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PNM Resources, Inc. (PNM)

Q4 2015 Earnings Call

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Anthony C. Crowdell
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MANAGEMENT DISCUSSION SECTION

Operator: Hello, and welcome to the PNM Resources Fourth Quarter 2015 Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Jimmie Blotter, Director of Investor Relations. Please go ahead.

Jimmie Blotter
Director-Investor Relations

Thank you, Carrie, and thank you everyone for joining us this morning for the PNM Resources fourth quarter 2015 earnings conference call. Please note that the presentation for this conference call and other supporting documents are available on our website at pnmresources.com.

Joining me today are PNM Resources Chairman, President, and CEO, Pat Vincent-Collawn, and Chuck Eldred, our Executive Vice President and Chief Financial Officer, as well as several other members of our Executive Management team.

Before I turn the call over to Pat, I need to remind you that some of the information provided this morning should be considered forward-looking statements, pursuant to the Private Securities Litigation Reform Act of 1995. We caution you that all of the forward looking statements are based upon current expectations and estimates and that PNM Resources assumes no obligation to update this information. For a detailed discussion of factors affecting PNM Resources' result, please refer to our current and future Annual Report on Form 10-K, Quarterly Report on Form 10-Q, as well as other reports on Form 8-K filed with the SEC.

And with that, I will turn the call over to Pat.

Patricia K. Vincent-Collawn

Chairman, President & Chief Executive Officer

Thank you, Jimmie. Good morning, everyone. And thank you for joining us as we close out our discussion on 2015 which was a very productive year for the company. We'll begin the presentation today on slide four with a look at our regulatory and operational achievements over the year.

2015 was, to say the least, an interesting year. I'm very proud that we are able to successfully over several challenges and finished the year on a strong note. Our most significant accomplishment was PNM obtaining final approval for the San Juan Generation Station BART plan. We received that approval two years from when we filed with the commission.

Many things were dependent on a positive decision, and we're now able to move forward with our comprehensive plan. It is the most cost-effective path forward and the best option for our customers who are already seeing lower bills as a result of a new coal supply agreement. It will also benefit the entire state by minimizing economic impact and providing significant environmental improvements.

Ultimately, the position that we and other utilities had regarding the definition of what constitutes a future test year was upheld. The commission revised its definition in a way that agrees with our understanding. And the New Mexico Supreme Court has dismissed the appeal. We're also pleased that we were able to settle our FERC transmission formula rate case. The settlement is awaiting final approval from FERC.

In Texas, TNMP successfully implemented two TCOS increases totaling $5.8 million annually. In addition, on January 8 of this year, the staff of the Public Utility Commission of Texas recommended that the commission approve, without changes, TNMP's filing for reconciliation regarding its AMS deployment. We anticipate the commission to rule at its open meeting on March 24.

We turn to our operational highlights. You always hear me talk about reliability being our customer's number one priority. I'm proud to say that in 2015, PNM delivered strong reliability and was recognized with a ReliabilityOne Award for Outstanding Midsize Utility. TNMP also continued to deliver excellent reliability despite extreme weather throughout the year in Texas. As a result of PNM's excellent reliability and focus on customers, in 2015, we continued to improve our J.D. Power Customer Service ratings. In July and August, PNM achieved its highest scores ever. At the same time, the number of merited complaints with the New Mexico Commission remained at the lowest level in the past five years. That's especially significant during the rate case year.

In 2015, PNM stayed on track with plans to increase generation capacity. We added four new solar facilities totaling 40 megawatts. And the new La Luz 40-Megawatt Gas Peaker is also now online. We're also proud of the fact that once again TNMP received ENERGY STAR's Market Leader Award for its energy efficiency programs. That's the 11th consecutive year that TNMP has earned that honor.

We continue to move forward with the AMS roll out at TNMP. We're now at 91% completion. In conjunction with the AMS deployment, we've implemented the new outage management system. This will be an important tool in improving response time, reducing outage time, and increasing both reliability and customer satisfaction. Let's now go to slide five for a snapshot of fourth quarter and year-end results.

As you can see, there is a significant difference between our GAAP and ongoing earnings, which is primarily due to a GAAP write off related to the shutdown of Units 2 and 3 at the San Juan Generating Station. Our GAAP EPS for fourth quarter 2015 was a loss of $1.15 compared to earnings of $0.24 in the fourth quarter of last year. For the year, GAAP earnings per share were $0.20 compared to $1.45 in 2014. For the fourth quarter, ongoing earnings per share were $0.23 compared to $0.24 from the fourth quarter last year. For the year, ongoing earnings totaled $1.64 up $0.15 from 2014. We're also affirming our 2016 guidance range of $1.55 to $1.76.

