EL PASO ELECTRIC CO
Moderator: Lisa Budtke
November 4, 2015
9:30 am CT

Operator: Good day ladies and gentlemen and welcome to the El Paso Electric Company's 3rd Quarter 2015 earnings conference call. At this time I'd like to turn the call over to Lisa Budtke. Please go ahead.

Lisa Budtke: Thank you Aaron. Good morning everyone. Thank you for joining the El Paso Electric Company's 3rd Quarter 2015 earnings conference call. My name is Lisa Budtke and I am the Assistant Treasurer for El Paso Electric. On the call are CEO, Tom Shockley; President, Mary Kipp; CFO, Nathan Hirschi and other members of the Senior Management Team. Today we will discuss our 3rd Quarter results, key earnings drivers, capital requirements and liquidity, revised 2015 guidance, and finally provide an update on our rate cases.

You should have a copy of our press release and today's presentation and if you do not you can obtain them from our website on the Investor Relations page.

We currently anticipate that our 3rd Quarter 2015 Form 10-Q will be filed with the Securities and Exchange Commission (SEC) on or before this Friday, November 6, 2015.

We also would like to inform you that we will be attending the EEI Financial Conference on November 8th through November 10th in Hollywood, Florida. Please refer to our website for all upcoming Investor Relations events.

A replay of today's call will be available shortly after our call ends and will run through November 18, 2015. The details as they relate to the replay are disclosed in our press release.

For forward-looking statements on slide 2 of our presentation you'll see our safe harbor provisions. 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 risk 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 risk and factors discussed in the Company's SEC filings. Our 10-Q and other SEC filings contain our forward-looking safe harbor statements and also lay out our risk factors and 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 exhaustive 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 risk and uncertainties that are difficult to predict. I would now like to turn the call over to Tom.

Tom Shockley: Thank you Lisa. Good morning and thanks to all of you for joining our call. As usual today after I make a few comments about some highlights of the 3rd quarter of this year, Nathan will be bringing you a lot more detail about the financial numbers that drive our results for the quarter and then following that Mary will give the group a summary of where we are in our rate cases and a little look into what we expect for our next rate case that will be happening in 2017.

I'll start by pointing out that on slide 3 we indicate that we did have a new system peak this year of 1,794 MW's that occurred on August 6, 2015. In fact, El Paso Electric has set a new native peak record in 10 out of the past 11 years. We also set a new megawatt hour sales record during the quarter; which surpassed the previous record which was established in 2011. The growth in sales and peak demand combined with the consistent customer growth in our service area have been the primary factors in driving our need for new generation resources. Our planning efforts and recent generation additions have allowed the Company to consistently meet the needs of our service area in a safe and reliable manner. Along those lines, significant progress has been made on the construction of Montana Power Station Units 3 & 4, both of which are on schedule. Unit 3 will be commercially operational for the summer peak of 2016 and Unit 4 will be operational by the end of 2016. Also during the 3rd quarter, we paid a quarterly cash dividend of $0.295 on September 30, 2015 to shareholders of record as of September 16, 2015.

As you can see, for the 3rd quarter 2015, we reported net income of $56.7 million or $1.40 per share compared to the 3rd quarter of 2014 with a net income of $52.5 million or $1.30 per share. Third quarter results were primarily due to hotter than normal weather in our service area. At this time, I'll turn the call over to Nathan to provide the details behind these earnings for the quarter.

Nathan Hirschi: Thanks Tom. Please turn to slide 4 and I'll walk you through the key earnings drivers for the third quarter.

Beginning with the positive earnings drivers, net income during the quarter was positively impacted by increased retail non-fuel base revenues, which resulted in increased earnings per share of $0.23. We believe, the hotter weather experienced in our service territory was responsible for the lion's share of the increased non-fuel base revenues during the quarter. Investment and interest income also had a positive effect on the earnings due to the further diversification of our Palo Verde decommissioning trust fund equity portfolio. The diversification of the trust fund increased earnings per share by $0.07 for the quarter.

