El Paso Electric Company

Moderator: Steven Busser
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10:30 AM ET

Operator: Good day, ladies and gentlemen, and welcome to the El Paso Electric Company second quarter earnings call. At this time, all participants are in a listen-only mode. Later, we'll conduct a question and answer session and instructions will follow at that time. If anyone should require assistance during the conference, please press star, then 0. As a reminder, this conference is being recorded. I would not like to introduce your host, Steve Busser. You may begin.

Steven Busser: Thank you, Stephanie and good morning, everyone.

Thank you for joining the El Paso Electric Company's second quarter 2011 earnings conference call. Also on the call with me today I have our CEO, David Stevens, and our CFO, David Carpenter. Today we'll provide an update on our second quarter 2011 and year-to-date performance highlights, and we will discuss key earnings drivers. We will also discuss our revised 2011 earnings guidance.

I would now like to cover some items that will be pertinent to our call today before we get started. You should have a copy of our press release. If you do not, you can obtain one from our website at www.epelectric.com on the Investor Relations page.

We currently anticipate that our second quarter 2011 Form 10-Q will be filed with the SEC on or before August 9, 2011.

Please call our Investor Relations Department if you have any inquiries or require further information.

A replay of today's call will be available shortly after our call ends and will run through August 17, 2011. The details as it relates to the replay are disclosed in our press release.

Let me cover the safe harbor provisions before I turn the call over to David Stevens.

On page 2 of our presentation you will see our safe harbor statement. In summary, our comments and answers to your questions may include forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward looking statements, involve known and unknown risks and other factors which may cause the Company's actual results in future periods to differ materially from those expressed here. Any such statement is qualified by reference to the risks and factors discussed in the Company's SEC Act filings. Our 10-K and other SEC filings contain our forward looking statements and also lay out the risk factors that should be considered. These filings may be obtained upon request from the company on our website or from SEC.

The Company caution that the risk factors discussed in these filings are not exclusive and we do not undertake to update any forward- looking statement that may be made from time to time by or on behalf of the Company. These statements, especially those made during the question and answer section of the call, are subject to risks and uncertainties that are difficult to predict.

Now I'd like to turn the call over to David Stevens.

David Stevens: Thank you, Steve. This is David Stevens, the CEO of El Paso Electric.

If you all will turn to page 3, I would now like to go over the second quarter 2011 highlights.

I am very pleased with our strong second quarter earnings of $0.78 per basic share which represents a $0.29 per share increase over the results of the second quarter of 2010. Our performance is reflective of our expanding customer base and usage per customer, new seasonal rates which are higher in the summer months, and the above average summer weather we experienced through June 2011. During the second quarter of 2011, every segment of our retail business posted growth with our residential customer segment displaying kWh sales growth of 9.3 percent compared to the same quarter in 2010.

During the second quarter of 2011, we repurchased approximately 324,000 shares of stock at a cost of $9.6 million. We remain focused on enhancing long-term shareholder value while appropriately balancing our capital structure through a combination of share repurchases and cash dividends. To that end, on June 30, 2011, we paid a quarterly cash dividend of $0.22 per common share, which marks the first dividend paid on the company's common shares since 1989.

Another important accomplishment that was achieved during the quarter was attaining a new native peak load record of 1,689 MW’s on June 27, 2011 which exceeded the previous record of 1,616 MW’s on August 23, 2010. The significant growth in our native peak load demand is a driving factor behind our need for new generation resources. We will be adding these new generation resources to meet future load growth and to replace our older gas fired units.

Along these lines, in the second quarter of 2011, we received the final required regulatory approvals on the Certificate of Convenience and Necessity to build the Rio Grande 9, an 87 MW aero derivative peaking unit at our Rio Grande site. Currently, we are doing preliminary infrastructure work at Rio Grande. And we will begin construction of the unit in the first quarter of 2012. We anticipate that Rio Grande 9 will be operational before the summer peak of 2013. We will continue to expand our generation portfolio in order to meet our growing load requirements and to enhance reliability for our customers.

If you turn to the slide 4, you will see that on April 21, 2011, the plant operator Arizona Public Service Company obtained final Nuclear Regulatory Commission approval on the Palo Verde 20-year license extension after the extensive two-year plus evaluation process and review. In the second quarter of 2011, the extension of the Palo Verde operating licenses reduced our depreciation and amortization expense by approximately $2.6 million and it lowered the accretion expense on Palo Verde asset retirement obligations by $0.7 million.

