EL PASO ELECTRIC CO.
Moderator: Lisa Budtke
August 5, 2015
9:30 am CT

Operator: Good day and welcome to the El Paso Electric Company 2nd Quarter 2015 earnings conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Lisa Budtke. Please go ahead.

Lisa Budtke: Thank you, Shannon. Good morning, everyone. Thank you for joining the El Paso Electric Company's 2nd quarter 2015 Earnings conference call. My name is Lisa Budtke, and I'm the Assistant Treasurer for El Paso Electric. On the call today are CEO, Tom Shockley; President, Mary Kipp; CFO, Nathan Hirschi; and other members of the senior management team. Today, we will provide an update on our service territory growth, regulatory lag, 2nd quarter 2015 financial results, an update on our capital requirements and liquidity, our revised 2015 guidance range, a procedural schedule for our New Mexico Rate Case filing, an update on our Texas Rate Case filing, and an update on our other regulatory filings.

You should have a copy of our press release and today's presentation and if you do not, you can obtain one from our website on the Investor Relations page.

We currently anticipate that our 2nd Quarter 2015 Form 10-Q will be filed with the Securities and Exchange Commission (SEC) on or before August 10, 2015. A replay of today's call will be available shortly after our call ends and will run through August 22, 2015. The details as it relates to the replay are disclosed in our press release.

For forward-looking statements, on slide 2 of our presentation you will see our safe harbor provisions. 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 filings. Our 10-Q and other SEC filings contain our forward-looking safe harbor statements, and also layout 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 section of the call, are subject to risks and uncertainties that are difficult to predict. I would now like to turn the call over to Tom.

Tom Shockley: Thank you, Lisa. As you can see on slide 3, for the second quarter of 2015, we reported a net income of $21.1 million or $ 0.52 per share. This compares to last year's net income of $30.1 million or $0.75 per share. As we have discussed previously, 2015 is going to be a challenging year for us primarily due to the regulatory lag related to the major projects that we have placed into service during the first quarter of this year.

Our next slide displays the primary components of the regulatory lag associated with the investment we have made to meet the growing needs of our service area. Since July of

2009, the Company has invested approximately $1.3 billion in new plant. We have added new generation at the Newman and Rio Grande plants, and facilities at the Montana Power Station including Units 1 and 2, related transmission and distribution, and the Eastside Operations Center. Our regulatory lag is caused by reduced AFUDC, increased depreciation and O&M costs, as well as increases in property taxes and interest expenses. As a consequence of these investments we will be filing for rate relief in both of our jurisdictions, New Mexico and Texas.

Slide 5 shows some of the economic indicators and the service territory growth during the second quarter of 2015. I will begin by pointing out that we set a new Native Peak record of 1,787 MW on June 22, 2015. This peak surpasses our previous peak of 1,766 MW, which was set last summer. We have now set a new native peak record in 9 out of the last 10 years. The new peak is reflective of the continued growth in our service area, and we also continue to see growth in the number of customers. In fact, for the period ending in June, we experienced an increase of 1.4 percent in the number of customers served. Another positive indicator is the unemployment rate. The local unemployment rate during the second quarter was the lowest we have seen in over six years. Through May, the local unemployment rate was also lower than the national average. The continued growth that has been realized in our service territory is the primary reason the Company must invest in new infrastructure to meet the needs of our growing service territory and to maintain our system reliability. On that note, I would like to mention that the construction at the Montana Power Station of Units 3 and 4 continues and we still anticipate the units to be completed on schedule.

At this time, I will turn the call over to Nathan.

Nathan Hirschi: Thanks Tom. Turning to slide 6, we listed key earnings drivers in the second quarter of 2015 compared to the second quarter of 2014. Beginning with the negative drivers, net income during the quarter was negatively impacted by an increase in operations and maintenance expense at our fossil-fuel generating plants, primarily due to an increased level of maintenance activity at the Newman and Four Corners plants. O&M also increased during the quarter as this is the first period that we had a full quarter of operations and maintenance expense associated with the Montana Power Station. In total, operation and maintenance expense related to fossil-fuel generating plants resulted in decreased earnings of $0.07 per share. Also during the quarter, earnings were lower by $0.04 per share due to decreased AFUDC resulting from lower balances of construction work in progress. This was primarily due to the Montana Power Station Units 1 and 2 being placed in service and the completion of the Eastside Operations Center during the first quarter of 2015. These assets being placed in service during the first quarter also contributed to an increase in depreciation expense. The increased depreciation and amortization expense resulted in a $0.03 per share reduction in earnings for the quarter.

