EL PASO ELECTRIC CO.
Moderator: Lisa Budtke
August 2, 2017

Operator: Good day, everyone, and welcome to the El Paso Electric Company Second Quarter 2017 Earnings Call. Today's conference is being recorded. At this time, I'm pleased to turn the conference over to Lisa Budtke. Please go ahead, ma'am.

Lisa Budtke: Thank you, Jennifer. Good morning everyone. Thank you for joining the El Paso Electric Company's Second Quarter 2017 Earnings Conference call. My name is Lisa Budtke, and I'm the Director of Treasury Services and Investor Relations. On the call today are CFO, Nathan Hirschi; VP and Regulatory Affairs, Jim Schichtl; VP and General Counsel, Adrian Rodriguez and other members of the Senior Management team. Mary Kipp, our CEO and President, ask that we apologize because she is traveling and technical difficulties have prevented her from joining us on today' call as planned.

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 2nd Quarter 2017 Form 10-Q will be filed with the Securities and Exchange Commission (SEC) on or before August 4, 2017.

A replay of today's call will be available shortly after our call ends, and will run through August 16, 2017. 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, comments and answers to your questions may include statements that are not historical facts and thus constitute forward looking statements. Such forward-looking statements involve known and unknown risk, uncertainties and other factors that may causes the Company's actual results in future periods to differ materially from those 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, 10-Q and other SEC filings for a discussion of the risk factors that should be considered. These filings maybe 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 and on behalf of the Company. Now, I'll turn the call over to Nathan.

Nathan Hirschi: Good morning everyone and thank you for joining today's call. I'd like to begin by summarizing our 2017 second quarter and year-to-date financial performance. As you can see on slide 3, the second quarter of 2017, we reported net income of $36.1 million or $0.89 per share compared to $22.3 million or $0.55 per share for the second quarter of 2016. For the first six months ended June 30, 2017, we reported net income of $32.1 million or $0.79 per share compared to the first six months of 2016 net income of $16.5 million or $0.41 per share.

For the quarter, our improved financial results are largely due to the new rates that were approved in our 2015 rate cases, the resolution of our 2016 Texas fuel reconciliation, continued customer growth and warmer weather conditions.

Our 2017 results are not exactly comparable to 2016. As you may recall, we recorded the impacts of the Texas rate case during the third quarter of 2016, which included the relate back revenues for consumption beginning on January 12, 2016. Therefore, the three month and the six months periods ending June 30, 2016 did not include approximately $8 million and $12.6 million of net income or $0.20 and $0.31 per share, respectively for the 2015 Texas rate case impact.

Also, despite the fact that new rates were in effect, we reported a net loss of $0.10 per share in the first quarter of 2017, which offset the earnings of $0.89 per share that we recorded in the second quarter of 2017. The loss in the first quarter was primarily due to the negative impact of regulatory lag, mild weather and the seasonality of our business. Further, it should be noted that the $0.79 per share earned in the first six months of this year is lower than the level of earnings that we reported in 2013 and 2014, which was before the substantial regulatory lag we experienced in recent years.

Now, I will provide you with a brief update of our 2017 Texas rate case filing.

On June 5th, the Texas Administrative Law Judges approved an unopposed motion to sever our rate case expenses into a separate docket. A motion to separate the rate case expenses was filed to promote efficiency and to prevent delays. This is consistent with what occurred in our last rate case.

On July 21st, we revised our requested non-fuel base revenue increase of $42.5 million to $39.2 million as part of our rebuttal testimony largely to reflect the separation of $3 million in rate case expenses. For our general rate case, hearings on the merits are scheduled to begin on August 21st, and continue through September 1st. Upon resolution of this case we will exercise the relate back provision, which will relate new rates back to consumption beginning on July 18, 2017. In the meantime, we continue to work diligently toward a successful resolution of this case. Turning to slide 5, I will now discuss some other recent developments.

