El Paso Electric

Moderator: Steven P. Busser
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10:30 AM ET

Operator: Good day, ladies and gentlemen, and welcome to the El Paso Electric Company's First Quarter Earnings Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question and answer session, and instructions will follow at that time. If anyone should require assistance during the conference, please press star, then zero, on your touch tone telephone. As a reminder, this conference is being recorded. I would now like to introduce your host for today's conference, Steven Busser. Mr. Busser, you may begin.

Steven Busser: Thank you Nikki, and good morning, everyone. Thank you for joining the El Paso Electric Company First Quarter 2011 Earnings Conference Call.

Also on the call with me today I have our CEO, David Stevens, and our CFO, David Carpenter.

Today we'll provide an update on our first quarter 2011 performance and our key earnings drivers. We will also discuss our 2011 earnings guidance.

I'd now like to cover some items that will be pertinent to our call today before we get started.

You should have a copy of our press release. If you do not, you can obtain one on our website on the Investor Relations page.

We currently anticipate that our First Quarter 2011 Form 10-K will be filed with the SEC on or before May 9, 2011. As for upcoming IR events, we will have a sell-side marketing tour with Ticonderoga Securities, formerly known as Soleil Securities, on May 24 and 25 in Boston and New York, respectively.

In addition, we will be having our annual shareholder meeting and Analyst Day presentation in New York on May 26. We will provide further updates on IR events on future conference calls. Please call our IR department if you have any questions or require further information.

A replay of today's call will be made shortly after our call ends, and will run through May 17, 2011. The details as it relates to the replay are disclosed in our press release.

I'd now like to cover the Safe Harbor provisions before I turn the call over to David Stevens.

On Page 2 of our presentation, you'll 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 reference to the risks and factors discussed in the Company's SEC Act filings.

Our 10-K and other SEC filings contain our forward-looking statements and also lay out the risks and 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.

Now I'd like to turn the call over to our CEO, David Stevens.

David Stevens: Thank you, Steve. Good morning and thanks to everybody for joining the call, today. This is David Stevens, the CEO of El Paso Electric. We're going to go ahead and get right into it.

If you'll turn to slide 3, our first quarter 2011 earnings were in line with our expectations due to the change in the rate design that resulted from our 2010 Texas Rate Case agreement and less heating degree days than what we had in 2010, but still approximating our historical average heating degree days.

I remain pleased with the inherent growth that we demonstrated in our retail business, as reflected by our expanding customer base. In the first quarter of 2011, our average number of residential and small commercial and industrial customers grew by 1.5 percent and 1.4 percent, respectively. Our kilowatt-hour sales to public-authority customers increased by 2.9 percent and is reflective of the significant growth at Fort Bliss.

The growth in our local economy has been significantly impacted by the ongoing expansion at Fort Bliss and it continues to positively impact all of our customer growth.

On April 28 of 2011, our Board of Directors declared a $0.22 per common share dividend that is payable on June 30, 2011, to shareholders-of-record on June 15, 2011. This will be the first dividend paid by El Paso Electric in over 20 years pursuant to the common stock dividend policy previously announced.

I'm also pleased to report that during the first quarter of 2011 we repurchased approximately 587,000 shares at a total cost of $16.7 million. We remain committed to enhancing long-term value to shareholders through a combination of cash dividends and share repurchases, while maintaining an appropriate capital structure.

Another important accomplishment that we achieved during the quarter was obtaining final approval from the Public Utility Commission of Texas on our Certificate of Convenience and Necessity or CCN filing for the Rio Grande 9 plant.

We expect to receive final approval for our CCN in New Mexico this summer. Rio Grande 9 will be an 87 megawatt aero derivative peaking unit at the Rio Grande site. After we obtain all necessary approvals, we will begin construction. And we expect Rio 9 to be completed before the summer peak in 2013.

Finally, I'm pleased to announce that on April 30, 2011, Newman 5 Phase II entered commercial operation. I'm proud of the fact that the project was completed on-time and under-budget. The addition of the Phase II of Newman 5 to our generation portfolio will enable us to meet our growing load requirements while allowing us to enhance the level of reliability to our customers.

