EL PASO ELECTRIC CO.
Moderator: Lisa Budtke
November 1, 2017

Operator: Good day, everyone and welcome to the El Paso Electric Company Third Quarter 2017 Earnings call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Lisa Budtke. Please go ahead.

Lisa Budtke: Thank you, Audra. Good morning everyone. Thank you for joining the El Paso Electric Company's Third Quarter 2017 Earnings Conference call. My name is Lisa Budtke and I'm the Director of Treasury Services and Investor Relations for El Paso Electric. On the call today are President and CEO, Mary Kipp; CFO, Nathan Hirschi and other members of Senior Management.

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 2017 Form 10-Q will be filed with the Securities and Exchange Commission (SEC) on or before this Friday, November 3, 2017.

We would also like to inform you that, we will be attending the EEI Financial Conference on November 5th through 7th in Lake Buena Vista, 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 15, 2017. 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 will 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 risks and other factors that may causes 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 filings. Our 10-Q and other SEC filings contain our forward-looking safe harbor statements and also layout 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 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 risks and uncertainties that are difficult to predict. I will now turn the call over to Mary.

Mary Kipp: Thank you, Lisa. Good morning and thanks for joining our call. Before I begin, I'd like to take this opportunity to thank our crews who traveled to Titusville, Florida last month, to assist with power restoration efforts in the wake of Hurricane Irma. We were very happy to partner with Florida Power & Light and were proud of our employees' efforts as they helped to restore electricity to many Floridians who were impacted by the storm.

On slide 3, I'll go over some of our recent highlights. The parties in our 2017 Texas rate case are working towards agreeing to formally support or not to oppose the final terms of the settlement. After this formal agreement is obtained and the settlement documentation is executed we will file the agreement with the Administrative Law Judges, along with a request that they return the case to the Commission for final approval.

We anticipate a final order will be issued by the Commission during the fourth quarter, which will allow us to recognize the financial impacts of the settlement including revenues relating back to July 18, 2017.

Recently, we filed a request to reduce our existing Texas fixed fuel factor by 19 percent to reflect lower estimated fuel and purchased power costs. The filing affects the fuel portion of rates for Texas retail customers and does not affect non-fuel base rates. The decrease in the Texas fixed fuel factor became effective beginning with the November 2017 billing month and will continue thereafter until changed by the PUCT.

I'm also pleased that we're taking another step forward to meet the growing energy needs of our community in a smart, environmentally responsible, and cost effective manner with the construction of a five megawatt solar project at Holloman Air Force Base. We anticipate this facility will be commercially operational by July 2018. The output from this solar project will be dedicated to the base and will assist the Air Force in meeting its renewable and energy security goals. I will now continue the discussion regarding our future generation projects on slide 4.

As a result of increasing electricity demand and customer growth, we have determined that a total of 370 megawatts of additional generation resources is expected to be needed by the summer of 2023. The Company issued an all-source request for proposal on June 30, 2017, and in October the Company received about two times the number of proposals we received when we issued our last RFP for up to 400 megawatts of generating resources in 2011. That RFP yielded a 50 megawatt solar purchase power agreement and an additional 354 MW of company owned gas-fired peaking capacity.

The process of evaluating the proposals has begun and we expect to have a decision by the end of the second quarter of 2018. We will be seeking regulatory approval from the Commission in Texas and New Mexico before a final decision is made; therefore, our capital expenditures plan will have additional certainty after that time.

If you'll now turn to slide 5, I would like to briefly cover our third quarter and year-to-date financial results.

For the third quarter, we reported net income of $59.7 million or $1.47 per share compared to third quarter of 2016 results of $74.6 million or $1.84 per share. As we previously communicated, we anticipated seeing a quarter-over-quarter decrease in earnings due to the impact of the 2015 Texas rate case. Approximately $12.6 million or $0.31 per share was recorded in August 2016, which pertained to the relate-back period of January 12, 2016 through September 30, 2016.

For the nine months ended September 30, 2017, we reported net income of $91.8 million or $2.26 per share compared to $91.1 million or $2.25 per share reported in the same period in 2016.

If you'll now turn to slide 6, I will go over more detail regarding the status of our 2017 Texas rate case.

In September, the City of El Paso approved in principle, the terms of a settlement agreement and we have been working to reach an un-opposed settlement.

We currently anticipate filing the settlement in November with the Administrative Law Judges assigned to our case, along with a request that they return the case to the PUCT for approval. As a result, we expect to receive a final order in the fourth quarter.

Turning to slide 7, I will walk you through the key terms of the settlement agreement.

