EL PASO ELECTRIC CO.

Moderator: Steven Busser
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9:30 am CT

Operator: Good day and welcome to the El Paso Electric Company's first quarter earning's call. Today's conference is being recorded.

At this time, I'd like to turn the call over to Mr. Steve Busser. Please go ahead, sir.

Steve Busser: Thank you, Anna. Good morning everyone.

Thank you for joining the El Paso Electric Company first quarter 2012 earnings conference call. This is Steve Busser. Also on the call with me today I have our interim CEO, Tom Shockley, and our CFO, David Carpenter. Today we will provide an update on our first quarter 2012 performance and we will discuss our key operating results. In addition, we will review the main points of our recently announced Texas Rate Case Settlement Agreement. Finally, we will discuss our 2012 earnings guidance, capital requirements and liquidity, capital expenditures and anticipated rate base balances.

Before we get started, I would like to cover some items that will be pertinent to our call. You should have a copy of our press release and if you do not, you can obtain one from our website on the Investor Relations page.

We currently anticipate that our first quarter 2012 Form 10-Q will be filed with the Securities and Exchange Commission (SEC) on or before May 10, 2012.

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 May 16, 2012. The details as it relates to the replay are disclosed in our press release.

I would now like to cover the safe harbor provision before I turn the call over to Tom Shockley.

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 the SEC.

The Company cautions 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 session of the call, are subject to risks and uncertainties that are difficult to predict.

Now, I'd like to turn the call over to Tom Shockley.

Tom Shockley: Thank you, Steve. Good morning and thank you for joining our call. This is Tom Shockley, interim CEO of El Paso Electric. If you will now turn to slide 3, I would like to go over our first quarter 2012 highlights. As many of you are aware, on April the 17th we announced that the El Paso City Council had approved the Texas Rate Case Settlement Agreement. The unanimous approval resolves the rate case preceding that commenced with the October 4, 2011 show cause resolution. Specifically, the settlement agreement implements new rates in the City of El Paso effective for bills rendered on and after May 1, 2012. No further action is required by City to implement the settlement. Rates for Texas service areas outside the city limits of El Paso are subject to final approval by the Public Utility Commission of Texas (PUCT) which is expected to occur in May or June. We feel that resolving the rate case was the most productive way of allowing the City and the company to move forward and focus on economic development in the El Paso area which will be of benefit to all parties. We plan to work closely with city officials and keep them abreast of the company's plans going forward. We feel this will be the best way to ensure that we have a collaborative, working relationship that will benefit the company and the city for many years into the future.

Also during the first quarter of 2012, El Paso Electric exercised the accordion on the revolving credit facility increasing the amount that the company can borrow on the facility from $200 million to $300 million. This provides the company with additional liquidity and borrowing capacity which will be necessary to finance our capital requirements in 2012.

Turning to slide 4 of our presentation, the El Paso Electric Board of Directors declared a $0.22 per share dividend payable on March 30, 2012 to shareholders of record on March 15, 2012. The dividend demonstrates our commitment to returning value to shareholders. As we have stated previously, we anticipate moving toward a target dividend payout ratio of approximately 45 percent for 2012. The Board will review the level of the dividend annually in conjunction with the shareholders' meeting, which is scheduled for May 31, 2012 in El Paso, Texas.

Turning to slide 5 of our presentation, I would like to provide an update on the actions taken by the Board of Directors regarding the search process for the new CEO. The Board has indicated that they will consider both internal and external candidates. The Board has not set a time frame for the replacement to be named and they have indicated that the selection of a permanent CEO will only be made after a comprehensive search has been completed. In the meantime, I have committed to serve as the interim CEO for the Company. I would like to take a moment to thank all of the employees of El Paso Electric for their hard work, dedication to their jobs, and to our communities. Our employees work diligently to provide safe and reliable service to our customers, while promoting long-term shareholder value.

I will now turn the call over to David Carpenter.

David Carpenter: Thank you Tom and good morning everyone. I would like to start on slide 6 of our presentation where you will see a summary of our first quarter financial results.
For the first quarter, we reported net income of $3.3 million or $0.08 per basic share compared to first quarter 2011 results of $0.16 per basic share. The highlight of the first quarter results was that we continued to experience robust growth in retail non-fuel base revenues which grew by 2 percent primarily due to a 3.3 percent increase in retail megawatt-hour sales.