Couple of quick regulatory updates, we're moving forward with the implementation of our BART plan at San Juan. The SNCR and balanced draft equipment are now in full operation on Units 1 and 4. And savings from the new coal supply and restructuring agreements are now flowing to our customers. And the 40 megawatts of solar that was in our replacement plan is now online. We're also on track with the rate case we filed last August. PNM and the interveners filed rebuttal testimony this past Monday. And the hearing is currently scheduled to run from March 14 to March 25.

On January 29, TNMP made its latest TCOS filing requesting an annual increase of $4.3 million. We expect that these rates will go into effect in March. This reflects a $25.8 million increase in transmission rate base over our last filing.

I'll now turn it over to our Chief Financial Officer, Chuck Eldred, for a more comprehensive look at the numbers.

Charles N. Eldred
Chief Financial Officer & Executive Vice President

Thank you, Pat, and good morning everyone.

We continue to make progress towards achieving our goal. The Westmoreland coal contract that became effective February 1 brings substantial savings to customers. We received approval on the BART and resolution of the future test year definitions on the New Mexico Commission in December. We also ended 2015 with an improvement in earnings compared to our revised guidance range.

So beginning on slide seven, let's start by reviewing load of both PNM and TNMP. Both were within the guidance ranges that we had for the year. At PNM, 2015 was down 1.4% compared to 2014. I want to point out the residential load was flat both for the fourth quarter and for the entire year.

Customer growth came in higher than our expectations at 0.8% for fourth quarter and 0.7% for the year. The economy in New Mexico continues to have mixed indicators. The employment growth recently in Albuquerque Metro area has been strong. And you can see that even on a 12-month rolling average, it's moving up with the strongest numbers we have seen in three years. The state overall is not faring as well though. That softness is driven primarily by the low oil and natural gas prices.

While we do not serve the regions of the state that produce oil and gas, we do expect the impacts of layoffs and the decrease in state royalty revenues will somewhat soften the economies in our service territory, particularly in Albuquerque Metro area in Santa Fe, as the state deals with budget shortfalls. We continue to expect 2016 load to be flat to down 2% for the year.

Moving to TNMP, load for 2015 was up 2.6% compared to 2014. Customer growth was higher than forecast at 1.5% for Q4 and for the year. The Texas economy continues to be strong, but the Houston area, in particular, is feeling the impact of low oil and natural gas prices. While Houston proper is suffering, we are not seeing the economy in our service territory soften. This is because of a couple of factors. We serve many refiners and petrochemical manufacturers who continue to have strong production. Additionally, we see some production movements into the smaller communities outside the Houston Metro area, population movements into the smaller communities outside the Houston area. TNMP serves some of those areas, and therefore, we are actually seeing customer increases rather than decreases.

For 2016, we continue to expect load to be up 2% to 3% as refiners and petrochemical manufacturers continue strong production. And our service territory that's near Dallas and Forth Worth continues to have a strong economy.

On slide 8, as I said before, we ended the year exceeding the upper end of our 2015 guidance range with $1.64 consolidated ongoing earnings. All of our segments performed well during the year. PNM came in $0.02 higher than guidance, TNMP at the upper end of the guidance range, and Corporate and Other was also $0.01 better than guidance.

Now moving to slide 9, ongoing earnings came in at $0.23 for fourth quarter compared to $0.24 in the fourth quarter 2014. PNM was down $0.03, and TNMP was flat. Corporate and Other came in $0.02 better than last year, driven by improvements in interest expense related to the repayment of the $119 million and 9.25% debt in May of 2015.

On slide 10, let's look at the drivers for PNM and TNMP. Beginning with PNM, AFUDC improved $0.03 compared to the fourth quarter of 2014. This was caused by higher capital spending and higher [ph] quip (12:31) balances, including the SNCR and balanced draft equipment in San Juan, the construction of the 40 megawatt La Luz Gas Peaker, and 40 megawatts of solar.