On an industry-related note, the NRC published a preliminary report for the nuclear industry on July 13, 2011 in which they identify risks to nuclear power plants and make recommendations stemming from the nuclear plant disaster in Japan. At this time, the Palo Verde owners are evaluating the risks identified in the report and determining the extent of possible modifications, if any, which may increase future capital expenditures. All of the owners at Palo Verde are committed to enhancing safety and the overall operating performance and we will provide updates on this initiative as they become available in the future.

For the twelve months ended June 2011, Palo Verde operated at a 93 percent capacity factor, compared to an 88 percent capacity factor for the twelve months ended June 2010. During the quarter, the Palo Verde Unit 2 scheduled refueling and maintenance outage was completed within its planned 35-day outage duration. On October 6, 2011, Palo Verde 1 will undergo its planned refueling and maintenance outage and we anticipate this outage to be 35 days in duration.

In closing and before handing the call off to David Carpenter, I would like to personally thank the entire team of El Paso Electric employees for their hard work, dedication, and significant contributions they made towards us attaining our goals and our second quarter and 2011 year-to-date earnings results. Our employees are an integral part of the success of our company. Now let me turn the call over to David.

David Carpenter: Thank you, David. Now, turning to slide 5 of our presentation, we reported net income of $33 million or $0.78 per basic share for the second quarter of 2011, compared to our second quarter 2010 net income of $21.5 million or $0.49 per basic share. For the six months ended June 30, 2010, we posted net income of $39.8 million or $0.94 per basic share, compared to net income of $33 million or $0.75 per basic share.

Now, if you turn to slide 6, I would like to discuss the main earnings drivers in the second quarter of 2011 compared to the second quarter of 2010. A $24.1 million increase in non-fuel base revenue pre-tax was by far and away the primary earnings driver in the second quarter of 2011 compared to the second quarter of 2010. The increase in non-fuel based revenue resulted in an increase in earnings per share of $0.36 and reflected a 6.2 percent increase in retail kWh sales and higher summer rates due to the 2010 Texas Rate Case Agreement which became effective July 1, 2010. I will provide additional information on the revenue increase later in the presentation. Offsetting the positive revenue effect in the quarter was increased operation and maintenance expenses at our gas-fired generating plants which decreased earnings by $2.7 million pre-tax or $0.04 per share due to higher maintenance which resulted from weather related damage that occurred during the severe winter weather event in February 2011.

On page 7 of the presentation, for the first 6 months of 2011, our earnings were primarily impacted by three factors. First, our retail non-fuel base revenues increased by approximately $18 million pre-tax or $0.27 per share. As I will discuss later in this presentation, non-fuel based retail revenues increased due to a 2.8 percent increase in retail kWh sales and new seasonal non-fuel base rates in Texas that are higher in the summer months.

Another factor that impacted our earnings for the first six months of 2011 compared to the same period in 2010 was a one-time charge to income tax expense in 2010 due to the elimination of the Medicare Part D subsidy in 2010 without any offsetting amounts in the current year. This item positively impacted our current earnings by $4.8 million or $0.11 per share.

The final factor that impacted our earnings for the six months ended June 30, 2011 was lower retained off-system sales margins which declined by $6 million or $0.09 per share due to an increase in sharing of off-system sales margins with customers and a decline in off-system sales margins reflecting lower average market prices for power.

Now, turning to slide 8, we detailed by customer class our 2011 retail megawatt- hour sales for the second quarter of 2011 and for the first six months of 2011, along with the percentage change over the comparable periods in 2010. In the second quarter of 2011 and on a year-to-date basis, every segment of our business posted megawatt-hour sales growth. The increase in megawatt hour sales reflects 1.4 percent growth in the average number of customers served due to our expanding local economy and the continued growth in usage per customer that we have been experiencing consistently over the last several years. In addition, megawatt-hour sales were positively impacted by hotter summer weather in 2011, compared to the same period in 2010. In the second quarter of 2011, cooling degree days were almost 18 percent higher than in the second quarter of 2010. We had 21 days of temperatures over 100 degrees in the second quarter of 2011, compared to only 14 days over 100 degrees in the second quarter of 2010. During the second quarter of 2011, our residential sales increased by 9.3 percent, while our sales to our small and large commercial and industrial customers grew by 5.5 and 6.9 percent, respectively. The increased sales to our residential and commercial and industrial segments during the second quarter of 2011 offset the decreases we experienced in these customer classes during the first quarter of 2011. Our sales to public authorities increased by 2.3 percent, which is a reflection of the ongoing expansion at Fort Bliss. At this time, Fort Bliss represents almost 70 MW's of load and we anticipate that the overall load at Fort Bliss will grow to over 90 MW's by 2013 as a result of the additional soldiers and military personnel that are expected to be stationed at Fort Bliss. Fort Bliss currently has an active duty soldier population of almost 26,000 which is expected to grow to approximately 30,000 soldiers by the end of 2012. The revised troop count that we have been provided by Fort Bliss is less than the 35,000 previously disclosed to us. In conversations with Fort Bliss personnel, the primary driver behind the reduced number is that the Army has decided to delay the decision on a brigade originally scheduled to relocate to Fort Bliss from Germany until at least 2015. Despite the revised troop count, the almost $5 billion construction program at the base is continuing and we will continue to see growth from follow on activities at the base including a $946 million hospital complex.

