EL PASO ELECTRIC CO

Moderator: Steven P. Busser
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9:30 am CT

Operator: Good day everyone and welcome to the El Paso Electric Company 2nd Quarter 2013 Earnings conference call. Today's call is being recorded. Your host for today's call is Mr. Steven Busser.

Steven Busser: Thank you, Rufus and good morning everyone. Thank you for joining the El Paso Electric Company 2nd Quarter 2013 Earnings conference call. Also, on the call with me today I have our CEO, Tom Shockley, and our CFO, David Carpenter. Today we will provide an update on our 2nd Quarter 2013 and year-to-date financial performance and we will discuss our key earnings drivers. In addition we will discuss our updated earnings guidance, our anticipated 2013 capital requirements and our liquidity position.

Before we get started, I would like to cover some items that would 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 2nd Quarter 2013 Form 10-Q will be filed with the Securities and Exchange Commission (SEC) on or before August 9, 2013.

Please call our Investor Relations department if you have any inquiries or require any further information. A replay of today's call will be available shortly after our call ends and will run through August 20, 2013. The details as it relates to the replay are disclosed in our press release.

We also have two upcoming Investor Relation events. First, we'll be attending the Goldman Sachs Conference in New York later this week on August 8th. Additionally, we'll be on a non-deal road show with Jefferies & Company on September 5th and 6th in Boston and Toronto.

I would now like to cover the safe harbor provisions before I turn the call over to our CEO 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 unknown and known risks and other factors which may cause the Company's actual results and 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 statement 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 risk and uncertainties that are difficult to predict.

At this time, I would like to turn the call over to Tom.

Tom Shockley: Thank you, Steve and let me welcome all of the participants. We appreciate your attendance.

If you will now turn to slide 3 of the presentation, I would like to go over our second quarter 2013 highlights. I'd like to start out with pointing out that we have set a new native peak record of 1,750 MW's on June 27, 2013. That exceeds our previous peak of 1,711 MW's that was set back in 2011. The significant growth in our native peak load demand is a driving factor behind our need for new generation resources.

We also completed the construction of our Rio Grande unit 9 and put it into commercial operation on May 13th. Rio Grande Unit 9 is a quick start General Electric LMS 100 aero-derivative unit that is capable of ramping up very quickly and it allows us a great deal of flexibility as we are adding more solar to our system and the need to quickly start and stop additional generation is becoming very important. The state-of-the-art jet engine technology is highly efficient and will provide fuel savings for our customers as well as enhanced system reliability.

Also, I would like to point out that on May 9, 2013 our Board of Directors approved a six percent increase in the quarterly cash dividend to $0.265 per share. The dividend increase reflects our commitment to return value to shareholders and to achieve a targeted 45 percent payout ratio. The Board also recently declared a quarterly cash dividend on July 26, 2013 of $0.265 per share of common stock payable on September 30, 2013 for the third quarter.

Now, if you turn to slide 4, our initiatives for the remainder of 2013 include obtaining air permits for our new Montana Power Station. Applications for air quality permits for the new Montana Power Station are already on file with the Texas Commission on Environmental Quality and with the US Environmental Protection Agency. Hearings in the TCEQ permit application were held in early June. We anticipate receiving air permits for the new Montana Power Station late this year or early next year. Our 2013initiatives also include the negotiation of a new collective bargaining agreement. The current agreement expires in September of this year.

So with that I'll hand the meeting over to our CFO, David Carpenter.

David Carpenter: Thank you Tom and good morning everyone. I would like to start on slide 5 of our presentation. As shown, we reported net income of $29.2 million or $0.73 per basic share for the 2nd Quarter of 2013, compared to the 2nd Quarter of 2012 net income of $30.9 million or $0.77 per basic share. For the six months ended June 30, 2013, we posted net income of $36.8 million or $0.92 per basic share, compared to net income of $34.2 million or $0.85 per basic share for the six months ended June 30, 2012.

Turning to slide 6, I would like to discuss the key earnings drivers in the 2nd quarter of 2013 compared to the 2nd quarter of 2012. Earnings were positively impacted by $0.02 per basic share due to increased revenues from retail sales of deregulated Palo Verde Unit 3 power. Driving this increase was increased generation at Palo Verde Unit 3 due to the 2012 spring refueling outage without any comparable outage in 2013, and higher proxy market power prices in 2013.

