EL PASO ELECTRIC CO.

Moderator: Steven P. Busser
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9:30 am CT

Operator: Good day and welcome to the El Paso Electric Second Quarter Earnings call. Today's conference is being recorded. At this time I would like to turn the conference over to Mr. Steve Busser. Please go ahead sir.

Steve Busser: Thank you Richelle and good morning everyone. Thank you for joining the El Paso Electric Company's second quarter 2012 earnings conference call. On the call with me today I also have our CEO Tom Shockley and our CFO David Carpenter.

Today we will provide an update on our second quarter 2012 and year to date financial performance and we will discuss our key earnings drivers. In addition we will discuss our earnings guidance, capital expenditures, and other items.

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 from our website on the Investor Relations page.

We currently anticipate that our second quarter 2012 Form 10-Q will be filed with the SEC on or before August 6, 2012. Please call our Investor Relations department if you have any inquiries or require further information.

A replay of today's call will be available shortly after our call ends and will run through August 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. On page 2 of our presentation you will see our Safe Harbor statement.

In summary, our comments and answers to your questions may include forward-looking statements made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks and other factors which may cause the company's actual results in future periods to differ materially from those expressed here.

Any such statement is qualified by the reference to the risks and factors discussed in our SEC filings. Our 10-K and other SEC filings contain our forward-looking statements and also lay out the risk factors that should be considered. These filings may be obtained upon request from the company, on our website, or from the SEC.

The company cautions that the risk factors discussed in these filings are not exclusive and we do not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the company. These statements, especially those made during the question and answer session of the call, are subject to risks and uncertainties that are difficult to predict.

At this time I would like to turn the call over to Tom Shockley but before I do I would like to congratulate Tom on being appointed as the new permanent CEO of El Paso Electric. Tom?

Tom Shockley: Thanks Steve. It is a pleasure to be here today but more particularly we thank each of you for joining us. We're going to have a lot of information for you.

And to begin with I'd like to comment on Steve's thanking me for becoming the CEO and let you know that after four months of being the interim CEO and working with El Paso Electric and a great management team and some wonderful employees, it is a real pleasure for me to have an opportunity to be the CEO and I'm looking forward to a lot of good things happening here.

El Paso Electric has got so much going for it in the way of an area that is growing. Our carbon footprint is I think envied by most other utilities so there's just a lot of good things going here.

If I could get you to turn to the slide number 3, I will mention some of the highlights of the quarter. Beginning in the quarter we were able to get final approval from the PUC for our Texas rate case. The financial highlights of that particular settlement include a reduction in non-fuel base rate revenue of $15 million partially offset by a reduction in annual depreciation of a little over $4 million.

But more importantly from our perspective is the rate case settlement created a completely new environment for us with the city council and in fact the entire city of El Paso. It has allowed us to really look forward to working with the city and so many different agencies here in creating what we hope will be a really robust economic development opportunity as we move forward with El Paso.

So it really reached a lot further than just settling the rate case. It has given us an opportunity to really look for positive things for this community as we see a lot of things happening.

On the operational front, we also filed a CCN which is a Certificate of Convenience and Necessity that has to be acquired before you can build a power plant and we filed for a new station that will be built in the eastern part of El Paso. The CCN is requesting a permit for two 88 megawatt natural gas fired generating units. The first one will be completed in the spring of 2014 and then a year later the second one will be completed.

And I would also point out that we are making great progress on getting our Rio generating, natural gas generating unit Rio 9 is under construction and we anticipate that it will be completed in May of '13 so that's coming along quite well also.

A comment or two before I hand it over to David Carpenter on our dividend. The board approved at the annual meeting an increase of the dividend from 22 cents per share to 25 cents per share. That dividend was paid on June 29. The date of record was June 15. And then on July 25 the board declared an additional dividend of 25 cents per share payable on September 28.

So we're excited that we've been able to keep the dividend moving in the direction that we had indicated and that it's something that we are very pleased has fallen into place. David has got a lot more information about the specifics, the financial specifics and so with that David I'll turn it over to you.

David Carpenter: Thank you Tom and good morning everyone. I would also like to start out by congratulating Tom on his appointment as our CEO. As many of you know, Tom and I have worked together before and I look forward to being part of his team here at El Paso Electric.