We are pleased to announce that the Company's Texas Community Solar Program became commercially operational in the second quarter of 2017. This was a significant accomplishment, as the addition of affordable large scale solar projects to our generation mix has been an objective for several years now. This three megawatt facility, which is located at the Montana Power Station, provides customers with a clean alternative that is fair for all customers as it does not rely on inter or intra class subsidies.

The Holloman Air Force Base project is another example of the Company's commitment to evaluate and invest in innovative ideas and technologies that benefit our communities and the environment. This five megawatt solar facility will be dedicated to the Base and will assist the Air Force in meeting its renewable and energy security goals. We anticipate the construction will be completed in the first half of 2018.

We continually evaluate how best to plan for the growth of our region and the changing needs of our customers. So, we continue to keep our customers' best interests in mind as we continue to explore additional projects.

If you now turn to slide 6, I would like to highlight the fact that we set a new native system peak record of 1,935 megawatts on June 22, 2017. This new peak surpassed our 2016 record peak of 1,892 megawatts by 2.3 percent or 43 megawatts. We have now set a new native peak record in16 out of the past 17 years. We experienced a heatwave in

June where the high temperature was above 100 degrees for 10 consecutive days. This heatwave contributed to the establishment of the new native peak. Due to the growth in our service territory and the demands placed on our system, we continue to plan diligently to add generation resources to meet the needs of our service territory in a safe and reliable manner. On the next slide, I will go over the request for proposal we recently issued to meet the future power needs of our region.

On June 30th, the Company issued an all-source request for proposal for new generating resources as a result of the increased electrical demand by our customers due to regional growth and to replace older, less-efficient generating units. Our resource planning studies indicate that a total of approximately 370 megawatts of additional resources will be needed by the summer of 2023. Approximately 50 megawatts of capacity will be needed by 2022 with the additional capacity of 320 megawatts by 2023. Bids are to be submitted by October 4th, and we anticipate a final decision will be made in the second quarter of 2018. Once we analyze all the bids from the RFP, we will provide more clarity with regards to our capital expenditures plan. All sources of generation will be considered in order to provide the most cost-effective, reliable and affordable electricity that promotes and supports the continued economic development of our service territory.

Next, we will look at the key earnings drivers for the second quarter. Although earnings for the second quarter appear favorable compared to last year, it’s important to consider that the impacts of the 2015 Texas rate case were not recorded until the third quarter of 2016.

Turning to slide 8, I will begin with the positive earnings drivers. Net income during the quarter was positively impacted by increased retail non-fuel base revenues, which resulted in increased earnings per share of $0.30. The increase was primarily due to the recognition of the rate increase approved in our 2015 Texas rate case. For the second quarter of 2016, increased revenues representing $0.18 per share were not recorded until the third quarter of 2016. In addition to the implementation of the new rates, warmer weather and the 1.8 percent customer growth in the average number of retail customers served also contributed to the increase in retail non-fuel base revenues.

Another driver for the quarter that contributed $0.08 per share was the recognition of the Palo Verde performance rewards, net of disallowed fuel and purchased power costs. This item was related to the resolution of the Texas fuel reconciliation proceeding.

Also during the quarter, an increase in investment and interest income primarily due to higher realized gains on securities sold from our Palo Verde decommissioning trust increased earnings by $0.06 per share. Another item that positively impacted the quarter was a decrease in our depreciation rates, which were approved in our 2015 Texas and New Mexico rate cases. The new depreciation rates, combined with the sale of the Company’s interest in the Four Corners Power Plant, increased earnings by $0.02 per share.

Turning to the negative drivers, earnings declined by $0.05 per share due to decreased AFUDC. The primary reason for the decline in AFUDC was lower balances of construction work in process due to the Montana Units 3 and 4 being placed into service in 2016. Earnings were also negatively impacted by $0.04 per share due to increased administration and general expenses primarily due to the timing of the accrual of employee incentive compensation and an annual merit increase.