Net income during the quarter also declined by $0.04 per share due to the recognition of the Palo Verde performance rewards in June 2014 with no comparable amount in the current period. Last year's rewards were associated with the 2009 to 2012 performance period, and were recorded as a result of the Texas fuel reconciliation being settled in the second quarter of 2014. We also experienced a decline in retail non-fuel base revenues which led to a decrease in earnings of $0.03 per share. The decline in revenues was primarily attributed to decreased revenues from sales to public authorities due to a 3.5 percent decrease in kilowatt hour sales and a military installation moving a portion of their load to an interruptible rate during the third quarter of 2014. Revenues also declined due to lower revenues from our Residential customers reflecting milder weather during the quarter. Part of the decline in Residential revenues was offset by 1.3 percent increase in the average number of residential customers served.

Also during the quarter, increased interest expense on long-term debt negatively impacted earnings by $0.03 due to interest accrued on the $150 million senior notes issued in December 2014. Palo Verde Unit 3 revenues also decreased earnings by $0.03 in the quarter due to a 13.3 percent decrease in proxy market prices reflecting a decline in natural gas prices when compared to the same period last year. Also impacting Palo Verde Unit 3 revenues was a planned 2015 spring refueling outage, which decreased generation by 37 percent. There was no comparable outage in 2014.

On the positive side, net income for the second quarter was positively impacted by decreased Palo Verde operations and maintenance expense, which benefited the quarter by $0.04 per share.

If you will now turn to Slide 7, we have illustrated how weather had an impact on our second quarter revenues. Although we did have a stretch of very warm weather in June, helping propel us to a new native peak record, overall the weather for the quarter was very mild. Cooling degree days for the second quarter of 2015 were 11.5 percent below the 10 year average and 15.2 percent below the same period of 2014. The cooling degree days recorded in May of 2015 were at the lowest level in over 20 years. As you can see on the chart provided, the cooling degree days recorded in the second quarter of 2015 were at the lowest level observed since 2007.

On slide 8, we have provided a comparative analysis of the changes in retail non-fuel base revenues and megawatt hour sales by customer class for the second quarter of 2015 compared to the same period of 2014. Total retail megawatt hour sales declined by 1.6 percent while total retail non-fuel base revenues declined by 1.3 percent during the second quarter of 2015. The decline in retail revenues was primarily driven by decreased revenues from sales to public authorities for the reasons I previously mentioned. The milder summer weather observed during the second quarter of 2015 had a negative effect on sales to the residential small commercial customers. The decrease in retail sales was partially offset by an increase in the average number of customers served. During the quarter, the average number of total retail customers served increased by 1.4 percent, which is in line with the rate of customer growth we have experienced over the past several years.

Turning to slide 9, I will briefly discuss our capital requirements and liquidity. During the first six months of 2015, our capital expenditures for additions to electric utility plant were $147.0 million. On July 23, our Board declared a quarterly cash dividend of $0.295 per share. In total, the Company paid $23.2 million in quarterly cash dividend payments during the first six months of 2015. On June 30, 2015 our liquidity was a $181.9 million which consisted of a cash balance of $10.4 million plus borrowings available on our credit facility. In total, we expect to spend approximately $276 million for capital expenditures in 2015. We may seek to issue long-term debt later this year or in early 2016 to help fund our on-going construction program for general corporate purposes.

Now turning to slide 10, we are narrowing our 2015 earnings guidance range to $1.75 to $2.05 per share from a previous guidance range of $1.75 to $2.15 per share. We are narrowing our range primarily to reflect the weaker levels of revenue we experienced during the quarter.

I will now turn the call over to Mary.

Mary Kipp: Thank you, Nathan. I'd like to provide a brief update of our current New Mexico Rate Case, which was filed on May 11, 2015. Recently, the hearing examiner in our case issued a procedural schedule, of the highlights which we included on slide 11.

As you can see, we are currently immersed in the discovery process as we're providing responses to requests for information and documentation from the Commission staff and intervenors. The discovery period is anticipated to last through November. The hearing examiner issued a date by which interested stakeholders may intervene in the rate case process which expired on August 3, 2015. We have estimated that a potential decision by the Commission could be reached by January 2016. We believe that using a historical test year will allow the case to be completed in the initial 10 month suspension period, and that new base rates will become effective early in the second quarter of 2016.

