

EL PASO ELECTRIC CO /TX/

Form 10-Q/A

November 22, 2004

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q/A
Amendment No. 1

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2004

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-296

El Paso Electric Company

(Exact name of registrant as specified in its charter)

Texas (State or other jurisdiction of incorporation or organization)	74-0607870 (I.R.S. Employer Identification No.)
Stanton Tower, 100 North Stanton, El Paso, Texas (Address of principal executive offices)	79901 (Zip Code)
(915) 543-5711 (Registrant's telephone number, including area code)	

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES NO

As of May 3, 2004, there were 47,589,845 shares of the Company's no par value common stock outstanding.

Table of Contents

EL PASO ELECTRIC COMPANY

FORM 10-Q/A

INTRODUCTORY NOTE

This Amendment No. 1 to quarterly report on Form 10-Q/A (Form 10-Q/A) is being filed to amend the Company s quarterly report on Form 10-Q for the quarter ended March 31, 2004, which was originally filed on May 7, 2004 (Original Form 10-Q). Accordingly, pursuant to rule 12b-15 under the Securities Exchange Act of 1934, as amended, this Form 10-Q/A contains the complete text of Items 1, 2, and 4 of Part I and Item 6 of Part II, as amended, as well as certain currently dated certifications. Unaffected items have not been repeated in the Amendment No. 1.

During the quarter ended September 30, 2004, the Company determined that Alternative Minimum Tax (AMT) credit carryforward assets pertaining to the pre-reorganization time period were overstated by \$4.5 million and reorganization-related transmission and distribution assets were understated by \$4.5 million. To correct this error, the Company has restated its consolidated balance sheets as of December 31, 2003 and March 31, 2004, the consolidated statements of operations for the three and twelve months ended March 31, 2003 and 2004, the consolidated statements of comprehensive operations for the three and twelve months ended March 31, 2003 and 2004, and the consolidated statements of cash flows for the three months ended March 31, 2003 and 2004. The Company has also restated the notes to consolidated financial statements as necessary to reflect the adjustments. The adjustments to the consolidated balance sheet as of December 31, 2003, include the elimination of \$4.5 million of AMT credit carryforward assets, the related increase of \$4.5 million in reorganization-related transmission and distribution assets, an increase of \$3.8 million in accumulated depreciation, an increase of \$0.3 million in deferred tax liabilities, and a decrease of \$4.1 million in retained earnings. The statements of operations and comprehensive operations were adjusted by a quarterly increase of \$0.1 million and an annual increase of \$0.5 million in depreciation and amortization expense. Net income and comprehensive income were reduced by \$0.1 million and \$0.3 million for the three and twelve months ended March 31, 2003 and 2004, respectively, as a result of the aforementioned adjustments. Please read Note G to the accompanying consolidated financial statements for a discussion of the adjustments.

This amendment does not reflect events occurring after the filing of the Original Form 10-Q, which was filed on May 7, 2004. Such events include, among others, the events described in the Company s quarterly reports on Forms 10-Q for the quarters ended June 30, 2004, and September 30, 2004, and the events described in the Company s current reports on Form 8-K filed after the filing of the Original Form 10-Q. Certain other items have been revised or added in response to comments from the SEC in its letter to the Company dated May 28, 2004.

(i)

Table of Contents

EL PASO ELECTRIC COMPANY AND SUBSIDIARY

INDEX TO FORM 10-Q/A

	<u>Page No.</u>
<u>PART I. FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements</u>	
<u>Consolidated Balance Sheets – March 31, 2004 (Restated) and December 31, 2003 (Restated)</u>	1
<u>Consolidated Statements of Operations – Three Months and Twelve Months Ended March 31, 2004 (Restated) and 2003 (Restated)</u>	3
<u>Consolidated Statements of Comprehensive Operations – Three Months and Twelve Months Ended March 31, 2004 (Restated) and 2003 (Restated)</u>	4
<u>Consolidated Statements of Cash Flows – Three Months Ended March 31, 2004 (Restated) and 2003 (Restated)</u>	5
<u>Notes to Consolidated Financial Statements (Restated)</u>	6
<u>Report of Independent Registered Public Accounting Firm</u>	21
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations (Restated)</u>	22
Item 4. <u>Controls and Procedures</u>	29
<u>PART II. OTHER INFORMATION</u>	
Item 6. <u>Exhibits and Reports on Form 8-K</u>	30

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****EL PASO ELECTRIC COMPANY AND SUBSIDIARY****CONSOLIDATED BALANCE SHEETS****ASSETS****(In thousands)**

