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 3rd Quarter Earnings Call. Today's conference is being recorded. At this time I would like to turn the conference over to Mr. Steven Busser. Please go ahead.

Steven Busser: Thank you Mark and good morning everyone and thank you for joining the El Paso Electric Company third quarter 2012 earnings conference call. Also on the call with me today I have our CFO Tom Shockley and our CFO David Carpenter.

Today we'll provide an overview of our third quarter and year to date 2012 financial performance. We will also discuss our earnings guidance and capital requirements. Before we get started I would like to cover some items that will be pertinent to our call today.

You should have a copy of our press release and if you do not, you can obtain one on our website on the Investor Relations page. We currently anticipate that our third quarter 2012 form 10-Q will be filed with the SEC on or before November 6, 2012. We also have two upcoming IR events.

First we will be attending the Edison Electric Institute Conference in Phoenix, Arizona from November 11 through November 13, 2012. Also, we are pleased to announce that we will be in New York City to ring the opening bell on the New York stock exchange for our 10th anniversary on December 4, 2012.

The following day, December 5, 2012, we are planning an Analyst Day at which time we plan to discuss the El Paso economy as well as announce our 2013 earnings guidance and our plans for future capital expenditures. We will provide more details in the future via ee-mail and through our website as they become available. Please feel free to call our Investor Relations department if you have any questions or require further information.

A replay of today's call will be available shortly after the call ends and will run through November 15, 2012. The details as it relates to the replay are disclosed in our press release. I would now like to cover the Safe Harbor provisions before I turn the call over to Tom Shockley.

On page two 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 the 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 and 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. At this time I'd like to turn the call over to our CEO, Tom Shockley.

Tom Shockley: Thank you, Steve. Good morning and thank you for joining our call. This is Tom Shockley, CEO of El Paso Electric.

If you will now turn to slide 3 of the presentation, I would like to go over our third quarter highlights. Starting with earnings, I'm pleased to announce that for the third quarter of 2012, we reported $1.29 per basic share compared to the third quarter of 2011 when we earned a $1.41 per basic share.

For the nine months ended September 30, 2012, we have earned $2.15 per basic share which compares to $2.33 per basic share for the same period last year. David Carpenter will discuss earnings in more detail later in the call.

Detailed on slide three you will see the Palo Verde Unit 2 recorded the best performance in plant history with a 518 consecutive day run from the spring of 2011 refueling outage to the current ongoing fueling outage that began in early October 2012. The focus at Palo Verde continues to be the safe and efficient generation of electricity and we are proud of the recent performance at Palo Verde.

Another highlight for the quarter was that on August 28, 2012, we completed the refinancing of our 2002 Farmington and 2005 Maricopa County Series A Pollution Control Bonds in the aggregate amount of $92.5 million. The refinancing of the Pollution Control Bonds will result in an annual savings of approximately $1.1 million.

The coupon on the Farmington Pollution Control Bonds was lowered to 1.875 percent from 4 percent and the coupon on the 2005 Series A Maricopa Pollution Control Bonds was lowered to 4.5 percent from 4.8 percent. The Maricopa bonds were also extended by two years until 2042 and both bond issues remain unsecured.

I am also very pleased to announce that on October 23, 2012, the Board of Directors declared a quarterly cash dividend of $0.25 per basic share of common stock payable on December 28, 2012. We anticipate paying out $38.9 million in dividends this year and continue to target a 45 percent payout ratio, which reflects our commitment to return value to shareholders and to balance the capital structure.

I would now like to turn he call over to David Carpenter.

David Carpenter: Thank you Tom and good morning everyone.

I would like to start on slide 4 of our presentation by discussing the main earnings drivers in the third quarter of 2012 compared to the third quarter of 2011.

As Tom mentioned briefly earlier, for the third quarter of 2012 we reported net income of $51.8 million or $1.29 per basic share compared to third quarter of 2011 net income of $58.3 million or $1.41 per basic share. We view three earnings drivers as most significant in the quarter.

First, on the positive side, increased capitalization of allowance of funds used during construction or AFUDC increased quarterly earnings by $0.04 per basic share. The higher AFUDC is driven by higher balances of construction work in progress primarily as a result of the construction of our next generating unit, Rio Grande 9, which is a General Electric LMS 100 gas turbine peaking unit scheduled to come online by May 1 next year.

