EL PASO ELECTRIC CO.

Moderator: Steven Busser
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9:30 am CT

Operator: Good day and welcome to the El Paso Electric Company 3rd Quarter Earnings call. Today's call is being recorded. At this time I would like to turn the call over to Mr. Steven Busser.

Steven Busser: Thank you, Ryan and good morning everyone. Thank you for joining the El Paso Electric Company 3rd Quarter 2013 Earnings conference call. Also, on the call with me today I have our CEO, Tom Shockley, our Executive Vice President, David Carpenter, our Chief Financial Officer, Nathan Hirschi, and our Senior Vice President and General Counsel, Mary Kipp.

Today we will provide a review of our recent organizational changes and update on the air permits that we are seeking for our Montana Power station, an update on the timing of our planned Texas and New Mexico rate cases, and an overview of our 3rd quarter and year-to-date 2013 financial performance. Finally, we will update our 2013 earnings guidance and our anticipated capital requirements.

Before we get started, I would like to cover some items that will be pertinent to our call. You should have a copy of our press release and if you do not, you can obtain one from our website on the Investor Relations page. We currently anticipate that our 3rd quarter 2013 Form 10-Q will be filed with the Securities and Exchange Commission (SEC) on or before November 8, 2013. We also hope to see everyone at the Edison Electric Institute Financial Conference in Orlando, Florida, next week on Sunday through Tuesday.

Please call our Investor Relations department if you have any questions or require further information. A replay of today's call will be available shortly after the call ends and will run through November 20, 2013. The details as it relates to the replay are disclosed in our press release.

On page two of our presentation you will 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 and 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 risk factors that should be considered. These filings may be obtained upon request from the company, on our website, or from the SEC.

The Company cautions that the risk factors discussed in these filings are not exclusive and we do not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company. These statements, especially those made during the question and answer portion of the call, are subject to risks and uncertainties that are difficult to predict. At this time I would like to turn the call over to our CEO, Tom Shockley.

Tom Shockley: Thank you, Steve, and good morning everyone and let me add my thanks for your being on our call to that of Steve's. I am Tom Shockley, the CEO of El Paso Electric. If you will now turn to page 3 of the presentation, I would like to go over our 3rd quarter highlights.

We started the quarter with a successful negotiation of a new three-year Collective Bargaining Agreement with El Paso Electric. I would like to thank the team who worked together to reach this agreement with the continued focus and priority on providing safe and reliable service to our customers. Also, of significance this quarter is the continued work on the Montana Power Station. Previously we had received approval for CCN's for Units 1 and 2, and we have just filed this quarter for CCN's on Units 3 and 4.

Also, we are pleased that the Texas Administrative Law Judge has recommended the approval of El Paso Electric's air permit for the Montana Power Station. The Environmental Protection Agency (EPA) has also issued a draft air permit for the Montana Power Station. Mary Kipp will be giving you a little more detail on that later in the presentation.

If you will now turn to slide 4, I would like to comment on some organizational changes. I am very pleased to announce as we position El Paso to move forward in a very, positive way. It gives me great pleasure to recognize the contributions of the talented leadership team and I'm especially happy to announce that David Carpenter and Hector Puente have both been promoted to Executive Vice President.

In their new positions, David and Hector will be providing both me and the Board of Directors with advice based on their decades of financial and operational experience. In their new roles David and Hector will also be available to mentor the newer members of our leadership team until their anticipated retirement date of January 2015.

In addition to the promotions of David and Hector, Steve Buraczyk has been promoted to Senior Vice President of Operations. Steve has been with the company since 1993 and has served in various leadership positions including Vice President of Regulatory Affairs, Vice President of Systems Operations and Planning, and Vice President of Power Marketing and Resource Delivery Planning.

Nathan Hirschi, who previously served as Vice President and Controller, has been promoted to Senior Vice President and Chief Financial Officer. Prior to joining the company in 2009, Nathan was a partner at a Big Four accounting firm.

Bill Stiller, who joined El Paso Electric in early 2013 and previously served as Chief Human Resources Officer, has been promoted to Senior Vice President of Human Resources and Customer Care. Bill is a Senior Human Resources executive with extensive career at leading companies in the chemistry, pharmaceutical, and telecommunications industries.

Finally, Mary Kipp, Senior Vice President, General Counsel, and Chief Compliance Officer, has also assumed responsibility for the Regulatory Affairs of the company.