Finally, a significant legal matter was resolved in April of 2011. The longstanding dispute between El Paso Electric and Tucson Electric, which had worked its way through the FERC and was currently pending in a couple of courts was resolved with Tucson Electric.

In conjunction with this settlement, El Paso Electric will enter into an agreement to provide transmission upgrades and transmission service from a Macho Springs power wind-generation facility near Deming, New Mexico to TEP. This settlement and agreement are subject to final approval by the FERC, but we are appreciative of Paul Bonavia and his entire UniSource Energy team working with us to resolve this amicably.

David Carpenter will discuss the impact of the settlement on our financials later in the call.

If you'll now turn to slide 4, I would like to take this opportunity to update you on Palo Verde.

To begin with, I'm very pleased to announce that on April 21, 2011 after an extensive 2-year evaluation process and review, the plant operator Arizona Public Service Company obtained the final Nuclear Regulatory Commission or NRC approval on the Palo Verde 20-year license extension.

The NRC license renewal process included a complete review of the ability to operate safely in the event of natural disasters such as earthquakes and floods.

Even though Palo Verde is an area of low seismic activity, it is approximately 75 miles from the Sonoran Fault and has been designed to withstand a substantial earthquake.

David Carpenter will also discuss the financial impact of this license extension later in the presentation.

Also, during the first quarter of 2011, Palo Verde operated at a 98.9 percent capacity factor compared to 95.6 percent in the first quarter of 2010. Currently Unit 2 is undergoing a 35-day scheduled refueling and maintenance outage that began on April 2, 2011 and is expected to last through early May.

In closing and before handing the call off to David Carpenter, I want to personally thank the entire team of El Paso Electric employees for their significant contribution they have made toward us attaining our goals. Our employees are a very important component in the success of our Company, and in the creation of long-term value for our shareholders.

Now let me turn the call over to David Carpenter.

David Carpenter: Thank you, David.

Now turning to slide 5 of our presentation, and as discussed by David Stevens, we reported net income of $6.8 million or $0.16 per basic share for the first quarter of 2011, compared to our first quarter 2010 net income of $11.4 million or $0.26 per basic share.

Now if you turn to slide 6, I would like to discuss the main earnings drivers in the first quarter of 2011 compared to the first quarter of 2010. There were three primary drivers affecting our earnings in the first quarter of 2011 compared to the first quarter of 2010.

First, we realized a decline in retail non-fuel base revenue during the first quarter of 2011 of $6.2 million pretax or $0.09 per share primarily due to the new lower winter non-fuel rates for small commercial and industrial customers per the provisions of our 2010 Texas Rate Case Agreement and a 1.2 percent decrease in kilowatt-hour sales.

The seasonal rates are lower in the winter months of November through April and higher in the months of May through October.

Second, off-systems sales margins declined by $4.4 million pretax or $0.07 per share when compared to the first quarter of 2010 due to increased sharing of off-systems sales margins with customers, coupled with lower average market prices for power and a 9.5 percent decrease in megawatt-hour sales.

Last, earnings were positively impacted during the first quarter of 2011 by a one-time non-cash charge of $4.8 million or $0.11 per share in the first quarter of 2010 to recognize a change in tax law included in the healthcare reform legislation, which eliminated the tax benefit of Medicare Part D subsidies with no comparable expense in the current quarter.

Now turning to slide 7, we detail by customer class the change in retail revenues and megawatt-hour sales for the first quarter of 2011 and the percentage change over the comparable period in 2010. As can be seen on this slide the primary driver for the revenue reduction compared to the first quarter of 2010 was lower non-fuel-base revenues from small commercial and industrial customers, which declined by nearly $6 million or 15.3 percent compared to the first quarter of 2010 despite only a 1.2 percent decrease in kilowatt-hour sales to this class of customer.

The primary driver for this reduction was the new seasonal rates that were implemented in Texas with the completion of the rate case in July of 2010. Rates for many small commercial and industrial customers are actually lower than the previous rates in the winter months of November through April. This rate decrease will be more than made up by higher rates for these customers in the summer months of May through October.