I would like to start on slide 5 of our presentation. As shown, we reported net income of $30.9 million or 77 cents per basic share for the second quarter of 2012 compared to the second quarter of 2011 net income of $33 million or 78 cents per basic share.

For the six months ended June 30, 2012 we posted net income of $34.2 million or 85 cents per basic share compared to net income of $39.8 million or 94 cents per basic share for the six months ended June 30, 2011.

Turning to slide 6, I would like to discuss the key earnings drivers in the second quarter of 2012 compared to the second quarter of 2011. Palo Verde operations and maintenance expense decreased in the second quarter due to the timing of the Palo Verde refueling outage.

The 2011 spring refueling outage for unit 2 began on April 2 and was completed in 35 days on May 6. For 2012 the spring refueling outage for unit 3 began on March 17 and was completed in 32 days on April 17.

As a result, higher maintenance expenses were incurred in the first quarter of 2012 and lower maintenance expenses were incurred in the second quarter of 2012. The reduction in maintenance expense resulted in a 4 cent increase in earnings per share in the second quarter of 2012.

The other item that served to increase earnings for the quarter was the reduced share count as a result of the share repurchases that the company made in 2011. The effect of the reduced share count increased the quarterly earnings per share by 3 cents per basic share.

Offsetting the positive key earnings drivers in the second quarter was a decline in deregulated Palo Verde unit 3 revenues. The reduction in Palo Verde unit 3 revenues was due to both lower proxy market prices associated with the decline in natural gas prices and a 21% decrease in generation at Palo Verde unit 3 due to the refueling outage. Decreased deregulated Palo Verde unit 3 revenues resulted in a 3 cent per share reduction in earnings for the quarter.

Additional negative earnings drivers for the quarter included increased realized losses on equity investments in our decommissioning trust fund which lowered investment and interest income by 3 cents per share and increased pension and benefits expenses due to lower discount rates which increased our liabilities and associated expenses. The increase in pension and benefits expenses resulted in a 2 cent per share reduction in earnings for the quarter.

The key earnings drivers for the first six months of 2012 are detailed on slide 7. Starting with positive earnings drivers, higher retail non-fuel based revenues resulted in a 3 cent per share increase in earnings. This was primarily due to a 2.8% increase in kilowatt hour sales.

Another positive earnings driver was lower Palo Verde operations and maintenance expense which increased earnings per share by 2 cents. The decrease in Palo Verde operations and maintenance expense reflected lower overall costs for the spring refueling outage for Palo Verde unit 3.

The final positive earnings driver for the year to date period as was the case with the quarterly earnings was the reduced share count resulting from the share repurchases the company made in 2011. The effect of the reduced share count increased the year to date earnings per share by 4 cents per basic share.

As with the second quarter, key earnings drivers that negatively affected our year to date earnings included a 5 cent per share decrease in Palo Verde unit 3 deregulated revenues due to the lower proxy market prices resulting from the lower natural gas prices and a 17% decrease in generation at unit 3 due to the refueling outage.

Earnings were also negatively impacted by fossil fuel plant operations and maintenance expenses due to the timing of planned maintenance on local generating units which resulted in a 5 cent reduction in earnings per share.

Other factors negatively affecting our 2012 year to date earnings were losses associated with the decommissioning trust fund investment which resulted in a decrease in earnings of 4 cents per basic share and increased pensions and benefits expense due to the lower discount rate used to determine the expense which resulted in a decrease in earnings of 4 cents per basic share.

If you now turn to slide 8 I would like to go over changes in revenues and sales by customer class for the second quarter of 2012 and for the first six months of 2012 compared to the same periods for 2011.

For both the quarter and year to date periods we were pleased to see megawatt hour sales growth in every segment except the large commercial and industrial class. This growth is largely attributable to a 1.5% increase in the average number of retail customers served. We also believe that this increase is due to our continued growth in usage per customer and our expanding local economy which includes the effects of Fort Bliss.

In regards to Fort Bliss, the First Armored Division's return from Germany has increased the number of soldiers assigned to Fort Bliss to approximately 30,000. Fort Bliss is the nation's largest Army post by physical size covering an area slightly larger than Rhode Island. Fort Bliss has undergone the most growth of any military installation since World War II and has grown from 9500 soldiers to about 30,000 in the past seven years.