The agreement calls for an annual non-fuel base rate increase of $14.5 million, a return on equity of 9.65 percent, and a determination that all new plant in service was prudent and used and useful and included in rate base. Other key terms of the settlement agreement allowed the Company to recover reasonable rate case expenses, subject to Commission Staff's review and currently estimated to be approximately $3.4 million. The rate case expenses will be recovered through a separate surcharge over a three year period.

The settlement agreement also establishes baseline revenue requirements for transmission and distribution investment costs. The establishment of baseline revenue requirements will allow the Company to recover incremental T&D capital investment outside of the comprehensive base rate proceeding. Based on recent cost recovery proceedings, we can reasonably expect a cost recovery filing to be concluded within a six-month time frame. The agreement also calls for the first filing to be made no earlier than January 1, 2019.

The settlement also includes the minimum monthly bill provision $30.00 for new residential customers with distributed generation, such as rooftop solar panels. New solar customers will also be charged an $85 interconnection fee. All of our existing customers will be grandfathered.

I would also like to remind everyone that regardless of when the final order is issued new rates will relate back to consumption on or after July 18, 2017. The financial impacts, relating back to July 18, will be booked when the final order is approved.

On another note, after we finalize our 2017 Texas rate case, we plan to determine the timing of our next general rate case in New Mexico. As a reminder, we're currently required to file a general rate case in New Mexico no later than July 31, 2019.

At this time, I'll hand the call over to Nathan.

Nathan Hirschi: Thanks, Mary. Turning to slide 8, I'll now discuss the main earnings drivers in the third quarter of 2017 as compared to 2016. As Mary mentioned earlier, the third quarter of 2016 included the impact of the relate-back period of the 2015 Texas rate case. You may recall that this significantly impacted several items to be addressed in the third quarter to third quarter earnings reconciliation.

Beginning with the negative drivers, retail revenues declined for the quarter by $0.31 per share. The reduction in revenues was primarily due to the recognition of $17.2 million or $0.28 per share of relate-back revenues booked in the third quarter 2016, as a result of the final order issued in our 2015 Texas rate case, and tied to consumption from the period from January 12, 2016 through June 12, 2016.

An increase in depreciation and amortization expense resulted in a decline of $0.10 per share for the quarter. This increase was primarily due to the reduction in 2016 of $5 million or $0.08 per share resulting from changes in depreciation rates associated with our 2015 Texas rate case relate back period. The increase in depreciation expense was also related to an increase in plant, including Montana Unit 4, which was placed in service in September of 2016. A decrease in wheeling revenues and miscellaneous revenues resulted in a decline of earnings of $0.05 per share. AFUDC also reduced third quarter earnings by $0.03 per share due to lower balances of construction work in process, primarily due to Montana Unit 4 being placed in service in September 2016, and a reduction in the AFUDC rate effective January 2017. Taxes other than income taxes also caused third quarter earnings to decrease by $0.02 per share.

Turning to the positive drivers, earnings increased during the quarter by $0.05 per share primarily due to a decrease in the effective tax rate. This decrease was caused primarily because we began normalizing state income taxes in 2016 as authorized by our 2015 rate case. Other factors were a reduction in tax reserves and a reduction in state income tax rates. Earnings were also positively impacted by $0.05 per share due to a decrease in A&G expense as a result of lower employee incentive compensation. Earnings were also positively impacted by a decrease in O&M at our fossil-fuel generating plants, which added $0.04 per share to earnings. The decrease in O&M expense was related to outage costs incurred at Newman Units 4 & 5 during the three months ended September 30, 2016.

Now turning to slide 9, we have provided a comparative analysis of the changes in the average number of customers and megawatt hour sales by customer class for the third quarter of 2017 as compared to the same period in 2016. During the quarter, the average number of total retail customers increased by a healthy 1.8 percent over the same period in 2016. Although customers continue to increase, our megawatt hour sales decreased slightly by 0.5 percent over the same period in 2016. This decrease was primarily due to milder summer weather experienced in the region compared to the same period in 2016. If you'll now turn to slide 10, I'll go into more details regarding weather.

During the quarter, we experienced relatively mild weather. This is especially true compared to the heat wave we experienced last summer. For example, the high temperature in El Paso reached or exceeded 100 degrees on only seven days during the third quarter of 2017. As a comparison, we recorded 27 days during the third quarter of 2016 when the high temperature reached or exceeded 100 degrees.

Turning to slide 11, I'll briefly discuss our capital requirements and liquidity. On September 30, 2017 our liquidity was $189.1 million, which consisted of a cash balance of approximately $7.1 million plus borrowings available on our credit facility. In total, we expect to spend approximately $223 million for capital expenditures in 2017, which is net of insurance proceeds. On October 26th, our Board declared a quarterly cash dividend of $0.335 per share payable on December 29th to shareholders of record as of December 15th.

