue*") and costs related to the Company's implementation of its new customer billing system. In addition, the Company increased its bad debt accrual throughout 1999 by $5.5 million as a result of a significant increase in delinquent accounts due to system implementation problems (see "*Implementation of New Billing System*" below for additional discussion). These increases primarily occurred in the distribution business. As a percentage of revenues, administrative and other remained relatively constant at 9.2% and 9.1% for the years ended December 31, 1999 and 1998, respectively. This is a result of a decrease in administrative and other, as a percentage of revenues, in the generation and transmission businesses due to an increase in costs for 1998 and 1999 allocated to the partners in a jointly-owned generation plant following an audit of such costs.

Energy production costs decreased $10.2 million (6.8%) for the year. These costs are generation related. The decrease is primarily due to reduced nuclear fuel storage costs at PVNGS. In 1998, the Company recorded a charge of $12.1 million for spent nuclear fuel at PVNGS as it was determined that alternatives to the United States Department of Energy ("DOE") storage and disposal facilities would be necessary due to the DOE's failure to complete such facilities by 1998 as required by law. The charge represents the cost of storage for spent fuel through 1998. As a percentage of revenues, energy production costs decreased form 17.9% to 15.3%. The decrease is due to cost control and the decreased nuclear fuel storage costs.

Depreciation and amortization increased $2.7 million (3.95%) for the year. The increase is due to pollution control improvements at certain generation plants and the impact of a new customer billing system. As a result of the additions, the Company revised its depreciation rates as required by the PRC. Depreciation and amortization as a percentage of revenues decreased from 8.4% to 8.0% reflecting an increase in energy production without a corresponding increase in plant additions.

Transmission and distribution costs decreased $1.1 million (3.4%) for the year. As a percentage of revenues, transmission and distribution costs decreased from 3.9% to 3.4%. These decreases were primarily the result of lower maintenance costs due to the milder weather.

Gas Operations

Operating revenues declined $19.3 million (7.5%) for the year to $236.7 million. This decline was driven by a 13.8% decline in the average rate charges per decatherm due to weak gas prices and a mild winter resulting in a 3.2% volume decrease to residential and commercial customers. Price declines were partially offset by a 7.7% volume improvement, as transportation volume posted double-digit growth of 10.3%.

The gross margin or operating revenues minus cost of energy, increased $2.6 million (2.2%). As a percentage of revenues, gross margin increased 4.9%. These increases are due to lower gas costs.

Administrative and general increased $3.5 million (7.2%). This increase is mainly due to Y2K compliance costs of $2.6 million and costs related to the Company's implementation of its new customer billing system. In addition, the Company increased its bad debt accrual throughout 1999 by $2.7 million, as a result of a significant increase in delinquent accounts due to system implementation problems (see "*Implementation of New Billing System*" below for additional discussion). As a percentage of revenues, administrative and other costs increased from 19.1% to 22.5% reflecting primarily the effects of lower gas costs discussed above.

Depreciation and amortization increased $3.9 million (24.7%) for the year. The increase is due to the impact of the new customer billing system. As a result of the addition, the Company revised its depreciation rates as required by the PRC. Depreciation and amortization, as a percentage of revenues, increased from 6.2% to 8.4% reflecting the effects of lower gas costs discussed above and plant additions.

Transmission and distribution expenses increased $3.9 million (16.1%) for the year. The increase is primarily due to Y2K compliance costs (see *"The Year 2000 Issue"*). Transmission and distribution expenses, as a percentage of revenues, increased from 9.5% to 11.9%, reflecting the effects of lower gas costs discussed above and the Y2K compliance costs.

Other

Other includes the Company's unregulated businesses, including Avistar and certain corporate functions.The unregulated businesses contributed $8.9 million in revenues in 1999 compared to $1.3 million in 1998. Operating loss for the unregulated businesses decreased from $5.8 million in 1998 to $4.6 million in 1999 reflecting their expansion.

Consolidated

Other income and deductions, net of taxes, increased $7.5 million for the year to $30.2 million due to the recording of interest income from the PVNGS Capital Trust. In addition, other income included certain one-time gains. The Company recognized $4.2 million of equity income from a passive investment and a gain of $1.2 million as a result of closing down of coal mining reclamation activities in an inactive subsidiary.

Net interest charges increased $7.5 million for the year to $70.7 million as a result of the issuance of $435 million in Senior Unsecured Notes ("SUNs") in August 1998, which replaced first mortgage bonds with a lower interest rate, and the issuance of pollution control revenue bonds of $11.5 million in October 1999. This was partially offset by the retirement of $31.6 million of SUNs in June and August 1999 and a decrease in short-term debt interest charges due to lower short-term borrowings in 1999.

The Company's consolidated income tax expense, before the cumulative effect of accounting change and discontinued operations, was $42.3 million, a decrease of $14 million for the year. The Company's income tax effective rate, before the cumulative effect of accounting change and discontinued operations, decreased from 37.2% to 34.7%. This decrease is primarily due to the favorable tax treatment received on the equity income discussed above. The investment income qualifies for the 80% dividends received deduction under Internal Revenue Service regulations.

The Company's net earnings from continuing operations for the year ended December 31, 1999, were $79.6 million compared to $95.1 million for the year ended December 31, 1998. Earnings per share from continuing operations on a diluted basis were $1.93 compared to $2.25 for the year ended December 31, 1998. Diluted weighted average shares outstanding were 41.1 million and 42.1 million in 1999 and 1998, respectively. The decrease reflects the common stock repurchase program in 1999. The 1999 results were negatively impacted by the electric rate reduction in the third quarter, increased fuel and purchased power costs, a weak gas market and cooler weather in the West during the summer months. In addition, costs related to Y2K compliance and the implementation of the new customer billing system increased costs. This impact was partially offset by the gains recorded in other income.

Discontinued Operations

In August 1998, the Company adopted a plan to discontinue the natural gas trading operations of its Energy Services Business Unit and completely discontinued these operations on December 31, 1998. Losses from discontinued operations, net of taxes, for the year ended December 31, 1998, were $12.4 million, or $0.30 per common share. These losses did not recur in 1999.

Cumulative Effect of a Change in Accounting Principle

Effective January 1, 1999, the Company adopted the Emerging Issues Task Force ("EITF") Issue No. 98-10. The effect of the initial application of the new standard is reported as a cumulative effect of a change in accounting principle. As a result, the Company recorded additional earnings, net of taxes, of approximately $3.5 million, or $0.08 per common share, to recognize the gain on net open physical electricity purchase and sales commitments considered to be trading activities.

Year Ended December 31, 1998 Compared to Year Ended December 31, 1997

Electric Operations

Operating revenues grew $112.8 million (15.6%) for the year to $835.2 million. The Company delivered wholesale (bulk) power of 8.8 million MWh of electricity this year compared to 6.9 million MWh delivered last year, an increase of 27.5%. Retail electricity delivery was 6.7 million MWh compared to 6.5 million MWh delivered last year, a 3.1% improvement. Retail revenues increased 3.3%. Revenue growth for the wholesale business was positively impacted by an unusually hot summer in Arizona and California.

The gross margin or operating revenues minus cost of energy increased $38.0 million; however, gross margin as a percentage of revenues decreased by 4.5%. This is the result of increased purchases for resale as wholesale power marketing activities increased.

Administrative and general increased $7.7 million (11.2%) for the year as a result of increased Y2K compliance costs and an increase in certain benefit costs. As a percentage of revenues, administrative and other decreased from 9.5% to 9.1%. Energy production costs increased $10.8 million (7.8%) for the year as a result of a charge of $12.1 million for spent nuclear fuel costs at PVNGS (see *"Year Ended December 31, 1999, Compared to Year Ended December 31, 1998 - Electric Operations"*). These costs are generation related. As a percentage of revenues, energy production costs decreased from 19.1% to 17.9%.

Depreciation and amortization increased $2.1 million (3.1%) for the year as a result of utility plant improvements and the write-off of certain unamortized computer software to depreciation and amortization expense. Depreciation and amortization as a percentage of revenues decreased from 9.4% to 8.4%.

Transmission and distribution costs decreased $1.2 million (3.8%) for the year as a result of lower maintenance costs. As a percentage of revenues, transmission and distribution costs decreased from 4.1% to 3.9%.

Gas Operations

Operating revenues declined $38.8 million (13.2%) for the year to $256.0 million. This decline was driven by a 13.8% decline in the average rate charges per decatherm. Total gas throughput volume increased 1.3%, while residential and commercial volume decreased 1.5%.

The gross margin or operating revenues minus cost of energy decreased $3.8 million (3.0%) as a result of warmer weather conditions in 1998. As a percentage of revenues, gross margin increased 4.9%.

Administrative and general increased $1.5 million (3.2%) for the year as a result of increased Y2K compliance costs and an increase in certain benefits costs. As a percentage of revenues, administrative and other costs increased from 16.1% to 19.1%. Depreciation and amortization increased $1.0 million (6.7%) for the year as a result of the write-off of certain retired plant assets to depreciation and amortization expense. Depreciation and amortization, as a percentage of revenues, increased from 5.0% to 6.2%.

Transmission and distribution expenses decreased $0.8 million (3.2%) for the year as a result of higher maintenance costs in 1997 for items that did not occur in 1998. Transmission and distribution expenses, as a percentage of revenues, increased from 8.5% to 9.5%.

Other

Other includes the Company's unregulated businesses, which were incorporated as Avistar in 1999, and certain corporate functions. The unregulated businesses contributed $1.3 million in revenues in 1998 compared to $3.3 million in 1997. Operating loss for the unregulated businesses increased from $3.3 million in 1997 to $5.8 million in 1998. The remaining costs represent corporate administrative costs.

Consolidated

Net other income and deductions increased $9.5 million over a year ago as a result of the investment income, proceeds from a litigation settlement and the reversal of a gas rate case reserve.

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.

The Company's consolidated income tax expense, before discontinued operations, was $56.3 million, an increase of $6.0 million for the year. The Company's income tax effective rate, before discontinued operations, increased from 36.8% to 37.2%.

The Company's net earnings from continuing operations for the year ended December 31, 1998, were $95.1 million compared to $86.5 million for the year ended December 31, 1997. Earnings per share from continuing operations on a diluted basis were $2.25 compared to $2.05 for the year ended December 31, 1997. Diluted weighted average shares outstanding were $42.1 million and $42.0 million in 1998 and 1997, respectively.

Discontinued Operations

In August 1998, the Company adopted a plan to discontinue the natural gas trading operations of its Energy Services Business Unit and completely discontinued these operations on December 31, 1998. Losses from discontinued operations, net of taxes, for the year ended December 31, 1998, were $12.4 million including a charge of $5.1 million for estimated loss on disposal, compared to $5.5 million in 1997. Loss per share, net of tax benefit, on a diluted basis for the discontinued operations was $0.30 and $0.13 for 1998 and 1997, respectively.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 1999, the Company had working capital of $167 million including cash and cash equivalents of $120.4 million. This is an increase in working capital of $87.8 million. This increase is primarily the result of an increase in cash and cash equivalents of $59.1 million and a reduction in short-term debt of $26.6 million, partially offset by an increase in accounts payable, reflecting higher year-over-year business levels.

Cash generated from operating activities was $214.5 million, an increase of $3.5 million from 1998. This increase was offset by an increase in receivables of $30.2 million due to billing problems associated with the new customer billing system (see *"Implementation of New Billing System"* below).

Cash used for investing activities was $55.9 million in 1999 compared to $340.1 million in 1998. This decreased spending reflects lower construction expenditures in 1999 of $32.3 million and the liquidation of insurance-based investments in the nuclear decommissioning trust of $26.6 million (see *financing activities for the payment of decommissioning debt of $26.6 million*). In addition, in 1998, the Company purchased $215.7 million of debt underlying certain of its leases of PVNGS.

Cash used for financing activities was $99.5 million in 1999. This increase is the result of the repurchase of $31.6 million of SUNs, $26.6 million of loan repayments associated with nuclear decommissioning trust activities and an $18.8 million stock repurchase by the Company. Cash provided from financing activities in 1998 was $173 million and included proceeds from the issuance of SUNs of $435 million and repayment of short-term borrowings of $231.3 million.

Capital Requirements

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. Projections for total capital requirements and construction expenditures for 2000 are $250.9 million and $219.1 million, respectively. Such projections for the years 2000 through 2004 are $1.2 billion and $1.1 billion, respectively. These estimates are under continuing review and subject to on-going adjustment (see *"Competitive Strategy"* above).

The Company's construction expenditures for 1999 were entirely funded through cash generated from operations. The Company currently anticipates that internal cash generation and current debt capacity will be sufficient to meet capital requirements for the years 2000 through 2004. 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.

Liquidity

At the end of February 2000, the Company had $175 million of available liquidity arrangements, consisting of $150 million from a senior unsecured revolving credit facility ("Credit Facility"), and $25 million in local lines of credit. The Credit Facility will expire in March 2003, and was fully available as of February 29, 2000. There were no outstanding borrowings as of February 29, 2000.

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.

On August 26, 1999, two major credit rating agencies, Moody's Investors Services, Inc. ("Moody's") and Standard and Poor's Corp. ("S&P") upgraded the Company's securities following the rate order by the PRC (see *"Electric Rate Case" below*). The Company's rating outlook by both rating agencies is "stable". Moody's upgrades include the Company's SUNs and senior unsecured pollution control revenue bonds to "Baa3" from "Ba1"; and preferred stock to "ba1" from "b1". The EIP lease obligation bonds were also upgraded to "Ba1" from "Ba2". S&P also upgraded, among other things, the Company's senior unsecured debt and bank loan credit rating to BBB- from BB+. Investors are cautioned that a security rating is not a recommendation to buy, sell or hold securities, that it may be subject to revision or withdrawal at any time by the assigning rating organization, and that each rating should be evaluated independently of any other rating.