Fort Bliss is also a top contender for the location of an Air Force training center that would increase the number of airmen trained on the base from about 1500 to 10,000 annually.

Of particular note, in regard to the growth in megawatt hour sales in our service area for the second quarter 2012 is the fact that this growth was achieved with summer weather that was essentially unchanged from the same quarter and year to date periods from 2011.

Cooling degree days were essentially flat in the second quarter of 2012 compared to the second quarter of 2011 and the six months ended June 30, 2012 when compared to the six months ended June 30, 2011. In both 2011 and 2012 cooling degree days were approximately 28% greater than the 30 year average.

We estimate that the above normal weather contributed approximately $5.2 million of additional revenues to the second quarter results when compared to normal weather.

Heating degree days in the first quarter of 2012 were approximately 8% lower than 2011 and 9% below the 30 year average which negatively impacted revenues in the first six months of 2012 compared to the first six months of 2011.

In terms of our total non-fuel based revenues for the second quarter, they were flat compared to the same period in 2011 while in the year to date period we experienced slightly less than 1% revenue growth despite the increase in megawatt hour sales I previously discussed.

Of note in terms of revenues is that base rates for certain Texas customer classes were reduced beginning May 1. The effect of the rate decrease reduced 2012 non-fuel revenues by an estimated $3.1 million compared to 2011 in both the quarter and the year to date periods. As can be seen on slide 8 the majority of this decrease as we have previously discussed was allocated to small and large commercial and industrial customers.

Now turning to slide 9, we have revised our 2012 earnings guidance to a range of $2.10 to $2.45 per basic share from the previous range of $2.05 to $2.40 per basic share. The primary driver for this increase is due to revised allowance for funds used during construction, capitalization assumptions, and lower depreciation estimates. These factors were partially offset by the realized losses on equity investments in our decommissioning trust fund.

If you could now turn to slide 10, I will cover our capital requirements and our liquidity position. In terms of our capital requirements, we expended almost $100 million for additions to electric utility plant in the first six months of 2012. We anticipate capital expenditures will be approximately $232 million for new construction in 2012.

Dividend payments to our shareholders for the first six months of 2012 totaled $18.8 million and we had a cash balance of $10.1 million at June 30, 2012. Also at June 30, 2012 we had liquidity of nearly $200 million including cash and funds available from our revolving credit facility.

We are currently working on remarketing our Farmington pollution and control bonds which have a principal amount outstanding of $33.3 million. We anticipate closing that transaction by the end of the third quarter.

Also in late 2012 or early 2013 we may issue long term debt to refinance borrowings from the revolving credit facility and finance future plant construction. I will now hand the call back over to Steve Busser for questions.

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

Operator: Thank you. The question and answer session will be conducted electronically. If you would like to ask a question please press Star followed by the digit 1. If you are using a speakerphone please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, Star 1 to ask a question. We will take our first question from Neil Mehta with Goldman Sachs.

Neil Mehta: Thank you very much. Tom congratulations on officially becoming the El Paso Electric CEO. We’re looking forward to working together. My first question here is given the lag between rate cases and your heavy CAPEX program, AFUDC will really be a key earnings driver. So how should we think about the appropriate AFUDC growth rate off the 2012 base?

David Carpenter: Yes Neil, We provided in our last earnings call an estimated CWIP balance for year end. The update that we made to our AFUDC calculation is really distinguishing between those CWIP balances that are capital for new generating plants which accrue 100% AFUDC and capital for recurring transmission and distribution plant additions that most will accrue AFUDC.

The way to think about it would be as we're building up the capital for these new generating plants, AFUDC should be increasing. As they go in service it will decrease and then it will increase again as we build up to the final completion date of the next unit.

Neil Mehta: Any advice in terms of trying to size the magnitude of the increases in the AFUDC?

Steve Busser: Neil this is Steve. Our actual amount that we originally assumed in our 2012 guidance for AFUDC for construction purposes was about $11.7 million. We think that number is probably going to increase by about 30% from our original estimate.