Taxes other than income taxes decreased due to lower revenues in Texas due to the base rate in fuel factor decreases effective in May 2012 and lower sales due to milder weather. In addition, property tax accruals were lower in 2013 than in 2012. Combined, these items resulted in an increase of $0.01 in earnings per share for the 2nd quarter of 2013 compared to the same period in 2012.

The final item that had a positive impact on earnings was an increase in Allowance for Funds Used During Construction or AFUDC which resulted from higher Construction Work in Progress balances in the quarter. This served to increase second quarter earnings by $0.01 per basic share.

As for the earnings drivers that negatively impacted the second quarter we saw a decline in retail non-fuel base revenues which was driven by a return to more normal weather conditions in the second quarter of 2013 and the remainder of the Texas rate decrease. This resulted in a $0.05 per basic share reduction in earnings for the quarter when compared to the same period of a year ago. Also, negatively impacting the quarterly earnings was increased interest on $150 million of 3.30 percent senior notes issued in December 2012. The increased interest on long term debt resulted in a $0.01 per basic share reduction in earnings for the quarter.

If you will now turn to slide 7, I would like to go over the significant factors affecting our revenues and sales by customer class for the 2nd quarter of 2013 compared to the same period for 2012. Megawatt-hour sales and revenues were primarily impacted by two factors, weather and the 2012 Texas rate settlement. Weather in the second quarter of 2013 was milder than the second quarter of 2012. Of particular significance, the summer cooling season in 2012 actually started in mid-April 2012 with temperatures above 95 degrees. In 2013, we did not have a 95 degree day until mid-May. As a result, we had weather related decreases in megawatt-hour sales and in the residential and small commercial classes and to a lesser extent in the public authority class. The second factor contributing to the non-fuel base revenue decrease was the Texas non-fuel base rate decrease that took effect May 1, 2012 and primarily affected our commercial and industrial customers. On a positive note, we still continue to see good customer growth in our service territory. For the quarter, we had positive growth in the number of customers for the quarter of 1.2 percent.

I would also like to note that we have revised our customer count methodology. We previously reported the number of retail customers based on the number of bills rendered including consolidated bills for customers operating multiple facilities. To properly state our customer count, we revised the methodology and our customer count is now based on the number of service locations. This is consistent with the methodology we used prior to the implementation of a new customer billing system back in 2010. The significance is that a number of customer locations are built on a consolidated basis which caused us to understate the number of facilities being served or actual customers. We have revised our customer counts for each month beginning in 2011. The revised customer numbers by month can be found on our website.

Now turning to slide 8 of our presentation, I will detail the key earnings drivers for the first six months of 2013. Starting with our positive earnings drivers, higher balances of construction work in progress resulted in an increase in AFUDC which had a $0.04 per basic share positive impact to earnings for the first six months of 2013.

Deregulated Palo Verde Unit 3 revenues also had a $0.03 per basic share positive impact on earnings year-to-date 2013 when compared to the same period in 2012. Driving this increase were higher proxy market power prices in 2013 resulting from higher gas prices and a 20.9 percent increase in Palo Verde Unit 3 generation which is the result of the 2012 spring refueling outage for Palo Verde Unit 3, with no comparable outage for 2013.

A decrease in taxes other than income taxes had a positive effect on the year-to-date June 2013 earnings by $0.03 per basic share as well. This increase in earnings is due to decreased property tax accruals and revenues in Texas resulting from the non-fuel base rate decrease in May 2012. The final positive driver for the year-to-date earnings is due to reduced maintenance expenses at our fossil-fuel generating units due to timing of planned maintenance which increased earnings per share by $0.03.

Offsetting the previously mentioned increases, net income for this first six months of 2013 was negatively affected by an increase in administrative and general expenses for software systems support and improvements, which resulted in a $0.04 reduction in earnings per basic share.

Other factors negatively affecting our 2013 year-to-date earnings were increased interest on long term debt due to the $150 million of 3.3 percent senior notes issued in December of 2012, which resulted in a decrease in earnings of $0.03 per basic share and decrease non-fuel base revenues which reduced year-to-date earnings by $0.01 per basic share. The decrease in non-fuel base revenues was primarily due to the reduction in our non-fuel base rates in Texas.