The increase in non-fuel base revenue added $0.03 to basic earnings per share. I will discuss retail non-fuel base revenues in more detail later in the presentation. The decrease in earnings reflected an expected increase in generation maintenance expense and a decrease in allowance for funds used during construction or AFUDC. First, fossil fuel plant maintenance expense increased primarily due to the timing of outages in 2012 where we had major scheduled overhauls performed on two of our local units to a reduced level of overhaul activity in 2011. Increased fossil fuel plant maintenance expense reduced first quarter 2012 earnings by $0.04 per basic share compared to the prior year. AFUDC capitalization also reduced first quarter 2012 earnings compared to the first quarter of 2011. Driving this decrease was the placement of Newman 5 Phase II into service on April 30, 2011 and the resulting lower construction work in progress balances subject to AFUDC capitalization. The reduced AFUDC decreased first quarter 2012 earnings by $0.03 cents per basic share compared to the same period in 2011.

There were two items of note related to Palo Verde that also resulted in decreased first quarter 2012 earnings. The first item was the planned refueling outage at Palo Verde Unit 3 which started on March 17, 2012. The reduced output of Palo Verde Unit 3 in the quarter when compared to last year combined with reduced natural gas prices in 2012 compared to 2011 resulted in a reduction to deregulated Palo Verde Unit 3 revenues for the quarter of $0.02 per basic share. The second item, higher Palo Verde maintenance expense, was also related to the timing of the Palo Verde refueling outage. The current year spring outage started approximately two weeks earlier than the outage for Unit 2 in 2011. The acceleration of the timing of the planned outage resulted in additional Palo Verde maintenance expense being incurred in the first quarter of 2012 when compared to the first quarter of 2011. These additional Palo Verde maintenance expenses reduced first quarter 2012 earnings by $0.02 per basic share. The good news is as it relates to the Palo Verde outage was that the unit returned to service on April 17, 2012. The outage duration of 31 days was the shortest refueling outage experienced in the last several years at Palo Verde. We are very pleased with the improved operational performance at Palo Verde.

Now turning to slide 7, we detail by customer class the change in retail revenues and megawatt-hour sales for the first quarter of 2012 and the percentage change over the comparable period in 2011. As can be seen on this slide, the increase in retail non-fuel base revenues in 2012 was primarily due to a 3.3 percent increase in megawatt-hour sales to retail customers. The increase in retail sales reflects growth in the average number of retail customers served of 1.5 percent in the first quarter of 2012 when compared to the first quarter of 2011. We continue to experience solid customer growth and believe that this growth is reflective of the expanding El Paso economy. It is important to note that the growth in retail revenue in the first quarter of 2012 was realized in a period of milder winter weather when compared to the first quarter of 2011. For the first quarter of 2012, there was an 8.4 percent decline in heating degree days when compared to the first quarter of 2011. Also of note was the 7.5 percent increase in sales to large commercial and industrial customers in the first quarter reflecting an improving economy.

Now turning to slide 8, we have revised our 2012 earnings guidance to a range of $2.05 to $2.40 per basic share from the previous range of $2.15 to $2.55 per basic share. The primary driver for this revision is the Texas Rate Case Settlement. The agreement reduces annual non-fuel base rate revenues and lowers annual depreciation expense for the Company's gas-fired generating units. As we previously disclosed, the effect of the Texas rate case settlement reduced both the high and low estimates of guidance by approximately $0.16 per basic share. Another item that had resulted in a downward revision to our guidance range for 2012 is reduced natural gas price expectations for 2012 which decreases the amount we expect to earn from sales of deregulated Palo Verde Unit 3 power. Items that resulted in upward revisions to our guidance were the increased retail non-fuel base revenues we experienced in the first quarter. We also revised our earnings guidance range upward to reflect an anticipated reduction in executive compensation costs related to the departure of two senior executives. This adjustment included amounts previously expensed for executive compensation that will not be earned related to the departure of these executives as well as amounts we had anticipated being expensed in 2012.