Turning to the results for the first six months of 2011, our residential megawatt hour sales grew by 3.4 percent and reflected our expanding customer base and hotter summer weather during the second quarter of 2011. In the first half of 2011, our cooling degree days were almost 21 percent above the same period in 2010 and were 18 percent above the 10-year average.

Overall, our total retail kWh sales in the first half of 2011 grew by 2.8 percent. We are also pleased by the fact that on a year-to-date basis our customer base grew by 1.4

percent. Our above-average customer growth illustrates the economic growth in our area and the significant expansion at Fort Bliss.

Now, turning to slide 9, we illustrate the impact of the seasonal rates that were placed into effect in Texas and New Mexico in 2010. On slide 9, we detailed the increase or decrease in megawatt-hour sales in the first and second quarters of 2011 compared to the same period in the prior year and the average non-fuel base rate per kilowatt hour for each customer class. The decrease in kilowatt hour sales that was experienced in the first quarter and the increase in kilowatt hour sales that was experienced in the second quarter were significantly influenced by weather. As has previously been discussed, we had milder weather in the first quarter of 2011 and a hotter than average weather in the second quarter of 2011. The effects of weather on our revenues are compounded when they are combined with the effects of the new seasonal rates that were placed into effect in Texas in July 2010 and New Mexico in January 2010 which provides for lower non-fuel base rates in the winter months of November through April and higher non-fuel base rates in the summer months of May through October.

As can be seen, the impact of the decrease in megawatt- hour sales in the first quarter of 2011 had a smaller impact on revenues due to the lower winter rates then the impact of the increase of megawatt-hour sales in the second quarter due to the higher summer rates. In short, the combined effect of weather and our new seasonal rate design were compounded in the second quarter and were the primary driving factors in the revenue growth we experienced in the second quarter of 2011. These factors will continue to affect the Company's revenues in the future.

Now, turning to slide 10 I would like to discuss our capital requirements and our liquidity position. In terms of our capital requirements, we expended approximately $87 million for cash additions to utility plants in the first six months for 2011. We expect to spend approximately $195 million for new construction in 2011. We also expect to pay approximately $27 million in dividends to our shareholders in 2011 assuming the current level of quarterly dividends of $0.22 per share. Through June 30, 2011, we repurchased approximately 911,000 shares at a cost of $26.3 million. Approximately 2.3 million shares remain available for repurchase under our current share authorization. We expect to continue to make additional share repurchases in excess of the dividends we pay to shareholders in the future to balance our capital structure.

At June 30, 2011 our liquidity was approximately $166 million which consisted of a cash balance of approximately $5 million and borrowing capability available to us under our credit facility of approximately $160 million. We believe that the available liquidity we have, along with our expected cash from operations, will be sufficient to finance our capital requirements through 2011 and most of 2012.

Now, turning to slide 11, we are revising our 2011 earnings guidance to a range of $2.20 per share to $2.50 per share from a range of $2.10 per share to $2.50 per share. The primary driver for the revision in the low end of guidance was the above average sales and revenues we experienced in the second quarter. Given the growth we experienced in the second quarter and the sales we have seen thus far in the third quarter, we have eliminated the weather normalization adjustment we previously had on the low end of guidance and revised the low end of guidance upward.

I will now hand the call back over to Steve for questions.

Steve Busser: Thank you, David.

Stephanie, at this time, we normally take questions.

Operator: Ladies and gentlemen, if you have a question at this time, please press star, then one, on your touch tone telephone. If your question has been answered or you wish to remove yourself from the queue please press the pound key. Our first question comes from Jack Moore from Harpswell Capital. Your line is open.

Jack Moore: Good morning. Nice quarters, guys, good to talk to you.