If you will not turn to slide 9, I would like to go over the changes in revenues and sales by customer class for the first six months of 2013 compared to the same period for 2012. As can be seen on this slide, retail non-fuel base revenues decreased 0.3 percent for the period; however, megawatt-hour sales increased 1.2 percent as the decrease in megawatt-hour sales in the second quarter was more than offset by higher megawatt-sales in the first quarter. Considering the later start to the cooling season, we were pleased with the increase in our megawatt-hour sales for the first six months of 2013. The revenue decrease for the period was mainly driven by our commercial and industrial customer classes, which again reflects the impact of the reduction in non-fuel base rates for our Texas customers effective in May 2012. At June 30, 2013, we had 391,728 customers which was a 1.2 percent increase from the prior year.

Now turning to slide 10, I would like to discuss our capital requirements and liquidity position. In terms of our capital requirements, we expended approximately $110 million for additions to utility plant in the first six months of 2013. We expect to spend approximately $238 million for new construction in 2013, which is lower than the previously reported $258 million mainly due to a delay in the construction of two new distribution centers on the east and west side of El Paso. We also made $20.7 million in dividend payments for the six months ended June 30, 2013 reflecting the dividend increase in the second quarter.

At June 30, 2013, our liquidity was almost $285 million which consisted of a cash balance of approximately $12 million plus borrowing capability available to us on our credit facility of approximately $273 million. We believe that our available liquidity, along with our expected cash from operations, will be sufficient to finance our capital requirements through 2013. Depending on market conditions, we may issue long-term debt in late 2013 or early 2014 to fund construction costs in 2014.

Now turning to slide 11, we have tightened our 2013 earnings guidance to a range of $2.20 to $2.50 per basic share from the previous range of $2.20 to $2.60 per basic share. The primary driver for the revision to the high end of guidance is a reduction in our assumed non-fuel base revenue growth. On the high end of guidance we had previously assumed a 3.2 percent growth rate for 2013 over 2012. We have revised that assumed growth rate down to 2.7 percent. The driver for this revision was the milder weather we have experienced for the first six months of this year and in July of 2013. The other revision to the high end of guidance results from the downward revision to the 2013 construction program which will reduce our anticipated level of AFUDC in 2013.

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

Steven Busser: Thank you David. Rufus normally at this time we take questions if there are any.

Operator: Thank you Sir. Ladies and gentlemen if you would like to ask a question please firmly press the star key followed by the digit 1 on your telephone keypad. If you are using a speakerphone please make sure your mute function is disengaged to allow your signal to reach our equipment. Again press star 1 to ask a question and we will pause for just a moment to assemble the question roster. We'll take our first question from Neil Mehta with Goldman Sachs.

Neil Mehta: Good morning.

David Carpenter: Good morning Neil.

Neil Mehta: Can you talk through your thinking around dividend growth, you've got a pay out well below peer levels but also recognize for the next couple of years you have a heavy capex program. So how do you balance the two and what do you think the right dividend growth rate is over the next couple of years?

David Carpenter: Neil I think we've been fairly clear with the kind of policy that we expect to be following. We expect that will continue to see increases in our dividends over the next several years. We expect to be in the 4 to 6 percent range. Likewise as we had previously stated we continue to believe that until we get through the majority of this construction program that we will be targeting 45 to 55 percent payout ratio primarily with the variance primarily due to variances in earnings from year to year going forward.

Neil Mehta: Got it. And you reduced capex plans for 2013. Is there a corresponding impact in 2014 and 2015, should we think about capex going up in those years and if so by what magnitude?

David Carpenter: Neil, we're actually in the process of working on plans for the next several years. There may be some impact in 2014. Some of the expenditures may be deferred indefinitely, but I think the expectation is that in 2014 we'd probably see a little bit of an increase in our capex compared to what we previously published.

Neil Mehta: Okay and the last question for me. What do you think about rate case timing both in Texas and New Mexico? Same schedule as what was discussed at the analysts day? And then can you just talk about the regulatory relationship with the El Paso City Council and the City broadly?

David Carpenter: Well I might let Tom start out with our relationship with the City of El Paso and then we can follow up with the schedule.

Tom Shockley: Right, we have as a consequence of the settlement of our last rate case dramatically changed the relationship between the Company and the City. We've just come through elections and we have a new mayor and several new council people. We've had an opportunity to visit with all of them and we're please at the relationship that has been established. So I think we'll be off on a good foot. Obviously nobody likes rate increases but I think we've got an opportunity to have a very constructive dialogue as we get prepared.

