

EL PASO ELECTRIC CO

Moderator: Lisa Budtke

May 7, 2014

9:30 am CT

Operator: Good day, ladies and gentlemen. Thank you for standing by. Welcome to the El Paso Electric Company 1st Quarter Earnings conference call. Today's call is being recorded. I would now like to turn the conference over to Ms. Lisa Budtke for opening remarks and introductions. Please go ahead, ma'am.

Lisa Budtke: Thank you, Catherine. Good morning, everyone. Thank you for joining the El Paso Electric Company 1st Quarter 2014 Earnings conference call.

My name is Lisa Budtke and I am the Assistant Treasurer for El Paso Electric. On the call today are CEO, Tom Shockley; Senior Vice President, General Counsel and Chief Compliance Officer, Mary Kipp; Chief Financial Officer, Nathan Hirschi, Executive Vice President, David Carpenter, and Vice President and Treasurer, John Boomer.

Today we will provide an update on the Company's air permit for the Montana Power Station, our recent accomplishments, our near-term goals, the expected timeline for our rate case filing, the corresponding rate base projections and our 1st Quarter earnings results. 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 1st quarter 2014 Form 10-Q will be filed with the Securities and Exchange Commission or SEC on or before May 9th. Additionally, our 2014 Annual Shareholders meeting is scheduled for May 29th in El Paso.

We would also like to inform you that we will be marketing with Goldman Sachs in Chicago and New York on May 13th and 14th, respectively. We will be attending the BGC Partners' The Utility Conference in New York on June 24th. Finally, we will be marketing with Ladenburg Thalmann in the Northeast on June 25th and 26th.

A replay of today's call will be available shortly after our call and then will run through May 21st. The details as it relates to the replay are disclosed in our press release.

For forward-looking statements, on page 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 which may cause the Company's actual results in future periods to differ materially from those expressed here. Any such statement is qualified by reference to the risks and factors discussed in the Company's SEC filings.

Our 10-K and other SEC filings contain our forward-looking safe harbor 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 section of the call are subject to risks and uncertainties that are difficult to predict.

Finally, we would like to inform everyone that beginning with the 2nd quarter of 2014, we will be modifying our quiet period policy. Our quiet period will now begin on the 10th calendar day from the end of each quarter and will continue until our quarterly earnings release. Please call Investor Relations Department if you have any inquiries or require further information.

Now I would like to turn the call over to Mary Kipp, our Senior Vice President, General Counsel and Chief Compliance Officer.

Mary Kipp:

Thank you, Lisa. Good morning and thank you for joining the call. I will begin by discussing recent significant developments related to the Environmental Protection Agency or EPA air permit for the Montana Power Station.

As you may already be aware, on March 25, 2014, the EPA issued an air permit for the construction and operation of the four units at the Montana Power Station in Far East El Paso. This was the final regulatory approval required before physical construction can begin at the Montana Power Station. Although the final permit was issued in March, we were required to wait 30 days for the permit to become effective. During this 30 day period, parties who commented on the initial draft of the EPA air permit were able to appeal the permit to the Environmental Appeals Board.

However, I am pleased to announce that no appeals were filed by the eligible parties prior to the filing dead-line; therefore the air permit became effective on April 25, 2014, which allows construction to commence on units one and two in early June. As we have previously disclosed, our plan is to have units one and two in service by the summer peak of 2015. In fact the turbine for Unit 1 is already at the site of the Montana Power Station. The successful resolution of our permitting issues was a result of our continued focus and commitment to the community and the environment. Our efforts to engage and reach a resolution with community members and our establishment of a Citizen Advisory Panel for ongoing community engagement were recognized by the EPA. It is our intent to continue to work with our community and continue our outreach efforts as we commence construction and prepare for the next phase of executing our regulatory strategy.

At this time, it is my pleasure to turn the call over to our CEO, Tom Shockley.

Tom Shockley:

Thank you, Mary. In addition to the wonderful news that us receiving the air permit is, the city of El Paso also experienced some outstanding wonderful news this past week.

Last Monday on April 28, El Paso's brand-new AAA ball team, the Chihuahuas played their first home game in a brand-new downtown ballpark. Nine thousand two hundred and forty three attended as the sellout game was a tremendous success. In the first eight games, the average fan count was over 8,500 fans at each game. It's been an exciting time in El Paso.

While construction at our Montana Station is a key goal over the next several years, we recognize that every area of our Company plays a vital role in the Company's success. In your handouts are information; slide 4 shows our Four Pillars of Value to maintain our commitment to the long-term success of our Company.