	March 31, 2004 (Unaudited)	December 31, 2003
	(Restated)	
Utility plant:		
Electric plant in service	\$ 1,797,557	\$ 1,788,652
Less accumulated depreciation and amortization	612,637	595,371
Net plant in service	1,184,920	1,193,281
Construction work in progress	72,935	69,175
Nuclear fuel; includes fuel in process of \$1,182 and \$6,878, respectively	72,275	70,198
Less accumulated amortization	38,230	33,888
Net nuclear fuel	34,045	36,310
Net utility plant	1,291,900	1,298,766
Current assets:		
Cash and temporary investments	44,348	34,426
Accounts receivable, principally trade, net of allowance for doubtful accounts of \$3,343 and \$3,470, respectively	58,682	66,589
Accumulated deferred income taxes	30,953	36,248
Inventories, at cost	25,308	25,321
Undercollection of fuel revenues	11,913	12,399
Prepayments and other	22,942	27,190
Total current assets	194,146	202,173
Deferred charges and other assets:		
Decommissioning trust funds	82,763	80,475
Other	13,180	15,200
Total deferred charges and other assets	95,943	95,675

Total assets	\$ 1,581,989	\$ 1,596,614
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See accompanying notes to consolidated financial statements.

Table of Contents**EL PASO ELECTRIC COMPANY AND SUBSIDIARY****CONSOLIDATED BALANCE SHEETS (Continued)****CAPITALIZATION AND LIABILITIES****(In thousands except for share data)**

	March 31, 2004 (Unaudited)	December 31, 2003 (Restated)
Capitalization:		
Common stock, stated value \$1 per share, 100,000,000 shares authorized, 62,549,631 and 62,487,263 shares issued, and 108,995 and 146,489 restricted shares, respectively	\$ 62,659	\$ 62,633
Capital in excess of stated value	264,470	264,235
Unearned compensation restricted stock awards	(625)	(878)
Retained earnings	353,853	350,939
Accumulated other comprehensive loss, net of tax	(9,570)	(9,613)
	<u>670,787</u>	<u>667,316</u>
Treasury stock, 15,070,266 shares, at cost	(171,548)	(171,548)
	<u>499,239</u>	<u>495,768</u>
Common stock equity	499,239	495,768
Long-term debt, net of current portion	574,159	588,536
Financing obligations, net of current portion		20,186
	<u>1,073,398</u>	<u>1,104,490</u>
Total capitalization	1,073,398	1,104,490
Current liabilities:		
Current portion of long-term debt and financing obligations	40,838	22,106
Accounts payable, principally trade	22,247	19,197
Taxes accrued other than federal income taxes	13,487	15,167
Interest accrued	14,427	14,706
Overcollection of fuel revenues	10,660	10,070
Other	22,199	20,781
	<u>123,858</u>	<u>102,027</u>
Total current liabilities	123,858	102,027
Deferred credits and other liabilities:		
Accumulated deferred income taxes	135,556	144,419
Accrued postretirement benefit liability	96,266	94,510
Asset retirement obligation	56,458	55,149
Accrued pension liability	53,550	53,000
Other	42,903	43,019
	<u>384,733</u>	<u>390,097</u>
Total deferred credits and other liabilities	384,733	390,097
Commitments and contingencies		

Total capitalization and liabilities

\$ 1,581,989

\$ 1,596,614

See accompanying notes to consolidated financial statements.

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Income before income taxes and cumulative effect of accounting change	4,035	2,903	34,687	39,288
Income tax expense	1,121	860	13,494	14,348
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Income before cumulative effect of accounting change	2,914	2,043	21,193	24,940
Cumulative effect of accounting change, net of tax		39,635		39,635
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net income	<u>\$ 2,914</u>	<u>\$ 41,678</u>	<u>\$ 21,193</u>	<u>\$ 64,575</u>
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Basic earnings per share:				
Income before cumulative effect of accounting change	\$ 0.06	\$ 0.04	\$ 0.44	\$ 0.50
Cumulative effect of accounting change, net of tax		0.81		0.80
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net income	<u>\$ 0.06</u>	<u>\$ 0.85</u>	<u>\$ 0.44</u>	<u>\$ 1.30</u>
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Diluted earnings per share:				
Income before cumulative effect of accounting change	\$ 0.06	\$ 0.04	\$ 0.44	\$ 0.50
Cumulative effect of accounting change, net of tax		0.80		0.79
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net income	<u>\$ 0.06</u>	<u>\$ 0.84</u>	<u>\$ 0.44</u>	<u>\$ 1.29</u>
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Weighted average number of shares outstanding	47,451,300	49,306,844	47,965,274	49,692,437
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Weighted average number of shares and dilutive potential shares outstanding	47,900,302	49,620,276	48,389,715	50,129,975
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

See accompanying notes to consolidated financial statements.