As we've seen through 2015, the half price of Palo Verde Unit 1 leases contributed $0.03. Weather was an improvement of $0.02 between the quarters as weather reduced fourth quarter 2014 earnings by $0.01 and improved fourth quarter 2015 by $0.01. The heating degree days for fourth quarter 2015 were not the driver for weather as they were only 8% higher than last year but 2% below normal. Instead, it was our cooling season that extended into October with temperatures that were warmer than normal and warmer than 2014.

We have been migrating to the Palo Verde Unit 3 Nuclear Decommissioning Trust from a shareholder asset to a regulated asset. This involves rebalancing the portfolio to reduce the percentages held in equity investments to better match the regulated assets. As we do this, we have opportunistically captured gains. In addition to that, we changed some of our managers, which resulted in further rebalancing of the investment portfolios. Together, these actions resulted in higher gains of $0.02 compared to fourth quarter 2014.

Renewables also improved results by $0.01. We had higher O&M expenses of $0.03 in the quarter, which brings our year-to-date expenses in line with our guidance range. Outage costs were $0.02 higher. This was caused largely by the San Juan Unit 4 outages [ph] and saw (14:10) SNCR and balanced draft equipment.

We took $0.02 write-off in fourth quarter 2015 for items on our balance sheet related to the exploration of alternative fuel supply contracts for San Juan. With the completion of the Westmoreland contract, we determined that it was appropriate to write-off these assets.

Interest expense was $0.02 higher related to the additional debt that PNM entered into August of 2015. Load was down a $0.01. Transition margins were down a $0.01, compared to fourth quarter 2014. We had two long-term point-to-point contracts expired during the year, which is the primary cause of this change. We also had higher depreciation and property tax expense of $0.01. Finally, we capitalized A&G load on capital projects. It's lower than it was last year. This is primarily relating to the timing of capital projects

At TNMP, rate relief from TCOS filings was up $0.01 compared to fourth quarter 2014. Weather was down $0.01. Heating degree days were 28% lower than fourth quarter of 2014 and 27% lower than normal. Depreciation and property taxes were also higher by $0.01.

Now turning to slide 11, before we review the 2016 forecast, I want to mention how the five-year bonus depreciation extension affects us. As you're aware, we have an NOL at PNM for income tax purposes that have been expected to be fully utilized in 2018. The extension of bonus depreciation will cost the NOL to last for a longer period of time, now carrying us into 2019. While the additional deferred tax from bonus depreciation decreases rate base, the NOL increases rate base. As a result, we do not expect to see significant change in our rate base. Looking at 2016, bonus depreciation does not impact our ongoing earnings guidance.

We have included our rate base projection on this slide for the expected impact of bonus depreciation and the extension of the NOL. The impact of bonus depreciation does not change our 2016 rate case numbers except the TNMP, which does not have an NOL. However, regardless of rate base change, our EPS expectations for 2016 are ineffective. As a reminder, we expect to update guidance in middle of this year after we resolve the ongoing rate case at PNM.

In the appendix to today's presentation, you will find the 2017 to 2019 potential earnings power slide. This is also been updated for bonus depreciation. As for 2016, PNM does not have a significant change in TNMP's rate base is reduced from our prior presentation by approximately $50 million in each period. Overall, the changes are not as significant earnings driver for the company. Since the NOL is expected to be utilized in 2019, bonus depreciation will have an impact in our 2020 rate case. We're currently viewing the capital projections and identifying which projects should be funded. We'll provide those updates later this year.

Finally on slide 12, we are focused on achieving our strategic goals. We expect to continue delivering above industry average earnings and dividend growth, which is displayed to the potential earnings power of the business and supports our 7% to 9% growth rate.

As I wrap up today, I want to express that 2015 ended with good results. We're optimistic about 2016. And we recognize the importance of PNM's rate case on this year's financial results and the need to bring it to a good resolution. We also expect to file our 2018 rate case in December of this year. That filing will include the major elements of the BART case, the abandonment of San Juan's Unit 2 and 3, the additional megawatts in San Juan Unit 4, and the inclusion of Palo Verde Unit 3 rates. The rate base valuations for each of these items have already been set to the BART process.

Pat, I'll turn the call back over to you.

Patricia K. Vincent-Collawn
Chairman, President & Chief Executive Officer

Thanks, Chuck.

As Chuck said, we're very proud of what we accomplished in 2015. We reached positive conclusions on key regulatory filings. The company delivered another solid financial performance. And most importantly, we continued to focus on serving our customers with reliable, affordable, and environmentally responsible electricity.