Steve Busser: Thanks, Jack.

Jack Moore: I was wondering if you could give a little bit more color on the beat, and just with respect more color on weather versus growth in Fort Bliss and what not.

David Carpenter: Yes. This is David Carpenter.

I think you can look at the results for the second quarter and you see that we had a 6.2 percent increase in sales. I think our baseline estimate for kilowatt hour sales growth is around 2.5 percent, so I think that difference there probably represents kind of a weather impact. It's also possible that we could be seeing slightly higher growth in that. But that's probably a fairly good baseline to look at.

Jack Moore: Great. It sounds like the buyback is going and not petering off, but becoming less of a priority for use of funds in the near term? Is that fair?

David Stevens: No, Jack. This is David Stevens. Let me kind of take that one.

I don't know that I would make that assumption. The bottom line is that we anticipate and you've seen that we're paying a dividend now at a rate of $0.22 and that what we will do then is use the share buyback to assist us in balancing the capital structure. And I think that would be the better way to look at it. That's going to be kind of our balancing factor for capital structure needs.

Jack Moore: Okay. That sounds good.

In the filing you made yesterday, it sounded like the company expects to continue to repurchase from time to time. And that's where I was coming from there.

David Stevens: I see.

David Carpenter: I would say that that language is more to say. We're not putting out a timeframe for when we make the share buybacks. But as David said, we will continue to make share buybacks at appropriate times.

Jack Moore: Great. And then just finally, can you comment a bit on depreciation amortization rates and tax rates this quarter versus past and what to expect going forward?

David Carpenter: Yes. You had a couple of things happen this quarter. First, we received a life extension on Palo Verde and so with the life extension that has the effect of decreasing our depreciation expense and increasing expense that's an O&M expense. For 2011 we expect that to have approximately a $10 million impact. On a going forward basis it has an impact of approximately $13 million.

Now, we also put in place our Newman 5 Phase II power plant which was about $150 million to $160 million addition. The depreciation on that is going to run around $6 million per year. So it will certainly offset any benefit that we received from Palo Verde.

Jack Moore: And taxes?

David Carpenter: I think taxes may have been a little high, probably about $4 million on Newman 5 Phase II.

Jack Moore: Just the 16, 7, 42 was a bit above what I was expecting. I got it. Thanks very much. Congratulations, guys.

David Carpenter: On the taxes, basically, we're looking at an effective tax rate over time of approximately 33 percent for 2011. You're going to see some impact on taxes as your AFUDC goes down with the completion of Newman 5 Phase II as your AFUDC goes down, then your tax rate will go up some because the AFUDC equity that you have been recording is not taxable.

Jack Moore: Right. Thanks, guys. Congratulations.

David Carpenter: Thank you.

David Stevens: Thank you.

Operator: Our next question comes from Neal Mehta from Goldman Sachs. Your line is open.

Neal Mehta: Good morning.

Steve Busser: Good morning.

Neal Mehta: Are you guys thinking about the timing of the next rate case in New Mexico and in Texas?

David Carpenter: Yes. I think we're still looking at probably our next rate case in the 2013 timeframe. As we continue to construct plants to meet load growth, we have received approval for the next generating plant addition which is the Rio Grande Unit 9. The in service date for that plant is before the peak of 2013. And so what we would expect is that we'll follow our rate cases in 2013 to bring that plant addition into rate base at that time. That's kind of our best guess at this time.

Neal Mehta: All right, and you guys talked of demand growth of 2 to 3 percent historically, at least that's your forecast for 2011 through 2013. How does this Fort Bliss troop revision impact the view?

David Carpenter: I'm not sure it really impacts it a whole lot. There's a lot of peripheral growth that goes around the base. You're going to still see this large hospital complex that goes into the base. And so we still feel fairly confident in the 2.5 percent growth rate. I think you should also recognize that we've always probably had a little bit at least as far as projections of growth, we've always expected some lag in the expansion at Fort Bliss. So right now, we'll continue to look at the numbers. But we really haven't changed our projection.

Neal Mehta: All right. And when's the next time you will evaluate the dividend?

David Stevens: Neal, this is David.

I would say that every quarter, we evaluate the dividend from the standpoint that we have to ensure that we still think that's a proper decision. I think everybody does that. I think it's an ongoing process for any company and since we've just now paid one, I don't know if there's a specific timeframe in place. But I would tell you, it's an ongoing process and we'll announce something to the extent we ever decide to change it some time in the future.