Second, on the negative side, we saw a decline in basic earnings per share in the quarter of $0.13 resulting from an expected reduction in non-fuel base revenues. The revenue reduction was driven by decreased kWh sales in all customer classes due to a return to normal summer weather in 2012 as compared to hotter than normal weather in 2011 and a reduction in non-fuel base rates as a result of the Texas rate case settlement we entered into earlier this year.

I will discuss the drivers behind the reduction in non-fuel base revenues in more detail a bit later on in the presentation. The third and final primary earnings driver for the quarter was the recognition of the settlement of a transmission service dispute with Tucson Electric Power which resulted in a $4.5 million one-time revenue adjustment in the third quarter of 2011 without any offsetting amounts in the third quarter of this year.

As a result, third quarter 2012 earnings were $0.06 per basic share lower than the third quarter of 2011. Other earnings drivers for quarterly earnings are outlined in our Earnings Release.

The key earnings drivers for the first nine months of 2012 are detailed on slide 5. For the nine months ended September 30, 2012, we posted net income of $86.0 million or $2.15 per basic share, compared to net income of $98.1 million or $2.33 per basic share for the nine months ended September 30, 2011.

Once again, much like the quarterly earnings drivers, expected reductions in retail non-fuel base revenues accounted for approximately $0.09 per basic share or 3.7 million in decreased earnings after tax. I will go into a more detailed explanation of the reduction in non-fuel base revenues on the next slide.

Also during 2012 we have seen a reduction in deregulated Palo Verde 3 revenues we collect from New Mexico customers which reduced earnings per basic share by $0.07. This is primarily the result of lower gas prices which have resulted in lower proxy prices for power provided from Unit 3. The output of Palo Verde Unit 3 is also down this year as a result of a refueling outage earlier this spring while Palo Verde Unit 3 did not have a fueling outage in 2011.

Earnings were also negatively impacted by $0.14 per basic share due to increased operation and maintenance expenses. Operation and maintenance expenses increased as a result of higher pensions and benefits expenses and higher operation and maintenance expenses at our fossil fuel plants.

For pension and benefits expense, this increase is the result of lower discount rates used to determine pension and other postretirement benefit costs in 2012 as compared to 2011. In terms of fossil fuel plant O&M expense, we saw an increase in those amounts due to increased scheduled maintenance at our Rio Grande Unit 8 and Newman power plants.

Offsetting these decreases was the effect of the share repurchases we made last year which reduced the outstanding share count and increased earnings in 2012 by $0.10 per basic share.

If you will now turn to slide 6, I would like to go over the changes in revenues and sales by customer class for the third quarter and first nine months of 2012 compared to the same periods for 2011.

In the third quarter of 2012, both megawatt-hour sales and revenues declined in all customer classes. The reductions are attributable to the combined effects of both a return to more normal summer weather and the Texas rate case settlement.

In terms of weather during the third quarter of 2012, while cooling degree days were close to normal, they were 16.2 percent lower than the same period in 2011. The effects of the return to normal weather in the third quarter of 2012 resulted in an estimated $8.0 million reduction in revenues. The Texas rate decrease resulted in an estimated $5.4 million reduction in revenues.

Excluding the effect of weather and the Texas rate reduction, we still saw solid underlying growth and non-fuel base revenues in the quarter due to growth in kilowatt-hour sales.

For year-to-date sales and non-fuel base revenues, we have seen growth in residential megawatt-hour sales and revenues despite a 9.5 percent reduction in cooling degree days. As can also be seen on this slide, non-fuel base revenues for the year-to-date period for the small and large commercial and industrial customer classes decreased.

These decreases are primarily the result of the reduction in rates for those customer classes as a result of the Texas rate decrease implemented on May 1st of this year. In total, year-to-date, despite the more normal weather in 2012, we have seen an increase of approximately 0.08 percent in megawatt-hour sales and including the effects of the rate decrease have only seen a 1.3 percent decrease in non-fuel base revenues.