Given the challenges and oppositions we faced through this year and continue to face, these achievements confirm that our strategy is sound and our hard work is creating positive results. Going forward, we plan to stay the course and continue to work in the best interest of our customers, the communities we serve, our employees, and our shareholders.

One more note about our rate case. No one likes rate increases. We understand that, and we take it very seriously. This request is driven primarily by capital improvements to our system designed to ensure continued reliability for our customers. As filed, the rate case would increase rates by 14%. But when you consider the customer benefits from the Westmoreland Coal contract and other items, the total increase is about 5%. That's an average of about 1% a year since our last increase.

I want to emphasize that it is of great importance that we achieved timely rate recovery in this proceeding. And we are confident that we have strong justification for the revenue requirement. As we have been saying all along, given the number of interveners in this case, it is likely that the best way to achieve this will be through litigation.

And in closing, I cannot say enough about the tremendous effort of our employees. They are responsible for our ongoing success and progress, and they make us proud every day.

Operator, let's now open it up for questions.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from Anthony Crowdell of Jefferies. Please go ahead.

Anthony C. Crowdell
Jefferies LLC
Q

Good morning.

Patricia K. Vincent-Collawn
Chairman, President & Chief Executive Officer
A

Morning, Anthony.

Charles N. Eldred
Chief Financial Officer & Executive Vice President
A

[ph] Hi, Anthony. (20:43)

Anthony C. Crowdell
Jefferies LLC
Q

I have a couple questions. One is I want to know what's left on your Palo Verde leases after you file for the rate case at the end of this year for new rates in 2018?

Charles N. Eldred
Chief Financial Officer & Executive Vice President
A

Yeah, there's a – after we – the lease is about 114 megawatts and still remain that actually extend on half price as a pass through to O&M through 2022, 2023.

Anthony C. Crowdell
Jefferies LLC
Q

Okay, great. Since, I guess, the BART filing in December or maybe even the third quarter call, you'd given this, I don't want to use the word guidance but maybe a rough estimate of the potential loss, the unregulated portion the San Juan plant would be. Power prices have since maybe taken another downturn. Could you give us an update on what your estimate would be for the unregulated portion of power of San Juan?

Charles N. Eldred
Chief Financial Officer & Executive Vice President

A

Yeah. Anthony, as you know, the 65 megawatts actually doesn't affect us until the BART implementation in 2018 when we taken on the 65 megawatts. And as you recall in our projections, we used spot prices, real-time prices of the markets. So you're right, prices have decreased considerably since we've last talked about it. I think we're around of $0.03 losses and with the additional lower prices, which are close to little less than $30 a megawatt hour, it's a breakeven in the mid-$40 a megawatt hour for San Juan 65 megawatt. We're probably additional $0.03 or $0.04 loss.

But let me just also comment that, as you're aware, with the Westmoreland contract, the financing that we have done through Westmoreland to support the closing of the purchase of the mine that there are some additional earnings that begin to reflect as a result of the financing and the basis spreads between what we were able to finance at PNM versus PNM Resources versus what Westmoreland was charged to reflect more of their credits. That benefit, if you will, is roughly around $0.04 or so. So it offsets the losses that we would have at the 65 megawatts I just referred to. So we remain kind of neutral. But overall, we're on the course that we said we'd be on and we're not really receiving an impact even with the lower prices at the 65 megawatt.

Anthony C. Crowdell
Jefferies LLC

Q

Okay. And just lastly, Pat, I know you had said you think the best way of achieving what you've requested in the rate proceeding given the large number of interveners and it looks like you went to [ph] dug (23:20) in their positions was through a litigated decision. Would you comment, at all, if there's even a potential for a settlement or it just seems like it's not really going to happen here?

Patricia K. Vincent-Collawn
Chairman, President & Chief Executive Officer

A

There's always a potential, but I think in this case, litigation is probably the best path forward because it's the most expeditious and the quickest path forward.

Anthony C. Crowdell
Jefferies LLC

Q

Great, thanks for taking my questions.

Patricia K. Vincent-Collawn
Chairman, President & Chief Executive Officer

A

Thank you.

Charles N. Eldred
Chief Financial Officer & Executive Vice President

A

Thanks.

Patricia K. Vincent-Collawn
Chairman, President & Chief Executive Officer

A

Thanks, Anthony.

Operator: Our next question comes from Brian Russo of Ladenburg. Please go ahead.

Brian J. Russo
Ladenburg Thalmann & Co., Inc. (Broker)

Q

Hi, good morning.