We'd like to point out that two tranches of debt totaling $83.3 million were repaid during the quarter by utilizing funds available under our revolving credit facility. We believe that we have adequate liquidity through the issuance of long-term debt, our current cash balances, cash from operations and available borrowings under our revolving credit facility to meet our anticipated cash requirements for the next twelve months.

Turning to slide 12, now that we have more certainty regarding the potential outcome of the 2017 Texas rate case, we're issuing 2017 guidance with a range of $2.30 to $2.50 per share. The middle portion of the range assumes normal weather for the remainder of the year and the financial impact of the issuance of a final order in our 2017 Texas rate case during the fourth quarter, including new rates relating back to July 18, 2017.

Currently, we anticipate providing 2018 earnings guidance, an updated capital expenditure forecast, and longer-term rate base expectations on our fourth quarter earnings call. That concludes our prepared remarks. Now, we'd like to open up for questions.

Operator: If you would like to ask a question, please press star 1 on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. A voice prompt on your phone line will indicate when your line is open. Again, that is star 1 for questions.

We'll go first to Chris Ellinghaus at Williams Capital.

Chris Ellinghaus: Hi, good morning everybody. How are you?

Nathan Hirschi: Morning Chris.

Chris Ellinghaus: Mary, can I just ask you about the settlement? The settlement is a little bit on the low side, but getting the established baseline is a positive. How do you view the settlement in the broader terms of having that DCOS capability?

Mary Kipp: Yes, we see that as a positive. As you pointed out, I think there were some expectations that the settlement might be slightly higher than it was. We're very comfortable with the actual number, 14.5 especially considering this is kind of the second of the two part rate increase and we knew though it would be a little bit of rate fatigue. We think it's really good to get this behind us. All our plants are in service. Establishing the baseline for the TCRF and DCRF which we haven't done previously, is going to be very, very beneficial to us in the future. And we also think having a good working relationship with our city is very important too. So, we're very pleased we were able to come to terms with the City of El Paso on this.

Chris Ellinghaus: Okay. I'm not sure if you mentioned the January 1, 2019 date, was that your first anticipated DCOS filing?

Mary Kipp: That is pursuant to the terms of the settlement the first day on which we can file either the TCRF or the DCRF.

Chris Ellinghaus: Okay, Nathan, it looks like weather was pretty close to normal, but did you have a number ofthe impact versus the year ago quarter, I don't recall that?

Nathan Hirschi: Yes, we didn't put that out, we think that weather negatively impacted usover prior year by about $2.5 million. Again, this quarter was about normal weather, but we really did have a very hot July last year and we had more positive weather conditions last year. So, it was about a $2.5 millionnegative year-over-year weather impact for the quarter..

Chris Ellinghaus: Pre-tax I assume?

Nathan Hirschi: Yes. That's pre-tax.

Chris Ellinghaus: Okay. Given the guidance, have you got any further thoughts on dividend policy going forward?

Mary Kipp: Yes, typically as you know, we've been looking at our dividend in connection with annual shareholders meeting in May. However, we've said that we are open to looking at it out of cycle and we're also open to doing larger increases than we have in the past. We feel very comfortable with our ability to increase the dividend as we move ahead, but like I said, no decisions have been made at this time.

Chris Ellinghaus: Okay. Thanks. We'll see you next week.

Mary Kipp: Thanks.

Nathan Hirschi: Thanks Chris.

Operator: Next, we'll move to Paul Fremont at Mizuho.

Paul Fremont: Thank you very much. I guess the first question is for the three months and six months, you had lower depreciation expense compared to last year. I'm just curious what caused the depreciation comparison to flip to negative in the third quarter?

Nathan Hirschi: Remember, last year, Paul, during the third quarter of 2016, we booked the relate-back. So we picked up lower depreciation rates going back to January 12th of 2016. So we had a big, if you would, a true-up adjustment in the third quarter of last year which reduced our depreciation expense significantly in the third quarter of last year. And of course this year, the primary driver was higher plant in service, partially because Montana Unit 4 came online in September of last year. Does that make sense, Paul?

Paul Fremont: Yes. And then the other question I have is, at this point I think in our forecast model we have you potentially not earning at your authorized return levels. Can you give us some idea as to when investors might expect that you would be able to sort of achieve your authorized returns?