These rating actions reflect the resolution of the Company's litigious electric rate case that began in 1997 and the passage of the Restructuring Act (see *"Overview"* above) that allows utilities to recover no less than fifty percent of their stranded costs. If certain conditions identified in the state law are met, utilities may be allowed recovery of up to one hundred percent of stranded costs. The rating agencies believe that the combination of these two events reduces a large component of regulatory and legislative uncertainty, which collectively help to support the Company's long-term prospects for maintaining cash flow and earning stability. Future rating actions for the Company's securities will depend in large part on the filing with the PRC relating to numerous restructuring issues, including the Company's plan to separate the utility into a generation business and a distribution and transmission business as required by the recently enacted state law. The Company is required to file a transition plan with the PRC by June 1, 2000.

Covenants in the Company's 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 Credit Facility imposes similar restrictions regardless of credit ratings.

Financing Activities

In 1999, the Company retired $31.6 million of its 7.1% SUNs through open market purchases, utilizing the funds from operations and the funds from temporary investments. In January 2000, the Company reacquired $35.0 million of its 7.5% SUNs through open market purchases. On October 28, 1999, tax-exempt pollution control revenue bonds of $11.5 million with an interest rate of 6.6% were issued to partially reimburse the Company for expenditures associated with its share of a recently completed upgrade of the emission control system at SJGS.

The Company currently has no requirements for long-term financings during the period of 2000 through 2004, except as part of its implementation of its holding company plan. 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.

Implementation of the Company's holding company plan will not result in any change in the consolidated outstanding indebtedness of the Company. In connection with the transfer of the regulated business by the Company to UtilityCo and the permanent debt financing for the assets to be transferred, subject to the receipt of the necessary regulatory and other approvals, UtilityCo may make an offer to holders of the Company's public SUNs ($403 million outstanding as of December 31, 1999) to exchange these notes for newly-issued SUNs of UtilityCo with substantially the same terms as the existing notes. Alternatively, some or all of these notes could continue to be debt securities of Energy depending on the results of any exchange offer or if it is more appropriate to capitalize UtilityCo with newly issued debt and use the proceeds from this debt issue to purchase a portion of the assets to be transferred to UtilityCo from Energy. It is currently planned that $586 million of currently outstanding pollution control revenue bonds (secured by SUNs and first mortgage bonds) will remain as a debt obligation of Energy after the share exchange and corporation separation since these bonds were issued to finance the ownership and operation of electric generation assets.

The Company's preferred stock ($12.8 million outstanding as of December 31, 1999), will remain an equity security of Energy after the share exchange unless an exchange offer is made by UtilityCo and accepted by all holders or the preferred stock is redeemed by the Company. Depending on the results of any exchange for the Company's preferred stock, some or all of the preferred stock could remain an equity security of Energy or become a new equity security of UtilityCo.

Stock Repurchase

In March 1999, the Company's Board of Directors approved a plan to repurchase up to 1,587,000 shares of the Company's outstanding common stock with maximum purchase price of $19.00 per share. In December 1999, the Company's Board of Directors authorized the Company to repurchase up to an additional $20.0 million of the Company's common stock. As of December 31, 1999, the Company repurchased 1,070,700 shares of its previously outstanding common stock at a cost of $18.8 million. From January 2, 2000 through February 29, 2000, the Company repurchased an additional 963,284 shares of its outstanding common stock at a cost of $15.7 million. The Company may from time-to-time repurchase additional common stock for various corporate purposes.

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 the extent to which cash flows will support dividends, the availability of retained earnings, the financial circumstances and performance of the Company, the PRC's decision on the Company's various regulatory cases currently pending, the effect of deregulating generation markets and market economic conditions generally. In addition, the ability to recover stranded costs in deregulation, future growth plans and related capital requirements and standard business considerations will also affect the Company's ability to pay dividends.

capital structure:

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

	1999	1998
Common Equity	46.7%	45.4%
Preferred Stock	0.7	0.7
Long-term Debt	52.6	53.9
Total Capitalization*	100.00%	100.00%

*Total capitalization does not include as debt the present value ($161 million as of December 31, 1999) of the Company's lease obligations for PVNGS Units 1 and 2 and EIP.

other issues facing the company

THE RESTRUCTURING ACT AND THE FORMATION OF HOLDING COMPANY

The Restructuring Act requires that assets and activities subject to the PRC jurisdiction, primarily electric and gas distribution, and transmission assets and activities (collectively, the "Regulated Business"), be separated from other competitive business, primarily electric generation and service and certain other energy services (collectively, "the Deregulated Competitive Businesses"). Such separation is required to be accomplished through the creation of at least two separate corporations. The Company has decided to accomplish the mandated separation by the formation of a holding company and the transfer of the Regulated Businesses to a newly-created, wholly owned subsidiary of the holding company, subject to various regulatory approvals. The holding company structure is expressly authorized by the Restructuring Act. Corporate separation of the Regulated Business from the Deregulated Competitive Businesses must be completed by January 1, 2001, although the date may be extended by up to one year by the PRC. Completion of corporate separation will require a number of regulatory approvals by, among others, the PRC and the Nuclear Regulatory Commission ("*NRC*").

Completion will also require shareholder approval and a number of other consents from creditors and lessors. Completion may also entail significant restructuring activities with respect to the Company's existing liquidity arrangements and the Company's publicly-held SUNs of which $403.4 million were outstanding as of December 31, 1999. Holders of the Company's SUNs, $135 million at 7.5% and $268.4 million at 7.1%, may be offered the opportunity to exchange their securities for similar SUNs of the newly created regulated business (see "*Financing Activities*" above).

REGULATED BUSINESS

The Regulated Business comprised approximately 47.9% of the Company's total assets and contributed approximately 39.6% of the Company's operating revenues and approximately 61.1% of the Company's operating income before interest charges in 1999.

STRANDED COSTS

The Restructuring Act 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 recognized under cost-of-service regulation. Utilities will be allowed to recover no less than 50% of such costs through a non-bypassable charge on all customer bills for five years after implementation of customer choice. The PRC could authorize a utility to recover up to 100% of its stranded costs if the PRC finds that recovery of more than 50%: (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. While recoverable stranded costs will be collected as part of the regulated business, it is anticipated that such collections would be paid to the Company and be part of the revenues available to the competitive businesses subsequent to restructuring. However, no determination and quantification of stranded cost recovery has yet been made by the PRC. Such determination will have a material impact on the consolidated financial results and position of the Company.

TRANSITION COST RECOVERY

Pursuant to the Restructuring Act, utilities will also be allowed to recover in full any prudent and reasonable costs incurred in implementing full open access ("transition costs"). The transition costs will be recovered through 2007 by means of a separate wires charge. The Company estimates that these costs will be in excess of $50 million. Transition costs include, but are not limited to, professional fees, financing costs including underwriting fees, consents relating to the transfer to assets, management information system changes including billing system changes and public and customer education and communications. Recoverable transition costs are currently being capitalized and will be amortized over the recovery period to match related revenues. Recovery of any transition costs, which are not deemed recoverable by the PRC, may be vigorously pursued through all remedies available to the Company with the ultimate outcome uncertain. Costs not recoverable will be expensed when incurred unless these costs are otherwise permitted to be capitalized under current and future acounting rules. If the amount of nonrecoverable transition costs is material, the resulting charge to earnings may have a material impact on the consolidated financial results and position of the Company.

DEREGULATED COMPETITIVE BUSINESSES

The Deregulated Competitive Businesses which would be retained by the Company include the Company's interests in generation facilities, including PVNGS, Four Corners, and SJGS, together with the pollution control facilities which have been financed with pollution control revenue bonds. Approximately $586 million in pollution control revenue bonds would remain as obligations of the generation subsidiary, as would certain other of the Company's long-term obligations. The Deregulated Competitive Businesses would not be subject to regulation by the PRC. Under the Company's restructuring plan, the Company's bondholders will continue to hold obligations of the Company following restructuring. Since the Restructuring Act requires significant changes in the assets and businesses of the Company, the bondholders will be accepting the risks involved in those changes.

The Company will continue its Deregulated Competitive Business following the restructuring, which will be subject to market conditions. Following the separation as required by the Restructuring Act, in support of its wholesale trading operations, the Company is targeting to double its generating capacity and triple its sales volume. Recently, the Company formed a non-regulated subsidiary, Avistar, in August 1999, to implement competitive business strategies. Avistar provides services in the areas of utility management for municipalities and other communities, remote metering and development of energy conservation and supply projects for federal government facilities. The Company does not anticipate an earnings contribution from Avistar over the next few years.

NRC PREFUNDING

Pursuant to NRC rules on financial assurance requirements for the decommissioning of nuclear power plant, the Company has a program for funding its share of decommissioning costs for PVNGS through a sinking fund mechanism. The NRC rules on financial assurance became effective on November 23, 1998. The amended rules provide that a licensee may use an external sinking fund as the exclusive financial assurance mechanism if the licensee recovers estimated decommissioning costs through cost of service rates or a "non-bypassable charge". Other mechanisms are prescribed, such as prepayment, surety methods, insurance and other guarantees, to the extent that the requirements for exclusive reliance on the fund mechanism are not met.

The Restructuring Act allows for the recoverability of 50% up to 100% of stranded costs including decommissioning costs (see *"Stranded Costs"*). If the Company is unable to meet the requirements of the NRC rules permitting the use of an external sinking fund because it is unable to recover all of its estimated decommissioning costs through a non-bypassable charge, the Company may have to pre-fund or find a similarly capital intensive means to meet the NRC rules. There can be no assurance that such an event will not negatively affect the funding of the Company's growth plans.

In addition, as part of the determination and quantification of the stranded costs related to the decommissioning, the Company will have to estimate future decommissioning costs. If the Company's estimate proves to be less than the actual costs of decommissioning, any cost in excess of the amount allowed through stranded cost recovery, may not be recoverable. Such excess costs, if any, will also be subject to the pre-funding requirements discussed above.

COMPETITION

Under current law, the Company is not in any direct retail competition with any other regulated electric and gas utility. Nevertheless, the Company is subject to varying degrees of competition in certain territories adjacent to or within areas it serves that are also currently served by other utilities in its region as well as cooperatives, municipalities, electric districts and similar types of government organizations.

The Restructuring Act opens the state's electric power market to customer choice for certain customers beginning in 2001 and the balance of customers in 2002. As a result, the Company may face competition from companies with greater financial and other resources. There can be no assurance that the Company will not face competition in the future that would adversely affect its results.

It is the current intention to have the Company's Deregulated Competitive Businesses engage primarily in energy-related businesses that will not be regulated by state or Federal agencies that currently regulate public utilities (other than the FERC and NRC). These competitive businesses, including the generation business will encounter competition and other factors not previously experienced by the Company, and may have different, and perhaps greater, investment risks than those involved in the regulated business that will be engaged in by the Regulated Businesses. Specifically, the passage of the Restructuring Act and deregulation in the electric utility industry generally is likely to have an impact on the price and margins for electric generation and thus, the return on the investment in electric generation assets. In response to competition and the need to gain economies of scale, electricity producers will need to control costs to maintain margins, profitability and cash flow that will be adequate to support investments in new technology and infrastructure. The Company will have to compete directly with independent power producers, many of whom will be larger in scale, thus creating a competitive advantage for such producers due to scale efficiencies. The Company's current five year business plan includes a 300% increase in sales and through doubling the construction or acquisition of additional power generation assets in its surrounding region of operations. Such growth will be dependent upon the Company's ability to generate \$400 to \$600 million to fund the deregulated competitive expansion. There can be no assurance that these Deregulated Competitive Businesses, particularly the generation business, will be successful or, if unsuccessful, that they will not have a direct or indirect adverse effect on the Company.

IMPLEMENTATION OF NEW 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 was unable to generate appropriate bills for all its customers through the first quarter of 1999 and was unable to analyze delinquent accounts until November 1999.

Under PRC rules and PRC approved Company rules, the Company is required to issue customer bills on a monthly basis. The Company was granted a temporary variance, and the PRC began a hearing on whether the Company violated PRC rules, regulations or orders or the New Mexico Public Utility Act. The investigation was concluded on November 2, 1999, without the PRC imposing any civil penalty on the Company and with a stipulation order that the Company be permitted to bill an additional service charge to customers who were not billed the appropriate electric service charge and/or gas access fee. The stipulation was limited to approximately \$0.7 million in the November and December billing cycles.

Because of the implementation issues associated with the new billing system, the Company estimated retail gas and electric revenues through July 1999. Beginning with August 1999, the Company was able to determine actual revenues for all prior periods affected and began reconciling with previously estimated revenues. In December 1999, the Company completed its reconciliation of system revenues. As a result, 1999 revenues represented actual revenues as determined by the new billing system. The resulting reconciliation did not materially impact recorded revenues. However, a significant number of individual accounts required corrections.

As a result of the delay of normal collection activities, the Company incurred a significant increase in delinquent accounts, many of which occurred with customers that no longer have active accounts with the Company. As a result, the Company significantly increased its bad debt accrual throughout 1999.

The following is a summary of the allowance for doubtful accounts during 1999, 1998 and 1997:

(in thousands)	1999	1998	1997
Allowance for doubtful accounts, beginning of year	$ 836	$ 783	$ 709
Bad debt accrual	11,496	3,325	3,378
Less: Write off (adjustments) of uncollectible accounts	(172)	3,272	3,304
Allowance for doubtful accounts, end of year	$ 12,504	$ 836	$ 783

ELECTRIC RATE CASE

In November 1998, the NMPUC issued a final order in the Company's electric rate case, requiring 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. The rate reduction order reflected, among other things, the revaluation of the Company's generation resources based on a so-called "market-based price" and the finding by the NMPUC that recovery of stranded costs is illegal. In December 1998, the Company appealed the rate case order to the New Mexico Supreme Court ("Supreme Court").

