EL PASO ELECTRIC CO
Moderator: Lisa Budtke
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9:30 am CT

Operator: Good day and welcome to the El Paso Electric Company 1st Quarter 2016 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, Yolanda. Good morning, everyone. Thank you for joining the El Paso Electric Company 1st quarter 2016 earnings conference call. My name is Lisa Budtke and I'm the Director of Treasury Services & Investor Relations. On the call 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 1st quarter 2016 Form 10-Q will be filed with the Securities and Exchange Commission (SEC) on or before Friday, May 6, 2016.

A replay of today's call will be available shortly after our call ends and will run through May 18, 2016. 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 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, 10-Q and other SEC filings for a discussion of risk factors that should be considered. These filings may be obtained upon request from the Company, on our Web site 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 maybe made from time to time by or on behalf of the Company. Now, I'd like to turn the call over to Mary.

Mary Kipp: Thanks, Lisa. Good morning everyone and thank you for joining our earnings call. I would like to begin by discussing some of our recent highlights on slide 3. Most notably and most recently, yesterday, we were able to place Montana Power Station Unit 3 into commercial operation. Unit 3 was successfully completed on time and on budget. As a result, we have an additional 88 megawatts which will work in concert with our renewable energy resources and enhance our overall power grid stability. Construction of Montana Unit 4 is ahead of schedule and we anticipate placing it into commercial operation in September of this year. Together, these two units will add 176 megawatts of efficient, reliable and clean burning natural gas to our local fleet of electric generation, and will provide enough energy to meet the needs of more than 80,000 homes in the Company's growing service territory.

Regarding our Texas rate case, we were able to reach a settlement agreement with a majority of the intervening parties and we filed that agreement with the Public Utility Commission of Texas on March 29, 2016. If approved, the proposed settlement would resolve all issues in the case except the revenue requirement for Four Corners.

With respect to our New Mexico rate case filing, the New Mexico Public Regulation Commission previously extended the suspension period through May 11, 2016, but the suspension period may also be extended one additional month.

On February 2nd, we took a major step towards becoming a coal-free utility when we filed with the New Mexico Commission a joint stipulation reflecting a settlement agreement among the Commission Staff, the New Mexico Attorney General and the Company proposing approval of abandonment and sale of our 7 percent ownership interest in Four Corners Units 4 and 5 and common facilities. A final order is expected in the second quarter of 2016 and no significant gain or loss is expected upon closing of the sale. After the necessary approval is received and the Four Corners sale is consummated, the Company will no longer have any ownership interest in coal-fired generation.

We also anticipate further improving our environmental footprint by constructing a 3 megawatt solar-powered generation plant to be located at the Montana Power Station. Prior to construction, we filed for approval of the Company's proposal to offer a community solar tariff because we are not planning to request inclusion of this facility in rate base. On April 5th, the City of El Paso authorized their counsel to move forward with the negotiated settlement. We currently anticipate receiving final approval in the second quarter of 2016.

On March 24, 2016 we issued $150 million of 5 percent Senior Notes with an estimated effective interest rate of 4.78 percent. The proceeds were used to repay outstanding borrowings under our Revolving Credit Facility. We are very pleased with the terms of our offering, and I would like to thank all the team members including Lisa Budtke and Nathan Hirschi who worked so hard to secure such favorable terms. I would also like to thank all our employees who successfully coordinated and completed the replacement of over 18,000 feet of power lines over Interstate 10 in March to accommodate the significant transportation enhancements occurring in our growing service territory. Their dedication and teamwork resulted in the projects being completed safely and ahead of schedule, which also helped to minimize traffic disruptions.

Turning to slide 4, I will discuss the latest developments regarding our Texas rate case filing in more detail.

Historically, we have sought to work with our intervenors and regulators to find common ground to settle our rate cases. We have settled with a majority of the intervenors in our current Texas rate case filing, including the Staff of the Public Utility Commission (PUC), City of El Paso, Texas Industrial Energy Consumers and many other intervenors. That Settlement Agreement was filed with the PUCT on March 29, 2016. The agreement calls for an annual non-fuel base rate increase of $37 million with the potential to collect an additional $8 million for costs related to the Four Corners Plant, which will be litigated separately. Other key terms of the settlement agreement are the lowering of annual depreciation expense by approximately $8.5 million, and setting the return on equity for AFUDC purposes at 9.7 percent. Part of the settlement was a determination that substantially all new plant in service was reasonable and necessary and therefore should be included in rate base.