We also experienced a decline in earnings per share during the quarter of $0.03 per share due to higher taxes primarily due to increased revenue related taxes and increased property valuations in Texas as a result of Montana Units 3 & 4 being placed in service in 2016.

If you now turn to slide 9, we have provided an analysis of the changes in megawatt hour sales by customer class for the second quarter of 2017 compared to the same period in 2016. Retail megawatt hour sales increased by 4.2 percent for the quarter. The increase in retail sales was primarily driven by increased sales to residential customers due to the warmer weather observed during the second quarter of 2017, and a 1.6 percent increase in the average number of residential customers served. As you can see, we continue to experience solid growth in the total number of customers served.

On slide 10, we have illustrated how weather had an impact on our second quarter revenues. Cooling degree days for the second quarter of 2017 increased by 14.8 percent when compared to the same period in 2016 and were 4.5 percent higher than the 10-year average.

Turning to slide 11, I will briefly discuss our capital requirements and liquidity. During the first six months of 2017, our additions to electric utility plant were approximately $108 million. In total, we expect to spend approximately $215 million for cash capital expenditures in 2017. On July 27th, our Board of Directors declared a quarterly dividend of $0.335 per share of common stock. This declaration is consistent with the Company's goal to move towards achieving an annual 55 to 65 percent payout ratio by 2020.

During the third quarter of this year, we have two tranches of debt for approximately $83 million that will mature or be subject to mandatory tender for purchase. We believe that we will have adequate liquidity through our current cash balances, cash from operations and available borrowings under our revolving credit facility to meet all of our anticipated cash requirements for the next twelve months, including the repayment of these tranches of debt.

Before we open the call for questions, I would like to remind everyone that during the third quarter of last year we recorded the impacts of the 2015 Texas rate case for the period from January 12, 2016 through September 30, 2016. So, for the third quarter of 2017 we anticipate a quarter-over-quarter decrease related to the January 12, 2016 through June 30, 2016 period of $12.6 million or $0.31 per share.

At this time, we would like to turn the call over to questions. Can you help us out there, Jennifer?

Operator: Yes, absolutely, sir. Thank you. If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you are using a speakerphone, please be sure your mute function is turned off to allow your signal to reach our equipment. Again, that is star one if you would like to ask a question. We'll pause for just a moment to allow everyone an opportunity to signal. Again that is star one if you would like to ask a question.

Our first question will come from Anthony Crowdell with Jefferies.

Anthony Crowdell: Hey, good morning, nice job, Nate. Just a couple of questions. The $0.30, you said, benefit this quarter. Did I hear you say that $0.18 of that is attributable to the relate back provision?

Nathan Hirschi: Yes, $0.18 was related to the revenue piece, and it was a $0.20 cent benefit year-over-year. The Texas rate case impacts that were recorded last year would have benefited earnings by $0.20 per share, of which, $0.18 would have been a revenue effect, and that's net of tax.

Anthony Crowdell: Okay. So when I look at slide 8, $0.30 driver, $0.18 of it is really a Q2 2016 benefit?

Nathan Hirschi: That's right.

Anthony Crowdell: Okay. Second, the Palo Verde performance rewards, does that happen every two years? Because it was a surprise to me. When may the next surprise occur?

Nathan Hirschi: It's every three years. Actually the last time we recorded it was the second quarter 2014. So we come in and we have to file a fuel reconciliation every three years and this fuel reconciliation was filed at the end of September of last year, September 27th. That filing covered the period April 2013 through March of 2016. So we file every three years. And again, the last time we recorded the performance rewards was the second quarter of 2014.

Anthony Crowdell: Have you ever been charged a penalty? In other words, every three years, it could either be a plus or negative or you just don't get anything?

Nathan Hirschi: Yes. Well, this reconciliation period had $436 million of fuel and purchased power costs, and some of those are disputed. In recent years though, the Palo Verde has been operating so well that we have been at or above the reward area. And so we have, in recent years, we've settled these things with positive results.