Neal Mehta: Got it. And then, last question, do you still expect the one time litigation benefit next quarter?

David Carpenter: I'm not sure what litigation. Do you mean the Tucson Electric Power?

Neal Mehta: Yes.

David Carpenter: Yes. We still expect that. I think we've received one approval and are waiting for a second approval to be okayed. We expect the approvals to be received within 60 days of our filing, which is the end of June. And so we would hope to have that by the end of August.

Neal Mehta: All right, thanks, guys.

Operator: Our next question comes from Brian Russo from Ladenberg Thalman. Your line is open.

Brian Russo: Hi. Good morning.

David Stevens: Morning, Brian.

Brian Russo: You've laid out kind of your baseline load growth which I guess is 2.5 percent and given that that's kind of the earnings driver until the next rate cases, I'm just curious, in terms of your operating expenses you had some positive moving parts in 2011 which basically has kept them flat year over year. But is there kind of a general type run rate in O&M expense growth that you could provide to us?

David Carpenter: I'm not sure we can give you a firm number on that. I think where we've been, we've been trying to hold our O&M expenses flat this year because of some of the extra expenses that we've seen associated with the weather event. We may not be able to achieve that this year. Next year, I think it would be our expectation to try to hold the expenses fairly flat again. Next year, hopefully, we won't have these weather events that we've seen this year and some of the extra expenses that we've seen and then, I think, Pat, once you get past the next year, I think our target will be to try to hold our expense growth in line with, really with our customer growth in kilowatt hour sales growth.

Brian Russo: Okay. I think your customer growth is around 1.5 percent, but due to increasing usage per customer, that translates into load growth of about 100 basis points higher than that?

David Carpenter: Right. So I think within that range of 1.5 to 2.5 percent would probably be a reasonable assumption.

Brian Russo: Okay. Then just on the guidance, I'm surprised you guys didn't raise the high end of the guidance. I'm not entirely sure why. You mentioned the low end was moved up because it reflected unseasonably mild weather, I guess? Could you just kind of walk through that again? And then maybe just note the one -time items and is the TEP settlement of $0.07 included in that?

David Carpenter: Yes. Let me start at the back here. The TEP settlement of $0.07 is included in that, so we had to raise the guidance last quarter to reflect that.

As we view the weather, you can think of it this way. On the low end of guidance, we assume we have below normal weather. On the high end of guidance, we assume that we have above normal weather and so what we've seen so far is that it doesn't look like we're going to have below normal weather for this year. We still have a significant portion of the third quarter to go and so at this point in time, we're not comfortable. We think the high end of guidance already reflects some above normal weather and we think at this point in time, is sufficient. Now, if the third quarter turns out to be a real blockbuster, then that could change. But right now, we think it should be sufficient. Plus on the high end, we still aren't seeing some of these extra O&M expenses for the weather event that could also offset that a little bit.

Brian Russo: Okay. So I think the weather event was $0.04 impact? I'm sorry, the storm-related cost?

David Carpenter: Yes, the storm-related costs were about $0.04. That's right. Thus far.

David Carpenter: Yes.

Brian Russo: Okay. So the $0.04 negative is in the guidance and $0.07 positive is also in the guidance for the TEP settlement and then the rest is basically weather-related?

David Carpenter: Yes and Brian, I think $0.04 so far, we expect to spend about another million dollars, a little over $1 million, to basically winterize our plants to a minus 10 degree thermal rating and so that's probably going to knock off another $0.02 before the end of the year.

Brian Russo: Okay. And then, also, I noticed that the equity ratio declined to about 47 percent. Is that just timing related? And should that kind of pick back up as we move through the year? Or will that kind of be an obstacle to incremental share buybacks for the remainder of the year?

David Carpenter: I think if you look at the equity ratio and if you exclude the Rio Grande Resources Trust, we're still about 52.5 percent equity ratio, which is above our target of 50 percent. So we still have quite a ways to go to get down to our target and we don't necessarily believe that we'll get there this year.

Now, what you will see a little bit is that because our earnings are seasonal and if you're buying stock back and you're paying dividends on a somewhat of a routine basis, those will have a bigger effect during the winter and somewhat during the second quarter when your earnings haven't picked up the majority of your earnings. When we hit the third quarter and we pick up our biggest portion of earnings, you're probably going to see the equity ratio go back up and then hopefully may come back down a little bit in the fourth quarter as we pay dividends, and possibly have some more stock buybacks.