On March 15, 1999, the Supreme Court issued a ruling, vacating the NMPUC order on the Company's electric rate case and remanding the case to the PRC, the successor of the NMPUC, for further proceedings.

On August 25, 1999, the PRC issued an order approving a settlement. The PRC ordered the Company to reduce its electric rates by $34.0 million retroactive to July 30, 1999. In addition, the order includes a rate freeze until retail electric competition is fully implemented in New Mexico or until January 1, 2003. The settlement will reduce annual revenues by an estimated $37.0 million based on expected customer growth and will reduce electric distribution operating revenues in the year 2000 by approximately $20 million.

As part of the settlement, the Company agreed that certain language changes to the tariff Kirtland Air Force Base ("KAFB") currently takes service under be set for a separate hearing before the PRC. Hearings on this issue have not yet been scheduled. KAFB has not renewed its power service contract with the Company that expired in December 1999 (see "*Effects of Certain Pending Events on Future Revenues*" below).

EFFECTS OF CERTAIN PENDING EVENTS ON FUTURE REVENUES

The Company's contract with San Diego Gas and Electric ("SDG&E") to provide electricity, will expire in April of 2001. SDG&E has notified the Company that it will not renew its contract. The Company currently estimates that the net revenue reduction resulting from the expiration of the SDG&E contract will be approximately $20 million annually. In addition, there is currently ongoing litigation between the Company and SDG&E regarding prior years' contract pricing.

On October 4, 1999, Western filed a petition at the FERC requesting the FERC to consider, on a expedited basis, ordering the Company to provide network transmission service to Western under the Company's Open Access Transmission Tariff on behalf of the United States Department of Energy as contracting agent for KAFB. The Company intends to litigate this matter vigorously. The net revenue reduction to the Company if the DOE replaces the Company as the power supplier to KAFB is estimated to be approximately $7.0 million annually.

A further discussion of these and other legal proceedings can be found in PART I, ITEM 3. - "LEGAL PROCEEDINGS" in the Company's Annual Report on Form 10-K.

THE YEAR 2000 ISSUE

The Company experienced no year 2000 failures of its electric generation or its gas and electric distribution and transmission systems during the critical year 2000 transition period. Further, the Company has experienced no failures in any of these systems in the ensuing period. As a result, no customers experienced a year 2000 related disruption to their gas or electric service.

The Company anticipates that minor, previously undetected, programming issues might surface during the year 2000. These are not expected to impact the Company's customers.

During 1999, the Company expended $15.3 million on the Year 2000 Project for a total expenditure of $20.7 million through the end of 1999. The Company expects to spend approximately $0.2 million in 2000 on efforts to finalize project documentation and to file reports with various regulatory agencies.

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. Additional coal resources will be required. The Company is currently in discussions regarding alternatives.

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 has not yet occurred. The Company is unable to predict the outcome of this matter and the Company's exposures have not yet been assessed.

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 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.

FUEL, WATER AND GAS NECESSARY FOR GENERATION OF ELECTRICITY

The Company's generation mix for 1999 was 67.6% coal, 31.0% nuclear and 1.4% gas and oil. Due to locally available natural gas and oil supplies, the utilization of locally available coal deposits and the generally abundant supply of nuclear fuel, the Company believes that adequate sources of fuel are available for its generating stations (see *"Coal Fuel Supply"* above).

Water for Four Corners and SJGS is obtained from the San Juan River. BHP holds rights to San Juan River water and committed a portion of such rights to Four Corners through the life of the project. The Company and Tucson have a contract with the United States Bureau of Reclamation ("USBR") for consumption of 16,200 acre feet of water per year for the SJGS, which contract expires in 2005, and in addition, the Company was granted the authority to consume 8,000 acre feet of water per year under a state permit that is held by BHP. The Company is of the opinion that sufficient water is under contract for the SJGS through 2005. Currently, the Company is in discussions with the Jicarilla Apache Tribe for a twenty-seven year contract, beginning in 2006, for replacement of the current USBR contract for 16,200 AF of water. The Company cannot predict the outcome of these discussions but expects to obtain a replacement water supply for the USBR contract that expires in 2005. Various enviromental appeals will likely be required for a replacement water supply. The Company is actively involved in the San Juan River Recovery Implementation Program to mitigate any concerns with the taking of the negotiated water supply from a river that contains endangered species and critical habitat. As a result, the Company believes that adequate sources of water are available for its generating stations.

PNMGS obtains its supply of natural gas primarily from sources within New Mexico pursuant to contracts with producers and marketers. These contracts are generally sufficient to meet PNMGS' peak-day demand. PNMGS serves certain cities which depend on EPNG or Transwestern Pipeline Company for transportation of gas supplies. Because these cities are not directly connected to PNMGS' transmission facilities, gas transported by these companies is the sole supply source for those cities. The Company believes that adequate sources of gas are available for its distribution systems.

COMPLIANCE WITH ENVIRONMENTAL LAWS AND REGULATIONS

The Company's operations are subject to various federal, state, local and tribal environmental laws and regulations, including, but not limited to, those governing discharges into the air and water, the storage, handling and disposal of solid and hazardous wastes, the remediation of soil and groundwater contaminated by hazardous substances or wastes, and the health and safety of employees particularly as it relates to the Company's coal, gas and nuclear based electric generation assets. Compliance with environmental laws, stricter interpretations of or amendments to such laws, or more vigorous enforcement policies by regulatory agencies may require material expenditures by the Company. The nature of the Company's current and former operations and the history of industrial uses at some of its facilities result in exposure to the risk of liabilities or claims with respect to environmental and worker health and safety matters. In addition, under certain environmental laws, a current or previous owner or operator of property may be jointly and severally liable for the costs of investigation, removal or remediation of certain substances on, under, or in such property, without regard to negligence or fault. The presence of, or failure to remediate properly, such substances may adversely affect the ability to sell or rent such property or to borrow using such property as collateral. In addition, persons who generate, arrange for the disposal or treatment of, or dispose of, hazardous substances may be jointly and severally liable for the costs of investigation, remediation or removal of such hazardous substances at or from the disposal or treatment facility, regardless of whether the facility is owned or operated by such person. Responsible parties also may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from a site.

LABOR UNION NEGOTIATIONS

The Company and the International Brotherhood of Electrical Workers ("IBEW") Local Union 611 will enter into negotiations for a successor agreement during the later part of the first quarter of 2000. The current collective bargaining agreement, which covers the 654 bargaining unit employees in the Company's regulated operations, expires on May 1, 2000. The Company's negotiating team is currently preparing for the upcoming negotiations. While the Company believes that its relations with its employees are satisfactory, a dispute between the Company and its employees' representative could have a material adverse effect on the Company.

NAVAJO NATION TAX ISSUES

Arizona Public Service Company ("APS"), the operating agent for Four Corners, has informed the Company that in March 1999, APS initiated discussions with the Navajo Nation regarding various tax issues in conjunction with the expiration of a tax waiver in July 2001, which was granted by the Navajo Nation in 1985. The tax waiver pertains to the possessory interest tax and the business activity tax associated with the Four Corners operations on the reservation. The Company believes that the resolution of these tax issues will require an extended process and could potentially affect the cost of conducting business activities on the reservation. The Company is unable to predict the ultimate outcome of discussions with Navajo Nation regarding these tax issues.

NEW AND PROPOSED 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 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.

EITF Issue 99-14, Recognition of Impairment Losses on Firmly Committed Executory Contracts:
The EITF has added an issue to its agenda to address impairment of leased assets. A significant portion of the Company's nuclear generating assets are held under operating leases. Based on the alternative accounting methods being explored by the EITF, the related financial impact of the future adoption of EITF Issue No. 99-14 should not have a material adverse effect on results of operations. However, a complete evaluation of the financial impact from the future adoption of EITF Issue No. 99-14 will be undeterminable until EITF deliberations are completed and stranded cost recovery issues are resolved.

Accounting for Derivative Instruments and Hedging Activities, SFAS 133: Statement of Financial Accounting Standards no. 133 ("SFAS 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 also 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. The Company is in the process of reviewing and identifying all financial instruments currently existing in the Company in compliance with the provisions of SFAS 133. It is likely that the adoption of SFAS 133 will add volatility to the Company's operating results and/or asset and liability valuations reflecting the impact of mark-to-market accounting for commodity contracts. In June 1999, Financial Accounting Standards Board ("FASB") issued SFAS 137 to amend the effective date for the compliance of SFAS 133 to January 1, 2001.

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.

quantitative and qualitative disclosure about market risk

The Company uses derivative financial instruments in limited instances to manage risk as it relates to changes in natural gas and electric prices and adverse market changes for investments held by the Company's various trusts. The Company is exposed to credit losses in the event of non-performance or non-payment by counterparties. The Company uses a credit management process to assess and monitor the financial conditions of counterparties. The Company also uses, on a limited basis, certain derivative instruments for bulk power electricity trading purposes in order to take advantage of favorable price movements and market timing activities in the wholesale power markets. Information about market risk is set forth in Note 5 to the Notes to the Consolidated Financial Statements and incorporated by reference. The following additional information is provided.

The Company uses value at risk ("VAR") to quantify the potential exposure to market movement on its open contracts and excess generating assets. The VAR is calculated utilizing the variance/co-variance methodology over a three day period within a 99% confidence level.

The Company's VAR as of December 31, 1999 from its electric trading contracts and gas purchase contracts was $2.4 million.

The VAR represents an estimate of the reasonably possible net losses that would be recognized on the portfolio of derivatives assuming hypothetical movements in future market rates, and is not necessarily indicative of actual results that may occur, since actual future gains and losses will differ from those estimated. Actual gains and losses may differ from estimates due to actual fluctuations in market rates, operating exposures, and the timing thereof, as well as changes to the portfolio of derivatives during the year.

financial statements and supplementary data:

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The accompanying financial statements, which consolidate the accounts of Public Service Company of New Mexico and its subsidiaries, have been prepared in conformity with generally accepted accounting principles.

The integrity and objectivity of data in these financial statements and accompanying notes, including estimates and judgments related to matters not concluded by year-end, are the responsibility of management as is all other information in this Annual Report. Management devotes ongoing attention to review and appraisal of its system of internal controls. This system is designed to provide reasonable assurance, at an appropriate cost, that the Company's assets are protected, that transactions and events are recorded properly and that financial reports are reliable. The system is augmented by a staff of corporate auditors; careful attention to selection and development of qualified financial personnel; programs to further timely communication and monitoring of policies, standards and delegated authorities; and evaluation by independent auditors during their audits of the annual financial statements.

The Audit Committee of the Board of Directors, composed entirely of outside directors, meets regularly with financial management, the corporate auditors and the independent auditors to review the work of each. The independent auditors and corporate auditors have free access to the Audit Committee, without management representatives present, to discuss the results of their audits and their comments on the adequacy of internal controls and the quality of financial reporting.

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, 1999 and 1998, 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, 1999. 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 in the United States. 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, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999 in conformity with generally accepted accounting principles in the United States.

ARTHUR ANDERSEN LLP

Albuquerque, New Mexico
January 26, 2000

consolidated statements of earnings:

(in thousands, except per share amounts)	1999	1998	1997
	YEAR ENDED DECEMBER 31,		
Operating Revenues: (note 1,7)			
Electric	$ 911,977	$ 835,204	$ 722,438
Gas	236,711	255,975	294,769
Unregulated businesses	8,855	1,266	3,314
Total operating revenues	1,157,543	1,092,445	1,020,521
Operating Expenses:			
Cost of energy sold	531,952	449,426	409,717
Administrative and general	153,709	135,727	124,591
Energy production costs	140,784	149,747	138,245
Depreciation and amortization	92,661	86,141	82,694
Transmission and distribution costs	59,264	56,457	56,983
Taxes, other than income taxes	34,084	37,992	36,803
Income taxes (note 7)	25,010	41,306	41,941
Total operating expenses	1,037,464	956,796	890,974
Operating income	120,079	135,649	129,547
Other Income and Deductions:			
Other	47,500	37,672	21,548
Income tax expense (note 7)	(17,298)	(14,985)	(8,384)
Net other income and deductions	30,202	22,687	13,164
Income before interest charges	150,281	158,336	142,711
Interest Charges:			
Interest on long-term debt (note 3)	65,899	50,929	46,670
Other interest charges	4,768	12,288	9,544
Net interest charges	70,667	63,217	56,214
Net Earnings from Continuing Operations	79,614	95,119	86,497
Discontinued Operations, Net of Tax (note 13)	–	(12,437)	(5,502)
Cumulative Effect of a Change in Accounting Principle, Net of Tax	3,541	–	–
Net Earnings	83,155	82,682	80,995
Preferred Stock Dividend Requirements	586	586	586
Net Earnings Applicable to Common Stock	$ 82,569	$ 82,096	$ 80,409
Net Earnings per Share of Common Stock (Basic) (note 6)	$ 2.01	$ 1.97	$ 1.92
Net Earnings per Share of Common Stock (Diluted) (note 6)	$ 2.01	$ 1.95	$ 1.91
Dividends Paid per Share of Common Stock	$ 0.80	$ 0.77	$ 0.63

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

consolidated balance sheets:

(in thousands)