We are pleased with these results and believe that they are further indication that we continue to see good underlying growth in our service territory on a weather normalized basis. In addition, we continue to see growth in megawatt-hour sales from the public authorities' class, including increased sales to Fort Bliss, which has grown 2.2 percent for the year-to-date period.

As a reminder, Fort Bliss has a current active duty soldier population of approximately 30,000 troops with approximately 67 MW's of load and is currently constructing a new $1 billion hospital complex.

On slide 7, you can see a comparison of weather. Even though cooling degree days were lower for the quarter and year-to-date compared to the prior year, we still experienced hotter than average weather primarily in the second quarter of 2012. For the quarter, cooling degree days were only 1.4 percent higher than the ten year average. And on a year-to-date basis cooling degree days were 7.9 percent higher than the ten year average.

Additionally, we continue to see robust customer growth, which for the year-to-date period has been 1.4 percent.

Now turning to slide 8, we have revised our 2012 earnings guidance to a range of $2.20 to $2.40 per basic share from the previous range of $2.10 to $2.45 per basic share. Now that we are through the summer cooling season and know the effects of summer weather on our revenues, we have reduced the range of possible outcomes. The tightening of the range in terms of possible outcomes for revenues had the effect of increasing the bottom end of the range by $0.10 from $2.10 to $2.20 per share. Conversely, it had the effect of lowering the top end of the range by $0.05 from $2.45 to $2.40 per share. The $0.20 range primarily reflects the potential for weather related revenue variances in the fourth quarter.

If you could now turn to slide 9, I will cover our capital requirements and our liquidity position. In terms of our capital requirements, we expended $144.6 million for additions to electric utility plant in the first nine months of 2012. We anticipate that capital expenditures will be approximately $220.7 million for construction in 2012. Dividend payments to our shareholders totaled $28.9 million for the first nine months of 2012 and $10.0 million for the third quarter.

Our cash balance of $8.7 million at September 30, 2012 along with our revolving credit facility provided us with liquidity of approximately $246.7 million at September 30, 2012. We anticipate issuing long-term debt in the form of senior notes within the next twelve months to repay short-term borrowings and for future construction of electric plant.

We believe that we will have adequate liquidity through our current cash balances, cash from operations, and available borrowings under the RCF to meet all of our anticipated cash requirements for the next twelve months.

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

Steve Busser: Mark at this point we normally take questions from those who have them.

Operator: Thank you very much and for the members of our telephone audience, if you would like to ask a question today you can do so by pressing star one on your telephone keypad. If you are using a speakerphone please insure that your mute function is off so we can receive your signal. And if you signaled earlier, please re-signal so we can receive that.

Again, star one for a question.

Our first question comes from Michael Klein of Sidoti & Company.

Michael Klein: Good morning.

Group: Good morning Michael.

Michael Klein: Looking at the C&I Small customer category, it looks like you lost a few customers in the quarter. Is that a normal course of business or is there anything more to that?

David Carpenter: Michael, I really view this as a normal course of business and when you look at C&I Small you can have a month to month variation. So what I really look at, is the average growth in customers on a quarterly and year-to-date basis which has generally run about 1.4 percent overall.

Michael Klein: Okay.

Sticking with that theme for a second, how would you characterize the overall business environment in the El Paso region and do the trends show some sort of a pickup from the last time we spoke?

David Carpenter: The business environment in El Paso continues to be fairly strong. Personally I think what we are seeing right now is a little bit of a hold up. I know we have a number of potential prospects that are looking at moving into El Paso but I believe a lot of decisions are being held off until after the election.

So I think where we'll really see what the business climate is like is after the election and people start making decisions on expansions.

Michael Klein: Okay and I guess my last question might be tied into that as well, but any update on some of the military moving back to Fort Bliss that you spoke about on the previous conference calls?

Steven Busser: Michael, at this point there is a unit actively deploying to Iraq and I'm not aware of any other shift other than that. Tom you might have an update there as well.

David Carpenter: I don't think it's been officially announced.

Steven Busser: There are some things as it relates to the military base that are in progress as we are aware of but haven't been officially announced.

Michael Klein: Okay, thanks a lot.

Operator: Next we'll hear from Neil Mehta of Goldman Sachs.

Neil Mehta: Good morning.