Brian Russo: Okay, great. Also, the seasonality of rates, do you also have tiered rates within your customer classes, meaning, you almost have a multiple impact, not only higher summer rates and better weather, but more usage. Does that also push the rate up higher?

David Carpenter: Brian, for the most part, once you get past a fairly baseline amount of cost, we don't have what you would call declining block rates anymore. Whereas you go up, the rates would go down. I haven't looked at it that closely lately, but most of the time, once we get past an initial block of rates, the rates are flat from there and the second block is pretty flat, maybe increasing slightly, but not that much from the first block.

Brian Russo: Okay. So when we look at the slide 9, that 9.25 cents for the residential customer, is that a good benchmark for the second quarter of each year going forward under this rate structure?

David Carpenter: Yes, I think that's probably pretty representative for what you'd see in the second quarter. It's probably a little bit lower than you might see in the third quarter because in the third quarter, you have three months. All three months are at the summer rates where in the second quarter, you have one month that was at the winter rate.

Brian Russo: Understood. And then lastly, can you give us an idea of what your year end 2011 rate base is?

David Carpenter: Yes, let me start with year-end 2010. If you looked at year-end 2010, you probably had the rate base pretty flat since our rate case, so it was about $1.4 billion on a total company basis.

If you then take the closing for Newman 5 Phase II, we probably added $150 to $160 million of rate base with that addition and so we moved it up to probably $1.55 billion or so and then probably given the rest of the year, we probably won't see significant increases in rate base because most of it will be taken. What additions you have, you'll also have depreciation and because of the bonus depreciation this year, we're picking up some extra deferred taxes this year. Maybe $25 million of additional rate base before the end of the year, but I wouldn't expect any big significant addition.

Brian Russo: Okay. And then, post that rough year-end 2011 rate base, it's basically just a capex minus depreciation, or are there going to be any other moving parts in that?

David Carpenter: Well, you'll continue to see some increase in deferred taxes which go to reduce your rate base. But that should fall off after we get through this year because I think the bonus depreciation goes away in 2011 or 2012, but we don't have the big plant additions in 2012.

Brian Russo: And what was that bonus depreciation? What was the impact to rate base in 2011?

David Carpenter: Yes. I think as we were looking at this the other day that probably is about a $35 million impact to rate base this year from the bonus depreciation.

Brian Russo: Okay, Great. That $1.55 billion of rate base you just quoted, does that exclude the decertified unit at Palo Verde?

David Stevens: Yes.

David Carpenter: No, it really doesn't. I'm kind of assuming that on a total company basis, we're earning at least a regulated return on the decertified Palo Verde.

Brian Russo: If we were to look to adjust that out of rate base, what would that amount be?

David Carpenter: It's about $50 million maybe, $40 to $50 million.

Brian Russo: Okay, great. Thanks a lot, guys.

Operator: Our next question comes from Maury May from Ticonderoga Securities. Your line is open.

Maury May: Yes, good morning, folks.

Steve Busser: Morning, Maury.

Maury May: What's the temperature going to hit in El Paso today?

Steve Busser I think it's forecasted to be right at 100, Maury, right at 100.

Maury May: And it's been at 100 a lot of July, hasn't it?

Steve Busser: I think yesterday was the first day that we'd hit 100 in the second quarter.

Maury May: You mean in the third quarter?

Steve Busser: In the third quarter I'm sorry.

Maury May: Okay. Because we see in the media there's a real heat wave hitting the Southwest and I'm just wondering whether some of the weather experience of the second quarter does move into the third quarter, which would imply, I think, you all earning at the upper end of your guidance range.

David Carpenter: Maury, this is David Carpenter.

I think the way I'd put it is that we have been cooler than the rest of Texas, but probably, I would say, we've probably been fairly normal to maybe just slightly above normal...

Maury May: Okay.

David Carpenter: For July so far.

Maury May: Okay, good. That's helpful.

And then, also, on a trailing 12-month basis, do you all have an estimate of your earned ROE?

David Carpenter: On a traveling 12-month basis?

Maury May: Yes, through June 30.

David Carpenter: Yes. Through June 30, our trailing ROE is going to be close to 12 percent.

Maury May: Okay. And you essentially see this drifting down. You can't file a rate case obviously when you're earning 12 percent. But you indicated earlier in the conference call that you would be perhaps filing rate cases in 2013. So you see the earned ROE's going down over the next couple of years or maybe fairly sharply next year?

David Carpenter: Right.

Maury May: What do you think?

David Carpenter: Right. We would certainly expect the ROE to trail down as we add plants that we're not adding to rate base. We're not adding increasing rates as we add plants. And so we do expect the ROE to decline over the next few years.