Turning to slide 9, I will cover our capital requirements and liquidity. During the three months ended March 31, 2012, our capital expenditures for additions to electric utility plant were $48.2 million. Our expectation for capital expenditures during 2012 has been revised downward to approximately $227 million from the previously anticipated amount of $242 million. In terms of dividends, we paid $8.8 million or $0.22 per share during the first quarter of 2012. On March 29, 2012 we increased the size of our revolving credit facility from $200 million to $300 million. On March 31, 2012, we had a $6.1 million cash balance and had liquidity of $213.1 million including the increase in the revolving credit facility. We believe that we will have adequate liquidity through our current cash balances, cash from operations, and our revolving credit facility to meet all of our anticipated cash requirements through 2012 based on our current projections. While we may issue long-term debt in 2012, we currently do not anticipate issuing additional long term debt prior to the first quarter of 2013.

On slide 10 of the presentation, you will find our cash expenditures for the next five years. At March 31, 2012, we had current construction work in progress of $189 million. We broke ground on our next generating unit, Rio Grande Unit 9 in January of this year. Rio Grande 9 will be a simple cycle General Electric LMS 100 aero derivative gas turbine peaking unit and we expect that it will go into commercial service by May 2013. In addition to Rio Grande 9, we currently anticipate four similar additional peaking units that will be placed into commercial operation by 2016. The primary additions to rate base through 2016 include $691 million in new generating plant, and $401 million in Transmission and Distribution infrastructure. As for Palo Verde, capital expenditures are expected to be approximately $154 million through 2016. We are currently reviewing our capital expansion plan and evaluating the possibility of extending the lives of some of our existing generating units which could delay some of the capital expenditures planned in the 2015 and 2016 time period. We anticipate filing for approval of the peaking units planned for 2014 and 2015 with the PUCT and NMPRC this week. We will provide further information as it relates to these plans as it becomes available.

On slide 11, we detail projected year end rate base balances for the next several years based on our current plan. It is anticipated that rate base through 2014 will grow at a compound average growth rate of 7.3 percent. Note that the beginning balance of rate base detailed here included the deregulated portion of Palo Verde Unit 3. Average plant additions are estimated to be $241 million per year over this time period. Rate base will be reduced by the accrual and recovery of depreciation expense and increases in accumulated deferred income taxes. We expect our rate base to grow to nearly $1.9 billion by the end of 2014.

This concludes our first quarter 2012 earnings presentation and I will now open the call up for questions.

Steve Busser: Anna, at this point, we normally take questions.

Operator: Yes, sir. Thank you. If you would like to ask a question, please signal by pressing the star key followed by the digit one on your telephone keypad. If you are using a speakerphone, ensure your mute function is turned off to allow your signal to reach our equipment. Once again, that is star one if you would like to ask a question.

Our first question will come from Anthony Crowdell with Jefferies.

Anthony Crowdell: Good morning. My questions are related to slide 11 and I guess the first question is why include deregulated Palo Verde 3 in your rate base because I don't think you guys get a regulated return off it.

The second question is related to CWIP balances. Are they included in those numbers and if they are not could you guys provide what your estimated CWIP balance is for 2012, '13, and '14?

David Carpenter: Anthony, this is David Carpenter. The reason for including the Palo Verde 3 plant in the rate base is because we do expect to earn a return on it and we earn a return through the sales of deregulated PV3 energy to New Mexico at a proxy market price.

So to a certain extent we do expect to earn a return on it and that's why we included it in there. It is in our Texas rate base and so that was really the basis for that. As far as CWIP balances, we anticipate they will increase throughout the period as we spend more money for construction. We'll see if we can kind of give you an idea of what those balances will be.

Steve Busser: Those CWIP balances are not included the numbers that you see on slide 11.

Anthony Crowdell: What is the total value of the deregulated portion of Palo Verde 3? What amount is in beginning rate base?

Steve Busser: Yes, that number is actually disclosed right below those numbers on the chart on page 11 there, Anthony.

Anthony Crowdell: So that's the amount that you're including in rate base of roughly $35 million.

Steve Busser: Yes, sir.

Anthony Crowdell: Okay.

David Carpenter: Our expected CWIP balances are about $260 million in 2012, $289 million in 2013, and $324 million in 2014.