Overall, our megawatt-hour sales were impacted by the milder winter weather in the first quarter of 2011 compared to a cold winter in the first quarter of 2010. This is illustrated by the 9.4 percent decline in heating degree days during the first quarter of 2011 compared to the first quarter of 2010.

As a result of this milder weather in the first quarter of 2011, our residential and small commercial and industrial customer classes each posted megawatt-hour sales declines for the quarter. This decline was expected since megawatt-hour sales in the first quarter of 2010 were 6.8 percent above the prior year reflecting weather that was significantly colder than normal.

We were pleased by the fact that we continued to post customer growth for each of these segments because it reflects an expanding economy and it underscores our above-average customer growth.

In the first quarter of 2011, our customer base grew by 1.6 percent. In addition, during the first quarter of 2011, our kilowatt-hour sales to public authority customers increased by 2.9 percent, which is reflective of the significant growth that is occurring at Fort Bliss.

Currently, Fort Bliss has an active-duty soldier population of 25,500 soldiers and 2,000 more soldiers are expected by the end of 2011 with a total base population of 35,000 soldiers expected by 2013.

At this time, Fort Bliss represents over 60 megawatt's of load and we anticipate the overall load at Fort Bliss will grow to over 90 megawatts by 2013 as a result of the additional soldiers and military personnel that are expected to be stationed at Fort Bliss.

Now turning to slide 8, we expended $45.4 million on new electric plant in the first quarter of 2011, approximately $33 million of which was for additions to generating plant. We have expended $151 million as of March 31, 2011 on the second phase of the Newman 5 combined cycle gas generating facility.

In addition, we are starting to incur expenditures for the Rio Grande 9 unit scheduled to be placed into service before the summer of 2013. We currently expect to incur $205 million for new construction in 2011.

The quarterly dividend payment at a level of $0.22 per share for the remainder of 2011 will result in $27 million of cash expenditures. We also spent approximately $16.7 million on the repurchase of stock during the quarter.

Currently, we have approximately 2.6 million shares available for repurchase under our current share authorization. We expect to make additional share repurchases during the remainder of 2011 to appropriately balance the debt and equity in our capital structure.

We expect that our current cash balance of $26.9 million and $187 million of available credit under our revolving credit facility will be sufficient to fund capital requirements for the remainder of 2011.

Now turning to slide 9, we are revising our 2011 earnings guidance upward from $2.00 to $2.40 per share to $2.10 to $2.50 per share. The primary driver for the revised guidance is to take into account the effects of the proposed Tucson Electric settlement agreement.

Net of tax, the Tucson Electric settlement is expected to contribute approximately $0.07 per share. Under the terms of the proposed settlement, the Company would receive $4.3 million in transmission revenues and $700,000 thousand in interest income for the period February 1, 2006 through March 31, 2011.

In addition, it is estimated that the proposed settlement will result in approximately $600 thousand of additional transmission revenues for the remaining months of 2011. Of these amounts, the Company would share 25 percent of the transmission revenues earned before July 1, 2010 or approximately $700,000 thousand as a fuel credit to Texas customers.

After taxes the impact on 2011 will be approximately $3 million or $0.07 per share.

In 2011, the primary variables that are expected to impact our earnings are retail non-fuel base rate revenues which will primarily vary due to weather and customer growth; the change in off-systems sales margin sharing; the impact of natural gas prices on the price of power received for the deregulated portion of Palo Verde Unit 3; our ability to manage operational and maintenance expenses and the impact of capital expenditures on the amount of allowance for funds used during construction.

In addition, earnings for 2011 will be impacted by the completion of Newman 5 and the NRC approval of a life extension for Palo Verde. Both of these items are reflected in earnings guidance.

Allowance for funds used during construction is expected to decline by approximately $3 million over the remainder of 2011 due primarily to the decline in construction work in progress as a result of the completion of Newman 5.

In addition, depreciation on Newman 5 will total approximately $3 million during 2011. The earnings decline associated with the completion of Newman 5 will be offset by a reduction in Palo Verde depreciation and accrued asset retirement obligations due to the life extension which together total approximately $10 million in 2011 and $13.5 million annually going forward.