Steven Busser: Good morning Neil.

Neil Mehta: Good morning. The first question relates to rate case timing. Are you thinking about the next time you need to file in both Texas and New Mexico?

Tom Shockley: Yes, Neil as we mentioned in the last call, what we really have been looking at is what is the best timing for our rate case. We think that right now we can put off filing a rate case until 2014, although I'd still say that a final decision has not been made. The primary reasons for wanting to put a rate case off until 2014 is to get in the Montana plant or the next plant that we filed for certificate to convene to necessity in both Texas and New Mexico and because that's a Greenfield plant site, you not only have the cost of the unit which would be a similar unit to Rio Nine but you also have significant cost for common facilities plus you have to staff up a new plant site. You don't have existing staff in which to operate the plant.

So as we look at it, if we can delay the rate case past 2013 to 2014, we'll have a much stronger case and it will put us on a much more solid footing going forward as we add additional units to the Montana plant site.

Neil Mehta: The second question's is on the dividend, can you continue to have a below average payout ratio at 45 percent or so. How are you thinking about moving that as you look forward or given the size of your CAPEX program, is that something that you'd look to keep relatively constant?

David Carpenter: Right now we expect to keep the payout ratio fairly constant. Certainly there will be some variations around that, but we have a pretty significant construction program as we look at 2013 and 2014. And so I really believe that to see any kind of significant movement in the dividend would be after we kind of get through the meat of our construction program.

Neil Mehta: Then finally David on depreciation in your first quarter earnings slide you provided the depreciation run rate for 2012 through 2014. Is that still the right depreciation expense assumption to use for the next few years?

David Carpenter: Right. Remember we reduced the depreciation rates with the rate decrease in Texas and so really kind of the run rate that you'd want to look at is what it was for the third quarter and that would be a run rate that you should be able to expect going forward.

Neil Mehta: Great. Thank you very much.

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

Brian Russo: Good morning.

Steven Busser: Good morning Brian.

Brian Russo: Any thoughts on the Barack Obama's initiatives and the presidential elections and potential, military budget cuts going forward. Do you know if that will have any impact on that initiative or is it independent?

David Carpenter: Right. We have not heard any announcements of any significant changes at Fort Bliss and really we don't expect to see anything. There may be some small changes, but Fort Bliss is probably less likely to see any significant changes because of the recent expansion and all of the new facilities that have been added out there. If anything, it has the potential to take on more troops and activities more easily than in many other bases.

Brian Russo: Okay, I just noticed that the number of retail customers at the end of the period, for other public authorities is essentially flat in the third quarter 2012 over third quarter 2011. How does it play in with the whole Barack Obama initiative? I mean are those customers there and does it show up in megawatt hours versus new customers?

David Carpenter: Yes that's correct. It really does insure up the new customers. You only have maybe a couple of customers related to Fort Bliss. So the expansion that you see there is really not adding new customers its adding load. A lot of the variation in customers that you see and the public authority's class is public housing related and so they're small customers. They're not significant drivers of the class to begin with.

Brian Russo: Okay and you mentioned that you expect solid organic with a normalized load growth to continue. Is 2 to 2.5 percent annual sales growth a reasonable assumption?

David Carpenter: Yes. We continue to think that's a reasonable assumption going forward.

Brian Russo: Okay and you mentioned that you'll likely issue debt in the next 12 months. Can you give us a better sense of the timing when that might occur and the amount?

David Carpenter: Well we can give you some ideas. Certainly we think that we would need some debt probably by the end of the first quarter. But really we could issue the debt any time between now and then really to take advantage of the markets and obviously the markets are in very good shape right now and we expect to probably issue 100 to $150 million of debt.

Brian Russo: Okay. Thank you very much.

Steven Busser: Thanks Brian.

Operator: And next we'll hear from Anthony Crowdell of Jeffries and Company.

Anthony Crowdell: Good morning. Just a couple of quick questions. What was the weather impact for the quarter I missed it. Was it $8 million or $8.5 million?

David Carpenter: It is $8 million for the quarter.