Turning to the negative earnings drivers, we experienced a decrease in earnings per share of $0.06 resulting from decreased AFUDC due to lower balances of construction work in progress mainly due to Montana Power Station Units 1 & 2 and the Eastside Operations Center being placed in service during the first quarter of 2015. Earnings declined by $0.03 per share due to increased interest accrued on our $150 million senior notes issued in December 2014. Earnings were also negatively impacted by $0.03 per share due to increased depreciation and amortization expense due largely to Montana Power Station Units 1 & 2, and the Eastside Operations Center being placed in service during the first quarter of 2015. Higher Palo Verde operations and maintenance expense reduced third quarter earnings by $0.03 per share. In addition, a decrease in proxy market prices due to a decline in the price of natural gas had a negative impact on deregulated Palo Verde Unit 3 revenues resulting in a $0.02 per share reduction during the quarter.

If you'll now turn to slide 5, I would like to discuss the significant impact hot summer weather had on our third quarter results.

As I mentioned earlier, the higher earnings were primarily driven by weather. The third quarter of 2015 had the second hottest quarter recorded in our service territory in the last 20 years in terms of cooling degree days. In El Paso specifically, cooling degree days for the third quarter of 2015 were 22 percent higher than the same period in 2014 and were

15.9 percent higher than the 10 year average. We experienced 71 days in a row during the quarter where the maximum temperature exceeded 90 degrees, and 8 days during the month of August where the temperature hit 100 degrees. In addition, the level of cooling degree days for El Paso recorded during the month of September was the highest level observed dating back to 1943.

Turning to slide 6, we have provided a comparative analysis of the changes in retail non-fuel base revenues and megawatt hour sales by customer class for the 3rd quarter of 2015 compared to the same period in 2014. Total retail non-fuel base revenues increased by 7.7 percent while total retail megawatt hour sales increased by 7.0 percent during the quarter. Revenue for the residential customer class increased by $9.5 million or 11.7 percent, primarily due to the hot summer weather. Small commercial and industrial customers are also sensitive to weather and recorded a 3.0 percent increase in revenue and a 3.4 percent increase in megawatt hour sales. Retail non-fuel base revenues from large commercial and industrial customers increased by 11.7 percent, while public authorities class also increased revenues by 4.7 percent during the quarter. In summary, we experienced an increase in revenues from all of our customer classes compared to the same period last year. Our consistent customer growth was also a contributing factor to the increases in revenues and sales. During the quarter, the number of retail customers increased by 1.4 percent over the same period in 2014.

Turning to slide 7, in terms of our capital requirements, we expended $212 million for additions to electric utility plant in the nine months ended September 30, 2015. Through this same period, the Company paid $35.1 million in quarterly cash dividends to our shareholders. On September 30, 2015 our liquidity was $193.5 million, which consisted of a cash balance of $12.6 million plus borrowings available on our credit facility. In total, we expect to spend $279 million for capital expenditures in 2015. We may seek to issue long-term debt in early 2016 to help fund our on-going construction program. However, we are evaluating market conditions and refining the amount and timing of our financing needs.

Now turning to slide 8, we are adjusting and narrowing our 2015 earnings guidance range to $1.95 to $2.10 per share from our previous guidance range of $1.75 to $2.05 per share. Guidance for 2015 includes the impact from hotter than normal summer weather, offset by regulatory lag expected to continue until completion of our ongoing New Mexico and Texas Rate Cases. The revision to guidance also factors in the impact of Four Corners pushing out a fourth quarter planned outage at Unit 5 into the first quarter of 2016. While beneficial to 2015, the expense associated with this outage will impact the first half of 2016 in addition to the continued impact associated with regulatory lag.

As you can see, the low end of guidance is below the year-to-date level that existed as of September 30, 2015. Given the regulatory lag that we are currently experiencing and until such time as we resolve the ongoing rate cases, it is possible that we could have negative earnings per share in the winter quarters when our revenue levels are lower.

At this time I would like to hand the call over to Mary to give a regulatory update.