	AS OF DECEMBER 31, 1999	1998
ASSETS:		
Utility Plant, at original cost except PVNGS: (notes 10,11)		
Electric plant in service	$1,976,009	$1,966,277
Gas plant in service	483,819	467,758
Common plant in service and plant held for future use	69,273	63,796
	2,529,101	2,497,831
Less accumulated depreciation and amortization	1,077,576	998,175
	1,451,525	1,499,656
Construction work in progress	104,934	66,677
Nuclear fuel, net of accumulated amortization of $20,832 and $21,898	25,923	27,426
Net utility plant	1,582,382	1,593,759
Other Property and Investments:		
Other investments (notes 5, 12)	483,008	518,959
Non-utility property, net of accumulated depreciation of $1,261 and $1,129	4,439	4,875
Total other property and investments	487,447	523,834
Current Assets:		
Cash and cash equivalents	120,399	61,280
Accounts receivables, net of allowance for uncollectible accounts of $12,504 and $836	147,746	130,809
Other receivables	68,911	59,745
Inventories	39,992	35,674
Regulatory assets (note 2)	24,056	15,618
Other current assets	4,934	4,666
Total current assets	406,038	307,792
Deferred charges:		
Regulatory assets (note 2)	195,898	186,383
Prepaid benefit cost (note 8)	16,126	16,714
Other deferred charges	35,377	40,121
Total deferred charges	247,401	243,218
	$2,723,268	$2,668,603
CAPITALIZATION AND LIABILITIES:		
Capitalization: (note 3)		
Common stock equity:		
Common stock outstanding--40,703 and 41,774 shares	$ 203,517	$ 208,870
Additional paid-in capital	453,393	465,386
Accumulated other comprehensive income, net of tax *(note 3)*	2,352	1,127
Retained earnings	227,829	186,220
Total common stock equity	887,091	861,603
Minority interest	12,771	13,405
Cumulative preferred stock without mandatory redemption requirements	12,800	12,800
Long-term debt, less current maturities (note 3)	988,489	1,008,614
Total capitalization	1,901,151	1,896,422
Current Liabilities:		
Short-term debt	–	26,620
Accounts payable	150,645	113,975
Accrued interest and taxes	34,237	34,289
Other current liabilities	54,137	45,169
Total current liabilities	239,019	220,053
Deferred Credits:		
Accumulated deferred income taxes (note 7)	153,335	129,990
Accumulated deferred investment tax credits (note 7)	50,996	54,404
Regulatory liabiliaties (note 2)	88,497	89,559
Regulatory liabiliaties related to accumulated deferred income tax (note 2)	14,935	14,287
Accrued benefit cost (note 8)	8,945	4,675
Other deferred credits (note 12)	266,390	259,213
Total deferred credits	583,098	552,128
Commitments and Contingencies (note 11)	–	–
	$2,723,268	$2,668,603

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

consolidated statements of cash flows:

(in thousands)	YEAR ENDED DECEMBER 31, 1999	1998	1997
Cash Flows From Operating Activities:			
Net earnings	$ 83,155	$ 82,682	$ 80,995
Adjustments to reconcile net earnings to net cash flows from operating activities:			
Depreciation and amortization	103,891	98,154	94,924
Gain on cumulative effect of a change in accounting principle	(5,862)	–	–
Other, net	27,623	27,462	20,025
Changes in certain assets and liabilities:			
Accounts receivables	(16,937)	1,302	(14,038)
Other assets	(20,189)	31,066	3,946
Accounts payable	36,670	(40,490)	23,808
Other liabilities	6,147	10,812	3,462
Net cash flows from operating activities	214,498	210,988	213,122
Cash Flows From Investing Activities:			
Utility plant additions	(95,298)	(128,784)	(128,371)
Return (purchase) of PVNGS lease obligation bonds	16,903	(204,364)	(23,882)
Other investing	22,509	(7,844)	(29,814)
Net cash flows from investing activities	(55,886)	(340,992)	(182,067)
Cash Flows From Financing Activities:			
Borrowings (note 3)	11,500	896,348	27,600
Repayments (note 3)	(58,200)	(694,651)	(28,870)
Exercise of employee stock options (note 9)	–	(3,687)	(1,285)
Common stock repurchase (note 3)	(18,799)	–	–
Dividends paid	(33,359)	(32,789)	(26,864)
Other financing	(635)	7,868	(3,693)
Net cash flows from financing activities	(99,493)	173,089	(33,112)
Increase (Decrease) in Cash and Cash Equivalents	59,119	43,085	(2,057)
Beginning of Year	61,280	18,195	20,252
End of Year	$120,399	$ 61,280	$ 18,195
Supplemental cash flow disclosures:			
Interest paid	$ 67,770	$ 50,109	$ 57,302
Income taxes paid, net of refunds	$ 36,575	$ 49,048	$ 20,175
Acquired DOE pipeline in exchange for transportation services	$ 3,100	–	–

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

consolidated statements of capitalization:

(in thousands)	AS OF DECEMBER 31, 1999	1998
Common Stock Equity: (note 3)		
Common Stock, par value $5 per share	$ 203,517	$ 208,870
Additional paid-in capital	453,393	465,386
Accumulated other comprehensive income, net of tax	2,352	1,127
Retained earnings	227,829	186,220
Total common stock equity	887,091	861,603
Minority Interest	12,771	13,405
Cumulative Preferred Stock: (note 3)		
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, 1999 were 128,000.	12,800	12,800
Long-Term Debt: (note 3)		
Issue and Final Maturity		
First Mortgage Bonds, Pollution Control Revenue Bonds:		
5.7% due 2016	65,000	65,000
6.375% due 2022	46,000	46,000
Total First Mortgage Bonds	111,000	111,000
Senior Unsecured Notes, Pollution Control Revenue Bonds:		
6.30% due 2016	77,045	77,045
5.75% due 2022	37,300	37,300
5.80% due 2022	100,000	100,000
6.375% due 2022	90,000	90,000
6.375% due 2023	36,000	36,000
6.40% due 2023	100,000	100,000
6.30% due 2026	23,000	23,000
6.60% due 2029	11,500	–
Total Senior Unsecured Notes, Pollution Control Revenue Bonds	474,845	463,345
Senior Unsecured Notes:		
7.10% due 2005	268,420	300,000
7.50% due 2018	135,000	135,000
Other, including unamortized premium and (discounted), net	(776)	(731)
Total long-term debt	988,489	1,008,614
Total Capitalization	$1,901,151	$1,896,422

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

notes to consolidated financial statements: *december 31, 1999, 1998 and 1997*

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting Principles

The Company prepares its financial statements 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.

The Company's accounting policies conform to the provisions of Statement of Financial Accounting Standards No. 71, *"Accounting for the Effects of Certain Types of Regulation"* ("SFAS 71"). SFAS 71 requires a rate-regulated entity to reflect the effects of regulatory decisions in its financial statements. In accordance with SFAS 71, the Company has deferred certain costs and recorded certain liabilities pursuant to the rate actions of the PRC, NMPUC and FERC. These "regulatory assets" and "regulatory liabilities" are enumerated and discussed in Note 2.

To the extent that the Company concludes that the recovery of a regulatory asset is no longer probable due to regulatory treatment, the effects of competition or other factors, the amount would be recorded as a charge to in earnings as recovery is no longer probable. The Company has discontinued the application of SFAS 71 as of December 31, 1999, for the generation portion of its business effective with the passage of the Electric Industry Restructuring Act of 1999 ("Restructuring Act") in accordance with Financial Accounting Standards No. 101, *"Accounting for the Discontinuation of Application of FASB Statement No. 71"*. The Company evaluated its regulatory assets under Financial Accounting Standards No. 121, *"Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of"* ("SFAS 121") and determined no impairment exists. The Company believes that it will recover costs associated with stranded assets including asset closure costs through a non-bypassable charge as permitted by the Restructuring Act. See Note 2 for additional discussion.

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.

Financial Statement Preparation and Presentation

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. Pursuant to a rate stipulation dated October 1993, the Company did not capitalize amounts relating to an allowance for funds used during construction in 1999, 1998 or 1997. Utility plant includes certain electric assets not subject to regulation.

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 PRC. The average rates used are as follows:

	1999	1998	1997
Electric plant	3.38%	3.32%	3.33%
Gas plant	3.37%	3.06%	3.23%
Common plant	7.73%	7.34%	7.60%

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.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Nuclear Decommissioning

The Company accounts for nuclear decommissioning costs on a straight-line basis over the respective license period. Such amounts are based on the future value of expenditures estimated to be required to decommission the plant.

Recoverable Fuel Costs

The Company's fuel and purchased power costs for its firm requirements wholesale customers that are above the levels included in base rates are recoverable under a fuel and purchased power cost adjustment approved by the FERC. Such costs are deferred until the period in which they are billed or credited to customers. The Company's gas purchase costs that are above levels included in base rates are recoverable under similar Purchased Gas Adjustment Clause administered by the PRC. For gas, the excess or deficiency is accumulated for refund or surcharge to customers on an annual basis. Future recovery of these costs is subject to approval by the PRC.

Amortization of Debt Acquisition Costs

Discount, premium and expense related to the issuance of long-term debt are amortized over the lives of the respective issues. In connection with the 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.

Stock Options

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.

Income Taxes

The Company reports income tax expense in accordance with SFAS 109, *Accounting for Income Taxes.* SFAS 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.

Asset Impairment

The Company regularly evaluates the carrying value of its regulatory and tangible long-lived assets in relation to their future undiscounted cash flows to assess recoverability in accordance with SFAS 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of.* Impairment testing of power generation assets is performed quarterly in response to market changes resulting from industry deregulation. Power generation assets used to supply jurisdictional and wholesale markets are evaluated on a group basis using future undiscounted cash flows based on current open market price conditions. The Company also has generation assets that are used for the sole purpose of reliability. These assets are tested as an individual group. Power generation assets held under operating leases are not evaluated for impairment (see note 4).

Financial Instruments

The Company periodically enters into energy trading contracts to take advantage of market opportunities associated with the purchase and sale of electricity. Such contracts are marked-to-market each period end. In addition, the Company protected its decommissioning and retiree trust assets against market price volatility by purchasing financial put and call options. These instruments are also marked-to-market each period end. The Company also periodically hedges natural gas purchases to limit commodity price volatility. Unrealized gains and losses from natural gas-related swaps, futures and forward contracts are deferred and recognized as the natural gas is sold and is recovered through gas rates charged to customers (see notes 5 and 14).

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Accounting for Contracts Involved in Energy Trading and Risk Management Activities

In December 1998, the Emerging Issues Task Force ("EITF") of the FASB reached consensus on EITF Issue No. 98-10 which 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. Effective January 1, 1999, the Company adopted EITF Issue No. 98-10. The effect of the initial application of the new standard is reported as a cumulative effect of a change in accounting principle.

Change in Presentation

Certain prior year amounts have been reclassified to conform to the 1999 financial statement presentation.

(1) NATURE OF BUSINESS AND SEGMENT INFORMATION

The Company is an investor-owned integrated utility engaged in the generation, transmission, distribution and sale of electricity and the transportation distribution and sale of natural gas. In addition, the Company provides energy and utility related services under its wholly-owned subsidiary, Avistar, Inc. ("Avistar").

Under current law, the Company is not in any direct retail competition with any other regulated electric and gas utility. The Restructuring Act in New Mexico, which was enacted into law on April 8, 1999, opens the state's electric power market to customer choice for certain customers beginning as early as 2001 with the balance of customers obtaining open access as early as 2002. The Restructuring Act requires that assets and activities subject to the PRC jurisdiction, primarily electric and gas distribution, and transmission assets and activities (collectively, the "regulated business"), be separated from other competitive business, primarily electric generation and service and certain other energy services operations (collectively, "the competitive businesses"). Such separation is required to be accomplished through the creation of at least two separate corporations. The Company has decided to accomplish the mandated separation by the formation of a holding company and the transfer of the regulated businesses to a newly-created, wholly owned subsidiary of such holding company, subject to various regulatory and other approvals. Corporate separation of the regulated business from the competitive businesses must be completed by January 1, 2001, although such date may be extended by up to one year by the PRC.

As it currently operates, the Company's principal business segments are electric ("Electric") and gas ("Gas") operations. Electric consists of three major business lines that include the Electric Service Business Unit ("Distribution"), Transmission Service Business Unit ("Transmission") and Generation Business Unit ("Generation").

Electric Operations

The Company's electric operations serve four principal markets. Sales to retail customers and sales to firm-requirements wholesale customers, sometimes referred to collectively as "system" sales, comprise two of these markets. The third market consists of other contracted sales to utilities for which the Company commits to deliver a specified amount of capacity (measured in MW) or energy (measured in MWh) over a given period of time. The fourth market consists of economy energy sales made on an hourly basis at fluctuating, spot-market rates. Sales to the third and fourth markets are sometimes referred to collectively as "off-system" sales.

The Company provides retail electric service to a large area of north central New Mexico, including the cities of Albuquerque and Santa Fe and certain other areas of New Mexico. As of December 31, 1999, approximately 361,000 retail electric customers were served by the Company, the largest of which accounted for approximately 4.7% of the Company's total retail electric revenues for the year ended December 31, 1999.

The Company has ownership interests in certain generating facilities located in New Mexico, including the Four Corners Power Plant, a coal fired unit ("Four Corners"), and San Juan Generating Station, a coal fired unit ("SJGS"). In addition, the Company has ownership and leasehold interests in PVNGS located in Arizona. These generation assets are used to supply retail and wholesale customers. The Company also owns Reeves Station, a gas and oil fired unit ("Reeves") and Las Vegas Generating Station, a gas and oil fired unit ("Las Vegas") that are used solely for reliability purposes or to generate electricity for the wholesale market during peak demand periods in the Company's wholesale power markets. As of December 31, 1999, the total net generation capacity of facilities owned or leased by the Company was 1,521 MW. In addition to generation capacity, the Company purchases power in the open market. The Company is also interconnected with various utilities for economy interchanges and the 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 purchase agreements to accommodate its trading activity.