Anthony Crowdell: And when we try to think about the fourth quarter I look at a customer rates with the settlement impact in May, and when I compare fourth quarter 2012 to fourth quarter 2011, is the customer's rate lower in 2012 than in 2011 because I wasn't sure there's seasonality to the settlement agreement.

David Carpenter: Yes. The rates will be a little bit lower in the fourth quarter than the fourth quarter of last year. It was a little bit more heavily weighted to the summer. Our expectation I think is about $3.3 million impact on revenues for the quarter.

Anthony Crowdell: Okay and lastly, I don't know if you guys have calculated what either your year to date, your first nine months or trailing 12 month ROE for your Texas jurisdiction?

David Carpenter: We really don't have a calculation of that. So, it's a number that is not easily calculated because of the allocations between the jurisdictions and we just have not calculated it.

Anthony Crowdell: Alright, great. Thanks for taking my questions.

Operator: As a reminder if you would like to ask a question today, star one on your telephone keypad.

And our next question will come from Chris Shelton of Millennium Partners.

Chris Shelton: Good morning. Can you hear me?

Steven Busser: Yes Chris. How are you?

Chris Shelton: Good. Quick follow-up on Palo Verde I think you said you have one extra outage this year versus last year or can you just reiterate what you were saying on that?

Steven Busser: Yes, sure. It's really the timing of the outages and the units. Remember Palo Verde Unit 3 is the only unit that has a piece that's deregulated and we have a pricing based on market price. So Unit 3 is refueled every 18 months and it just so happened that in 2011 there was no refueling outage for Unit 3. For 2012 there was a spring refueling outage and for 2013 there'll be a fall refueling outage.

For all three units there are two refueling outages each year, one in the spring and one in the fall.

Chris Shelton: That's for Units 1 and 2 in the spring and fall, right?

Steven Busser: One, two and three. If you look at all three units together, there's always going to be a spring and a fall refueling outage. But if you look at just Unit 3 by itself then every third year there will be no refueling outage.

Chris Shelton: Okay, understood.

And then just an update, I had seen a story on Unit 3 on an outage. Was it planned or can you give an update just on Unit 3 currently?

Tom Shockley: This is Tom and the information that we have is that it was not planned and it was taken down to repair the unit and it's expected to be back up any day now.

Chris Shelton: Okay. So fairly minor?

Tom Shockley: Yes.

Chris Shelton: Okay, great. That was it. Thank you very much.

Steven Busser: Thanks Chris.

Operator: Again as a reminder star one for a question.

Next is Tim Winter with Gabelli & Company.

Tim Winter: Good morning. I wanted to see if you could follow-up a little more on planned rate case activity. It's been a while since you visited the regulators in New Mexico. What is your current plan there?

David Carpenter: Right now we don't have any plans to file a rate case in New Mexico. You had a little bit different situation there and so we have no firm plans to file a rate case. If we do file one I think it would be after our Texas rate case in 2014.

Tom Shockley: I would add to David's comment that we have not visited them in the context of rate relief, but we continually visit with them and make sure they're aware of what we're doing as a company and activities that we have going on.

Tim Winter: Absolutely. It sounded like the Air Force Training Center, may be close to an announcement. Can you remind us what the potential size of that training center is and what it means for you guys?

David Carpenter: Sure. What it would be is that if they consolidated the security training, it would be about 200 to 300 permanent employees at the base plus you would have 10,000 air force troops being trained each year. So you would have, a three month training and you'd have 2500 additional troops stationed at the base on kind of a consistent basis compared to what you have now.

Tim Winter: Okay. And will we still expect something by the end of the year there?

David Carpenter: We thought it would be announced by now, but I would certainly think by the end of the year.

Tim Winter: Thank you.

Steven Busser: Thank you Tim.

Operator: And at this time we have no further questions in the queue. I will turn the conference over to our host for any closing or additional remarks.

Tom Shockley: This is Tom and again thanks for everyone attending. As I know all of you are concerned about issues on the east coast. We are as well. We have sent employees and hopefully they can be helpful in restoring power in that area as quickly as possible. I know that virtually every utility is concerned in doing what they can to help that situation.

Steven Busser: Thank you everybody for joining us. We look forward to speaking with you at EEI. Have a great day.

Operator: And that does conclude today's conference call. Thank you for your participation.

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