Mary Kipp: Thank you Nathan. Turning to slide 9, I'd now like to provide some details on our rate case filings in Texas and New Mexico. In New Mexico, intervener testimony was filed with the New Mexico Public Regulation Commission on September 30th. We reviewed the numerous pages of the intervener testimony and filed our rebuttal testimony with the Commission last Wednesday, October 28th. Additionally, on October 28th, the Commission ruled that the Company's proposal to create a new rate class for residential customers with roof top solar systems would violate a 1999 ruling by the Commission that prevents the separation of residential customers into two classes. However, the ruling does not prevent El Paso Electric from seeking an additional charge for residential customers with roof top solar systems. The Company could still apply for a rider in a separate proceeding in order to recover the additional costs associated with serving those customers; although at this time it is too early to comment on what options the Company may pursue. The ruling handed down by the New Mexico Commission will not likely impact the request filed in our Texas Rate Case. Our general rate case hearing should be done in mid-November and we still anticipate rates to become effective early 2nd quarter 2016.

In Texas, the deadline to file for intervention passed on September 25, 2015, and we are currently responding to numerous requests for information as part of the discovery process. The next milestone in the Texas rate case process is December 11, which is when intervener testimony is due to be filed with the Commission. Based on the current procedural schedule, a hearing on the merits is scheduled to begin on January 26, 2016. If you'll now turn to slide10, you'll see a detailed timeline proposed for both the Texas and New Mexico Rate Cases.

Before I review slides 10 and 11, I'd like to point out that the following timelines contemplate fully litigated rate case proceeding in both jurisdictions. However, historically we've worked with our interveners and regulators to settle our rate cases and continue to be open to exploring the settlement option in our rate case proceedings. As you can see on the timeline, we anticipate hearings to begin in New Mexico on November 16, 2015 and we anticipate that a potential decision by the Commission could be reached by January 2016. New Mexico has the ability to suspend the effective date of rates another three months, which would allow for a final decision and implementation of new rates to occur early in the second quarter of 2016.

The timeline for our Texas Rate Case includes a relate-back provision, which was signed into law in June and informally known as House Bill 1535. As the timeline reflects, we anticipate hearings to begin in Texas on January 26, 2016. Based on that hearing date, we anticipate the final order to be released in Texas by early second quarter 2016, similar to New Mexico. However, by applying the provisions available under House Bill 1535, rates in Texas could become effective on the 155th day after the rate case was filed. This would allow El Paso Electric to relate back the approved rates to January 12, 2016. The relate back provision would allow the Company to surcharge customers in Texas for an amount reflective of the new rates dating back to January 12th. If approved, the surcharge could be implemented over a period not to exceed 18 months.

House Bill 1535 helps to reduce regulatory lag while also preserving a municipality's original jurisdiction over electric rates. We remain focused on working with all regulators and stakeholders throughout the entire process to ensure the successful and timely execution of our regulatory strategy.

Turning to slide 11, we've illustrated a potential timeline for our next round of rate changes in Texas and New Mexico. Montana Power Station Unit 3 should come online in May of 2016 in time for the summer peak as Tom said. Montana Power Station Unit 4 will not be far behind, with an expected in service date of December of 2016. We anticipate filing new rate cases in Texas and New Mexico in the first quarter of 2017 using an historical test year ended September 2016.

House Bill 1535 not only established a relate back provision, but it also created new guidelines for post-test year adjustments. The new regulations in Texas allow for post-test year adjustments up to 30 days before a rate case filing, which will allow us to include Montana Power Station Unit 4 in the filing so long as the plant is in service before the new rates to into effect.

In Texas, our expected timeline anticipates a final order by the fourth quarter of 2017. Applying the relate back provision would allow for new rates to become effective in the second quarter of 2017. In New Mexico we anticipate that new rates could become effective by the first quarter of 2018.

With regard to future rate cases, we believe it would be premature to anticipate or discuss the amount of rate relief we would file for at this time. In fact, a final decision regarding the size of rate relief for our future rate cases will be largely dependent on the results of our current rate cases.

