EL PASO ELECTRIC CO
Moderator: Lisa Budtke
February 24, 2016
9:30 am CT

Operator: Good day and welcome to the El Paso Electric Company 4th Quarter 2015 earnings conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Lisa Budtke. Please go ahead.

Lisa Budtke: Thank you, Deanna. Good morning, everyone. Thank you for joining the El Paso Electric Company 4th quarter 2015 earnings call. My name is Lisa Budtke and I'm the Director of Treasury Services and Investor Relations for El Paso Electric. On the call with us today are 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 2015 Form 10-K will be filed with the Securities and Exchange Commission (SEC) on or before Monday, February 29, 2016.

A replay of today's call will be available shortly after our call ends and will run through March 9, 2016. The details as they relate to the replay are disclosed in our press release.

On slide 2 of our presentation you will see our safe harbor provisions. In summary, our earnings presentation, comments and answers to your questions may include statements that are not historical fact and thus constitute forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the Company's actual results in future periods to differ materially from the expectations stated here. As the format of this presentation does not permit a full discussion of these risks, please refer to our Form 10-K and other SEC filings for a discussion of 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. At this time, I would like to turn the call over to Mary.

Mary Kipp: Good morning, everyone. On slide 3 of the presentation, I will briefly cover our financial performance in 2015. During the fourth quarter we were able to record positive earnings of $0.02 per share despite the negative impact resulting from regulatory lag associated with the placement of new assets into service in the first quarter of 2015, without a corresponding increase in revenues. For the year, we reported net income of $81.9 million, or $2.03 per share, which was right at the midpoint of our guidance range issued during our third quarter earnings call.

Also of note, on January 28, 2016, the Board of Directors declared a quarterly cash dividend of $0.295 per share payable to shareholders on March 31, 2016.

If you will now turn to slide 4 of the presentation, I would like to point out some of the significant highlights that the Company achieved in 2015.

As I look back on all of the challenges we faced in 2015, I'm extremely proud of the achievements made by the Company during a very dynamic year. We began the year by completing construction of the first two generating units at the Montana Power Station. These first two units were completed on schedule and are currently providing enough energy to serve 80,000 homes in our growing service territory. We also completed construction of our new 100,000 square foot Eastside Operation Center in early 2015. The new operations center incorporates green design features which include energy efficiency and water conservation concepts. The operations center will also consolidate many of our El Paso warehousing, fleet, line crew and engineering personnel into one location allowing us to improve the efficiency of operations, including outage response times.

One of the biggest accomplishments in 2015 was the filing of rate cases in both Texas and New Mexico. The cases were necessary to seek recovery of approximately $1.3 billion that has been invested in new electric plant to meet customer growth and grid modernization since June 2009. I am also pleased with the progress of construction on the latest additions to our portfolio of local generation. Construction of Montana Units 3 & 4 is on schedule, on budget and is progressing well. In 2015, our consistently growing service territory and hotter than normal summer weather combined to create another native peak record of 1,794 megawatts achieved on August 6, 2015. This was the second native peak record achieved by the Company during 2015. El Paso Electric has set a new native peak record in 10 out of the last 11 years. I'm also pleased that Palo Verde had another stellar year in 2015 increasing its capacity factor to 94 percent. Palo Verde recorded its highest output ever in 2015, and once again ranks as the nation's largest power producer for the 24th consecutive year.

Also during 2015, the Company was able to successfully implement a management transition strategy. Several key management positions were filled from within the Company in 2015 which will leave the Company well positioned for the future and will enable us to provide the safe and reliable service that our community has grown to know.

Also in 2015, our employees' commitment to excellence and our continued focus on our customers allowed us to maintain favorable customer satisfaction ratings. I am also happy to see how the El Paso Electric family came together to benefit the local community last year. Our employees devoted their time and effort by volunteering almost 10,000 hours to our communities.

At this time, I would like to turn to slide 5 where I will discuss the Company's 2016 objectives.

Construction of Montana Units 3 & 4 continues as planned. We expect Montana Unit 3 to be available for commercial operation in time for our summer peak season and we anticipate that Unit 4 will be placed into service by the end of this year, which are among our main objectives for 2016.

Also in 2016, we anticipate further lowering our carbon footprint by becoming a coal free utility. We intend to sell our 7 percent ownership interest in Four Corners Units 4 & 5 and associated common facilities to Arizona Public Service Company in July pending regulatory approval. This transaction will not only allow us to become a cleaner utility, but it will help limit the Company's financial obligations relating to changing environmental regulations.