I will now hand the call back over to Steve.

Steve Busser: Thank you, David.

Nikki, at this point, we normally take questions.

Operator: Ladies and gentlemen, if you have a question at this time, please press star, then one, on your touch tone telephone. If your question has been answered or you wish to remove yourself from the queue please press the pound key. Again, ladies and gentlemen if you have a question at this time please press star, then one on your touch tone telephone. And I'm showing our first question comes from Brian Russo; Ladenburg Thalmann. Your line is open.

Brian Russo: Hi! Good morning.

Steven Busser: Good morning, Brian.

Brian Russo: Could you just provide us the equity ratio at the utility? At the end of March of 2011.

David Carpenter: Sure.

Brian Russo: I think consolidated was 48 percent. But I know it's a little higher at the utility.

David Carpenter: Right. Well, it's all the same. It's 48 percent on a consolidated basis and I think what you're really referring to is on a regulatory basis.

Brian Russo: No, that's right.

David Carpenter: On a regulatory basis it's going to be closer to 52 percent.

Steve Busser: Between 51 and 52 percent, Brian.

Brian Russo: Okay; good. So it looks like you've still got a little equity cushion there and as you move through the year like you said, ongoing share repurchases are likely.Correct?

David Carpenter: Yes, sir. That's correct.

Brian Russo: Okay. And then just elaborate a little bit more on the FERC transmission settlement with TEP. The $0.07 isn't any sort of one-time payment; it's the ongoing transmission revenues that you expect from this settlement?

David Carpenter: Yes. Brian, there are two components of this the first is a one-time kind of catch-up amount that is reflected in the $0.07. And then going forward, at least for nine months of the year we expect to realize $600 thousand which is really representative of the ongoing level.

That amount could go up slightly when this Macho Springs interconnection is completed and the facility is placed in service. So in total as we go forward in the future, if the Macho Springs facility is completed and is delivering power to Tucson Electric then we're looking at a little bit over $1 million. Think $1.1 million or so going forward, on an annual basis.

Brian Russo: And when is that wind farm supposed to be operational?

David Carpenter: I think it's supposed to be operational this summer or fall.

Brian Russo: Okay.

Okay and I think a couple of other positive and negative drivers to your 2011 guidance. It looks like Newman 5 Phase III depreciation is a $3 million. Is that correct?

David Carpenter: Yes.

Brian Russo: And that's for the nine months?

David Carpenter: That applies to depreciation. Yes. We'll have nine months of depreciation this year and it's approximately $3 million.

Brian Russo: Okay. If I recall because that Phase II is an expansion of an existing site there isn't really much incremental O&M expense. Correct?

David Carpenter: That's correct. It's at an existing generating facility and we don't expect to incur any significant amount of O&M expense incrementally.

Brian Russo: Okay. Then the benefit from the PV life extension is $10 million? Is that the ongoing number?

David Carpenter: That's the effect on 2011. Going forward we expect the impact to be approximately $13.5 million per year.

Brian Russo: Okay; great.

And with the CCN for the new gas plant you guys were proposing for commercial operation date and peak period of '13. When can we expect you to seek recovery for that?

And then maybe you could just talk about kind of your general rate case cycles.

David Carpenter: Yes. Brian, I don't know that we can give you a specific time for when we would seek recovery. The plant is going in service in 2013.

So in New Mexico we can use a future test year. So you could literally file the test year, if it were appropriate. You could file the test year and seek to increase your rates in 2013.

In Texas, under the current rules it's fairly difficult and I don't think this facility would qualify for a filing before the plant actually goes in service.

So if you put it in service in 2013 you would be looking at filing a rate increase probably before the end of the year or by the end of the year of 2013 which would allow rates to go effect in 2014.

So it will depend a little bit on how much we spend what our customer growth is, but that would be kind of the timing and if you filed to reflect rates for that plant.

Brian Russo: Okay. Then just lastly more of a kind of big picture type of question.

Just the ongoing share buybacks versus the common dividend I realize that you just initiated a dividend about a month ago.