Before we wrap things up today I wanted to take a moment to recognize the exceptional leadership Tom Shockley has provided to the Company since his appointment as CEO by the Board back in 2012. Under Tom's leadership the Company has been able to refocus its efforts on improving relationships with our regulators and other stakeholders. He also guided the Company through a significant and challenging construction program to meet the needs of our growing community. Tom has also been instrumental in planning and preparing for the future by keeping the Company focused on providing safe, affordable and reliable service to our customers. On a personal note, I want to thank Tom for sharing his wisdom and experience with me and the other members of this team.

This will be Tom's last earnings call as CEO of El Paso Electric and I know I speak for everyone at the Company when I say we will all truly miss his day-to-day leadership and expertise that spans 45 years in the electric utility industry. Tom, I want to thank you for your dedication and commitment to El Paso Electric and we all look forward to continuing to work with you as a member of our Board of Directors.

At this time I will now turn the call back over to Lisa who will open the call up for questions.

Lisa Budtke: Thanks Mary. This concludes our third quarter 2015 earnings presentation. Aaron please open the call up for questions.

Operator: Absolutely. If you would like to ask a question at this time please signal by pressing star 1on your telephone keypad and if you're using a speakerphone please be sure that the mute function is turned off to allow the signal to reach our equipment and again that is star 1to ask a question at this time.

We'll go first to Anthony Crowdell with Jefferies.

Anthony Crowdell: Good morning, just a couple questions. First how much of the $0.23 benefit in revenues do you believe is related to growth?

Nathan Hirschi: Obviously our customer growth has been at a consistent level of 1.4 percent. So the vast majority of it is weather, although there is some component that does relate to the consistent customer growth in the 1.4 percent range.

Anthony Crowdell: But you guys have not quantified the portion that's growth in that $0.23?

Nathan Hirschi: No we're not minimizing the fact that it is largely weather. It was an excellent quarter from a weather perspective and we're not trying to minimize that amount.

Anthony Crowdell: Industrial sales, just given the hot temperature and everything else, I believe industrial sales declined 2.2 percent. What was the driver behind your decrease in large C&I customers?

Nathan Hirschi: Well, that's just the individual usage on the customers and it did relate to a couple of those smaller C&I's that reduced their operations this year. The revenues came from some interruptible penalties that were paid during the quarter. So we had a higher level of revenues this quarter than the kWh because of some interruptible penalties that were paid during the quarter.

Anthony Crowdell: But you've sold lower kWh this quarter than last quarter for large C&I's, is that correct?

Nathan Hirschi: Yes, a couple of those C&I customers reduced their usage.

Anthony Crowdell: Okay. I guess in New Mexico I don't want to call it a setback, but you had the ruling regarding setting that separate class up and I believe you are also requesting a solar or a separate charge for solar customers in Texas. You also introduced a new intervener that previously was not involved in rate cases in Texas for El Paso Electric. Do you think that's going to present some challenges also in Texas?

Mary Kipp: Anthony, this is Mary. We have a very different political climate in Texas compared to New Mexico and as we've always said we firmly believe that states have the right to set their own public policy. But we don't expect a result in Texas similar to that in New Mexico.
Additionally the law is written in a very different way in Texas.

Anthony Crowdell: Okay and Nathan you spent about three seconds on hinting that you may see a negative, was it quarterly or first half earnings in '16?

Nathan Hirschi: Just quarterly. I just wanted to make the point that we've always had relatively low earnings in the first and fourth quarters and until we get this rate relief structure finalized, we could be in a break-even or a slight negative in the first and fourth quarter.

Those two quarters could be in the break even range and we have typically seen our earnings shifted more heavily to the summer months and that's what we've seen in the last couple of years. I just didn't want to make sure we all understood it could be in the position that we are break even or a slight loss in the first and fourth quarters until we get these new rate cases resolved.

Anthony Crowdell: What's the impact? I apologize, I thought it was Four Corners or one of the fossil plants you had shifted an outage to the first quarter. Have you guys quantified the impact of shifting that into the first quarter of next year?

Nathan Hirschi: Yes it's about a $3 million outage. It's a major outage. So it's about $3 million.

Anthony Crowdell: Great thanks and Tom congratulations on retirement.

Tom Shockley: Thank you.