On a trajectory basis we anticipate that number will continue to grow for the next several years, I would say the next three to four years probably at a clip of $1 million to $2 million a year and then beyond that it will start to taper off a little bit as we get through the heavy construction phase that we are at the beginning of.

Neil Mehta: Perfect. And then thoughts on rate case timing in both Texas and New Mexico?

David Carpenter: We have mentioned before that we anticipated filing a rate case in 2013. As we have been looking at our construction expenditures and our revenues and expenses, we're thinking that if possible, we'll defer filing a rate case in 2013 to 2014 and we won't make a decision on that until late this year.

The rationale for that is: as we look at the Montana plant that Tom talked about, the first unit will be completed in 2014. Because that's a green field plant we'll have new operating expenses associated with that plant, plus it will be a little bit more expensive because of all the common facilities that will have to be built with the first unit. So as far as timing of rate cases, our target is to push it off to 2014 if possible.

Neil Mehta: All right thank you very much.

Steve Busser: Thanks Neil.

Operator: And next we'll move to Brian Russo with Ladenburg Thalmann.

Brian Russo: Hi, good morning.

Male: Good morning Brian.

Male: Good morning.

Brian Russo: Just to clarify on the strategy on the general rate case filings, did I understand you correctly that you would file in 2014 thus essentially new rates in 2015 to capture both the first and second unit of the Montana gas plant?

David Carpenter: It would just be capturing one unit. Assuming we get the plant put in service in early 2014, the goal would be to file by the third quarter of 2014 and we would probably be looking at new rates in effect in the first quarter of 2015.

Brian Russo: Okay and how much debt can we expect you to issue later this year or early next year?

David Carpenter: Brian we really haven't made a decision on that. As we look at it, we're probably going to need upwards of $85 million. It won't be a huge debt issue but it will depend on some other factors of how much debt we issue.

Brian Russo: Okay and your ability to push out rate cases. It seems that it's a function of the margins generated from the sustainable to the 2-1/2% load growth and your ability to offset cost escalations with managing other costs. Is that accurate?

David Carpenter: That's accurate, yes.

Brian Russo: On the guidance, can you elaborate on what adjustments you've made to AFUDC which created a positive delta? Is this decommissioning trust fund, is this just a 2Q event or is this something that we could see in the third and fourth quarter?

David Carpenter: Yes, let me address the last question first on the decommissioning trust fund. This is a one-time event that we had a mutual fund that wasn't performing well that we sold and we took a loss on.

As we look at the performance of our other funds we don't see any need to take losses for the remainder of the year unless the market crashed. But we don't expect that to happen in the fourth quarter or the remainder of this year.

Now addressing the first question on the allowance for funds used during construction, what we did is simply refine our calculation. What I was referring to earlier, the real refinement was splitting out the AFUDC - related to the generation plant additions and calculating that separately from the rest of our AFUDC calculation of ongoing plant additions and when we did that, it increased the amount of AFUDC that we were estimating for the year.

Brian Russo: Okay, I understand. That ties in to Steve's comments earlier that we should see a 30% increase in AFUDC in 2012 versus11.7 that was previously estimated for 2012.

David Carpenter: That's correct.

Brian Russo: I just wanted to follow up on your earlier comment on the potential for expansion of both the Bliss Air Force portion of the base that could bring I think you said an additional 10,000 troops.

David Carpenter: Let me clarify that, it wouldn't bring 10,000 troops. What they would be doing as I understand it probably only bring about 100 permanent troops but you would be running 10,000 troops through the base on an annual basis for training.

Brian Russo: When do you think that might be finalized or when do you think we might see the impact of that in the service territory growth?

David Carpenter: I think it will be finalized in August, this month, and the impact would probably be in late 2013 I think.

Brian Russo: So it looks like you've got 30,000 permanent troops at Fort Bliss and you've got this added kicker with some of the additional annual troops for the Air Force. Do you get a sense that your robust 2% to 2-1/2% organic growth is sustainable past 2013?

David Carpenter: Brian, I think it certainly will be. We'll have to see. We'll have to see other areas of the economy pick up. But I can also tell you that we're seeing a lot of economic activity really starting in the area outside of Fort Bliss and so I think to the extent that this other economic activity is picking up I think the growth rate is sustainable. We can't make a guarantee on that but we certainly think that it will be there.