Our 2016 objectives also include the negotiation of a new collective bargaining agreement with the International Brotherhood of Electrical Workers Local 960, which represents approximately 38 percent of our local workforce. The current agreement expires in September of this year. We look forward to working with our union to reach a new agreement that allows us to continue to provide our customers with a high level of service.

The addition of affordable large scale solar projects to our generation mix has been an objective of the Company for several years now. We currently receive over 5 percent of our total generating capacity from solar resources. As the cost of producing large scale solar continues to decrease, we will be exploring the possibilities of expanding this renewable resource. In the near term, our current integrated resource plan calls for the addition of 8 megawatts of large scale solar to be added to our system by year end.

Over the past several years, El Paso Electric has consistently ranked near the top for grid reliability as compiled by the Public Utility Commission of Texas and we are confident we will continue that trend in 2016. In addition, our customer care department has made it a priority to always strive to improve upon the good results of recent customer satisfaction surveys. An additional objective, that is very important to our Company, is to continue to improve communication and relationships with all stakeholders.

Last but not least, the next round of rate cases will be primarily driven by the need to recover costs for Montana Units 3& 4. These cases are currently anticipated to be filed in early 2017.

If you'll now turn to slide 6, I will provide some details on our current rate case filings in Texas.

In Texas, we initially filed for an increase in non-fuel base revenue of $71.5 million, which was then revised to $63.3 million. The filing also included a requested Return on Equity of 10.1 percent and an equity ratio of 49.5 percent. On January 21, 2016, the Company filed a joint motion to abate the procedural schedule for our Texas Rate Case filing. The joint motion was filed on behalf of the Company, the City of El Paso, the Public Utility Commission of Texas staff, the Office of Public Utility Council and the Texas Industrial Energy Consumers. The motion to abate the procedural schedule was filed in order to facilitate ongoing settlement talks. We continue to work towards a settlement with all parties and we will continue to file weekly updates with the PUCT regarding progress. We anticipate that the Company will begin billing customers for the new rates during the 2nd quarter of this year, but pursuant to legislative changes we have the ability to surcharge customers for new rates relating back to consumption beginning on January 12, 2016.

On slide 7, I will provide a brief update of our New Mexico regulatory filings. In New Mexico, our original rate case filing requested a non-fuel base rate increase of $8.6 million, which we subsequently lowered to $6.4 million. Hearings on the merits of the general rate case took place in mid- November. Last week, the Hearing Examiner recommended a $640 thousand non-fuel base rate increase. Although we are not in agreement with all the items contained within the Hearing Examiner's recommendation, we recognize that this is just another step in the process and look forward to making our case before the full New Mexico Commission. The Commission currently is scheduled to issue a Final Order by April 8, 2016, although this deadline maybe extended by the Commission up to two months. All parties in the case will be filing exceptions to the Hearing Examiner's recommendation in the coming weeks, after which there will be an opportunity for parties to respond to those exceptions.

The primary reason for the difference between our request of $6.4 million and the Hearing Examiner's recommendation of $640 thousand is due to approximately $97.7 million for pension and other post-employment benefit liabilities, on a total company basis, being included as a rate base offset. Another reason for the difference between our ask and the Hearing Examiner's recommendation involves return on equity. We've requested an ROE of 9.95 percent and the Hearing Examiner recommended an ROE of 9.6 percent. These two items comprise a little over one half of the difference. Several smaller cost of service items make up the remaining difference. A critical component of the Hearing Examiner's recommended decision is that substantially all of our plant in service was deemed reasonable and necessary.

The treatment of our pension and other post-employment benefit liability as a rate base offset is one of the items to which we will file an exception. Our attorneys and other members of the regulatory team are still evaluating the recommended decision and are identifying all items to which we will file an exception.

We currently anticipate that a Final Order from the New Mexico Commission could be issued in the second quarter.

Also along the regulatory front in New Mexico, we recently participated in hearings regarding the sale and abandonment of our 7 percent ownership in Units 4 & 5 and related facilities at the Four Corners plant. On February 2nd, the Company filed an unopposed joint stipulation reflecting a settlement agreement. We anticipate receiving a final order by the first half of this year. In December 2015 the Federal Energy Regulatory Commission authorized Arizona Public Service Company to purchase our ownership interest in Units 4 & 5 and common facilities of Four Corners. So we anticipate closing this transaction in July of 2016.