Nathan Hirschi: Thanks Anthony.

Operator: We'll go next to Brian Russo with Ladenburg Thalmann.

Brian Russo: Hey good morning.

Mary Kipp: Good morning.

Brian Russo: Just on the 2015 guidance and the increase of the mid-point, from $1.90 to $2.03. If the Four Corners outage is $3 million or roughly $0.04 of EPS would the balance of the increase in the mid-point be associated with the impact of weather above normal?

Nathan Hirschi: Yes I mean it was largely the weather that moved it up.

Brian Russo: Okay. And why did you postpone the Four Corners outage?

Nathan Hirschi: We are only a minority participant. We only own 7 percent of those units so it was not our decision as much as it was the operator's decision to do that.

Brian Russo: Got it, understood. And, when we look at your dividend policy and the trajectory of your potential earnings power is the goal to stay within that 50 to 60 percent payout target for the next several years or is there a scenario where it could dip below that until, after MPS 3 and 4 are in operation and you get recovery in rates?

Nathan Hirschi: Yes, obviously as the earnings have declined this year it will be a larger payout percentage than what we've seen in the past. But we're going to wait until the rate cases are resolved and then we will make some substantial progress before we really re-address that, but we said our long-term goal is to get to a payout ratio consistent with our peer averages; which we believe is in the 60 percent payout ratio range and that's our longer-term goal.

Brian Russo: Will you wait until the second round of rate cases to be finalized or the first round of rate cases to be finalized?

Nathan Hirschi: We address in May of each year as part of the annual meeting, so we won't wait until the 2017 to re-address it. How much action we'll make before that depends on how the rate cases go and re-address in the May timeframe.

Brian Russo: Okay. And, when we look to '17 and you kind of have a similar scenario as you do in '16 where you have net plant expenses hitting the income statement prior to, the timing of when new rates go into effect. When we look at '17 and the lag related to MPS 3 and 4, it's really just depreciation and then lower AFUDC, correct?

Nathan Hirschi: That's right. The amount of O&M that's going to come on line with the two additional units at Montana is not nearly as significant as it was when the first two units were brought online.. And of course the amount of CAPEX that we're bringing out in that 2017 timeframe is much lower than what we saw in 2015. ,

Brian Russo: All right, great. And when I look at slide 9 on the Texas rate case,, the timing of intervener testimony, when if at all will we get any filings or position from the city council? Were they interveners?

Mary Kipp: Yes. We have kind of a dual role in our rate case in Texas. This is Mary. Actually, we filed a rate case with them at the same time that we filed it with the PUCT, but at the same time if we were to go all the way to the PUCT, if we weren't able to settle it, they become a party there and its de novo review by the Texas Commission.

Tom Shockley: All the interveners have obligation to file their testimony.

Brian Russo: Oh so they will...

Tom Shockley: Yes, December 11th.

Mary Kipp: Sorry if I'm answering the wrong question. It says December 11th is the date that intervener testimony is due.

Brian Russo: So city council will file their position on December 11th?

Mary Kipp: Yes.

Brian Russo: Okay, got it. Then, post MPS 3 and 4, I mean any thoughts on, longer term generation needs to meet incremental growth?

Nathan Hirschi: Yes currently our long term forecast has our next combined cycle coming in 2022, but of course that's a fair way out and that's still subject to change. So we were going to anticipate that the CAPEX associated with that will come in in the five years before that. But still that would be the next round of generation that we currently anticipate. Of course that's subject to change based on load growth and other determinants.

Brian Russo: And how many megawatts do you think that will be?

Nathan Hirschi: Two hundred eight one megawatts.

Mary Kipp: That's right, 281 megawatts.

Brian Russo: Great. Thank you very much.

Operator: Just as a reminder everyone that is star 1 if you'd like to ask a question at this time. We have no questions holding in the queue at this time.

Lisa Budtke: Okay. I would like to thank everyone again for joining us on today's call. We look forward to seeing you next weekend at EEI. Have a great day and be safe.

Operator: This does conclude today's conference everyone. We thank you for your participation. You may now disconnect.

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