Our Four Pillars of Value are operational excellence, stakeholder satisfaction, people and technology development, and financial and regulatory success. These pillars ensure that the Company meets the needs of our customers for safe and reliable energy and provides good customer service.

To provide service to our customers at a fair price, we must ensure that our people and technology are adequate to get the job done. If we take care of our customers and our

employees, we believe that financial and regulatory success will follow. Our focus on this philosophy has led to the successful completion of our goals and positions us to meet the needs of our growing territory.

The next slide highlights some of our recent accomplishments. As Mary mentioned, we were able to finalize and move forward with the EPA and the permit for our Montana Power Station. Though not yet commercial, we are already receiving energy from a 50 megawatt new solar generation at Macho Springs, New Mexico.

We recently received the highest customer satisfaction rating that we have attained in five years. Our employees' efforts have once again resulted in El Paso Electric being ranked number one in reliability in Texas. This is the third consecutive year in which we have been ranked number one in terms of frequency and duration of outages in the state.

We also recently restructured our retirement benefits to move to a cash balance plan with an enhanced 401K plan. Nearly 50 percent of our employees elected this new plan. Additionally, we received an upgrade to our credit rating to BAA 1 from BAA 2 by Moody's Investment Services.

Slide six shows the goals that we are working on in 2014. We will begin construction of the new Montana Power Station completing Units 1 and 2 in time to meet our summer peak of 2015. On the same site as the Montana Power Station, we will complete the construction of our new Eastside Distribution Operation Center in early 2015.

Also into 2014, we expect to receive final approval for the Certificates of Convenience & Necessity for our Montana Units 3 and 4. We will also continue our efforts to support the Four Corners owners and the Navajo Nation to extend the life of the power plant beyond the original retirement date of July 2016, when the 50 year agreement expires.

El Paso Electric has notified all remaining owners of our intent to cease participation in the plant when the agreement expires in July 2016. Later in 2014, we plan to issue additional debt to fund the capital construction program that is currently underway. We will also be reducing our carbon footprint further as we incorporate an additional 10 megawatts of solar generation into our generation portfolio at our existing Newman Generation Station.

Slide 7 shows two recent additions to our management team. To prepare and execute our regulatory strategy, Michael D. Blanchard was recently added as Vice President of Regulatory Affairs. Michael brings with him over 30 years of legal, regulatory and rate-making experience. Prior to joining our team, Michael was Assistant General Counsel at Nebraska Public Power District. While there, he was responsible for the daily administration of the legal division and for long-term strategic planning. Prior to joining Nebraska Public Power District, Michael spent 20 years with the Texas-New Mexico Power Company where he was Vice President and General Counsel with responsibilities for government relations, environmental and regulatory affairs.

John Boomer is Vice President and Treasurer for El Paso Electric. John previously worked for the Company in our legal department as an Assistant General Counsel and externally worked for us while at Kemp Smith Law Firm. John joins El Paso Electric from Helen of Troy, a publicly traded consumer products company where he most recently served as Senior Vice President responsible for investor relations and held a variety of executive and international operating positions.

We are excited about these positions to our management team and we are confident that their expertise and leadership will complement the rest of our team.

Now, Mary will discuss the rate case timelines.

Mary Kipp:

Thank you, Tom. If you would turn to slide 8, I'll discuss the expected timeline for rate case filings in both Texas and New Mexico.

The illustration provided represents the expected timeline for each of our upcoming rate cases in Texas and New Mexico, assuming that Montana Power Station Units 1 and 2 begin commercial operation in the second quarter of 2015.

Given that our air permits are effective and construction will commence shortly, we believe that we'll be able to bring the first two MPS Units online by the summer peak of 2015. We continue to remain focused on refining our filing package and strategy in an effort to reduce regulatory lag given that our permit is now effective. We will look at our options to file a Texas rate case earlier in 2015 and utilize its pro forma adjustment to capture all the rate base additions for the MPS Units through June. As I said, we are evaluating our options to determine the optimal strategy going forward. However, we currently expect to file rate cases in both Texas and New Mexico using historic test years.

In New Mexico, the rules for post test year adjustments will allow us to file a rate case using historic test year ended December 31, 2014 and reflect both MPS 1 and 2 in rate base through a pro forma adjustment. Assuming we file the rate case in May 2015, we would expect a final order by April 2016. New Mexico has the ability to suspend the effective date another three months but we believe that using a historic test year will allow for the rate case to be completed in the initial ten month suspension period.