Patricia K. Vincent-Collawn
Chairman, President & Chief Executive Officer

A

Morning, Brian.

Charles N. Eldred
Chief Financial Officer & Executive Vice President

A

Hey.

Brian J. Russo
Ladenburg Thalmann & Co., Inc. (Broker)

Q

You mentioned that when the NOLs run off at the end of 2019, there will be an impact to your rate base for bonus depreciation in 2020. Can you quantify that?

Charles N. Eldred
Chief Financial Officer & Executive Vice President

A

Yeah, we actually haven't put out the 2020 rate base at this point. So we'll – but it does – it pretty much keeps the rate base slightly lower than what we have through 2019. But we haven't quantified at this point, Brian. So I'd rather wait till we really run through the numbers and look to see if there's some additional capital funding that we can benefit from the bonus depreciation and additional cash flow. We'll update the number and provide them to you.

Brian J. Russo
Ladenburg Thalmann & Co., Inc. (Broker)

Q

Well. Maybe I'll ask in a different way. In 2016 rate base, hypothetically, if you didn't have the NOL, what would the impact to your rate base be, if you can answer that?

Charles N. Eldred
Chief Financial Officer & Executive Vice President

A

2016?

Brian J. Russo
Ladenburg Thalmann & Co., Inc. (Broker)

Q

Or 2015.

Charles N. Eldred
Chief Financial Officer & Executive Vice President
A

I don't have 2015. Let me get – we'll just have to get back with you on that. I've got the numbers of 2016. I don't have 2015 with me.

Brian J. Russo
Ladenburg Thalmann & Co., Inc. (Broker)
Q

Okay. So could you share with us for the 2016?

Charles N. Eldred
Chief Financial Officer & Executive Vice President
A

Yeah. 2016, if you would, roughly with the effects – without NOL, the net effect of that looks like it would be about [ph] 2.6% to 2.4% (25:22) about $200 million net.

Brian J. Russo
Ladenburg Thalmann & Co., Inc. (Broker)
Q

Okay, thank you very much.

Patricia K. Vincent-Collawn
Chairman, President & Chief Executive Officer
A

Thanks, Brian.

Operator: [Operator Instructions] Our next question comes from [ph] John Allie (25:37) of Castleton. Please go ahead.

Q

Good morning, guys.

Patricia K. Vincent-Collawn
Chairman, President & Chief Executive Officer
A

Good morning, [ph] John. (25:42)

Charles N. Eldred
Chief Financial Officer & Executive Vice President
A

[ph] Morning (25:42)

Q

Just two quick questions. You said the litigation is the quickest route, what's the timeline you guys are thinking for that? And then secondly, do you have any thoughts on the formation of the [ph] REIT for your taxes as such (25:55)?

Patricia K. Vincent-Collawn
Chairman, President & Chief Executive Officer

A

I'll take the first one and let Chuck take the second one. The hearings John start on the 14th of March and go till the 25th of March. We would hope that the effective date would be close to the beginning of Q3. I think you all know that Q3 is our largest quarter so therefore having the rates in place early in that quarter makes a big impact, which is why we want timely rate increase. So that's probably the schedule we are looking at.

Q

Great.

Charles N. Eldred
Chief Financial Officer & Executive Vice President

A

Yeah, John in regards to the [ph] REIT (26:28), we're watching as everyone else to see what the commission ultimately does with the on proposal and the actions relative to how they pursue that going forward and whether they actually allow that to be approved and the [ph] REIT (26:43) gets formed with Encore.

So we'll monitor that, and if we feel that that decision is made, as I'm sure all the T&D companies in Texas, we'll do the rigor and analysis necessary to see if it makes any sense for our structures to consider that as well. So at this point, we're just on the sidelines keeping a close eye on it.

Q

Great, thank you.

Charles N. Eldred
Chief Financial Officer & Executive Vice President

A

Okay.

Patricia K. Vincent-Collawn
Chairman, President & Chief Executive Officer

A

Thanks, John.

Operator: And this concludes our question and answer session. I would now like to turn the conference back over to Pat Vincent-Collawn for any closing remarks.

Patricia K. Vincent-Collawn
Chairman, President & Chief Executive Officer

Thank you. And again, thank you all for joining us this morning. We appreciate you joining us on this call to hear about our very successful 2015 and our plans for going forward. And we look forward to speaking with you and seeing you all throughout the year. Have a great weekend.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines. Have a great day.