(1) NATURE OF BUSINESS AND SEGMENT INFORMATION *(continued)*

Gas Operations

The Company's gas operating division, Public Service Company of New Mexico Gas Services ("PNMGS"), a division of the Company, distributes natural gas to most of the major communities in New Mexico, including Albuquerque and Santa Fe, serving approximately 426,000 customers as of December 31, 1999. PNMGS' customer base includes both sales-service customers and transportation-service customers. Sales-service customers purchase natural gas and receive transportation and delivery services from PNMGS for which PNMGS receives both cost-of-gas and cost-of-service revenues. Additionally, PNMGS makes occasional gas sales to off-system customers. Transportation-service customers, who procure gas independently of PNMGS and contract with PNMGS for transportation and related services, provide PNMGS with cost-of-service revenues only. Transportation services are provided to gas marketers, producers and end users for delivery to locations throughout the PNMGS distribution systems, as well as for delivery to interstate pipelines.

PNMGS obtains its supply of natural gas primarily from sources within New Mexico pursuant to contracts with producers and marketers. These contracts are generally sufficient to meet PNMGS' peak-day demand. PNMGS serves certain cities which depend on El Paso Natural Gas Company or Transwestern Pipeline Company for transportation of gas supplies. Because these cities are not directly connected to PNMGS' transmission facilities, gas transported by these companies is the sole supply source for those cities. Such transportation is regulated by FERC. As a result of FERC Order 636, PNMGS' options for transporting gas to such cities and other portions of its distribution system have increased.

Unregulated

The Company's wholly-owned subsidiary, Avistar was formed in August 1999 as a New Mexico corporation and is currently engaged in certain unregulated, non-utility businesses, including energy and utility-related services previously operated by the Company. The PRC authorized the Company to invest $50 million in equity in Avistar and to enter into a reciprocal loan agreement for up to $30 million. The Company has currently invested $25 million in Avistar. In February 2000, Avistar invested $3 million in AMDAX.com, a start-up company which will provide an on line auction service to bring together electricity buyers and sellers in the deregulated electric power market. Avistar operates and manages the City of Santa Fe's water system.

Risks and Uncertainties

The Company's future results may be affected by changes in regional economic conditions; the outcome of labor negotiations with unionized employees, fluctuations in fuel, purchased power and gas prices; the actions of utility regulatory commissions; environmental regulations and external factors such as the weather. As a result of state and Federal regulatory reforms, the public utility industry is undergoing a fundamental change. As this occurs, the electric generation business is transforming into a competitive marketplace. The Company's future results will be impacted by its ability to recover its stranded costs, costs incurred previously in providing power generation to electric service customers, and the costs of transition to an unregulated status. In addition, as a result of deregulation, the Company may face competition from companies with greater financial and other resources.

(1) NATURE OF BUSINESS AND SEGMENT INFORMATION *(continued)*

Summarized financial information by business segment for 1999, 1998 and 1997 is as follows:

	ELECTRIC						
(in thousands)	DISTRIBUTION	TRANSMISSION	GENERATION	TOTAL	GAS	UNREGULATED	CONSOLIDATED
1999:							
Operating revenues:							
External customers	$525,348	$15,520	$371,109	$911,977	$236,711	$ 8,855	$1,157,543
Intersegment revenues	-	29,801	318,872	348,673	-	-	348,673
Depreciation and amortization	23,564	8,373	40,949	72,886	19,775	-	92,661
Interest income	13,731	4,569	20,681	38,981	9,093	6,095	54,169
Net interest charges	21,510	7,515	26,341	55,366	16,353	(1,052)	70,667
Income tax expense (benefit) from continuing operations	22,406	2,745	17,904	43,055	3,211	(3,958)	42,308
Operating income	48,796	9,454	51,275	109,525	15,135	(4,581)	120,079
Cumulative effect of a change in accounting principle, net of tax	-	-	3,541	3,541	-	-	3,541
Segment net income (loss)	34,939	4,615	41,644	81,198	4,171	(2,214)	83,155
Total assets	593,485	207,132	1,394,283	2,194,900	502,838	25,530	2,723,268
Gross property additions	30,585	12,489	24,426	67,500	27,798	-	95,298
1998:							
Operating revenues:							
External customers	$539,972	$15,596	$279,636	$835,204	$255,975	$ 1,266	$1,092,445
Intersegment revenues	-	29,091	362,722	391,813	-	-	391,813
Depreciation and amortization	23,396	8,527	38,292	70,215	15,863	63	86,141
Interest income	9,200	4,286	15,001	28,487	6,130	424	35,041
Net interest charges	16,057	7,547	26,179	49,783	13,784	(350)	63,217
Income tax expense (benefit) from continuing operations	15,160	4,165	33,804	53,129	7,754	(4,592)	56,291
Operating income	30,895	11,868	78,750	121,513	20,099	(5,963)	135,649
Discontinued operations, net of tax	-	-	-	-	-	(12,437)	(12,437)
Segment net income (loss)	22,317	6,828	61,949	91,094	11,056	(19,468)	82,682
Total assets	587,835	198,718	1,410,818	2,197,371	447,074	24,158	2,668,603
Gross property additions	50,399	9,156	30,969	90,524	38,260	-	128,784
1997:							
Operating revenues:							
External customers	$522,835	-	$199,603	$722,438	$294,769	$ 3,314	$1,020,521
Intersegment revenues	-	-	370,019	370,019	-	-	370,019
Depreciation and amortization	21,754	-	46,335	68,089	14,587	18	82,694
Interest income	6,715	-	12,714	19,429	4,313	34	23,776
Net interest charges	15,900	-	27,613	43,513	12,701	-	56,214
Income tax expense (benefit) from continuing operations	15,924	-	26,963	42,887	10,169	(2,731)	50,325
Operating income	37,296	-	72,175	109,471	23,444	(3,368)	129,547
Discontinued operations, net of tax	-	-	-	-	-	(5,502)	(5,502)
Segment net income (loss)	24,496	-	51,260	75,756	14,602	(9,363)	80,995
Total assets	612,136	-	1,257,767	1,869,903	482,206	55,301	2,407,410
Gross property additions	45,302	-	51,661	96,963	31,408	-	128,371

The unregulated segment includes Avistar and certain corporate activities which are not material.

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

On August 4, 1998, the Company adopted a plan to discontinue the natural gas trading operations of its Unregulated Energy Services Business Unit and completely discontinued these operations on December 31, 1998 (see note 13).

(2) REGULATORY ASSETS AND LIABILITIES

The Company is subject to the provisions of SFAS 71, with respect to 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:

(in thousands)	1999	1998
ASSETS:		
Current:		
PGAC	$ 19,310	$ 5,294
Gas Take-or-Pay Costs	4,746	10,324
Subtotal	24,056	15,618
Deferred:		
Deferred Income Taxes	35,713	35,564
Loss on Reacquired Debt	8,133	8,499
Gas Imputed Revenues	7,290	6,726
Gas Reservation Fees	7,029	7,029
Deferred Customer Expense on Gas Assets Sale	6,468	5,260
Gas Retirees' Health Care Costs	3,264	4,804
Proposed Transmission Line Costs	2,432	2,660
Gas Rate Case Costs	1,571	1,571
Other	331	471
Subtotal	72,731	72,584
Stranded and Transition Assets	123,167	113,799
Total Assets	219,454	202,001
LIABILITIES:		
Deferred:		
Deferred Income Taxes	(46,815)	(49,971)
Gas Regulatory Reserve	(20,830)	(21,308)
Customer Gain on Gas Assets Sale	(7,226)	(7,226)
DOE Line Acquisition	(3,083)	–
Gain on Reacquired Debt	(708)	(484)
Other	(607)	(774)
Subtotal	(79,269)	(79,763)
Stranded and Transition Liabilities	(24,163)	(24,083)
Total Liabilities	(103,432)	(103,846)
Net Regulatory Assets	$ 116,022	$ 98,155

Substantially all of the Company's regulatory assets and regulatory liabilities are reflected in rates charged to customers or have been addressed in a regulatory proceeding.

In 1999, the State of New Mexico enacted the Restructuring Act that provides guidelines to deregulated power generation activities in New Mexico and opens the state's power markets to customer choice beginning as early as 2001. The Restructuring Act 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 recognized under cost-of-service regulation. As of December 31, 1999, the Company discontinued the use of the provisions of SFAS No. 71 for generation activities due to the passage of the Restructuring Act. Utilities will be allowed to recover no less than 50% of such costs through a non-bypassable charge on all customer bills for five years after implementation of customer choice. The PRC could authorize a utility to recover up to 100% of its stranded costs if the PRC finds that recovery of more than 50%: (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. The Restructuring Act also allows for the recovery of decommissioning costs by means of a separate wire charge. The Company expects to recover its regulatory assets associated with the deregulated business through its stranded costs recovery. As a result, a regulatory asset has been established to reflect the costs associated with discontinuation of SFAS 71 accounting and adoption of SFAS 101. The Company's estimate of its stranded costs, including nuclear and fossil fuel decommissioning costs, ranges from $530 million to $730 million which includes other operating costs in excess of its related regulatory assets. The Company believes that it will recover these costs as permitted under the Restructuring Act. Final determiniation and quantification of stranded cost recovery has not been made by the PRC. Such determination will have an impact on the recoverability of the related assets.

(2) REGULATORY ASSETS AND LIABILITIES *(continued)*

Pursuant to the Restructuring Act, utilities will also be allowed to recover in full any prudent and reasonable costs incurred in implementing full open access ("transition costs"). The transition costs will be recovered through 2007 by means of a separate wire charge. The Company estimates that these costs are being in excess of $50 million. Transition costs include, but are not limited to, professional fees, financing costs including underwriting fees, consents relating to the transfer to assets, management information system changes including billing system changes and public and customer communications. Recoverable transition costs will be capitalized and amortized over the recovery period to match related revenues. Costs not recoverable will be expensed when incurred unless otherwise capitalizable under the accounting rules.

Regulatory assets and liabilities reflected in the Consolidated Balance Sheets as of December 31, 1999, related to stranded or transitions costs are as follows:

(in thousands)	1999	1998
ASSETS:		
Transition Costs	$ 4,293	$ -
Mine Reclamation Costs	78,856	75,101
Deferred Income Taxes	37,725	36,089
Loss on Reacquired Debt	2,293	2,609
Subtotal	123,167	113,799
LIABILITIES:		
Deferred Income Taxes	(14,935)	(14,287)
PVNGS Prudence Audit	(5,809)	(6,185)
Settlement Due Customers	(3,384)	(3,564)
Gain on Reacquired Debt	(35)	(47)
Subtotal	(24,163)	(24,083)
Net Stranded Cost and Transition Cost	$ 99,004	$ 89,716

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.

(3) CAPITALIZATION

Changes in common stock, additional paid-in capital, retained earnings and comprehensive income are as follows:

	COMMON STOCK				
(dollars in thousands)	NUMBER OF SHARES	AGGREGATE PER VALUE	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	COMPREHENSIVE INCOME
Balance at December 31, 1997	41,774,083	$208,870	$469,073	$129,188	$ 486
Exercise of stock options	–	–	(3,687)	–	–
Net earnings	–	–	–	82,682	–
Dividends:					
Cumulative preferred stock	–	–	–	(586)	–
Common Stock	–	–	–	(25,064)	–
Other Comprehensive Income, net of tax:					
Unrealized gain (loss) on securities:					
Unrealized holding gains arising during the period	–	–	–	–	1,519
Less reclassification adjustment for gains included in net income	–	–	–	–	(673)
Minimum pension liability adjustment	–	–	–		(205)
Balance at December 31, 1998	41,774,083	208,870	465,386	186,220	1,127
Stock Repurchase	(1,070,700)	(5,353)	(11,993)	–	–
Net earnings	–	–	–	83,155	–
Dividends:					
Cumulative preferred stock	–	–	–	(586)	–
Common Stock	–	–	–	(40,960)	–
Other Comprehensive Income, net of tax:					
Unrealized gain (loss) on securities:					
Unrealized holding gains arising during the period	–	–	–	–	4,120
Less reclassification adjustment for gains included in net income	–	–	–	–	(4,282)
Minimum pension liability adjustment					1,387
Balance at December 31, 1999	40,703,383	$203,517	$453,393	$227,829	$ 2,352

CAPITALIZATION *(continued)*

Comprehensive Income

The Company's investments held in rabbi trust for nuclear decommissioning and certain retirement benefits are classified as available-for-sale, and accordingly unrealized holding gains and losses are recognized as a component of comprehensive income. Realized gains and losses are included in earnings. Net losses related to the Company's pension plans, not yet recognized as net periodic pension costs (or additional minimum liability) are reported as a component of comprehensive income. Changes in the liability are adjusted as necessary. All components of comprehensive income are recorded, net of any tax benefit or expense. A deferred asset or liability is established for the resulting temporary difference.

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.

In March 1999, the Company's Board of Directors approved a plan to repurchase up to 1,587,000 shares of the Company's outstanding common stock with maximum purchase price of $19.00 per share. The repurchase program was created to facilitate the Company's stock option program. In December 1999, the Company's Board of Directors authorized the Company to repurchase up to an additional $20.0 million of the Company's common stock. As of December 31, 1999, the Company repurchased 1,070,700 shares of its previously outstanding common stock at a cost of $18.8 million. From January 2, 2000 through February 29, 2000, the Company repurchased an additional 963,284 shares of its previously outstanding common stock at a cost of $15.7 million. The Company may from time-to-time repurchase additional common stock for various corporate purposes.

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

The Company has no long-term debt that matures from 2000 through 2004.

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.

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.