In Texas, the post test year adjustment rules are not as advantageous as they are in New Mexico. Therefore, our expected timeline contemplates using historic test year ended June 30, 2015, after the units are in service. Assuming that the rate case is filed in November 2015, rates would be expected to become effective in Texas by July 1, 2016. We will continue to refine our rate filing timeline and are working to ensure that the filings can be made and resolved on a timely basis.

Turning to slide 9, we have included the projected rate base schedule presented during our fourth quarter earnings release presentation. This schedule illustrates our anticipated rate base additions for the Montana Units 1 and 2 in 2015, which will be included in our upcoming rate case filing in Texas and New Mexico, as well as our anticipated rate base after the completion of Montana Power Station Units 3 and 4, which will require subsequent rate case filings. Given the nature of the growth in our service territory and ultimately our rate base, we remain focused on working with our regulators to communicate the timing and the need for future rate adjustments to incorporate new plant additions in to our rates and minimize the impact of regulatory lag.

Our CFO, Nathan Hirschi will now discuss our first quarter financial results.

Nathan Hirschi:

Thank you, Mary. Looking at slide 10, I will begin by summarizing our first quarter 2014 results. For the first quarter of 2014, we reported net income of \$4.6 million or 11 cents per share compared to the first quarter of 2013 net income of \$7.6 million or \$0.19 per share.

Turning to slide 11, I will discuss the key earnings drivers in the first quarter of 2014 compared the first quarter of 2013, beginning with the negative drivers.

We experienced a decline in earnings per share during the first quarter of 2014, of \$0.08 per share, resulting from decreased retail non-fuel base revenues, primarily due to milder winter weather in the first quarter of 2014 compared to the same period last year, as we

experienced a 28.4 percent decline in heating degree days as compared to prior year. We will discuss the impact that weather had on the quarter in more detail in a moment.

We also experienced a decline in earnings per share of \$0.04 per share, resulting from increased taxes other than income taxes due primarily to an adjustment in Arizona property taxes related to 2013 which the adjustment was made late in the first quarter of 2014. As a result, approximately half the increase in taxes other than income is a true up of 2013 property taxes and is essentially a one time charge.

Earnings also declined by \$0.03 per share during the quarter due to increased fossil fuel plant maintenance expense, resulting from an increased level of maintenance activity at Four Corners and the Newman Units 1 and 2. In addition, increased depreciation and amortization, due to higher depreciable plant balances, including Rio Grande Unit 9 resulted in a decline of \$0.02 per share for the first quarter of 2014 when compared to the first quarter of 2013.

On a positive side, net income for the first quarter of 2014 compared to the same period last year was positively impacted by an increase in investment and interest income, primarily due to increased realized gains on equity investments in our Palo Verde Nuclear Trust Fund, which resulted in increased earnings per share of \$0.06 per share.

In addition, the earnings for the first quarter of 2014 increased by \$0.02 when compared to the same period last year as a result of increased miscellaneous income primarily due to the sale of land in the first quarter of 2014 with no comparable activity during the same period of last year. Deregulated Palo Verde Unit 3 revenues increased earnings per share by \$0.02 in the first quarter of 2014 when compared to the same period last year, due to a 29.8 percent increase in proxy market prices associated with higher natural gas costs.

Now turning to slide 12, we have provided the number of heating degree days that were observed in El Paso during the first quarter of the last 10 years. As you can see, the first quarter 2014 heating degree days were 19.2 percent below the 10 year average and 28.4 percent below the first quarter of 2013.

The 958 heating degree days observed in the first quarter of 2014 was the lowest level observed over the past 10 years and was approximately 6 percent below lower than the next lowest amount. The weather in February 2014 was particularly mild. In fact, the level of heating degree days that we experienced in February 2014 was the lowest level that was observed in El Paso in a February in over 50 years.

It is also important to point out that not only was the first quarter of 2014 an extremely mild quarter, the first quarter of 2013 had very favorable weather conditions and experienced the second-highest level of heating degree days recorded over the same ten year period making for a difficult comparison to prior year.

On slide 13, we have provided a comparative analysis of the changes in retail non-fuel base revenues and megawatt hour sales by customer class for the first quarter of 2014 compared to the same period of 2013.

Total megawatt hour sales declined by 5.7 percent, while retail non-fuel base revenues declined by 4.4 percent during the first quarter of 2014 as a result of milder winter weather. The residential customer class experienced the greatest decline during the first quarter of 2014.

The residential class experienced a decline of megawatt hour sales of 9.3 percent and a decline of non-fuel base revenues of 8.1 percent. This class is the most sensitive to weather and therefore was significantly impacted by the milder weather that I previously

discussed. On a positive side, we continue to see solid growth in the number of customers served. We experienced a 1.2 percent increase in the number of residential customers during the first quarter of 2014.