Nathan Hirschi: Yes, we'll put out more specific 2018 guidance in the first quarter with our fourth quarter call. You know, we are growing pretty fast. As we mentioned on today's call, we had customer growth of 1.8 percent in the third quarter. So, we're growing fast. We're putting in $223 million of CAPEX this year, without a major generating unit coming into service. So we are growing pretty fast and that obviously keeps some constant degree of regulatory lag. We feel pretty good about our O&M, . This was a pretty good quarter from an O&M year-over-year perspective. And we've been doing a pretty good of job keeping O&M down. But it's a constant struggle, and so we're working toward that. We'll provide a little bit better guidance on that in the fourth quarter call.

Paul Fremont: Thanks a lot.

Nathan Hirschi: Thanks Paul.

Operator: And as a reminder, if you do have a question, please press star 1. We'll go next to Stuart Allan at Bank of America Merrill Lynch.

Julien Dumoulin-Smith: Hey, it's Julien here actually.

Nathan Hirschi: Hi Julien.

Mary Kipp: Hi Julien.

Julien Dumoulin-Smith: Hi, quick question. Just following up a little bit on the last one in terms of, structural ROE, can you describe a little bit of how you think about it under prospect of DCOS type structure in terms of structural lag i.e., what would be building blocks that would not allow you to earn relative to kind of the new revenue recovery mechanisms or prospectively new revenue recovery mechanism?

Nathan Hirschi: Well, even the Distribution and the Transmission cost recovery factors will be on a historic test-year basis. So as we're growing, it is going to be tough to over earn or to earn our allowed return as we're always in a historic cost space. Although, our customer growth and our usage growth will help offset that lag a bit, as the growth stage goes and the fact that we're using historic temperatures will present some challenges to get to our allowed return.

Mary Kipp: But I think in hearing in your question, cost recovery factorsdo help a lot. These will allow us to start recovering our wire spend, which is going to be most of our spend in the near-term without going in for a general rate case. But these aren't just a tracker per say, we do have to go in for an abbreviated proceeding and it is on a historic basis. Sorry about the voice I'm kind of sick today.

Julian Dumoulin-Smith: Hope you feel better. The quick question just to elaborate on that, what kind of customer growth do you think you would need to see in order to offset the lag be it because of the higher cost structure or depreciation and interest driven by the historical test year? How do you think about that just because you guys are obviously at the higher end of your peer group already in terms of that customer growth?

Nathan Hirschi: Yes, if you look back to where we were 10 years ago, we were growing with customer growth and usage growth coming in relatively close to 3 percent or a little bit below 3 percent, if you look back over a 10 year period. And that was keeping us out of rate cases at that point. And so now our CAPEX is a little bit higher nowadays and our customer growth is still about 1.8 percent, which is a little bit higher than it was a year or two ago. But still that's probably not enough to keep us out of any kind of rate cases..

Julien Dumoulin-Smith: Got it. And then lastly in terms of the RFP and the potential for new generation , can you give us a little bit of sense, what are the paths in terms of that RFP? I suppose there's a self-build option but I suppose separately you could have build on transfer. And how do you think about that ultimately playing out here?

And then, maybe secondarily, if you could comment on additional generation sources from solar, be it whether it's large scale or perhaps more likely community or direct source type projects here in the near-term. Where do you stand on those procurement efforts?

Mary Kipp: Well, we can't go into too much detail right now because we've just received the bids and are in the process of analyzing them. But I will tell you that in addition to traditional generation sources, we are seeing some solar, solar-plus storage in there, and we'll be looking very closely at those as well. But stay tuned, we should complete the analysis by the end of second quarter next year and be able to talk you more concretely.

Nathan Hirschi: And then, you're right, as Mary mentioned the Holloman dedicated solar unit, and those type of items are being looked as well as outside of this larger scale RFP.

Mary Kipp: Yes, and we've had a lot interest in those types of projects as well. So, we have a team that's looking at how we would effectively build those as well. So, stay tuned on this. There should be more talk about in the future.

Julien Dumoulin-Smith: Got it. Both on the direct sourcing and community front after this fix?

Mary Kipp: Yes.

Julien Dumoulin-Smith: Okay. Excellent. Well, thank you all very much, I appreciate it.

Mary Kipp: Thank you.

Nathan Hirschi: Thanks, Julien.

Operator: And as a final reminder if you would like to ask a question please press star 1. We'll pause just a moment. And it appears at this time there are no further questions in the queue. I'll turn the conference back over to Ms. Budtke for any closing remarks.

Lisa Budtke: Thank you all for joining us on today's call and we look forward to seeing you at EEI, Florida. Have a great day and please be safe.

Operator: And that does conclude today's conference. Again, thank you for your participation.