In 1999, the Company retired $31.6 million of its 7.1% SUNs through open market purchases, utilizing the funds from operations and the funds from temporary investments. On October 28, 1999, tax-exempt pollution control revenue bonds of $11.5 million with an interest rate of 6.60% were issued to partially reimburse the Company for expenditures associated with its share of a recently completed upgrade of the emission control system at SJGS. The gain recognized was immaterial. In January 2000, the Company reacquired $35.0 million of its 7.5% SUNs through open market purchases.

CAPITALIZATION *(continued)*

Revolving Credit Facility and Other Credit Facilities

At December 31, 1999, the Company had a $300 million unsecured revolving credit facility (the "Facility") with an expiration date of March 31, 2003. The Company must pay commitment fees of .1875% per year on the total amount of the Facility. The Company also had an $80 million credit facility, which expires on May 20, 2001, and was 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 had $25 million in local lines of credit. On February 15, 2000, the Company reduced the borrowing capacity under its $300 million revolving credit facility to $150 million and terminated its $80 million securitization facility.

(4) 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. 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, 1999 are:

2000	$ 79,675
2001	78,726
2002	78,613
2003	78,610
2004	78,610
Later years	799,197
Total minimum lease payments	$1,193,431

Operating lease expense, inclusive of PVNGS leases, was approximately $81.1 million in 1999, $82.6 million in 1998 and $80.8 million in 1997. Aggregate minimum payments to be received in future periods under non-cancelable subleases are approximately $4.6 million.

(5) FINANCIAL INSTRUMENTS

The Company uses derivative financial instruments in limited instances to manage risk as it relates to changes in natural gas and electric prices and adverse market changes for investments held by the Company's various trusts. The Company also uses, on a limited basis, certain derivative instruments for bulk power electricity trading purposes in order to take advantage of favorable price movements and market timing activities in the wholesale power markets.

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

	1999		1998	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
Long-Term Debt	$(988,489)	$(932,687)	$(1,008,614)	$(1,042,557)
Decommissioning Trust Debt	-	-	(26,620)	(26,620)
Investment in PVNGS Lessors' Notes	424,605	455,888	443,748	459,167
Derivatives	-	(25,921)	-	11,307
Decommissioning Trust	51,752	51,770	59,803	64,509
Fossil-Fueled Plant Decommissioning Trust	4,591	4,591	7,676	7,676
Rabbi Trust	16,901	16,931	9,804	17,012

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

(5) FINANCIAL INSTRUMENTS *(continued)*

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.

The Company is exposed to credit losses in the event of non-performance or non-payment by counterparties. The Company uses a credit management process to assess and monitor the financial conditions of counterparties.

Natural Gas Contracts

Pursuant to an order issued by the NMPUC, predecessor to the PRC, the Company has previously entered into swaps to hedge certain portions of natural gas supply contracts in order to protect the Company's natural gas customers from the risk of adverse price fluctuations in the natural gas market. The financial impact of all hedge gains and losses from swaps flowed through the Company's purchased gas adjustment clause and are fully recoverable by the Company. As a result, earnings were not affected by gains or losses generated by these instruments. The Company hedged 40% of its natural gas deliveries during the 1998-1999 heating season. Less than 15.5% of the 1998-1999 heating season portfolio was hedged using financial hedging contracts. The Company has hedged a portion of its 1999-2000 heating season gas supply portfolio through the use of both physical and financial hedging tools. Less than 9.1% of the Company's 1999-2000 heating season portfolio is hedged using financial hedging contracts. As of December 31, 1999, the Company had unrecognized mark-to-market losses of $1.1 million associated with its gas-related financial hedging activities.

Electricity Trading Contracts

To take advantage of market opportunities associated with the purchase and sale of electricity, the Company's wholesale power operation periodically enters into derivative financial instrument contracts. In addition, the company enters into forward physical contracts and physical options. The Company accounts for these financial instruments as trading activities under the accounting guidelines set forth under The Emerging Issues Task Force ("EITF") Issue No. 98-10. As a result, all open contracts are marked to market at the end of each period. The physical contracts are subsequently recognized as revenues or purchased power when the actual physical delivery occurs. The effect of the initial application of the new standard is reported as a cumulative effect of a change in accounting principle. Accordingly, the new company recorded additional earnings, net of taxes, of approximately $3.5 million, or $0.08 per common share, to recognonize the gain on the net open physical electricity purchase and sales commitments considered to be trading activities.

Through December 31, 1999, the Company's wholesale electric trading operations settled trading contracts for the sale of electricity that generated $43.9 million of electric revenues by delivering 1.2 million KWh. The Company purchased $46.2 million or 1.4 million KWh of electricity to support these contractual sale and other open market sales opportunities.

As of December 31, 1999, the Company had open trading contract positions to buy $29.1 million and to sell $32.3 million of electricity. At December 31, 1999, the Company had a gross mark-to-market gain (asset position) on these trading contracts of $6.9 million and gross mark-to-market loss (liability position) of $6.8 million, with net mark-to-market gain (asset position) of $0.1 million. The mark-to-market valuation is recognized in earnings each period.

Corporate Hedge

The Company has about $62 million invested in domestic stocks in various trusts for nuclear decommissioning, executive retirement and retiree medical benefits. At the end of March 1999, the Company began using financial derivatives based on the Standard & Poor's ("S&P") 500 Index to limit potential loss on these investments due to adverse market fluctuations. The options are structured as a collar, protecting the portfolio against losses beyond a certain amount and balancing the cost of that downside protection by foregoing gains above a certain level. If the S&P 500 Index is within the specified range when the option contract expires, the Company will not be obligated to pay, nor will the Company have the right to receive cash. The Company accounts for the market value changes of these options under mark-to-market accounting on a quarterly basis. At December 31, 1999, the Company recorded an unrealized year-to-date loss of $2.6 million (pre-tax) on the market value of these options, although the S&P 500 Index is still within the specified range of the collar.

(6) 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:

(in thousands except per share amounts)	1999	1998	1997
BASIC:			
Net Earnings from Continuing Operations	$79,614	$95,119	$86,497
Discontinued Operations, net of tax (note 13)	–	(12,437)	(5,502)
Cumulative Effect of a Change in Accounting Principle, net of tax (note 14)	3,541	–	–
Net Earnings	83,155	82,682	80,995
Preferred Stock Dividend Requirements	586	586	586
Net Earnings Applicable to Common Stock	$82,569	$82,096	$80,409
Average Number of Common Shares Outstanding	41,038	41,774	41,774
Net Earnings (Loss) per Share of Common Stock:			
Earnings from continuing operations	$ 1.93	$ 2.27	$ 2.05
Discontinued operations (note 13)	–	(0.30)	(0.13)
Cumulative effect of a change in accounting principle (note 14)	0.08	–	–
Net Earnings per Share of Common Stock (Basic)	$ 2.01	$ 1.97	$ 1.92
DILUTED:			
Net Earnings from Continuing Operations	$79,614	$95,119	$86,497
Discontinued Operations, net of tax (note 13)	–	(12,437)	(5,502)
Cumulative Effect of a Change in Accounting Principle, net of tax (note 14)	3,541	–	–
Net Earnings	83,155	82,682	80,995
Preferred Stock Dividend Requirements	586	586	586
Net Earnings Applicable to Common Stock	$82,569	$82,096	$80,409
Average Number of Common Shares Outstanding	41,038	41,774	41,774
Diluted effect of common stock equivalents (a)	65	298	217
Average common and common equivalent shares outstanding	41,103	42,072	41,991
Net Earnings (Loss) per Share of Common Stock:			
Earnings from continuing operations	$ 1.93	$ 2.25	$ 2.05
Discontinued operations	–	(0.30)	(0.13)
Cumulative effect of a change in accounting principle	0.08	–	–
Net Earnings per Share of Common Stock (Basic)	$ 2.01	$ 1.95	$ 1.91

(a) Excludes the effect of average anti-dilutive common stock equivalents related to out-of-the-money options of 66,143; 23,794; and 36,310 for the years ended 1999, 1998, and 1997, respectively.

(7) INCOME TAXES

Income taxes before discontinued operations and cumulative effect of a change in accounting principle consist of the following components:

(in thousands)	1999	1998	1997
Current Federal income tax	$23,511	$32,785	$35,875
Current state income tax	8,502	11,451	10,502
Deferred Federal income tax	13,494	15,797	8,781
Deferred state income tax	210	(324)	(397)
Amortization of accumulated investment tax credits	(3,409)	(3,418)	(4,436)
Total income taxes	$42,308	$56,291	$50,325
Charged to operating expenses	$25,010	$41,306	$41,941
Charged to other income and deductions	17,298	14,985	8,384
Total income taxes	$42,308	$56,291	$50,325

(7) INCOME TAXES *(continued)*

The Company's provision for income taxes before discontinued operations and cumulative effect of a change in accounting principle 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:

(in thousands)	1999	1998	1997
Federal income tax at statutory rates	$42,673	$52,993	$47,888
Investment tax credits	(3,409)	(3,418)	(4,436)
Depreciation of flow-through items	605	531	519
Gains on the sale and leaseback of PVNGS Units 1 and 2	(527)	(527)	(527)
Dividends received deduction	(1,301)	–	–
Annual reversal of deferred income taxes accrued at prior tax rates	(2,320)	(1,905)	(1,082)
State income tax	5,541	7,074	6,381
Other	1,046	1,543	1,582
Total income taxes	$42,308	$56,291	$50,325
Effective tax rate	34.70%	37.18%	36.78%

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

(in thousands)	1999	1998	1997
Deferred fuel costs	$ 3,176	$(11,097)	$(9,133)
Depreciation and cost recovery	5,111	7,526	6,390
Contributions in aid of construction	(1,709)	(2,826)	(3,185)
Alternative minimum tax in excess of regular tax	15,634	21,144	12,482
PVNGS decommissioning costs	(793)	(618)	(1,512)
Contribution to 401(h) plan	(1,185)	(763)	3,181
PVNGS spent fuel disposal costs	(5,202)	–	–
Other	(1,328)	2,107	161
Net deferred taxes provided	$13,704	$ 15,473	$ 8,384

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

(in thousands)	1999	1998
DEFERRED TAX ASSETS:		
Alternative minimum tax credit carryforward	$ 18,420	$ 34,055
Nuclear decommissioning costs	22,073	20,062
Regulatory liabilities related to income taxes	44,547	47,615
Other	52,199	45,480
Total deferred tax assets	137,239	147,212
DEFERRED TAX LIABILITIES:		
Depreciation	184,687	184,462
Investment tax credit	50,996	54,404
Fuel costs	15,984	12,808
Regulatory assets related to income taxes	71,170	69,298
Other	33,668	24,921
Total deferred tax liabilities	356,505	345,893
Accumulated deferred income taxes, net	$219,266	$198,681

(7) INCOME TAXES *(continued)*

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	$20,585
Change in tax effects of income tax related regulatory assets and liabilities	(4,940)
Tax effect of excess pension liability	(910)
Tax effect of mark-to-market on investments available for sale	(2,119)
Deferred tax expense relating to cumulative effect of a change in accounting principle	(2,321)
Deferred income tax expense from continuing operations for the period	$10,295

INCOME TAXES

The Company has no net operating loss carryforwards as of December 31, 1999.

The Company defers investment tax credits related to rate regulated assets and amortizes them over the estimated useful lives of those assets. The Company anticipates that this practice will continue after the generation assets are no longer rate regulated upon full implementation of the Restructuring Act in 2002.

(8) PENSION AND OTHER POSTRETIREMENT BENEFITS

Pension Plan

The Company and its subsidiaries have a pension plan covering substantially all of their union and non-union 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 Board of Directors approved changes to the Company's non-contributory defined benefit plan ("Retirement Plan") and implementation of a 401(k) defined contribution plan effective January 1, 1998. Salaries used in Retirement Plan benefit calculations were frozen as of December 31, 1997. Additional credited service can be accrued under the Retirement Plan up to a limit determined by age and years of service. The Company contributions to the 401(k) plan consist of a 3 percent non-matching contribution, and a 75 percent match on the first 6 percent contributed by the employee on a before-tax basis. The Company contributed $8.4 million in the years ended December 31, 1999 and 1998.