Sales to large commercial and industrial customers decreased by 7.4 percent and non-fuel base revenues decreased by 2.6 percent primarily due to discontinued operations by a couple of our customers. Additionally sales to public authority customers during the first quarter of 2014 declined by 4.5 percent when compared to the same period in 2013, however, non-fuel base revenues associated with this class increased slightly due to higher demand charges.

Turning to slide 14, I will now discuss our capital requirements and liquidity. During the first quarter of 2014, our capital expenditures for additions to electric utility plant were \$48.3 million. Our expectation for capital expenditures during the full year of 2014 is now \$316.4 million. In terms of dividends, we paid \$10.7 million of dividends during the quarter or \$0.265 per share.

On March 31, 2014, we had \$13.4 million cash on hand and had liquidity of approximately \$267 million including cash and borrowings available under our revolving credit facility. As we have previously indicated, we currently anticipate issuing senior notes during the second half of the year to provide sufficient liquidity to meet our anticipated cash requirements, including construction expenditures.

Now turning to slide 15, we are reaffirming our 2014 earnings guidance with a range of \$2.10 to \$2.50 per share. Although the mild weather conditions caused our first quarter revenues to come in towards the lower and upper expectations, there were several offsetting positive developments which occurred during the first quarter.

These positive developments included lower than anticipated pension expense associated with changes to our retirement plan, higher deregulated Palo Verde Unit 3 revenues and the nuclear decommissioning trust gains previously discussed. As a result, we are maintaining the earnings guidance that was previously issued earlier in the year.

I will now hand the call back over to Lisa for potential questions.

Lisa Budtke: Thanks, Nathan. This concludes our first quarter 2014 earnings presentation. So I will now open up the call for questions, Catherine.

Operator: Thank you, ladies and gentlemen, to queue up for a question or comment please press star 1 on your touch-tone telephone. If you're on a speakerphone please make sure your mute function is turned off to allow your signal to reach our equipment. Again, ladies and gentlemen, star 1 for questions. We'll go first to Paul Fremont with Jefferies.

Lisa Budtke: Good morning, Paul.

Paul Fremont: Hi. My first question is, can you just quantify in terms of cents per share what the weather only impact was on the quarter, both relative to last year and relative to normal?

Nathan Hirschi: The total amount of revenues was about \$0.08 per share, substantially all of that was related to the residential customer class and residential is the the most sensitive to weather. And so we would estimate that the majority of that decrease was related to weather.

On the public authorities' class, the revenue stayed about the same as last year. Well, it was actually flat, slightly up. So we would say, the majority of that, if not substantially all of that, was weather related to the residential class.

Paul Fremont: Okay, and then when I think in terms of non-recurring pieces in the quarter, you said that roughly half of the property tax increase was non-recurring so about \$0.02 of the expense?

Nathan Hirschi: Yes.

Paul Fremont: And then, I would assume that the Palo Verde nuclear decommissioning gains and the sale of land would be the other non-recurring items, right?

Nathan Hirschi: I think that's fair, Paul.

Paul Fremont: Okay, My last question is, I think Mary laid out the rate filings having to do with Montana. Are there anticipated rate filings in the years beyond '15 for additional rate base investment coming online?

Mary Kipp: Yes. We currently plan to file an additional rate case when we bring Montana Unit 4 on in 2017. But as I said previously, we are constantly analyzing what the strategy will be as we move ahead and obviously it's going to be somewhat depending on growth as well as our success in the upcoming rate case.

Paul Fremont: Okay, but would that happen after the plant is in commercial operation? Or could there be a rate filing between the '15 filings and that unit coming online?

Mary Kipp: There could be a filing and we just haven't solidified that strategy yet. There could be a filing after Unit 3, for example, after that comes on commercial operation.

Paul Fremont: Okay. Thank you very much.

Operator: Thank you. Once again star 1 for questions. We'll take our next question from Neil Mehta with Goldman Sachs.

Neil Mehta: Good morning.

Lisa Budtke: Good morning, Neil.

Neil Mehta: So first question relates to O&M growth. I think we have a good sense of what the O&M level is going to be in 2014. How do you recommend modeling that growth rate in terms of O&M post 2014? And what are the biggest components that are going to drive up side or down side?