But when we look at the size of your company with the additional 2.5 million of shares to be repurchased it looks like your shares outstanding is going to shrink to about 40 million. And I'm just wondering at what point is it more beneficial from a liquidity perspective and maybe even from a valuation perspective, if you were to wind down that share buyback and use that excess cash to boost the dividend up to a more average industry payout and yield?

David Stevens: You know, Brian, this is David Stevens. I guess it's a perfect question by the way and well-worded. It's what we are actually continually working through.

I think at this point in time as you're aware we have a pretty robust capital program over the next few years. And since we actually haven't even paid the first dividend it's something we continue to study and something we continue to look at.

I think it is definitely one of the things that we will consider on a going forward basis. But at this point in time I think it would be too premature for us in light of the fact that we haven't even begun paying a dividend to really go much past where we are today.

Brian Russo: Okay; great. Thanks a lot.

David Carpenter: Thank you.

Operator: And our next question comes from Michael Lapides; Goldman Sachs. Your line is open.

Michael Lapides: Hey guys quick question.

When we think about the rate design impact across the quarters of 2011 weight on pretax about $6 million in the first quarter how do we think about the allocation of that in the future quarters?

David Carpenter: Yes. Michael, really in the second quarter what we have done is just look at what was the quarterly impact of the rate design change and nothing else. No change in kilowatt-hour sales.

That analysis really shows in the first quarter, which is all winter rates it had the biggest negative impact which was probably about $7.7 million.

Now in the second quarter what we'll see is that you'll then only have one month of the winter rates and two months of the summer rates and so we actually expect that we'll make up about $7 million of that decrease in the second quarter. Then in the third quarter, which reflects most of the rate increase last year was reflected in the third quarter, you actually pick up about $15 million of additional revenue.

And our estimate is, because we prorated the first month of the rate increase we only picked up about one-half month in July. So there's probably about $3 million that we'll pick up in additional revenue over 2010 in July of this year.

Michael Lapides: Got it. So I want to make sure I follow that $7 million in the second quarter of 2011 and prorated portion of $15 million in third quarter?

David Carpenter: Well, it's prorated fortunately for one month, which is probably about $3 million to $3.5 million.

Michael Lapides: So roughly $11 million or $11.5 million or $12 million in the third quarter? And then anything in the fourth?

David Carpenter: Well remember we had the rates in effect in July of 2010.

Michael Lapides: Oh, that's right. That's right.

David Carpenter: So year-over-year we won't see. All we'll see in the third quarter is the incremental impact of the rates in July which is again $3 million to $3.5 million.

And then really what you're looking at is kilowatt-hour sales growth impact on revenues going forward.

Michael Lapides: Got it. Thank you guys. Much appreciated.

Steve Busser: Thanks, Michael.

Operator: Again, ladies and gentlemen, if you have a question at this time please press star, then one, on your touch tone telephone. And I'm showing our next question comes from John Hanson from Praesedis. Your line is open.

Eric McCarthy: Hey, good morning. It's actually Eric McCarthy.

David Stevens: Good morning, Eric.

Eric McCarthy: Hey. A quick question and I'm sorry if you addressed it already.

The ice storms in January and February in Texas, was there an impact to earnings this quarter from that? And if so, could you quantify that?

David Carpenter: Yes. Certainly we had a little bit of an impact in the first quarter. We estimate that on operation and maintenance expenses it was probably around $1.5 million. Maybe a little bit more than that.

And then it also, because of the allocation of purchased power to our off-system sales it also had an impact on off-system sales in the quarter which is why we actually had a small loss on off-system sales during the quarter.

Eric McCarthy: Okay. So if I were to take that out of an ongoing earnings number we could probably add back about $0.03 or $0.04 to the quarter?

David Carpenter: That's probably about right.

Eric McCarthy: Okay; great. Thank you.

Operator: I'm showing no further questions at this time.

David Stevens: All right. Well thanks everybody for joining the call today and we look forward to talking to you.

For those of you who can make it to the annual meeting and analyst day we're going to have in New York we look forward to seeing you there at the end of this month. Thank you.

Operator: Ladies and gentlemen, thank you for participating in today's conference. This does conclude the conference and you may now disconnect. Everyone have a wonderful day.