On March 30, the Commission approved the implementation of interim rates for the $37 million non-fuel base rate increase that was agreed to as a part of the settlement. The interim rates became effective on April 1st and are subject to refund or surcharge. Final approval of the settlement agreement is still required by the Commission. Four parties have indicated their opposition to the Settlement Agreement and they are entitled to a hearing. Additionally, the recovery of rate case expenses will be handled in a separate proceeding.

If you'll turn now to slide 5, a prehearing conference was held on April 21st and an order was issued the following day to establish the procedural schedule. Based on the procedural schedule, a hearing on the merits of the settlement has been set for June 21st and 22nd, excluding the Four Corners Power Plant issue. At this time we cannot predict when the Commission will issue a Final Order. However, in accordance with Section 36.211 of the Texas Utilities Code, which was added by the recent House Bill 1535, new rates would relate back to energy consumed on and after January 12, 2016, which is 155 days after the rate case was filed.

Turning to slide 6, in New Mexico, you will recall the primary difference between our request of $6.4 million and the Hearing Examiners' 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.

The treatment of our pension and other post-employment benefit liability as a rate base offset is one of the items to which we filed an exception. The next step in the process is for the New Mexico Commission's General Counsel to discuss exceptions to the Hearing Examiners' Recommended Decision.

I'll now walk through a potential timeline for our next round of rate cases.

As you can see on slide 7, our timeline now reflects an earlier in-service date for Montana Unit 4, which was moved up to September 2016. Otherwise, the remaining milestone dates remain unchanged.

I would now like to turn the call over to Nathan.

Nathan Hirschi: Thank you Mary. If you'll now turn to slide 8, I'll begin by summarizing our first quarter 2016 results. As discussed on previous calls, we anticipated the first quarter of 2016 would be a challenge. First quarter results suffered from the regulatory lag associated with the completion of the first two generating units at the Montana Power Station without corresponding increase in rates. For the first quarter of 2016, we reported a net loss of $5.8 million or $0.14 per share compared to 2015's net income $3.5 million or $0.09 per share.

Turning to slide 9, I will discuss the key drivers for the quarter as compared to the prior year beginning with the negative drivers. We experienced a decline in earnings per share during the first quarter of 2016 of $0.06 per share due to decreased AFUDC. The primary reason for the reduced AFUDC was lower balances of construction work in progress due to Montana Units 1& 2 and the Eastside Operation Center being placed in service during March 2015, which was partially offset by AFUDC earned on construction costs related to Montana Units 3 & 4. Earnings declined in the quarter by $0.05 per share due to increased operations and maintenance expense associated with our fossil-fuel generating plants. The planned outages at Four Corners Unit 5 and Rio Grande Unit 7 were more extensive than the outages that occurred during the same period in 2015 and was the primary driver for the increased expense. The addition of Montana Units 1 & 2 resulted in higher O&M in the first quarter 2016 as compared to 2015. On a positive note, the operating expense levels at MPS are not anticipated to significantly increase as Units 3 & 4 are placed into service.

Earnings were also negatively impacted by a decreased investment and interest income. Lower realized gains on securities sold from the Company's Palo Verde decommissioning trust portfolio reduced first quarter earnings by $0.05 per share. In addition, an increase in depreciation and amortization expense related to an increase in depreciable plant, primarily due to Montana Units 1 & 2 and the Eastside Operations Center being placed in service in March of 2015, reduced earnings by $0.03 per share in the first quarter. Earnings were also negatively impacted by decreased deregulated Palo Verde Unit 3 revenues primarily due to a decline in natural gas prices, which decreased earnings by $0.02 per share.

On a positive side, our performance compared to the same period last year was positively impacted by an increase in retail non-fuel base revenues, which resulted in increased earnings of $0.02 per share. The increase in revenue was primarily attributable to our residential customers, which recorded an increase in the average number of customers served of 1.5 percent.

On slide 10, you'll see a comparative analysis of the historical weather experienced during the quarter. As you can see, we experienced mild winter weather during the first quarter of 2016. Heating degree days were approximately 11 percent below the 10 year average and were the second fewest recorded over the past seven years. Heating degree days were also lower compared to the same period last year by approximately 9 percent. Almost half of our high temperatures in March were 80 degrees or higher, which for our service territory is a sign of an early arrival of spring like weather.

Turning to slide 11, we have provided an analysis of changes in retail non-fuel base revenues and megawatt hour sales by customer class for the first quarter of 2016 compared to the same period in 2015. Retail megawatt hour sales increased by 0.8 percent for the quarter and retail non-fuel base revenues increased by 0.9 percent. The increase in retail revenues was primarily driven by the residential customer class, despite the mild winter weather recorded in our service territory during the first quarter.