(8) PENSION AND OTHER POSTRETIREMENT BENEFITS *(continued)*

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

	PENSION BENEFITS	
	1999	1998
CHANGE IN BENEFIT OBLIGATION:		
Benefit obligation at beginning of year	$330,048	$297,679
Service cost	7,407	6,660
Interest cost	21,777	20,101
Actuarial loss	(12,797)	19,380
Benefits paid	(15,374)	(13,772)
Benefit obligation at end of period	331,061	330,048
CHANGE IN PLAN ASSETS:		
Fair value of plan assets at beginning of year	330,556	330,550
Actual return on plan assets	46,458	13,593
Employer contribution	-	185
Benefits paid	(15,374)	(13,772)
Fair value of plan assets at end of year	361,640	330,556
Funded Status	30,579	508
Unamortized transition assets	(2,322)	(3,486)
Unrecognized net actuarial loss	(12,209)	19,580
Unrecognized prior service cost	78	112
Prepaid benefit cost	$ 16,126	$ 16,714
WEIGHTED - AVERAGE ASSUMPTIONS AS OF DECEMBER 31,		
Discount rate	7.50%	6.75%
Expected return on plan assets	8.50%	8.50%
Rate of compensation increase	N/A	N/A

	PENSION BENEFITS		
	1999	1998	1997
COMPONENTS OF NET PERIODIC BENEFIT COST:			
Service cost	$ 7,407	$ 6,660	$ 6,535
Interest cost	21,777	20,101	19,592
Expected return on plan assets	(27,466)	(26,755)	(23,426)
Amortization of prior service cost	(1,130)	(1,130)	(1,130)
Net periodic pension expense (income)	$ 588	$ (1,124)	$ 1,571

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:

	PENSION BENEFITS	
	1999	1998
CHANGE IN BENEFIT OBLIGATION:		
Benefit obligation at beginning of year	$ 74,539	$ 59,084
Service cost	1,402	1,292
Interest cost	4,782	4,501
Actuarial loss (gain)	(6,958)	9,662
Benefit obligation at end of period	73,765	74,539
CHANGE IN PLAN ASSETS:		
Fair value of plan assets at beginning of year	37,602	33,158
Actual return on plan assets	5,269	4,444
Employer contribution	597	-
Benefits paid	(1,643)	-
Fair value of plan assets at end of year	41,825	37,602
Funded Status	(31,940)	(36,937)
Unamortized transition assets	(622)	6,826
Unrecognized prior service cost	23,617	25,436
Accrued benefit cost	$ (8,945)	$ (4,675)
WEIGHTED - AVERAGE ASSUMPTIONS AS OF DECEMBER 31,		
Discount rate	7.50%	6.75%
Expected return on plan assets	8.75%	8.75%
Rate of compensation increase	N/A	N/A

(8) PENSION AND OTHER POSTRETIREMENT BENEFITS *(continued)*

	1999	1998	1997
COMPONENTS OF NET PERIODIC BENEFIT COST:			
Service cost	$1,402	$1,292	$1,300
Interest cost	4,782	4,501	4,452
Expected return on plan assets	(3,135)	(2,943)	(1,884)
Amortization of prior service cost	1,817	1,817	1,817
Net periodic benefit expense	$4,866	$4,667	$5,685

The effect of a 1% increase in the health care trend rate assumption would increase the accumulated postretirement benefit obligation as of December 31, 1999, by approximately $12.1 million and the aggregate service and interest cost components of net periodic postretirement benefit cost for 1999 by approximately $1.4 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, 1999, was $18.1 million, of which the accumulated and vested benefit obligation was $19.5 million. As of December 31, 1999, the Company has recognized an additional liability of $3.6 million for the amount of unfunded accumulated benefits in excess of accrued pension costs. The net periodic pension cost for 1999, 1998 and 1997 was $2.3 million, $2.3 million and $2.2 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 $12.1 million (fair market value of $16.9 million) are presently in trust. No additional funds have been provided to the trust since 1989.

(9) STOCK OPTION PLANS

The Company's Performance Stock Plan ("PSP") is a non-qualified stock option plan, covering a group of management employees. Options to purchase shares of the Comapny's comon stock are granted at the fair market value of the shares on the date of the grant. Options granted through December 31, 1995, vest on June 30, 1996 and 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. Options granted or approved on or after February 9, 1998, can also vest upon retirement. 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 options to purchase shares of the Company's common stock. The number of options granted in 1999 under the DRP was 8,000 shares with an exercise price of $9.69. No options were exercised under the DRP during 1999. The maximum number of options authorized are 100,000 shares through April 30, 2002. The number of options outstanding as of December 31, 1999, was 29,000.

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 1997, 1998 and 1999, respectively: dividend yield of 3.0%, 3.75% and 4.9%; expected volatility of 20%, 26.78% and 30.29%, risk-free interest rates of 5.69%, 4.65% and 6.43%; 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.

	1999		1998		1997	
FIXED OPTIONS	SHARES	WEIGHTED AVERAGE EXERCISE PRICE	SHARES	WEIGHTED AVERAGE EXERCISE PRICE	SHARES	WEIGHTED AVERAGE EXERCISE PRICE
Outstanding at beginning of year	996,175	$18.819	1,539,214	$17.704	1,619,406	$15.905
Granted	608,708	$17.397	10,000	$12.750	312,707	$23.033
Exercised	-	N/A	473,063	$14.663	379,833	$14.453
Forfeited	19,949	$18.649	79,976	$21.194	13,066	$19.450
Outstanding at end of year	1,584,934		996,175	$18.819	1,539,214	$17.704
Options exercisable at year-end	749,948		400,158		861,221	
Options available for future Grant	2,183,624		2,752,806		2,672,832	
Weighted-average fair value of Options granted during the year:						
PSP	$3.89		N/A		$ 4.21	
DRP	$5.85		$7.32		$15.69	

The following table summarizes information about stock options outstanding at December 31, 1999:

	OPTIONS OUTSTANDING			OPTIONS EXCERCISABLE	
RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING AT 12/31/99	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED AVERAGE EXERCISE PRICES	NUMBER EXERCISABLE AT 12/31/99	WEIGHTED AVERAGE EXERCISE PRICES
$ 5.50 - $12.75	29,000	8.15 years	$ 9.466	21,000	$ 9.381
$11.50 - $23.688	1,555,934	7.56 years	$ 18.398	728,948	$17.343
	1,584,934	7.57 years	$ 18.235	749,948	$17.120

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 (in thousands, except per share data):

	1999		1998		1997	
	AS REPORTED	PRO FORMA	AS REPORTED	PRO FORMA	AS REPORTED	PRO FORMA
Net earnings: (available for Common)	$82,569	$81,573	$82,096	$81,554	$80,409	$80,018
Net earnings per share						
Basic	$ 2.01	$ 1.99	$ 1.97	$ 1.95	$ 1.92	$ 1.92
Diluted	$ 2.01	$ 1.98	$ 1.95	$ 1.95	$ 1.91	$ 1.90

(10) CONSTRUCTION PROGRAM AND JOINTLY-OWNED PLANTS

The Company's construction expenditures for 1999 were approximately $95.3 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, 1999, 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).	$704,458	$330,457	$ 5,088	46.3%
Palo Verde Nuclear Generating Station (Nuclear)* . .	$197,369	$ 49,284	$18,818	10.2%
Four Corners Power Plant Units 4 and 5 (Coal) . . .	$117,799	$ 66,755	$ 1,788	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, 1999, 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, ("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 a participant 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. (See Note 11 for additional discussion.)

(11) COMMITMENTS AND CONTINGENCIES

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 to 70 MW from 1999 through 2003. In addition, the Company is interconnected with various utilities for economy interchanges and mutual assistance in emergencies.

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. The agreement calls for PLP to construct and operate a gas turbine generating unit located on the Company's retired Person Generating Station site in Albuquerque, New Mexico.

In 1998, 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. 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.

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.

Construction Commitment

The Company has committed to purchase a combustion turbine for $36 million. In February 2000, the Company made a 10% deposit toward the purchase price. The turbine is for a planned power generation plant with an estimated cost of approximately $63.0 million for which a contract has not been finalized. The planned plant is part of the Company's ongoing competitive strategy of increasing generation capacity over time.

Plains Acquisition

The Company and Tri-State Generation and Transmission Cooperatives, Inc. ("Tri-State") entered into an asset sale agreement dated September 9, 1999, pursuant to which Tri-State has agreed to sell certain assets consisting primarily of transmission assets, a fifty percent interest in an inactive power plant located near Albuquerque, and an office building to the Company. The purchase price is $13.2 million, subject to adjustment at the time of closing. The asset sale agreement contains standard covenants and conditions for this type of agreement. Currently the Company anticipates that the purchase will be completed by approximately the fall of 2000.

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 was unable to generate appropriate bills for all its customers through the first quarter of 1999 and was unable to analyze delinquent accounts until November 1999.

Because of the implementation issues associated with the new billing system, the Company estimated retail gas and electric revenues through July 1999. Beginning with August 1999, the Company was able to determine actual revenues for all prior periods affected and began reconciling with previously estimated revenues. In December 1999, the Company completed its reconciliation of system revenues. As a result, 1999 revenues represented actual revenues as determined by the new billing system. The resulting reconciliation did not materially impact recorded revenues. However, a significant amount of individual accounts required corrections.

As a result of the delay of normal collection activities, the Company incurred a significant increase in delinquent accounts, many of which occurred with customers that no longer have active accounts with the Company. As a result, the Company significantly increased its bad debt accrual throughout 1999.

The following is a summary of the allowance for doubtful accounts during 1999, 1998 and 1997:

(in thousands)	1999	1998	1997
Allowance for doubtful accounts, beginning of year	$ 836	$ 783	$ 709
Bad debt accrual	11,496	3,325	3,378
Less: Write off (adjustments) of uncollectible accounts	(172)	3,272	3,304
Allowance for doubtful accounts, end of year	$ 12,504	$ 836	$ 783

(11) COMMITMENTS AND CONTINGENCIES *(continued)*

Bad debt accruals for 1999 represent management's best estimate of potential uncollectible accounts based upon information available at December 31, 1999. The Company will make every reasonable effort to collect all amounts owed from delinquent customers. As new data becomes available from these efforts, management will re-evaluate the adequacy of the bad debt reserve. Any required change to the allowance for doubtful accounts will be reflected in operating results in the period new information becomes available. The Company will also provide additional disclosures as collection efforts progress over time.

Rate Case Settlement

On August 25, 1999, the PRC issued an order approving the rate case settlement resulting from the NMPUC's final order of November 30, 1998. The PRC ordered the Company to reduce its electric rates by $34.0 million annually retroactive to July 30, 1999. In addition, the order includes a rate freeze until electric competition is fully implemented in New Mexico or until January 1, 2003. The settlement will reduce annual revenues by an estimated $37.0 million based on expected customer growth.

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 primary liability insurance limit, 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 reactor 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 $27.0 million, with an annual payment limitation of $3 million per incident. 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 and Congress are reviewing the related laws. The Company cannot predict whether or not Congress will change the law. However, certain changes 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, 2000. The Company is a member of an industry mutual insurer which 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 $2.6 million per year.

PVNGS Decommissioning Funding

The Company has a program for funding its share of decommissioning costs for PVNGS. The nuclear decommissioning funding program is invested in equities and fixed income instruments 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 $163.1 million (in 1999 dollars).

The Company funded an additional $3.1 million, $3.0 million and $2.1 million in 1999, 1998 and 1997, respectively, into the qualified trust funds. The estimated market value of the trusts at the end of 1999 was approximately $51.8 million.

Nuclear Spent Fuel and Waste Disposal

Pursuant to the Nuclear Waste Policy Act of 1982, as amended in 1987 (the "Waste Act"), the 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. 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. DOE has announced that such a repository now cannot be completed before 2010.

The operator of PVNGS 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 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.

(11) COMMITMENTS AND CONTINGENCIES *(continued)*

The company currently estimates that it will incur approximately $41.0 million (in 1999 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 1999, the Company expensed approximately $1.0 million for on-site interim nuclear fuel storage costs related to nuclear fuel burned prior to 2000. The operator of PVNGS currently believes that spent fuel storage or disposal methods will be available for use by PVNGS to allow its continued operation beyond 2002.

Contingencies

There are various claims and lawsuits pending against the Company and certain of its subsidiaries. The Company is also subject to Federal, state and local environmental laws and regulations, and is currently participating in the investigation and remediation of numerous sites. In addition, the Company periodically enters into financial commitments in connection with business operations. It is not possible at this time for the Company to determine fully the effect of all litigation on its consolidated financial statements. However, the Company has recorded a liability where an outcome of such litigation can be estimated and where an outcome is considered probable. The Company does not expect that any know lawsuits, environmental costs and commitments will have a material adverse effect on its financial condition or results of operations.

(12) ENVIRONMENTAL ISSUES

The normal course of operations of the Company necessarily involves activities and substances that expose the Company to potential liabilities under laws and regulations protecting the environment. Liabilities under these laws and regulations can be material and in some instances may be imposed without regard to fault, or may be imposed for past acts, even though such past acts may have been lawful at the time they occurred. Sources of potential environmental liabilities include (but are not limited to) the Federal Comprehensive Environmental Response Compensation and Liability Act of 1980 and other similar statutes.

The Company records its environmental liabilities when site assessments and/or remedial actions are probable and a range of reasonably likely cleanup costs can be estimated. The Company reviews its sites and measures the liability quarterly, by assessing a range of reasonably likely costs for each identified site using currently available information, including existing technology, presently enacted laws and regulations, experience gained at similar sites, and the probable level of involvement and financial condition of other potentially responsible parties. These estimates include costs for site investigations, remediation, operations and maintenance, monitoring and site closure. Unless there is a probable amount, the Company records the lower end of this reasonably likely range of costs (classified as other long-term liabilities at undiscounted amounts).

The Company's recorded estimated minimum liability to remediate its identified sites is $8.3 million. The ultimate cost to clean up the Company's identified sites may vary from its recorded liability due to numerous uncertainties inherent in the estimation process, such as: the extent and nature of contamination; the scarcity of reliable data for identified sites; and the time periods over which site remediation is expected to occur. The Company believes that, due to these uncertainties, it is remotely possible that cleanup costs could exceed its recorded liability by up the $30.3 million. The upper limit of this range of costs was estimated using assumptions least favorable to the Company.

Remediation of identified sites previously used in operations, used by tenants or contaminated by former owners required spending of $4.4 million in 1999 and $1.0 million in 1998. In 2000, the Company anticipates spending $2.2 million for remediation and $6 million for control and prevention. The majority of the December 31, 1999 environmental liability is expected to be paid over the next five years, funded by cash generated from operations. Future environmental obligations are not expected to have a material impact on the results of operations or financial condition of the Company.

(13) 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 were $5.1 million (net of income tax benefit of $3.3 million), which includes a provision for anticipated operating losses prior to disposal.

Operating losses of the discontinued operations prior to the date of discontinuation were $7.4 million and $5.5 million in 1998 and 1997, respectively. Such amounts include income tax benefits related to the losses from discontinued operations of $4.8 million in 1998 and $3.6 million in 1997. Total sales from the discontinued operations were $159.2 million and $114.7 million in 1998 and 1997, 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.

(14) NEW AND PROPOSED 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.