Maury May: Okay. But if you file in 2013, you're going to file for on a historic test year. And I would assume you would only file if you needed it or if you had additional revenue requirements. So you could see the ROE fall quite sharply, I think in 2012. Is that the implication here?

David Carpenter: Yes, Maury. I think you could see there is a lot of things that could impact it. But certainly, you could see a pretty good decline next year, and certainly, by 2013, we would expect it to decline to a level that would probably require us to follow rate case.

Maury May: Okay. And would that be like early 2013 or late 2013 for maybe new rates in 2014?

David Carpenter: Yes, I think it's probably appropriate to assume that the new rates would probably hit in 2014. We can make some adjustments in New Mexico that would probably allow us to file the case by probably mid-year, before the July 1st anyway, in New Mexico. And in Texas because of the way the roles read, you probably wouldn't file until late 2013.

Maury May: Okay, so you would be going for a forecast test year perhaps in New Mexico?

David Carpenter: Not necessarily. I think you still have a five-month rule where you can go out and pick up plant additions five months in advance.

Maury May: Right. Okay.

David Carpenter: And we'll take a look at it and see which works better for us. Do we use what I would call the post-test year adjustment? Or do we use the forecast test year and see which option works best for us?

Maury May: Okay. Good enough. Thank you very much, folks.

Steve Busser: Thanks, Maury.

Operator: Our next question comes from Michael Klein from Sidoti & Co. Your line is open.

Michael Klein: Hi, guys.

Did you guys quantify the impact from weather in the quarter?

David Carpenter: We have not made a specific quantification of the impact of weather. If you just take the increase in kilowatt hour sales times the average rate per kilowatt hour, you're going to get about a $9 million impact. And probably some of that is normal growth. So somewhere probably between $5 million and $9 million is probably realistic.

Michael Klein: Okay, you already talked about expectations for O&M costs going forward. But speaking to cost at Palo Verde specifically, what do you guys expect going forward? I know you've talked about those costs declining. Have you given a run rate or a percentage year over year that we can expect those costs to drop by?

David Stevens: Michael, this is Davis Stevens. Let me kind of take that, at least at first.

What's happened I think a little bit is in light of the situation that occurred in Japan, the unfortunate situation, I think that O&M is a little bit under. We originally did have a pretty good feel for what we anticipated in a declining O&M rate in operating costs at Palo Verde. And to David's point earlier, that's kind of what was offsetting any increases we had in operating costs on an internal basis was the fact that we had the declining rate at Palo Verde.

In light of some of the recent comments by the NRC and recent paper written by them, we are having to go back and kind of re-evaluate that as we speak and I don't know that I would feel comfortable right now stating anything other than to say we still anticipate they're going to decline. But right now, I'm a little bit unsure as to what the rate of decline is going to be at this point.

Michael Klein: Okay, but it still should decrease year over year?

David Stevens: Yes, sir.

Michael Klein: Okay, and just looking at the C&I large segment, it was up about 7 percent in the quarter. Is that just the seasonality? Or is there any specific trend going on there?

David Carpenter: Really, if you look at the customers we've had, I don't think it's really a seasonal rate. What it really reflects is some benefit in the economy where some of our larger customers probably one of them in particular was steel mill that had significantly increased sales. These are customers that had been hit pretty hard when in 2008 when the economy went down and what we're really seeing is those customers really coming back up to full capacity.

Michael Klein: Okay. And lastly, do you guys still expect to raise capital in the 2012 time period? Or is that still up in the air?

David Carpenter: Yes, I think will still be looking at trying to be somewhat opportunistic if we can. But clearly, probably by the end of 2012, we expect probably need to seek some debt capital.

Michael Klein: Okay, great. Thanks, guys.

Operator: Our next question comes from Chris Shelton from Millennium. Your line is open.

Chris Shelton: Good morning, guys. Chris Shelton. How are you?

Steve Busser: Good Chris, How are you?

Chris Shelton: All right. Actually, I just wanted to follow up real quick on Fort Bliss. I just want to make sure I understand. So the goal or the amount of troops for 2013 is 33,000. What was it supposed to be before?

David Stevens: Chris, this is David.

The original estimate from Fort Bliss was to go to 35,000 troops in total. Today, we're at approximately 26,000. And by the end of 2012, there'll be close to 30,000 at which point, now the balance between the brigade that is in Germany that was going to be moved to Fort Bliss is kind of on a bubble, if you will. They haven't made a decision and don't anticipate a decision on that brigade until closer to 2015.