Brian Russo: Okay great, and one last question. The CAPEX, multi-year CAPEX that you've outlined in previous presentations and on the first quarter earnings call. Are those still intact?

David Carpenter: Yes.

Brian Russo: Okay thank you very much.

Operator: And next we'll move to Michael Klein with Sidoti & Company.

Michael Klein: Good morning guys.

Male: Good morning.

Michael Klein: Can you help me understand how to quantify the impact of earnings this quarter and what is sustainable? What would you say was the bigger contributor to earnings; would it be the 1-1/2% increase in customers or the warmer than average weather?

David Carpenter: Actually they were pretty similar in impact. The growth in customers might have been a little bit bigger than the weather but they were both in the $5 million to $6 million range.

Michael Klein: And where does the pension stand now in terms of funding requirements and what type of funding do you expect for the rest of the year?

David Carpenter: We're still funding at the rate that we had said that we would fund it. Our target is to fund about $19 million for the year and we've been funding that ratably so we have about $9 million to $10 million remaining to fund for the remainder of the year.

Michael Klein: Okay.

Steve Busser: And we can get you that exact number here if you just give us a second.

Michael Klein: Sure. While you dig for that I'll ask another question it is qualitatively, where do you see the dividend moving over the long run? Do you have a payout range that you would ultimately like to get to now that you're targeting the 45% payout for this year?

David Carpenter: We have consistently said that we're targeting a 45% payout ratio at this time. I think as we go along we'll continue to look at our dividend on an annual basis and look at our cash flow as well as other factors.

I think we've said it would be quite a few years before we would expect to get up to an industry type average dividend. Right now that's about all the information that we can provide and we'll continue to analyze it on an annual basis. And to the extent we think it makes good business sense then we'll try to start pushing it up a little bit but I think it will be a slow process.

Steve Busser: Michael this is Steve just to go back on your previous question in regards to pension contributions, thus far this year to the pension alone we have contributed about $11-1/2 million of our projected $19.8 million and on the retirement plan we've contributed about $600,000 of our projected $2-1/2 million so I just wanted to follow up on that for you.

Michael Klein: Okay thanks. And last question just given the new rate design, is there still the seasonality in rates that favor the summer season or has that been more or less neutralized now?

David Carpenter: No there is still seasonality. One thing that was done in the settlement was we reduced the amount of seasonality in the rates but there is still a fair amount of seasonality remaining in the rate structure.

Michael Klein: Okay great. Thanks a lot guys.

Operator: And next we'll move to Tim Winter with Gabelli.

Tim Winter: Good morning guys. I just wanted to follow up on the strength of the service area you're discussing, specifically the large C&I class. I realize it's a smaller class but can you talk about the weakness we saw in the second quarter?

David Carpenter: Yes, I've spent a little bit of time trying to see if there was any real weakness or if it was other factors. And let me start with the kilowatt hour sales.

As we look at the kilowatt hour sales, it probably reflected at least one customer that sold out and as somebody else was buying their usage went down considerably while they were changing out operations or getting everything set up.

A couple of other customers just had decreases and were cyclical as far as the businesses that they were in. I don't necessarily think that's an ongoing trend, it just really reflects some cyclical nature of their business.

When you look at the revenues on top of the rate decrease there was some billing adjustments for prior periods included in there and also we had at least one large customer that had converted a fair amount of their load to an interruptible rate which had an additional lower rate on top of that. And so as I look at the industrial class going forward I think it will continue to be fairly steady.

And one thing I forgot to mention as far as the economic activity, I mentioned that we're starting to see pickup in economic activity in other areas. I know of one company that is expanding their staff by 500 employees in El Paso, another company that is hiring 300 software engineers in El Paso.

So we're really starting to see some economic activity. We have talked in the past about the additions of medical facilities in El Paso where Fort Bliss is building $1 billion hospital that is really just kicking off construction late last year and then they just completed the Children's Hospital in El Paso in February. And so as we see it living here, we just see a lot of positive things happening on the economic front.

Tim Winter: Okay great. And then on the capital allocation decisions, no share repurchases this year. Were there any regulatory issues that are involved in that decision or is it purely economic?