If you will now turn to slide 8, our potential timeline for the next round of rate cases has not changed. In New Mexico, the Company anticipates filing a rate case in the first quarter of 2017 using an historic test year ended September 30, 2016. Although Montana Power Station Unit 4 is not scheduled to be placed into service until December of 2016, precedent in New Mexico allows us to include in rate base plant additions completed within five months of the test year end date. A final order and new rates would then be anticipated to take effect during the first quarter of 2018.

Looking at the Texas timeline, we also anticipate filing our rate case in the first quarter of 2017 using an historic test year ended September 30, 2016. Our timeline reflects a potential final order to be issued during the first quarter of 2017; however, due to legislative changes we have the ability to surcharge customers for new rates relating back to consumption beginning on the 155th day after the rate case is filed. This means the effective date for new rates could be applied as early as the third quarter of 2017, even if the schedule for the rate case were to be extended.

I'd now like to turn the call over to Nathan who will discuss our financial results.

Nathan Hirschi: Thank you, Mary. Turning to slide 9, we list the key earnings drivers for the 4th quarter and the year compared to the prior year.

Beginning with the negative drivers for the quarter, earnings were lowered by $0.07 per share due to decreased AFUDC resulting from lower balances of construction work in progress. As we have discussed, this was primarily due to the placement in service of Montana Units 1 & 2 and the Eastside Operations Center in the first quarter of 2015. Placing these assets into service also contributed to an increase in depreciation expense resulting in a $0.03 per share reduction in earnings for the quarter. The impacts of regulatory lag associated with placing these assets into service without a corresponding increase in revenue was expected and is the primary reason we have filed for rate increases in Texas and New Mexico.

Increased administration and general expenses also decreased earnings per share by $0.04 for the quarter and was primarily due to increased payroll costs and employee incentive compensation, as well as increased payroll and benefits costs. Also during the quarter, interest accrued on $150 million of senior notes issued in December 2014 negatively impacted earnings by $0.02 per share. Earnings also declined during the quarter by $0.02 per share due to decreased Deregulated Palo Verde Unit 3 revenues reflecting a decline in the price of natural gas when compared to the same period of last year.

On the positive side, net income for the fourth quarter of 2015 compared to the same period last year was positively affected by a decrease in operation and maintenance expense related to our fossil-fuel generating units. The decrease in expense was primarily due to decreased maintenance at the Four Corners and Newman plants. The lower level of O&M expense resulted in an increase in earnings of $0.06 per share. However, a planned outage at Four Corners was moved from the fourth quarter of 2015 to the first quarter of 2016 so we will have a corresponding increase in the first quarter. Retail non-fuel base revenues also increased during the 4th quarter primarily driven by an increase in number of customers in our residential customer class and slightly more favorable weather conditions. Non-fuel base revenues increased earnings by $0.02 per share when compared to the same period of 2014.

As you can see on the same slide, many of the same drivers that impacted the 4th quarter earnings also serve as drivers for the year-to-date results of $2.03 per share. The earnings drivers that impacted the year-to-date results that were not already mentioned for the 4th quarter were investment and interest income and the Palo Verde Performance Rewards. Investment and interest income had a positive impact on earnings for the year due to gains resulting from the further diversification and rebalancing of our Palo Verde decommissioning trust portfolio, which increased earnings by $0.07 per share. Palo Verde performance rewards impacted the year negatively by $0.04 per share due to the performance rewards associated with the 2009 to 2012 performance periods being recorded in 2014 with no comparable amount in 2015, as these amounts are normally recorded upon the completion of our Texas fuel reconciliation filings.

If you now turn to slide 10, we have provided a chart to illustrate the weather conditions experienced in our service territory during the past 10 years.

The chart includes a comparison of normal weather to the actual weather recorded in our service territory. As you can see, heating degree days in 2015 were 10.3 percent higher than the same period last year, but remained 3.6 percent below the 10 year average. In 2015, cooling degree days were 5.3 percent higher than the 10 year average and 6.3 percent higher than 2014, which helped to drive the increase in revenues from our residential customers and primarily impacted our 3rd quarter results.