I believe these changes are an important step in succession planning and ensuring a successful future for El Paso Electric. I look forward to working with this new leadership team and I am happy to announce that my contract has been extended as CEO for El Paso Electric through December of 2015. I will now hand the call over to Mary Kipp to give us a little more insight on the permitting at Montana Power Station.

Mary Kipp: Thank you Tom and good morning everyone. Before I start, I'd like to say that I'm excited about my new regulatory responsibilities and I very much look forward to working with Tom, David, and the team to shape the Company's regulatory strategy as we move ahead. To that end, I'd like to provide you with an update on a couple of activities on the regulatory front related to the Montana Power Station.

During the third quarter, we filed for Certificates of Convenience and Necessity in Texas and New Mexico for Units 3 and 4 which we expect to receive by September 2014. Also in late September, our Texas Administrative Law Judge, as Tom mentioned, recommended approval of the air permit for the Montana Power Station.

The air permit will now be considered by the Texas Commission on Environmental Quality later this quarter. A separate draft greenhouse gas emissions permit was also issued by the EPA. We're expecting decisions on both applications by the end of this year or early next year. Construction on the Montana Power Station will begin after all final approvals are received.

I should mention that if there's an appeal of the EPA Greenhouse gas emissions permit, a final decision from the EPA could be delayed until the second quarter of 2014 and construction would start at that time. We continue to anticipate Montana Unit 1will be commercially operational in time for the 2015 peak. I'd now like to turn the call over to David Carpenter.

David Carpenter: Thank you, Mary. Before I discuss the timing of our next rate case request, I would like to say that I have enjoyed serving as the Chief Financial Officer of El Paso Electric Company over the last four years, and I believe that Tom and the Board have put in place a process for a smooth transition to my retirement in January 2015.

In my new role, I look forward to working with both Nathan Hirschi and Mary Kipp as they assume responsibility for the financial and regulatory functions of the Company. In particular, during this transition period I will work with Mary on planning and developing our expected rate case filings in 2015.

The expected timeframe for the issuance of the air permit has affected our timing for rate cases to reflect Montana Units 1 and 2 in rates. In New Mexico, we still expect that we will use a calendar year 2014 test year and file for higher rates in May 2015. The rules in New Mexico for post-test year plan adjustments allow us to use the December 2014 test year end and include both Montana Units 1 and 2 in rates.

The rules in Texas will require us to delay the expected filing date for the Texas rate case. We will likely wait to file the rate case to use a test year ending the quarter after Montana Unit 1is completed and placed in service. Assuming that the final air permits are not received until the second quarter of 2014 and both Montana Units 1 and 2 are completed in the second quarter of 2015, we would use the 12 months ended June 30, 2015, as the test year.

A June 30, 2015, test year will result in filing the request for higher rates in November 2015. Filing the Texas and New Mexico rate cases on this timeframe will result in new rates being placed into effect by midyear 2016. If the final air permits are received in early 2014, then we would be able to file the Texas rate case earlier.

I would now like to turn the call over to Nathan Hirschi, but before I do, I'd like to congratulate Nathan on his appointment as the new Chief Financial Officer of El Paso Electric.

Nathan Hirschi: Thank you David and good morning everyone. I would like to start on slide 5 of our presentation for the third quarter 2013 reported net income of $50.6 million or $1.26 per basic share, compared to the 3rd quarter of 2012 when we earned $51.8 million or $1.29 per basic share, for the nine months ended September 30, 2013, we posted net income of $87.4 million or $2.17 per basic share compared to net income of $86 million or $2.15 per basic share for the same period of the prior year.

Turning to slide 6, I would like to discuss the key earnings drivers in the 3rd quarter of 2013 compared to the 3rd quarter of 2012. First, on the positive side, Palo Verde operations and maintenance expense decreased primarily due to reduced employee benefit costs and operational expenses. The reduction in Palo Verde O&M expense increased quarterly earnings by $0.02 per basic share for the third quarter 2013 when compared to the same period in 2012.

On the negative side, we saw a decline in the basic earnings per share in the third quarter of $0.05 resulting from increased property tax accruals due to increased property values and estimated assessment rates. Also negatively impacting quarterly earnings was increased interest expense from the $150 million of 3.3 percent senior notes, which were issued in December 2012. The increased interest on long-term debt resulted in a $0.02 per basic share reduction in earnings for the quarter when compared to the prior year.

Turning to slide 7, I would like to go over the main factors affecting retail non-fuel base revenues and megawatt hours, and megawatt hour sales by customer class for the 3rd quarter of 2013 when compared to same quarter of 2012. We were pleased to see a slight increase in total megawatt hour sales despite the cooler weather we experienced in the third quarter of 2013 when compared to the same period of 2012.