Chris Shelton: Okay. So that brigade accounts for 5,000 troops? Is that the quick math?

David Stevens: That's the quick math. Unfortunately, I don't remember exactly the number of troops in a brigade, but it's the right difference.

Chris Shelton: Okay. Got it.

And of the troops that get you to the year-end in 2012 amount, are any of those troops coming from abroad? Or do they give you that kind of clarity, I guess?

David Stevens: I don't recall the clarity on that one. The problem is right now is at Bliss you've got people that are deploying periodically and then coming back. And so you've got people that are both already assigned here that get deployed and come back.

I think my guess is it's probably a combination of both people from abroad as well as some combination of existing bases. There are a lot of troop movements just by virtue of the reconfiguration of Bliss to a different type of base than what it historically was. So you had troops that moved out, troops that moved in, and it's kind of all over the place.

Chris Shelton: I guess the other point is, is they're building out the infrastructure in anticipation of that brigade showing up.

David Stevens: Yes, they're still, Chris, the number is $5 plus billion. And to David's point earlier, they're also building a pretty massive hospital complex. So all of that's being built out. Most of it's built if you get right down to it with the exception of the hospital complex.

But there's still things going on and will be going on for the next probably several years. And that's the point of the tale, if you will, on this is that it's not all done but it's going to take some period of time, but a lot of the large infrastructure projects have been built. And so I think they did build out with the anticipation to go to ultimately that number of troops.

Chris Shelton: Got it. So the only difference is instead of having 35,000 troops by 2013, it may be 2015?

David Stevens: Well, there's a chance. I don't want to assume what the US government's going to do. They may still say they're not going to move them there. But I think over time they'll have to look at what the cost benefit is of each of the bases and ultimately, I do think Fort Bliss comes out very well when you look at the cost to the US government for housing troops. It tends to be a lower cost area than a lot of the other bases in the country.

Chris Shelton: Okay, great. Well, thank you, David. Thank you, guys.

David Stevens: Thanks, Chris.

Chris Shelton: You're welcome.

Operator: Again, ladies and gentlemen, if you have a question at this time, please press star, then one, on your touch tone telephone.

Our next question comes from Tim Winter from Gabelli and Company. Your line is open.

Tim Winter: Good morning, guys, congratulations on the quarter.

Steve Busser: Thanks, Tim.

Tim Winter: I just want to follow and clarify. Was there a negative earnings impact from the contingent reliability purchase for the wildfire?

David Carpenter: There was a slight impact here primarily because the impact on purchase power from the wildfire, we purchased some extra reserves and it's not completely clear under our pricing mechanism how we should treat that and so we went ahead and reserved for any losses on that purchase power versus what we would have sold it for. And then we'll be seeking recovery of that in our next fuel reconciliation.

So there was a negative impact there and the additional costs beyond that were not really significant.

Tim Winter: And what was the reserve amount?

David Carpenter: It's about $800,000.

Tim Winter: Oh, okay.

And then I understand it's been normal weather for July thus far, but I think it's been pretty hot around the Palo Verde region. Can you talk a little bit about what you're seeing as far as power prices in the area and how that might impact margins going forward?

David Carpenter: Right. I haven't really looked at the power plants that closely. But I can tell you that they have continued to be fairly low.

Steve Busser: And one other thing to think about there, too, Tim, is that we share a majority of those margins with the customer. So our activities there are obviously focused on trying to reduce the bills for customers.

Tim Winter: Okay, final question, the capex number for 2011 is $195 million. Is that a reduction from the previous quarter's estimate?

David Carpenter: It's a reduction from what we put in our 10-K and primarily reflects delay in some transmission projects. And so it's a slight reduction of about $10 to $13 million.

Tim Winter: Okay, so it's just a delay, the three year number you gave in the 10-K is still the forecast?

David Carpenter: Right. I think that these projects that have been delayed, we would expect to pick them up in probably 2012 and 2013. I don't know right now when the projects will be completed, but certainly, the projects that have been delayed; we would expect to do them in the future.

Tim Winter: Okay Great. Thanks, guys.

Steve Busser: Thanks, Tim.

Operator: And I'm, showing no further questions at this time.

David Stevens: Okay, well thanks, everybody for joining us today. And we look forward to the release of our third quarter earnings call and talking to you then.

David Carpenter: Thank you.

Operator: Ladies and gentlemen, that does conclude today's conference. You may all disconnect and have a wonderful day.