Anthony Crowdell: And you've never settled or never had one with a negative result?

Nathan Hirschi: Not in my memory. So I think it goes back to the early 2000's or so.

Anthony Crowdell: Okay and just lastly you don't break out the benefit of what weather was in the quarter as an earnings driver. But I believe when you guys file the TCOS, you have to submit a monitoring, or an earnings monitoring report that you weather normalize. Is that accurate?

Nathan Hirschi: Yes, that's right. Our regulatory filings are weather normalized.

Anthony Crowdell: So are you able to apply the method that you weather normalize that to the quarter and what was the benefit of whether for the quarter?

Nathan Hirschi: Well, for the quarter, we think it was around $3 million. About $3 million benefit for the quarter. For the first six months though, it was almost nothing. We had, if you remember, Anthony, we had a relatively poor weather quarter in the first quarter, and we had an above average quarter in this quarter. So for the six months, there wasn't much of a weather effect, but we did pick up, maybe $3 million in this quarter on weather.

Anthony Crowdell: Okay. And just lastly, I hate to take up all the questions. When I think of your ROE in Texas, I don't want to predict whatever the ROE is. Is there some costs that are not passed through or not recovered in rates that cause you to maybe under earn a certain amount, I don't know if it's 50 bps or something, is that the case?

Nathan Hirschi: Well, yes. There are some costs, for example, financial incentive plans to employees that we did not file for. We did not think that those would be consistent with the Texas statutes. So there are some costs that we did not request. Whereas, there are other costs that we factor in changes in employees, compensation, salary headcount these type items, so they kind of go both ways as we filed the rate case, but there are some cost, incentive compensation that are financially based. That's one that we don't file. So there are some that we do not request, although there areother ways when you annualize yearly headcount that has kind of an offsetting effect.

Anthony Crowdell: Okay, thanks for taking my questions.

Nathan Hirschi: Thanks, Anthony.

Operator: And once again that is star one if you would like to ask a question. And next we'll hear from Brian Russo with Ladenburg Thalmann.

Brian Russo: Just a follow-up on an earlier question on the $0.30 year-over-year impact from non-fuel retail revenues. Just to clarify $0.18 would have been attributable to the second quarter of last year, right? So really the year-over-year, excluding the rate impact is $0.12?

Nathan Hirschi: Yes. So that would be the $0.12 per share; that is, the difference would be attributable to customer growth and weather.

Brian Russo: Got it. Okay and would you be submitting a self-build options in this RFP process?

Nathan Hirschi: That's my understanding. Yes, that we will. So we'll see how that goes.

Brian Russo: And then just on allowed returns or earned ROE going forward. The fact that you have positive load growth and rates are based on a historical test year that helps you earn your ROE in a normalized year?

Nathan Hirschi: Well, it does. I thought one of the better things of the quarter was our customer growth. We had based, on average, 1.8 percent customer growth, which is a little bit higher than what we saw in the 2014-2015 timeframe when we were having customer growth at 1.3 percent and 1.4 percent. So that helps us. It doesn't assure that we'll get there. There's obviously costs that are going up and these capital costs that we're adding are relatively substantial. But even this year, we have $215 million of CAPEX that we plan. So there's headwinds going both ways, but obviously the customer growth and usage growth helps us.

Brian Russo: Got it. Okay, great. Thank you.

Nathan Hirschi: Thanks, Brian.

Operator: And at this time, we have no further questions remaining in queue, but again as a reminder, that is star one to ask a question.

Lisa Budtke: Okay Jennifer, if there's no more questions we can wrap things up.

Operator: Okay.

Lisa Budtke: So thank you for joining us on today's call. Have a great day and please be safe.

Operator: Thank you so much. That does conclude today's call. We do thank you all for your participation. You may now disconnect.