Cooling degree days decreased 3.5 percent compared to the same period last year and we're actually lower than the 10-year average by 1.2 percent. The cooler weather in the quarter was driven by an increase in precipitation we saw in the quarter. While we saw a similar amount of days with precipitation in the third quarter when compared to the third quarter of the prior year, we saw an 80 percent increase in the total amount of rainfall. This increase in rainfall drove the cooler weather this year when compared to the same period of the prior year.

The primary effect of the cooler summer weather can be seen in the residential and small commercial customer classes as they are more sensitive to the effects of weather than the other customer classes. This decrease in sales was offset by an increase in megawatt hour sales to large commercial and industrial and public authority customer classes.

Although the large commercial and industrial class increased by 6 percent in megawatt hour sales, non-fuel based revenues decreased by 1.3 percent due primarily to increased usage of lower off-peak and interruptible rates by some of those customers.

Despite slightly lower base revenues, we continue to see robust customer growth. During the quarter, the average number of retail customers showed growth of 1.3 percent, which is largely in line with the rate of customer growth we have experienced for the last several years. The increase in the average number of customers helped to offset the effects of milder weather.

Now, turning to slide 8 of our presentation, you will see the key earnings drivers for the first nine months of 2013. Starting with the positive earnings drivers, maintenance expense decreased at our fossil-fuel generating units due to scheduled major maintenance at Rio Grande Unit 8 and Newman Unit 1in 2012 with comparable reduced level of maintenance activity during the first nine months of 2013.

This increase earnings per share by $0.04. Deregulated Palo Verde Unit 3 revenues increased earnings by $0.03 for the year-to-date 2013 one compared to the same period of 2012. Driving this increase was a 15.8 percent increase in proxy market power prices in 2013 due to higher gas prices and a 14.7 percent increase in generation at Palo Verde Unit 3 due to a spring refueling outage in 2012 without any offsetting outage at Palo Verde Unit 3 for the first nine months in 2013.

Also during 2013, higher balances of construction work in progress resulted in an increase in AFUDC, which increased earnings for the year-to-date by $0.03 per share. Finally, reduced operations expense at Palo Verde resulted in a $0.02 earnings per share increase for the nine months ended September 2013 when compared to prior year.

Year-to-date 2013 earnings were negatively impacted due to increased interest expense on the $150.0 million of 3.3 percent senior notes issued in December 2012, which resulted in a decrease in earnings of $0.05 per basic share. The other primary factor that negatively affecting our 2013 year-to-date earnings was an increase in administration and general expenses for outside services related largely to software system support and improvements, which resulted in a $0.04 reduction in earnings per basic share.

If you would turn to slide 9, I would like to go over the changes in non-fuel base revenues and megawatt hour sales by customer class for the first nine months of 2013 compared to the same period of 2012. For the year-to-date period total megawatt hour sales increased while revenues declined slightly. The decline in revenues in the commercial and industrial classes is primarily attributable to the reduction in our non-fuel base rates resulting from our 2012 rate case settlement and an increase in the number of customers utilizing our interruptible rate structure.

We continue to see growth in mega-watt hour sales and revenues from our residential customers. Overall, the average number of retail customers increased by 1.3 percent during the nine months ended September 30, 2013 in comparison to the corresponding period in prior year. In terms of weather, cooling degree days were 3.6 percent lower than the same period in 2012, which is reflective of the milder weather that we have seen in 2013.

On slide 10, I would now like to discuss our capital requirements and our liquidity position. In terms of our capital requirements, we expended approximately $165 million for additions to utility plant in the first nine months of 2013. As Mary mentioned earlier, timing of capital expenditures for the Montana Power Station will be dependent on when final air permits for the units are received.

In regards to dividend payments, we paid just over $31 million to our shareholders for the first nine months of 2013. At September 30, 2013, our liquidity was $346 million, which consisted of a cash balance of approximately $62 million plus borrowing capability available to us on our credit facility of approximately $284 million.

We believe that our available liquidity, along with our expected cash from operations, will be sufficient to finance our capital requirements for the next 12 months. We may issue additional long-term debt to fund capital expenditures in 2014.

Now turning to slide 11, we have revised our 2013 earnings guidance to a range of $2.25 to $2.40 per basic share from the previous range of $2.20 to $2.50 per basic share. The revision to guidance is mainly due to the cooler weather we experienced in the third quarter of this year.

I would now to hand the call back to Steve Busser for questions.

Steven Busser: Ryan, at this point we normally take questions if there are any.