We also recorded an increase in revenue and megawatt hour sales to the small commercial and industrial class, as well as to the public authorities class. We are pleased to see the increases in total retail revenue and megawatt hour sales despite the fact that we experienced mild weather and fewer Heating Degree Days.

Now turning to slide 12, our cash capital expenditures for additions to electric utility plant were approximately $53 million during the first quarter of 2016. In terms of cash dividends, the Board of Directors declared a quarterly cash dividend of $0.295 per share on January 28, 2016, which was paid on March 31, 2016. During the first quarter of 2016, we paid $11.9 million in quarterly cash dividends. The Board of Directors will evaluate the Company's dividend policy during the second quarter of this year.

On March 31, 2016, we had liquidity of approximately $254 million including a cash balance of approximately $41 million and the borrowing capability available to us on our revolving credit facility. In total, we expect to spend approximately $231 million for cash capital expenditures in 2016. As we mentioned earlier, in March the Company issued $150 million of 5 percent Senior Notes due in 2044. The proceeds from the issuance of these senior notes were approximately $158 million after deducting the underwriters' commissions.

Now turning to slide 13, I'd like to wrap up today's presentation with some comments regarding our 2016 Earnings Drivers. Given the pendency of our rate case filings in Texas and Mexico, we continue to delay issuance of a defined range of guidance until we gain more certainty regarding our pending rate cases in both jurisdictions. However, we are able to provide information related to some assumptions that will drive our earnings in 2016.

There are several factors that will negatively impact 2016 earnings. Most of the negative earnings drivers are directly relate to the regulatory lag, which already had a substantial effect on the first quarter of 2016.

The primary components of regulatory lag remain in 2016 are higher property taxes, lower AFUDC, and increased O&M, depreciation expense, and interest expense. Other factors that are anticipated to negatively impact earnings include a higher effective tax rate, a return to normal weather and decreases in investment and interest income. Earnings are anticipated to be positively impacted by rate increases in Texas and New Mexico as well as continued customer growth.

The challenges that occurred in the first quarter will continue until the interim revenues in Texas are no longer subject to refund. Although we are hopeful that this will be resolved in time to recognize the revenues in the second quarter, this may not occur until later in the year. Regardless, all but 11 days of the $37 million increase will be recognized in 2016 due to our ability to relate back rates to January the 12th.

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

Lisa Budtke: Thanks Nathan. This concludes our first quarter 2016 earnings presentation. Yolanda, at this time we will open the call up for questions.

Operator: Certainly. If you would like to signal for a question at this time please do so by pressing star 1 on your telephone keypad. If you are using a speakerphone please make sure that your mute function has been turned off to allow your signal to reach our equipment. Again, that's star 1 for questions at this time. And we'll pause for just a moment to assemble our queue.

We'll take our first quarter from Brian Russo from Ladenburg Thalmann. Please go ahead.

Brian Russo: Good morning.

Nathan Hirschi: Good morning.

Lisa Budtke: Morning Brian.

Brian Russo: Just the lag in the second quarter obviously it is magnified in the first quarter because that's rather a small contributor to your top-line to cover the incremental cost and in the fourth quarter you kind of alluded to a potential loss in earnings in the first quarter.

How should we look at the second quarter? Can you give us a sense of what percentage of annual sales or margin is typically derived in 2Q?

Nathan Hirschi: Yes. Last year for example, we got 95 percent of our earnings in the second and third quarter. So obviously that trend we anticipate continuing. The trouble here is that we are not recording the relate back revenues until we have some resolution in the Texas rate case and at the moment it's unclear if we're going to get resolution in time to record that in the second period, or the second quarter or the third quarter. But again, despite the quarter that's recorded in will be pushed back to January the 12, which will allow us to pick it up for essentially the whole year or 11 days less than a year.

Mary Kipp: Brian I would add to that, this is Mary that we are collecting the revenues from our customers effective April 1 we're just not booking them until we get more certainty around the final outcome.

Brian Russo: Understood, so how from an accounting perspective or from an income statement and cash flow perspective, how will that look once you book the revenues? Will it just be like a one-time type of accrual to the income statement say in the second half of the year?

Nathan Hirschi: Yes that's right. That's how we anticipate it that we will have a true up that will allow us to record that when we get resolution of the rate case and then we will be allowed to recover that either over 12 or perhaps an 18 month period of time. So we will record that and then have a surcharge that we envision collecting over a 12 to 18 month period.