David Carpenter: And maybe to follow up on the schedule then Neil is I think we haven't really changed here either. The primary driver for the timing of our next rate case will be the completion of the first unit of the Montana units. Our expectation is that we'll seek recovery of the capital costs for both unit 1 and 2 of the Montana Power Plant when we file our next rate case in both Texas and New Mexico. Currently the expectation is that we complete Montana Unit 1 in the December 2014 timeframe. There's always a possibility that could slip some but both units are expected to be in service by the peak of 2015. The timing then of the rate case would be if the plants are completed in December, we'd probably use a December test year end to file rate cases in both Texas and New Mexico and we'd probably be seeking to file those cases before the end of May in both jurisdictions.

Neil Mehta: Okay with the known in measureable for Montana too to ensure that you get that second piece in rate base as well?

David Carpenter: That's our intention currently.

Neil Mehta: Okay terrific, thank you.

Operator: As a reminder ladies and gentlemen that is star 1 to ask a question. We go next to Brian Russo with Ladenburg Thalmann.

Brian Russo: Hi good morning.

Steven Busser: Good morning Brian.

Brian Russo: I think on the previous call you had laid out specific earnings drivers and I was wondering if you had any update to those negative $0.07 on D&A, negative $0.06 on long-term debt and there were several others. One item in particular was a plus $0.10 for AFUDC, but I supposed that has now been revised lower to reflect the timing of the capex?

David Carpenter: Yes Brian we've had a few changes. The primary factor, as we pointed out, is that there are really two factors - revenue and AFUDC. As I think of that, they are pretty close to the same on net mid impact, around the $0.03 range per share for each of those. You obviously have some small changes in other items but they tend to pretty much offset each other. And so I think probably the best way to think about it is that the reduction is about 50 percent revenue decrease and about 50 percent related to AFUDC.

Brian Russo: Okay great that's helpful and then to just clarify your statements earlier on the capex and the $20 million reduction in 2013. I thought you said it was attributable to a delay in the construction of the distribution center, so why might some of that be reduced indefinitely? Why isn't it just shifted into a later period?

David Carpenter: Right there's kind of two things there. What we're looking at currently is a delay in construction of the facilities and we may also look at scaling down the scope of at least one of the facilities. And so there may be a combination of a delay on one hand and a reduction in the scope of the projects going forward.

Brian Russo: Okay do you have the customer growth in the first half of 2013?

David Carpenter: Yes I think that year over year it is 1.2 percent, if you look on the average. The average for the year was about 1.3 percent.

Brian Russo: Okay so the 1 to 1½ percent customer growth that you guys have been forecasting that's still intact? And I think maybe on the last conference call you said that you were expecting you know some moderation in the growth in the first half but then a pickup in the second half, is that still accurate?

David Carpenter: Everything that we see right now still seems to be a fairly accurate representation of our expectations.

Brian Russo: Okay great thank you.

Operator: And as a final reminder that is star 1 to ask a question. And again if you are on a speakerphone please make sure that your mute button is turned off so that your signal can reach our equipment. Again that is star 1 to ask a question. And for our next question we go to Ashar Khan with Visium Asset Management.

Ashar Khan: As part of the variance table that you had from 2013 to 2012 there was about $0.18 of earnings for the year for the underlying growth and I guess $0.10 from AFUDC and capitalized interest. Are those numbers still good as you stand right now middle of the year?

David Carpenter: Right Ashar what we really kind of went through earlier is that when we reduced our guidance, if you think about the midpoint of guidance going down around $0.05 or $0.06 per share and the upper range coming down $0.10; that really most of the reduction in the upper range is about 50 percent due to a decline in expectations for revenues and about 50 percent that's due to declining capital expenditures reducing our allowance for funds used during construction. So as we look at it, it's about 50/50 of what the impacts are.

Ashar Khan: So if I'm right the top end of the guidance has been reduced by what $0.10? Am I right?

David Carpenter: Yes.

Ashar Khan: So $0.05 is AFUDC and $0.05 is underlying growth. So is that a fair rate of what you said?

David Carpenter: Yes.

Ashar Khan: So then I can reduce this variance table from $0.18 to $0.13 and AFUDC from $0.10 to $0.05?

David Carpenter: You're not going to be far off doing that.

Ashar Khan: Okay thank you so much, really appreciate it.

Operator: With that ladies and gentlemen we have no further question on our roster. Therefore Mr. Busser I will turn the conference back over to you for any closing remarks.

Steven Busser: Thank you Rufus and thank you to everyone who joined us on the call today. We look forward to speaking to you in the future. Thank you very much.

Operator: Ladies and gentlemen this will conclude today's conference. Thank you for your participation.

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