Now turning to slide 11, we have provided a comparative analysis of the changes in retail non-fuel base revenues and megawatt hour sales by customer class for the 4th quarter of 2015 compared to the same period of 2014. During the quarter, total retail non-fuel base revenues increased by $1.4 million, pretax, or 1.2 percent over the same period in 2014. The increase was primarily due to a 2.6 percent increase in megawatt hour sales to the residential customer class, which also recorded a 3 percent increase in non-fuel base revenues, reflecting favorable weather and 1.4 percent increase in the average number of customer served.

We have provided the same analysis for the year on slide 12. For the year, total retail non-fuel base revenues increased by $14.3 million, pretax, or 2.6 percent over the same period in 2014. Most of this was attributable to an increase in sales to the residential class. Hotter than normal summer weather was largely responsible for the 5.1 percent increase in residential non-fuel base revenues when compared to the same period in 2014.

Now turning to the slide 13, our cash capital expenditures for 2015 for additions to electric utility plant were $281.5 million. In terms of cash dividends, we paid $47.1 million during the 12 months ended December 31, 2015. On December 31, 2015 we had liquidity of approximately $166 million including a cash balance of $8.1 million and borrowing capacity available to us on our credit facility. As we continue to make progress on our current construction program, we anticipate returning to the debt markets in the first half of 2016 to issue long-term debt.

Now turning to slide 14, I'd like to provide our five year projection of capital expenditures. On this chart you will see that we plan to spend $231 million on construction expenditures in 2016. Over the next five years we currently anticipate spending approximately $1.1 billion to ensure that we have the generating capacity required to meet our customers' growing demand for electricity. The projection also includes expanding and updating our transmission and distribution infrastructure. These amounts are subject to revision as we continue to adjust and revise our construction plans.

Now turning to slide 15, I would like to discuss a revised rate base projection based on our current construction plan. As Mary mentioned earlier, we anticipate Montana Units 3 & 4 to be placed into commercial operation by the end of 2016. After the completion of these two units, total rate base is expected to grow to approximately $2.1 billion. This amount is an approximation of our rate base at the time of our next rate case filings in 2017.

Turning to slide 16, I would like to wrap up today's presentation with some comments regarding our 2016 Earnings Drivers. Once we get further down the road on our rate cases we will provide specific guidance. For now, we will discuss some key earnings drivers for 2016.

As you can see there are several factors that will negatively impact earnings in 2016. Most of the negative drivers are directly related to the regulatory lag which will especially impact the first quarter and in fact could result in negative earnings per share for the first quarter of 2016. The primary components of regulatory lag in 2016 are higher property taxes, lower AFUDC, increased O&M, depreciation expense and interest expense. Other items that are anticipated to negatively impact earnings include a higher effective tax rate, a return to normal weather conditions and a decrease in investment and interest income. The effective tax rate is anticipated to increase to approximately 36 percent for the next several years due to higher state income taxes and a reduction in the manufacturing tax credit due to bonus depreciation being extended through 2019. Earnings are anticipated to be positively impacted by rate increases in Texas and New Mexico as well as customer growth. Again just to emphasize the point, it is possible that we could have negative earnings per share in the first quarter of 2016.

At this time, I'd like to turn the call back over to Lisa.

Lisa Budtke: Thanks, Nathan. Deanna, please open the call for questions.

Operator: Thank you, ma'am. If you'd like to ask a question, please press star 1 on your touch-tone phone. Please be sure you are unmuted so your signal reaches our equipment. Again, star 1 for questions. We'll go first to Brian Russo of Ladenburg Thalmann.

Brian Russo: Hi, good morning.

Nathan Hirschi: Hey Brian. How are you?

Mary Kipp: Good morning.

Brian Russo: Good, thanks. Can you quantify if any, the impact to rate base from bonus depreciation?

Nathan Hirschi: The bonus depreciation will give us about a $30 million impact in 2016.Then, until it expires in 2019, it'll be about a $65 million benefit. So a moderate benefit. And that benefit has been factored into the rate base charts that we provided on slide 15.

Brian Russo: Okay. I apologize but I didn't have time to compare slide 15 with your prior update, but there have been some adjustments on that slide?

Nathan Hirschi: Some adjustments, although it's pretty consistent with what we've shown in the past.

Brian Russo: Okay. So I guess the $65 million is the cash flow benefit? Is there any rate base offset?

Nathan Hirschi: Yes. It'll both be a cash flow benefit and the rate base offset, but that's at the end of the four-year period. For 2016, it kind of has an offsetting effect; we think we will be in an NOL position so it won't really have that dramatic of effect for 2016. It will generate bonus depreciation that we didn't initially anticipate. Some of that will be offset by some NOLs, so it won't have that dramatic of an effect.