Turning to slide 12, as it currently stands next week we plan to file a general rate case with the City of El Paso, other incorporated municipalities in our service territory and the Public Utility Commission of Texas. As soon as the rate case is filed, we will be hosting a webcast for the investment community to cover the details of the filing and to answer any questions you may have. Therefore, we ask that you hold all questions regarding the Texas Rate Case until that time. The Texas Rate Case will be based on a historical test year ended March 31, 2015 and we anticipate that new rates would become effective in Texas by early second quarter 2016. The filing will include generation plant additions including Montana Power Stations Units 1 and 2, the common costs associated with those plants, the related transmission and distribution infrastructure and the Eastside Operation Center.

If you'll turn to slide 13, I'd now like to walk you through some of the other regulatory filings made during the second quarter.

The Company filed a request in Texas to decrease the fixed fuel factor by approximately 24 percent. On May 20th, the Company received final approval to decrease the fixed fuel factor as proposed, although the new rates went into effect on May 1st on an interim basis.

During the month of June, the Company continued to demonstrate a cost effective and environmentally conscious effort to diversify our generation portfolio by filing for solar projects to be located at the Montana Power Station and at the Holloman Air Force Base in New Mexico. The Company filed in Texas for approval of a new renewable energy tariff to implement a voluntary community solar pilot program. The proposed tariff would allow customers to voluntarily subscribe for output of a proposed 3 MW solar-powered plant located at our Montana Power Station. In New Mexico, the Company filed for a Certificate of Convenience and Necessity for a 5 MW Solar Power Generation project to be located at Holloman Air Force Base. This facility would be dedicated to the Base and would assist the United States Air Force in meeting its renewable energy and energy security goals. If approved, both facilities will be operational by year end 2016.

At this time I will turn the call back over to Lisa for questions.

Lisa Budtke: Thanks Mary. This concludes our second quarter 2015 earnings presentation. Before I open the call up for questions, I would like to remind our listeners that we will host a special webcast next week dedicated to covering the details of our planned Texas Rate Case Filing, and to answer any questions you may have related to the filing. I would also like to inform you that we will be marketing with Ladenburg Thalmann in New York and Boston on September 15th and 16th. Please contact our Investor Relations Department or visit the Investor Relations page of our website for details.

Now at this time I would like to open up the call for questions.

Operator: Thank you. If you would 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 time to reach our equipment.

One again, that is star 1 to ask a question and we will pause for just a moment to allow everyone an opportunity to signal for questions.

First question comes from Anthony Crowdell with Jefferies.

Anthony Crowdell: Good morning. I was just hoping if you could give us more clarity on the $0.10 you took off the high end of guidance?

Nathan Hirschi: Yes, thanks for calling Anthony. It's good to hear from you. But, it's really related to the revenues that we didn't see. We lost $0.03 during the quarter over prior year and of course we anticipated an increase year-over-year due to customer growth and the expanding service territory. So it was really a revenue related issue that didn't pan out quite as well as we hoped in the first quarter, partially due to the weather.

Anthony Crowdell: So if you're taking $0.03 off of retail non-fuel base revenues do I assume that the other $0.07 hits third quarter? Because that $0.03 is a combination of weather and some other issues.

Nathan Hirschi: The $0.03 is year-over-year. We had anticipated sales growth during the quarter, so the guidance is in fact now a slightly larger amount than that.

Anthony Crowdell: So when I look at the range now of $1.75 to $2.05 where does this normal weather get you to, the mid $1.90 or does normal weather get you closer to the higher end of that revised range?

Nathan Hirschi: Well, there's lot of factors, but yes it puts us closer to midpoint.

Anthony Crowdell: So to hit the $2.05 now you need I guess better than average weather?

Nathan Hirschi: Well, all other things being equal, yes other things could benefit us one way or the other.

Anthony Crowdell: Okay and just some housekeeping when I look at, Palo Verde maintenance you guys had a $0.04 positive on that, but you also had, I guess an outage on Palo Verde 3 during the quarter which drove revenues down. How did you achieve the $0.04 savings that Palo Verde O&M?

Nathan Hirschi: Well Palo Verde had a good quarter. Some of it was the allocation of overhead costs that they adjusted during the quarter and then they revised the estimates for the year. So Palo Verde overall had a good quarter and they're having a good year.

Anthony Crowdell: Even with an outage on Unit 3 this quarter?

Nathan Hirschi: Yes, the majority of that savings came in the A & G side of it, not in the maintenance.

Anthony Crowdell: Great. Thanks for taking my question guys. Look forward to hearing next week.