Anthony Crowdell: Is that a year-end CWIP balance or an average CWIP balance.

David Carpenter: That's the year-end CWIP balance.

Anthony Crowdell: Thank you very much.

Operator: Our next question will come from Brian Russo with Ladenburg Thalmann.

Brian Russo: Good morning.

Steve Busser: Good morning, Brian.

Brian Russo: Just to follow up on slide 11, the way we should look at this is given your historical test year, that the year-end rate base in 2013, that's what you'll earn on 2014 following the Texas rate case filing and possibly a New Mexico rate case filing in 2013 for rates in 2014? Is that accurate?

David Carpenter: That's a pretty good way to look at it. While we may not file rate cases exactly on the year-end balances in those periods, what we're looking at is generally that we look at adding a new generating plant in the first five months of the next year and we'll seek to include those new generating plant additions into the rate base balances. I believe that we've included in these beginning balances some of the rate base additions that extend out in those periods.

Brian Russo: So my analysis is generally accurate. You're going to earn on the 2013 estimated rate base in 2014.

David Carpenter: That is correct.

Brian Russo: Give or take a couple of months on the timing of when you file and when your test year ends.

David Carpenter: That's correct.

Brian Russo: Okay.

David Carpenter: We do have an option to file with a future test year in New Mexico and we will be reviewing that in the future to see whether we would do that or not.

Brian Russo: I think I read in the press release that your GAAP equity ratio is 44 percent. That seems low. I would imagine that's just the timing of or the seasonality of your margins.

David Carpenter: Yes.

Brian Russo: It looks like from the guidance and the revisions, you brought the top end down $0.15 but you only brought the low end down $0.10. What are the assumptions there?

David Carpenter: As we said the assumptions primarily are some reductions in expenses that we expect that will certainly lower or increase the bottom end. And in some expectations or some sales that we've already seen so far this year that are really kind of an above the bottom end of guidance.

In other words, the bottom end of guidance really reflects not seeing normal weather trends and even though the first quarter weather was a little bit below normal we still saw the growth in sales that we would have expected in the above then lower end of guidance.

Until we get through the summer though we don't know how those sales will compare on the upper end of guidance and so it's really a reflection that the bottom end of guidance, we don't expect sales to be as low as maybe we could see with kind of abnormal weather. Whereas on the top end of guidance we don't know at this point in time. It's really dependent upon the summer.

Steve Busser: The other revision there, too, Brian, is that on the top end of guidance we had assumed previously, we didn't have an equalized range around the center for gas prices that drive the Palo Verde 3 reprice.

On the bottom end we had assumed about $0.50 between the bottom end and the middle and on the top end we had assumed a range of gas prices greater than that so we have brought that range more in line on both sides of the expected case as well so that's the other piece that drove the difference in the top end and the bottom end of the guidance range.

Brian Russo: Understood. Then lastly I think it's rather remarkable that you could have an 8 percent decrease in heating degree days yet show a plus 3percent in retail sales. I would imagine it's a function of the customer growth plus expanding usage. Is that how we should interpret it?

David Carpenter: I think that's a fair assumption.

Brian Russo: Okay, great, thanks a lot.

Steve Busser: Thanks, Brian.

Operator: Once again, that is star one if you would like to ask a question. And our next question will be from Neil Mehta with Goldman Sachs.

Neil Mehta: To pick up there, what's happening at the C&I large segment because that seems to be where you're getting some outsize growth in the quarter when we think about that 10.5 percent number?

David Carpenter: Yes, the C&I large segment has rebounded and continues to rebound. Really you could almost tie this growth to two customers.

One is to a refining customer that had some outages in the first quarter last year and so they really operated at full load this year. And the other is a steel mill that not only has operated at an increased level and continues to operate at an increased level but as we go forward is also adding additional load. And so we're really seeing those operations continue to operate at very high capacity factors.

Neil Mehta: Got it. Tom, this is a question for you. What's the Board looking for here in the next CEO and any incremental color on where you stand on the search would definitely be appreciated.

Tom Shockley: I think the Board is progressing. The process is underway and they are meeting and discussing the situation on a fairly routine basis. Obviously the Board is looking for someone that has got the experience that we think is necessary to be effective leading El Paso Electric. I think that we feel like it's very, very important that we find someone who values communicating with the community and city and maintains the relationship there that is constructive going forward.