EITF Issue 99-14, Recognition of Impairment Losses on Firmly Committed Executory Contracts: The EITF has added an issue to its agenda to address impairment of leased assets. A significant portion of the Company's nuclear generating assets are held under operating leases. Based on the alternative accounting methods being explored by the EITF, the related financial impact of the future adoption of EITF Issue No. 99-14 should not have a material adverse effect on results of operations. However, a complete evaluation of the financial impact from the future adoption of EITF Issue No. 99-14 will be undeterminable until EITF deliberations are completed and stranded cost recovery issues are resolved.

Accounting for Derivative Instruments and Hedging Activities, SFAS 133: SFAS 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 also 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. The Company is in the process of reviewing and identifying all financial instruments currently existing in the Company in compliance with the provisions of SFAS 133. It is likely that the adoption of SFAS 133 will add volatility to the Company's operating results and/or asset and liability valuations reflecting the impact of mark-to-market accounting for commodity contracts. In June 1999, FASB issued SFAS 137 to amend the effective date for the compliance of SFAS 133 to January 1, 2001.

quarterly operating results:

The unaudited operating results by quarters for 1999 and 1998 are as follows:

				QUARTER ENDED
(in thousands, except per share amounts)	MARCH 31	JUNE 30	SEPTEMBER 30	DECEMBER 31
1999:				
Operating Revenues	$272,818	$261,371	$340,604	$282,750
Operating Income	35,068	29,247	30,275	25,489
Earnings before Discontinued operations	23,130	18,172	21,401	16,911
Net Earnings (1)	26,671	18,172	21,401	16,911
Net Earnings per share before Discontinued Operations	$ 0.55	$ 0.44	$ 0.52	$ 0.41
Net Earnings per Share (Basic)	$ 0.64	$ 0.44	$ 0.52	$ 0.41
Net Earnings per Share (Diluted)	$ 0.63	$ 0.44	$ 0.52	$ 0.41
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 (2)	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	$ 0.76	$ 0.36
Net Earnings per Share (Diluted)	$ 0.50	$ 0.35	$ 0.76	$ 0.34

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) Effective January 1, 1999, the Company adopted EITF Issue No. 98-10, Accounting for Contracts Involved in Energy Trading and Risk Management Activities. The effect of the initial application of EITF Issue No. 98-10 was reported as a cumulative effect of a change in accounting principle which increased the Company's consolidated net income by approximately $3.5 million (after related income tax expense of approximately $2.3 million), or $.08 per common share.

(2) 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 13 of the notes to consolidated financial statements.) In addition, certain prior periods amounts have been restated.

comparative operating statistics:

(in thousands)	1999	1998	1997	1996	1995
ELECTRIC SERVICE:					
Energy Sales – KWh (in thousands):					
Residential	2,027,099	2,007,852	1,976,434	1,892,290	1,795,371
Commercial	2,980,935	2,888,539	2,841,831	2,698,087	2,578,243
Industrial	1,559,155	1,571,824	1,556,264	1,505,801	1,434,974
Other ultimate customers	236,394	271,659	160,370	310,118	220,777
Total sales to ultimate customers	6,803,583	6,739,874	6,534,899	6,406,296	6,029,365
Sales for resale	11,171,621	8,782,315	6,785,643	4,575,220	2,590,513
Total KWh sales	17,975,204	15,522,189	13,320,542	10,981,516	8,619,878
Electric Revenues (in thousands):					
Residential	$ 184,088	$ 187,681	$ 184,813	$ 177,220	$ 168,633
Commercial	238,830	241,968	237,629	226,146	218,222
Industrial	85,828	88,644	86,927	83,651	79,964
Other ultimate customers	13,777	18,124	10,135	20,804	18,749
Total revenues to ultimate customers	522,523	536,417	519,504	507,821	485,568
Sales for resale	365,368	274,979	185,334	121,329	80,949
Total revenues from energy sales	887,891	811,396	704,838	629,150	566,517
Miscellaneous electric revenues	24,086	23,808	17,600	16,489	17,767
Total electric revenues	$ 911,977	$ 835,204	$ 722,438	$ 645,639	$ 584,284
Customers at Year End:					
Residential	321,949	319,415	311,314	304,900	296,821
Commercial	38,435	37,652	36,942	36,292	35,390
Industrial	375	363	363	375	374
Other ultimate customers	625	665	637	632	598
Total ultimate customers	361,384	358,095	349,256	342,199	333,183
Sales for Resale	83	83	66	56	37
Total customers	361,467	358,178	349,322	342,255	333,220
Reliable Net Capability – KW	1,521,000	1,506,000	1,506,000	1,506,000	1,506,000
Coincidental Peak Demand – KW	1,291,000	1,313,000	1,209,000	1,217,000	1,247,000
Average Fuel Cost per Million BTU	$ 1.3169	$ 1.2433	$ 1.2319	$ 1.2735	$ 1.3177
BTU per KWh of Net Generation	10,490	10,784	10,927	10,768	10,811
WATER SERVICE: *					
Water Sales – Gallon (in thousands)	–	–	–	–	1,616,544
Revenues (in thousands)	–	–	–	–	$ 6,196
Customers at Year End	–	–	–	–	23,752

* 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:

	1999	1998	1997	1996	1995
(in thousands)					
GAS THROUGHPUT – DECATHERMS					
PNMGS:					
Residential	29,309	30,258	30,755	27,387	25,865
Commercial	10,134	10,387	10,644	9,310	8,864
Industrial	2,338	1,553	1,280	2,136	661
Public authorities	2,902	3,427	4,153	2,591	2,411
Irrigation	1,382	1,869	1,593	1,418	1,245
Sales for resale	1,181	1,205	1,233	3,094	1,266
Off-system sales	1,073	1,889	1,179	5,745	1,176
Unbilled	3,784	(1,343)	(202)	1,405	(1,764)
PNMGS sales	52,103	49,245	50,635	53,086	39,724
Transportation throughput	40,161	36,413	33,975	47,010	49,136
PNMGS throughput	92,264	85,658	84,610	100,096	88,860
Gathering Company:					
Spot market sales	–	–	–	–	39
Transportation throughput	–	–	–	–	20,695
Total throughput	92,264	85,658	84,610	100,096	109,594
GAS REVENUES:					
PNMGS:					
Residential	$148,968	$161,153	$187,563	$129,911	$125,290
Commercial	36,528	42,680	50,502	33,022	32,328
Industrial	8,550	4,887	4,536	5,179	1,873
Public authorities	9,782	12,610	17,577	8,018	7,939
Irrigation	4,229	5,780	5,041	3,252	3,077
Sales for resale	2,530	3,596	4,465	2,106	3,114
Off-system sales	2,357	3,816	1,926	14,352	1,885
Imbalance penalties	1,182	1,416	1,273	1,231	1,786
Unbilled	4,107	(955)	(2,172)	2,678	(2,430)
Revenues from gas sales	218,233	234,983	270,711	199,749	174,862
Transportation	12,390	13,464	14,172	17,215	18,532
Liquids	1,867	1,463	4,451	7,608	12,782
Other	4,221	6,065	5,435	2,729	3,606
PNMGS operating revenues	236,711	255,975	294,769	227,301	209,782
Gathering Company:					
Spot market sales	–	–	–	–	42
Transportation	–	–	–	–	3,640
Imbalance penalties	–	–	–	–	418
Processing Company:					
Liquids revenue	–	–	–	–	632
Processing fees	–	–	–	–	3,471
Total operating revenues	$236,711	$255,975	$294,769	$227,301	$217,985
CUSTOMERS AT YEAR END:					
PNMGS:					
Residential	390,428	383,292	375,032	367,025	358,822
Commercial	32,116	32,004	31,560	30,757	30,493
Industrial	51	55	50	54	59
Public authorities	2,547	2,429	2,735	2,462	2,444
Irrigation	1,026	1,078	1,027	1,076	886
Sales for resale	3	3	3	3	2
Gas choice	112	112	–	–	–
Transportation	32	29	31	36	38
Total customers	426,315	419,002	410,438	401,413	392,744

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 thorugh this date.

shareholders information:

for help with your stockholder account or information about PNM stock or dividends, call us toll-free at **800-545-4425.**

CORPORATE HEADQUARTERS: Public Service Company of New Mexico, Alvarado Square, Albuquerque, NM 87158, 505-241-2700

ANNUAL MEETING OF SHAREHOLDERS: Tuesday, June 6, 2000, 9:30 a.m. (MDT), South Broadway Cultural Center, 1025 Broadway SE, Albuquerque, NM

STOCK TRADING INFORMATION:
Ticker symbol: PNM is primarily traded on the New York Stock Exchange
Newspaper financial listings: PSvNM
As of December 31, 1999, there were 15,681 common shareholders of record

FOR ADDITIONAL INFORMATION: PNM's 1999 Annual Report to the Securities and Exchange Commission on Form 10-K is available to shareholders upon written request, without charge. Write: Barbara Barsky at the corporate headquarters address.

PNM's 1999 Environmental Annual Report will be available after June 1, 2000 by writing Russell Rhoades at the corporate headquarters address.

DIRECT PURCHASE OF PNM STOCK: PNM offers a dividend reinvestment and direct stock purchase plan as a service to all interested participants. In addition to full or partial reinvestment of dividends, the PNM Direct Plan gives shareholders the opportunity to make direct cash investments ranging from $50 to $5,000 as often as once a month. Information regarding the Plan can be obtained by calling Shareholder Records at the toll-free number listed on this page or by returning the business reply card included in this annual report.

PNM ON THE INTERNET: Our home page is: http://www.pnm.com

TRANSFER AGENT AND REGISTRAR: PNM Shareholder Records Department, Alvarado Square – 1104, Albuquerque, NM 87158, Telephone (toll-free): 800-545-4425, Fax: 505-241-4311, E-Mail: yjohnso@ pnm.com

INVESTOR RELATIONS CONTACT: Barbara L. Barsky, Senior Vice President, Planning and Investor Services, Telephone: 505-241-2662, Fax: 505-241-2368, E-Mail: bbarsky@pnm.com

NEW MEXICO UTILITY SHAREHOLDERS ALLIANCE: A volunteer group was formed by PNM stockholders in 1997 to support the interests of investors and consumers in the political and regulatory arenas. For more information about the Alliance, contact:

New Mexico Utility Shareholders Alliance
P.O. Box 728
Albuquerque, NM 87103

IMPORTANT NOTICE FOR INVESTORS: PNM posts quarterly earnings results and other important information on its web site at http://www.pnm.com. Investor information is also available continuously by calling 800 - 840 - 0PNM (0776). If you would like to receive news by regular mail, fax or e-mail, let us know by calling or writing the Investor Relations contact.

COMMON STOCK PRICES AND DIVIDENDS PAID: *(in dollars)*

	1999			1998		
QUARTER	DIVIDEND	HIGH	LOW	DIVIDEND	HIGH	LOW
1	$0.20	20 5/8	14 27/32	$0.17	24 11/16	22 1/8
2	$0.20	21 1/8	16 7/8	$0.20	24 3/4	20 15/16
3	$0.20	21 1/2	16 3/4	$0.20	23 3/16	19 1/16
4	$0.20	18 7/8	15 7/16	$0.20	23 5/16	17 3/8

board of directors:

John T. Ackerman, 58 [1990] ✱ ✦ ★ ❊
Chairman Emeritus
Chairman, Executive Committee
Retired President and Chief Executive Officer of PNM

Robert G. Armstrong, 53 [1991] ✦ ✱ ✣
President of Armstrong Energy Corporation

Joyce A. Godwin, 56 [1989] ★ ✱ ✣ ❊
Retired President and Secretary of Presbyterian Healthcare Services

Manuel Lujan, Jr. 71 [1994] ✦ ★
Previously served as U.S. Secretary of the Interior, consults on U.S. governmental matters and is an insurance agent with Manuel Lujan Insurance, Inc.

Benjamin F. Montoya, 64 [1993]
Chairman and Chief Executive Officer of PNM

Reynaldo ("Reynie") U. Ortiz, 53 [1992] ✦ ★
Founder, Chairman & CEO of AduroNet.com, an internet network company in London

Robert M. Price, 69 [1992] ✱ ✣ ✹
President of PSV, Inc. a technology consulting business

Paul F. Roth, 67 [1991] ✱ ✣ ✹ ❊
Retired President of the Texas Division of Southwestern Bell Telephone Company

Jeffry E. Sterba, 44 [2000] ✹
President of PNM

✦ 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

This list is effective as of 3/15/00

officers of the company:

Benjamin F. Montoya, 64
Chairman and Chief Executive Officer

Jeffry E. Sterba, 44
President

Roger J. Flynn, 57
Executive Vice President, Electric and Gas Services

Willam J. Real, 51
Executive Vice President, Energy Services and Power Production

Barbara L. Barsky, 55
Senior Vice President, Planning and Investor Services

Marc D. Christensen, 51
Senior Vice President, Enterprise Solutions

Max H. Maerki, 60
Senior Vice President and Chief Financial Officer

Patrick T. Ortiz, 50
Senior Vice President, General Counsel and Secretary

Edward Padilla, Jr., 46
Senior Vice President, Bulk Power Marketing and Development

R. Blake Ridgeway, 41
Senior Vice President, Energy Services

Ernest T. C'de Baca, 46
Vice President, Governmental Affairs

Melvin J. Christopher, 39
Vice President, Operations and Engineering

Patrick J. Goodman, 50
Vice President, Power Production

Terry R. Horn, 47
Vice President and Treasurer

Sarita P. Loehr, 42
Vice President, Human Resources

John R. Loyack, 36
Vice President, Corporate Controller and Chief Accounting Officer

Cindy E. McGill, 43
Vice President, Public Policy

John H. Myers, 42
Vice President, Construction and Reliability

Terry D. Rister, 48
Vice President, Customer Service

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PNM

public service company of new mexico >

Alvarado Square   Albuquerque, New Mexico 87158   www.pnm.com

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