Brian Russo: Okay. So you record the entire revenue requirement but you'll surcharge customers over a period of time?

Mary Kipp: The period that we would surcharge for would be the period that we're not collecting currently which would be that January 12 to April 1 period. And then of course if we were able to get additional revenues rather related to the $8.5 million that is still at stake on Four Corners and of course rate case expenses are also being handled in a separate proceeding, those amounts would be surcharged as well.

Nathan Hirschi: Yes, just to clarify. So we have interim rates in place since April the 1st for the $37 million. So that amount as we're collecting it currently would of course not be part of the surcharge.

Brian Russo: Okay, got it.

Nathan Hirschi: But would be recognized when we get resolution.

Mary Kipp: In the quarter in which we receive the resolution.

Brian Russo: Okay. And then the $30 million revenue requirement in the Texas settlement and the $8 million lower depreciation rates on an annual basis. I mean, conceptually can we look at this as more like a $45 million, you know, impact to the income statement due to not only the revenue requirement but the lower depreciation. Is that a kind of one way to look at it?

Nathan Hirschi: Yes, that's a fair way to look at it and plus we have two $8 million numbers there. You talked about the $8.5 million lower depreciation rates and you also have the $8 million of potential additional revenues related to the Four Corners which is being been separately litigated. So that's in addition to the 45 essentially that you laid out there Brian.

Brian Russo: All right, great. And then you mentioned there are four parties in opposition to the Texas rate case settlement. What parties are they?

Mary Kipp: Yes, so they are the Office of Public Utility Council, Sunrun, ECO El Paso and Energy Freedom Coalition of America and their issue really revolves around our treatment, our proposed treatment of rooftop solar customers in the settlement.

Brian Russo: Then this investment in interest income I think was a $0.05 hit in the first quarter is that year-over-year in the first quarter is that what we should expect for the entire year or will there be deltas in 2Q to 4Q?

Nathan Hirschi: We are in a rebalancing process within the Nuclear Decommissioning Trust portfolio so it could be slightly less as we go forward year-over-year, on a year-over basis, but it won't be a significant as what we saw on the first quarter. The first quarter was we had a relatively large amount of rebalancing and reallocation last year in the first quarter that did not reoccur this time, but we will continue to have a comparable level to last year to slightly below what we've seen in prior years.

Brian Russo: And then also so I guess just to summarize, it looks like first half of '16 would be challenging until new rates go into effect which will cause a regulatory lag and kind of deteriorating year-over-year ROE, but once new rates go into effect the second half of the year we should see quite a bit of year-over-year improvement.

Mary Kipp: I think that's a very fair characterization Brian obviously it's contingent on the decisions made by our regulators.

Brian Russo: Understood. And then real quickly MPS 4 what was original start date?

Nathan Hirschi: We have been talking about prior to December of 2016, so now we're focused on a September 2016.

Mary Kipp: It's a couple of months that we've moved it up.

Brian Russo: Got it. Thank you very much.

Mary Kipp: Thank you.

Operator: We'll take our next question from Anthony Crowdell with Jefferies. Please go ahead.

Anthony Crowdell: Good morning. First question I had was in New Mexico the rate case. Do you anticipate another delay from the original 30 day delay that they just granted?

Mary Kipp: Anthony we don't know that. They're actually meeting today and that maybe one of the action items. They have the ability to extend it one more time and that would put us at June 10.

Anthony Crowdell: And the meeting today will potentially of they were thinking of delaying it would be decided by the end of day today?

Mary Kipp: It could be and I believe that would be the case.

Anthony Crowdell: If it's not decided today then could we assume that there is no delaying and we should get rate relief on or in order on the specified time?

Mary Kipp: Currently the suspension period was extended to May 11, so I guess theoretically they could extend it next week as well.

Anthony Crowdell: Okay. Looking at you talked about the big difference between the Hearing Examiner recommendation and the Company's request has mainly been the pension I guess maybe over funding of the pension or pension treatment in rate base. Is this unique this case that this is drawing this level of scrutiny compared to your previous New Mexico cases or any changes why this has attracted so much attention in your case?

Nathan Hirschi: As you know, Anthony there was a recent Supreme Court ruling in New Mexico that brought some attention to this. Also of course the last couple of New Mexico cases were settled earlier than this one and this one has gone through hearings and of course all the items have gotten a little bit more attention. So it really isn't a change of how we have treated it for regulatory purposes from our most recent cases but it has gotten more attention than what it had in the past.