Nathan Hirschi: Thanks Anthony.

Operator: Next question comes from Brian Russo with Ladenburg Thalmann.

Brian Russo: Hi, good morning.

Lisa Budtke: Good morning.

Nathan Hirschi: Hey, Brian. How are you?

Brian Russo: Good, thanks. Just can you comment on the weather normalized load growth outlook, we still kind of assuming that 1 ½ to 2 percent target?

Nathan Hirschi: Yes that's right. We think weather during the quarter cost us about $3 million. And if we had factored that in we probably would be in that range of the 1 ½ percent. And like we said, that's continued with our customer growth and the kind of the range that we'd expect.

Brian Russo: So the range is what, 1 ½ to 2?

Nathan Hirschi: At this point I'd probably say 1 ½ percent is looking like the current trend.

Brian Russo: Okay. Now I always thought load growth exceeded customer growth because you had usage expansion per customer maybe you can comment on that?

Nathan Hirschi: Certainly that's been the trend for the last 10 years. Our overall load growth has been closer to 3 percent and we have had a period of time where it seems that the load growth, particularly at the military installations and the government installations, in our service territory have had some energy conservation and some energy efficiency efforts and that's kind of hampered the growth a little bit.

Brian Russo: Okay and just remind us, when is the commercial operation of MPS 3 and 4 and is there a possibility to have that commercially available sooner than the target just like happened in MPS 1 and 2.

Nathan Hirschi: Well it's currently targeted before the summer peak of 2016 for Unit 3 and toward the end of the calendar year '16 for unit 4 and that kind of meets our needs. So that looks like that's a realistic goal and probably won't change much.

Brian Russo: Okay and you guys touched upon this earlier, but just if you could elaborate a little bit on the New Mexico Rate Case Filing and the use of the historical test year cause we've seen other New Mexico utilities face some challenges with the Commissions interpretation of a forward test year and I was just curious if that lends support to possible settlement.

Mary Kipp: This is Mary, Brian, nice to hear from you. Obviously we are pleased now that we did file a historical test year. I think it's always easier for a Commission to deal with something it has had a long history of dealing with. We are hopeful that we will have a settlement in this case, but at the same time we're also willing to litigate all the way if need be.

Brian Russo: Okay, great. Thank you very much.

Operator: As a reminder ladies and gentlemen it is star 1 to ask a question. That is star 1 and we go to Joe Zhou.

Joe Zhou: So, will you give us some guidance on how the weather looks in July and will this kind of weak weather pattern continue in August and whether your low end of the guidance contemplates the weather?

Nathan Hirschi: Yes, one component of both ends is weather. We had an above average July, although, a slight bit below prior year, and August is starting off very well. We'll likely get to 100 degrees today, so that's hot for us in August. So the weather has been positive in the third quarter and the low end of guidance like I mentioned to Anthony would change. You know there's a lot of factors going in there, but below normal weather would lead us toward the lower end.

Joe Zhou: Okay. So, let me clarify, so since the weather has been good in 3Q, so for the $0.10 guidance decrease has that indicator you already considered this positive weather or is it before this?

Nathan Hirschi: It was factored in slightly Joe, although, of course the fixed month that was just this one month of the six months. So it had a factor but not a significant factor in that.

Joe Zhou: Okay. Got it.

Andy Levy: Hi, it's Andy Levy. Just to clarify, because I guess my understanding from just watching the weather down in Texas over the last week to two weeks the weather has been extremely hot with a very strong forecast going forward for August thus far.

Nathan Hirschi: Well, that's true.

Andy Levy: Are you experiencing that weather or is that in a different part of Texas?

Nathan Hirschi: Yes, the eastern part of Texas has been a lot hotter than we have. I think it's been close to 100 in Houston and those areas. So, we haven't quite had those extreme temperatures although we do have forecasts of 100 plus degree temperatures for the next few days.

Andy Levy: Well enjoy that.

Nathan Hirschi: Thanks.

Andy Levy: Good utility weather. Thank you very much.

Nathan Hirschi: Thanks Andy.

Operator: Ladies and gentlemen with no further questions in queue I'd like to turn the conference back over to management for closing remarks.

Lisa Budtke: Okay, thank you, Shannon and thank you everyone for joining us on today's call. We look forward to speaking with you next week. Please be safe.

Operator: Ladies and gentlemen that does conclude today's conference. We do thank you for your participation. You may now disconnect. Have a great rest of your day.

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