Nathan Hirschi: Well, probably one of the best developments there is pension and OPEB. We think we've gotten a good handle around that which will keep it somewhat flat for the next several years where it has been on the increase. But besides that, I think that the biggest changes will be just trying to keep the growth of the business at a lower level of O&M than our revenue of sales. So the business is growing when we bring Montana online, we will see some additional O&M cost with operating that plant, obviously, and we are optimistic that we, or the goal is to keep that below the level of revenue growth.

Neil Mehta: And as you target revenue growth, is 2 to 2.5 percent still the number you are dialing in post 2014 in terms of growth in load and also in terms of revenue?

Nathan Hirschi: Yes, what we use for guidance for 2014, we used the 2 percent growth when we met in New York for Analyst Day. I think that's still where we are targeting at and we will have to see how things play out a little bit. You know, that's a little bit lower than what we had

forecasted for the last 10 years or so, but that 2 percent is probably what we will focus on until we see a more consistent trend.

Neil Mehta: Then the dividend for EE is still well below peer levels in terms of the pay outs. So when do you start thinking about relating the dividend, bringing that pay out closer to peer levels?

Nathan Hirschi: We are going to, as we have said in the past, try to anticipate growing up by the 4 to 6 percent that we have talked about in the past and during the construction process of Montana and then the regulatory process that will soon follow that. We'll probably stay during that stage into the plan that we have been marching on although at that point, we will have to reconsider when the uncertainties related to the regulatory situation in the Montana construction. Then we will have to readdress that.

Neil Mehta: Got it, thank you very much.

Operator: Thank you. Once again, ladies and gentlemen, star 1 for questions. And Maury May with Power Insights. Your line is open.

Maury May: Yes, good morning, folks.

Lisa Budtke: Good morning, Maury.

Maury May: On your sales in the first quarter, your large commercial and industrial was also down by a significant amount, not as much as residential, but still down 7.4 percent, and you said that was due to the discontinued operation of a couple of customers. I was just wondering who those customers were or at least what kind of industries they were in?

David Carpenter: This is David Carpenter. Maury, one was a Rock Quarry, excuse me, not Rock Quarry, a metal shredding business and then fairly light manufacturing. What we expect and what we already are aware of basically some industrial customers that are likely to replace that load later in the year. One other factor there is that we had at least one other very large customer that had a fairly significant maintenance outage during the first quarter that we don't expect it to see in future quarters.

Tom Shockley: Yes, on that one, Maury, the C&I large KWH, over 60 percent of that decline related to the refinery in town that had a maintenance overhaul, but its revenue was relatively flat based on the demand charges there. So the 60 percent of that related to one customer that didn't see decline in revenues.

Maury May: Okay. I am a little confused. You said that 60 percent of the decline related to a refinery that had an outage.

Nathan Hirschi: No, 40 percent of the KWH.

Maury May: I am looking at KWH, and I am a little confused here. You said 60 percent of the lower KWH sales was related to an outage at a refinery and that didn't have anything to do with the two customers leaving the discontinuing operations.

Nathan Hirschi: That's right, the discontinued operations really affected the revenue line and the usage at the refinery was the primary driver on the KWH line but didn't affect the revenues.

Maury May: Okay. So your economic argument about improving El Paso trade with Juarez does continue intact. Is that correct?

Nathan Hirschi: Yes, I mean the C&A large is 7.2 percent of our revenues and so we think that most of the sales growth related to Juarez and the rebound of Juarez will probably come in to the C&I small category.

Maury May: Okay, good enough. Thank you very much.

Lisa Budtke: Thanks, Maury.

Operator: Thank you. Once again star 1 for questions. And we'll go to Joe Zhou with Avon Capital Advisors.

Joe Zhou: So one question on your negative \$0.08 on weather. So how much is that due to the normal and how much of that is related to the favorable weather condition in 1Q '13?

Nathan Hirschi: That's a good question. We really haven't analyzed it that closely to be able to draw the distinction but part of it is part of both. Last year was a favorable weather condition, and this year it was below favor. So, yes, some of it is.

Tom Shockley: The chart really speaks for that pretty effectively when you look at the bar chart that shows how much under we were from average and how much over 2013.

Nathan Hirschi: Perhaps half and half on slide 12.

Joe Zhou: Half and half. So \$0.04 worth is normal?

Nathan Hirschi: That's probably close.

Joe Zhou: Okay. Thank you.

Operator: Thank you and with no additional questions, I will go ahead and turn things back over to our speakers for any additional or closing remarks.

Lisa Budtke: Thank you, Catherine, and everyone that joined us on the call today. We look forward to seeing you at one of our upcoming marketing tours. Thank you.

Operator: Thank you. Ladies and gentlemen, that does conclude today's conference. Thank you all again for your participation.

END