Anthony Crowdell: And just lastly when I look at the load or I guess customer growth in Texas, I think that's slide 11, it looks like maybe even longer but second or third quarter where we are seeing a decent decline in the large industrial customers, what's the real driver or do you have any ideas of what causing that degradation but yet the other two classes are nice and healthy?

Nathan Hirschi: Yes and that was over 100 percent of our decline in the C&I large class related to one customer who had reduced operations during the quarter, so it is related to a single customer as opposed to more pervasive about our overall base.

Anthony Crowdell: What sector was it, manufacturing or wire copper?

Nathan Hirschi: The steel manufacturing.

Anthony Crowdell: Steel. Okay. Great, thank you so much for taking my questions.

Operator: And again that is star 1 if you would like to signal at this time, star 1 for questions. We'll take our next call from Joe Zhou with Avon Capital Advisors. Please go ahead.

Andy Levi: Hey, it's Andy Levi. How are you?

Nathan Hirschi: Hey Andy, how are you?

Mary Kipp: Morning Andy.

Andy Levi: I'm doing well. I guess most of the questions were asked but just on the early completion of the peaking units does that change your rate case schedule for your next case at all or not?

Mary Kipp: We're currently not anticipating it changing our rate case schedule but we will evaluate that and if it does we'll let you know.

Andy Levi: Okay. And then just kind of longer term, so we get these two cases done in Texas and New Mexico and then you give us guidance depending on when they get done hopefully for '16. But what's the thought about giving longer term guidance and a growth rate? Any thought of that as you get through this one case and you have kind of one case to go but probably signals how the subsequent plants are going to be treated?

Nathan Hirschi: Yes, will have of course Andy, we have the second round of rate case that comes on the heels of this rate case, we have tried to provide the CAPEX expenditures and rate base kind of forecast that will allow the development of guidance. But we'll look at it again when we have little more certainty in the regulatory environment. So we'll continue to look at that and see if it really does make sense for us to provide a little bit more guidance like some of our peers do.

Andy Levi: Yes, I mean what are the pros and cons that you guys are looking at because ultimately obviously regulatory lag has been an issue but once you get through that the earnings power of the company is very strong especially relative to where stock is trading on a relative PE basis to the sector probably giving a longer term look in confidence is maybe advantageous. So I was curious what the thinking is though uncommon on doing that?

Nathan Hirschi: Well it is just that in the midst of rate cases we have historically not provided even short-term guidance let alone longer-term guidance. Once we get through the rate case processes we probably will have a little bit more visibility and be able to be a little more confident in making those assumptions. So that's really it is just our historic practice of not providing these type of forecasts when we're in the middle of these rate cases.

Andy Levi: Okay. Then as far as the dividend policy is concerned as you get through this first rate cycle and into the second, can you kind of talk more about that as well?

Nathan Hirschi: Yes, of course in the first quarter every year the Board re-valuates the dividend policy and we have been looking at the resolution of these rate cases to before we made any really significant changes and as we see now these rate cases are dragging out a little bit longer than what we had originally hoped. And so we will re-look at it again but really like we said in the past that we really wait till we get a little bit more resolution from a regulatory perspective and anticipate making any significant change.

Andy Levi: And assuming that again you get done in Texas and New Mexico and I don't want to say timely fashion but why does it say the end of second quarter beginning of the third quarter. That may like you said you said you generally increased the dividend when?

Mary Kipp: Our Board looks at it in connection with the May Board meeting.

Andy Levi: Okay.

Mary Kipp: So they'll be looking at it in May and then they'll look at it again in May of '17.

Andy Levi: Okay. And then again assuming you get a fair outcome to the current cases, is there any thought since the earnings power could be considerably higher to take an earlier look at that dividend?

Mary Kipp: We don't have any plans to do that right now, but I guess anything is possible.

Andy Levi: Okay. Thank you.

Nathan Hirschi: Thanks Andy.

Operator: And as a final reminder that is star 1 for questions at this time, star 1 for questions. And we'll pause for just another moment to allow everyone the opportunity to signal. And it appears we have no further questions in queue at this time.

Lisa Budtke: Thank you Yolanda. Before we close today's call I would like to remind everyone that you are welcome to join us at our 2016 Annual Shareholders Meeting which is scheduled for May 26 in El Paso. Thank you for joining us on today's call. Have a great day and please be safe.

Operator: That will conclude today's conference. Thank you all, once again for your participation.

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