Operator: Thank you. If you'd like to ask a question, please signal by pressing star 1 on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, that's star 1 to signal for a question. We'll take our first question from Neil Mehta with Goldman Sachs.

Neil Mehta: Good morning.

Steve Busser: Good morning, Neil.

Neil Mehta: Thanks, congratulations on all these leadership changes here. Just want to confirm. Are you saying a mid-2016 rate increase implementation in Texas and is that the same for rate case implementation in New Mexico?

David Carpenter: Neil, if you look at the statutory time limits for how long the commissions have to consider the rate increases, New Mexico could stretch the rate decision out as long as 13 months, which if you followed in May 2015 could push it to June 2016. I think our experience has been that we've generally been able to resolve cases in New Mexico on really a seven to nine-month basis.

So it may well be or I think what we'd like to think is that we can get New Mexico rates into effect probably in the second quarter of 2016 but they could stretch it out under the statutory time limits.

Neil Mehta: Okay. And in terms of thinking about the changes to potential capital spending, do you have a best estimate for CAPEX levels for 2014, 15, and 16 now?

Steven Busser: Neil, this is Steve. We have not updated our capital expenditures forecast versus what we've disclosed in our 10-K and updated earlier this year, and so we will be providing those updates going forward but at this point those are still kind of our official estimates and our best estimates at this point.

Neil Mehta: All right. And then last question relates to cash, both equity and then dividends. Can you comment on both? Can you confirm that you don't see a need for equity over the next couple of years and then also just talk about your dividend growth strategy?

Nathan Hirschi: Yes, that's our plan is to get through the next few years without an equity issuance so that's our goal and that's our plan at the moment, and as we've said in the past, the dividend growth rate we're hoping that we're anticipating that we can be consistent with a 4 to 6 percent dividend growth rate over the next several years and keep that at a dividend payout ratio of the 45 to 55 percent. So those are keeping consistent with those goals.

Neil Mehta: Great. Thank you.

Operator: Once again as a reminder that's star 1 to signal for a question. We'll take our next question from Anthony Crowdell with Jefferies.

Anthony Crowdell: Good morning, guys. Congrats to all on promotions. Congratulations, David on the retirement. Two questions, one is rate case timing. I mean, it seems like you're kind of guiding till you get new rates in 2016. I know it’s dependent upon getting permits, but how much of an impact does the 2016 earnings with I think from the last rate proceeding in 2012 where your rates are kind of more summer peaking and so you don't get much boost in earnings from, first quarter fourth quarter.

How much of an impact, I guess, would that be to your earnings and then does the delay in the rate filing, does that help out our 2015 numbers because do you accrue AFUDC any longer before these guys get in rates? And then I guess the second topic would be related to guidance. I mean, this is the second, I guess, revision. We've lost $0.20 off of high end of guidance from when the year started. I think we originally $2.60 is a high point; we're now down to $2.40.

I mean, is that all that $0.20 just related to weather?

David Carpenter: I'll start here, Anthony, and let Nathan handle the guidance question. First let me say that as far as the timing that we laid out in the presentation, I think that kind of pretty much reflects the latest period that we'll file the Texas rate case in and if we can get the permits earlier, then we would certainly file earlier and get rates into effect.

I don't have an exact quantification for you of the impact of the change in timing on rates, the earnings in 2015 and 2016, but I think one way to look at it is that the regulatory lag will basically be the same either way but you are correct. What will happen is that if the construction is delayed and the plants are completed until May 2015, you'll certainly accrue more AFUDC and you will also have less depreciation that you would record because of the delay.

And so 2015 will certainly look a lot better. Unfortunately, about half of that regulatory lag will move into 2016, which would decrease the expected earnings in 2016. So, right now I can't give you an impact of that but I think you're correct in the assumptions that you had.

Nathan Hirschi: From the timing of the guidance, a significant portion of that does relate to the revenue. The weather in the third quarter was not as favorable as we had seen last year and that tightened up the guidance quite a bit there. AFUDC is also our construction expenditures which came in a little bit below what we had first forecasted. So those two are the largest components of tightening the guidance.

Anthony Crowdell: Great. Thanks again for taking my question.

Operator: Once again as a reminder if you would like to signal for a question, please press star 1 at this time. Once again, that's star 1 to be placed in the queue. Mr. Busser, we have no further questions in the queue at this time.

Steven Busser: Ryan thank you very much and thank you to all who joined us on the call today. We will see you all next week. Have a great day.

Operator: And that does conclude today's conference. Thank you for your participation.

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