David Carpenter: I think it's purely economic at this point in time. We believe our capital structure is fairly reflective of where we would like for it to be and anticipated to be at the end of the year. And based on that, right now we think we can pretty much manage our capital structure with the dividend. If something happens to change that we have some flexibility if we need to buy some more shares back.

Tim Winter: Okay thank you.

Operator: And as a reminder, it's Star 1 if you would like to ask a question. Next we'll move to Anthony Crowdell with Jefferies.

Anthony Crowdell: Hey, just a super quick question. What type of interest savings do you guys think you'll get if you are able to refinance the (Farmington) bonds?

Steve Busser: The current coupon on the (Farmington) is 4%. We're likely probably going to go towards the shorter end of the curve on the refinancing of those bonds. We'd probably pick up 150 basis points to 175 basis points off the current coupon on an all-in basis so you can do that math.

Anthony Crowdell: And on a different set of bonds, I thought you guys also had some outstanding bonds and I could be wrong, maybe like 9% and I know there were some prepayment penalty involved there. But does it make sense in this interest rate environment maybe to take the prepayment penalty and refinance those bonds?

Steve Busser: We don't have any bonds outstanding at 9% or I might not be the treasurer. But we do have some high coupon debt out there related to some pollution control bonds that we did in the middle of the economic crisis back in early 2009.

So those bonds however are out to term and have 10 year call provisions and so are not callable at anything other than the treasury at this point. So it's fairly unlikely that we'll be doing those bonds just given the premium that we'd have to pay on them.

Our other debt that is outstanding is unsecured senior notes 6% for about $400 million at about 7-1/2% for the $150 million that we have outstanding. Once again we have some pretty heavy treasury call revisions on those and so, the economics on those just don't work even given the relatively low interest rates that we see today.

Anthony Crowdell: Great, thanks Steven. Thank God you're the treasurer.

Steven Busser: Thanks Anthony.

Operator: And we'll move on to Maury May with Wellington Shields.

Maury May: Yes good morning folks.

Male: Good morning Maury.

Male: Good morning.

Maury May: A question on the third quarter. Last year you all reported $1.40 in the third quarter and you had cooling degree days that were like 27% above normal. And the third quarter this year started out as normal, I think July weather was pretty much normal and the consensus out there is for a down quarter, the consensus is about $1.30 and I'm at $1.28. I'm just wondering whether you were comfortable with these down estimates.

David Carpenter: Well certainly. I can't give you a specific number but obviously you'll have some reduction due to the rate decrease. You'll have some additional reduction to the extent that the weather is normal this year, compared to a very hot third quarter last year there will be some reductions. And so I think it's fair to assume that there will be some decline in earnings in the third quarter compared to last year.

Maury May: Okay but no further color than that.

David Carpenter: That's right.

Maury May: Okay great, thank you David. The second question is on your capital expenditures, you've spent about $100 million so far and you've got $132 million to go. Where is that

$132 million going in the second half? Is it going for Rio Grande 9, is it going for Montana 1? Where is it going for?

David Carpenter: You'll have certainly a fair amount of expenditures for the Rio Grande 9. We are starting to spend money on a fairly regular basis on the Montana plants too. And then we are also expecting a pickup in the construction of transmission and distribution plant in the second half of the year and so we'll probably see, I don't know that I have the split out for the year but that's the three primary areas.

We indicated in our press release that we were going to be spending about $5 million more than we had put out last quarter. And what that reflects is our board has approved the construction of two distribution service centers on - in the El Paso area and we expect to spend about $5 million on that this year.

That will likely be an increase in our estimated construction expenditures next year. So I think in total we're going to be spending around $45 million over the next 2-1/2 to 3 years.

Maury May: Okay great. Okay well thank you very much folks.

Male: Thank you Maury.

Operator: And there are no further questions. At this time I will turn the call back over to Mr. Busser for any additional or closing remarks.

Steve Busser: Thank you Richelle and thank you everyone who joined our call today. We look forward to hearing from you in the future at future events. If you have any questions please call our Investor Relations department. Thank you and have a great day. Bye-bye.

Operator: And that will conclude today's call. We thank you for your participation.

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