Brian Russo: Okay. Understood and then the CAPEX slide, it looks like there were some upward increases in the annual CAPEX. Can you maybe talk about that?

Nathan Hirschi: It's very comparable to what we saw last year actually. What we had last year was $281 million that we expended .. But we added a relatively high year in 2020 when we anticipate building the next two combined cycles. So we ended the year slightly below with the five-year projection at $1.084 billion, which is slightly below what we had in the five-year projection last year. So that stays relatively consistent to what we had last year on a five-year basis.

Brian Russo: Okay. Can you talk about where the normalized load growth was in '15 and what your outlook is?

Nathan Hirschi: Yes. Obviously we had a very good year last year from a revenue perspective and a lot of that was obviously attributable to the very hot summer. If you remember, we had 106 days in a row where it was over 90 degrees, so we had a very nice summer. Regarding revenue growth, we think about half of it was attributable to above average weather. We also saw solid customer growth which we've continued to see expanding at the 1.4 percent growth rate and that's been real positive. Perhaps about $5 to $6 million or about half the growth was weather related.

Brian Russo: And then just with the new legislation in Texas and your ability to capture the rate increase 155 days prior to when rates are effective. How does that kind of like flow through the income statement? And what's kind of like conceptually the margin impact from that?

Nathan Hirschi: Yes. That's why the first quarter looks kind of challenging. Although, ultimately when we settle the Texas rate case, we will be able to relate back the revenues to January 12th. But we won't record that in the first quarter. We don't have the certainty of the amount of the rate increase until we have a final order. So when we have the final order which we anticipate would be likely during the second quarter, that's when we would pick up the revenue that would relate back and that would be billed as a surcharge over perhaps an 18-month period..

So that's one of the reasons why we have a challenging first quarter. We don't feel comfortable recording that revenue until the second quarter. Assuming all the regulatory issues work out as we hope.

Brian Russo: Okay. So when new rates go into effect you will collect over an 18-month period conceptually, rates effective starting in January of '16.

Nathan Hirschi: Yes. That's how we envision it working.

Brian Russo: Okay. Thank you.

Nathan Hirschi: Thanks Brian.

Operator: Thank you. Again, star 1 for questions. We'll go next to Ben Budish of Jefferies.

Ben Budish: Good morning, guys. How are you doing?

Nathan Hirschi: Hi Ben.

Mary Kipp: Good morning.

Ben Budish: I just have a quick question on New Mexico. It looks like with Texas it should be fairly easy to, push those rates back to January. Is there any kind of sensitivity to the delay in implementation of rates if the decision gets pushed back into June? Any guidance on that?

Nathan Hirschi: Yes. I mean that is one of the issues we had originally anticipated putting in new rates, perhaps April 1st in New Mexico and as the case continues it will be pushed back a little bit later in the year. We're not sure exactly how quickly it could move from here, but it could delay further into the year. We think during the second quarter is probably a reasonable date.

Mary Kipp: And because so much of our revenue is dependent on the second and third quarters, we're hopeful that we'll have the new rates in time to take advantage of them during those quarters.

Ben Budish: Okay, great. Then I saw one of the year over year drivers is the lower AFUDC. In the release you had mentioned that it was due both to Montana 1 & 2 being put into service and a reduction in the rate base or I'm sorry, the AFUDC rate. Is that reduction significant or is this looking to apply when 3 & 4 go in, thinking about the timing and comparing that to when 1 & 2 went in?

Nathan Hirschi: No, I'm sorry the rate?

Ben Budish: The AFUDC rate. Yes.

Nathan Hirschi: The rates should be relatively constant from what we have now. We just have a more outstanding balance on our revolving credit facility which kind of causes the rate to go down a bit. So you'll see the rate that we disclose in the 10-K coming up, when we file that and that should be pretty close to the rate that we have going forward.

Ben Budish: Okay, great. Thank you.

Nathan Hirschi: Thanks Ben.

Operator: Once again, star 1 if you'd like to ask a question and please be sure you are unmuted so your signal reaches our equipment. Star 1 for questions and it appears we have no further questions. I'd like to turn the conference back over for any additional or closing remarks.

Lisa Budtke: Thank you, Deanna. I just want to thank everyone for joining us on today's call and please be safe.

Operator: Thank you for your participation. That does conclude today's conference. You may now disconnect.

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