El Paso has a great deal of opportunity and I think that the opportunities that can be developed from economic development activities are something that can add a lot of value to El Paso Electric.

So there's just kind of the traditional utility attributes that I think would play very well here in El Paso and really create a good opportunity for the Company to see really kind of exciting growth compared to the rest of the United States.

Neil Mehta: My last question is around the outages. It looks like you pulled forward multiple outages in the quarter. Does that imply outage expenses will be lower year-over-year for the balance of the year?

David Carpenter: As far as the production and maintenance? Correct?

Neil Mehta: Yes.

David Carpenter: Yes. We think they're going to be about flat for the year. We had quite a bit of maintenance in the fourth quarter of last year that will certainly offset but we expect a little lower outage level this year. And a lot of the timing of our outages is largely we try to do a lot of it in the first quarter before we hit our summer peak period and we want to have our plants operating at peak condition but for the year we think they'll be fairly flat.

Neil Mehta: Thanks, David. Thanks, Tom.

Operator: We'll now take our next question from Maury May with Power Insight.

Maury May: Hi, good morning folks.

David Carpenter: Good morning, Maury.

Maury May: Got some questions on your planned generation expenditures. First of all, you said that later this week you will file in Texas and New Mexico for new peakers. How many peakers and what locations?

David Carpenter: Yes, these are two peaking units that we're filing for. They will be in east El Paso is where we expect to locate these units.

Maury May: Is that the new Greenfield site?

David Carpenter: It's a new Greenfield site, that's correct.

Maury May: My second question is you referred to life extension. Now I know you've had a ten-year plan of loads and resources out there and you've updated it from time to time, but it assumed the closing of Rio Grande 6 and 7 and Newman's 1 and 4. 1, 2 and 4 actually and then you're interested in Four Corners 4 and 5. What is now subject to life extension among these units?

Tom Shockley: We are looking at all of those that are designated to be retired as potential to be kept on and available for meeting capacity needs. Obviously they are older units and they're not very efficient and don't dispatch very often. But if they are available to be kept online with our maintenance dollars not being excessive to keep them online it just makes a lot of sense to keep them available even to the point of maybe being able to adjust if not the four turbines that we're talking about, the timing of the turbines have to be pushed out. Obviously at some point, units like this will have a failure that to repair costs more than you're going to get return in value so it's just those types of events that we have to be prepared to fully be committed to meeting the growth in the El Paso area with new capacity. But at the same time we may be able to postpone some of that with some of these older units.

Maury May: Including Four Corners?

Tom Shockley: Right.

Maury May: Good. Thank you very much.

Operator: As a final reminder, that is star one if you would like to ask a question. And we'll take a follow up from Anthony Crowdell.

Anthony Crowdell: Just a quick follow up. Is there a way you guys could break out on the Palo Verde expenses what was related to maybe lower gas prices and what was related to lower availability because of the outages? Is it fair to say it was a penny of each or is the lion's share of that due to lower power prices?

The second question is when, just following up on Maury's question, with maybe delaying some new generating units, are the ones most at risk or getting delayed, is it accurate to believe it's going to be the two additional CCGTs for 18 and 19?

David Carpenter: Yes, Anthony, it may well be the two combustion turbines out there later. I think what we'd be looking at is pushing out a little bit to the combined cycle units going forward.

Steve Busser: Anthony, in regards to your question on Palo Verde 3, just looking at the outage relative to last year, the unit ran the entire time it was out this year, it ran last year in the comparable time frame. So that would be about an 8-1/2 percent reduction in the annual capacity factor just related to having the outage this year and not having it last year. And in terms of gas prices our gas prices that we experienced that was embedded in what we saw for Palo Verde 3 deregulated revenues last year was about $3.90 an M and this year we think that number is probably going to be in the $2.50 to $2.60 range.

Anthony Crowdell: Thank you.

Operator: Gentlemen it appears there are no further questions.

Steve Busser: Thank you, Anna, and thank you everyone for joining the call.

Operator: That does conclude today's conference call. We thank you for your participation.