Table of Contents**EL PASO ELECTRIC COMPANY AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF COMPREHENSIVE OPERATIONS****(Unaudited)****(In thousands)**

	Three Months Ended March 31,		Twelve Months Ended March 31,	
	2004	2003	2004	2003
	(Restated)		(Restated)	
Net income	\$ 2,914	\$ 41,678	\$ 21,193	\$ 64,575
Other comprehensive income (loss):				
Minimum pension liability adjustment			(4,234)	(21,148)
Net unrealized gains (losses) on marketable securities:				
Net holding gains (losses) arising during period	287	(1,184)	10,235	(8,973)
Reclassification adjustments for net (gains) losses included in net income	(233)	664	(175)	4,555
Total other comprehensive income (loss) before income taxes	54	(520)	5,826	(25,566)
Income tax benefit (expense) related to items of other comprehensive income (loss):				
Minimum pension liability adjustment			1,673	8,193
Net unrealized gains (losses) on marketable securities	(11)	182	(2,310)	1,571
Total income tax benefit (expense)	(11)	182	(637)	9,764
Other comprehensive income (loss), net of tax	43	(338)	5,189	(15,802)
Comprehensive income	\$ 2,957	\$ 41,340	\$ 26,382	\$ 48,773

See accompanying notes to consolidated financial statements.

Table of Contents**EL PASO ELECTRIC COMPANY AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)****(In thousands)**

	Three Months Ended March 31,	
	2004	2003
	(Restated)	
Cash flows from operating activities:		
Net income	\$ 2,914	\$ 41,678
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of electric plant in service	23,179	21,482
Amortization of nuclear fuel	4,302	4,404
Cumulative effect of accounting change, net of tax		(39,635)
Deferred income taxes, net	(3,460)	(1,188)
Loss on extinguishments of debt	2,106	1
Other amortization and accretion	2,138	2,011
Other operating activities	6	634
Change in:		
Accounts receivable	7,907	4,751
Inventories	149	154
Net under/overcollection of fuel revenues	1,076	7,659
Prepayments and other	3,750	531
Accounts payable	3,050	(632)
Taxes accrued other than federal income taxes	(1,680)	(2,585)
Interest accrued	(279)	(1,403)
Other current liabilities	1,418	(1,732)
Deferred charges and credits	3,507	1,424
Net cash provided by operating activities	50,083	37,554
Cash flows from investing activities:		
Cash additions to utility property, plant and equipment	(15,656)	(12,767)
Cash additions to nuclear fuel	(2,019)	(2,335)
Interest capitalized:		
Utility property, plant and equipment	(711)	(1,245)
Nuclear fuel	(59)	(71)
Decommissioning trust funds:		
Purchases	(5,566)	(7,552)
Sales and maturities	3,333	1,004
Other investing activities	(1,741)	1,002
Net cash used for investing activities	(22,419)	(21,964)
Cash flows from financing activities:		
Proceeds from exercise of stock options	305	
Purchases of treasury stock		(4,675)

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Repurchases of and payments on first mortgage bonds	(16,370)	(39,360)
Nuclear fuel financing obligations:		
Proceeds	2,315	2,700
Payments	(3,769)	(4,815)
Other financing activities	(223)	(282)
Net cash used for financing activities	(17,742)	(46,432)
Net increase (decrease) in cash and temporary investments	9,922	(30,842)
Cash and temporary investments at beginning of period	34,426	75,142
Cash and temporary investments at end of period	\$ 44,348	\$ 44,300

See accompanying notes to consolidated financial statements.

Table of Contents

EL PASO ELECTRIC COMPANY AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Restated)

(Unaudited)

A. Principles of Preparation

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Annual Report of El Paso Electric Company on Form 10-K/A for the year ended December 31, 2003 (the 2003 Form 10-K/A). Capitalized terms used in this report and not defined herein have the meaning ascribed for such terms in the 2003 Form 10-K/A. In the opinion of management of the Company, the accompanying consolidated financial statements contain all adjustments necessary to present fairly the financial position of the Company at March 31, 2004 (restated) and December 31, 2003 (restated); the results of its operations and comprehensive operations for the three and twelve months ended March 31, 2004 (restated) and 2003 (restated); and its cash flows for the three months ended March 31, 2004 (restated) and 2003 (restated). The results of operations and comprehensive operations and the cash flows for the three months ended March 31, 2004 (restated) are not necessarily indicative of the results to be expected for the full calendar year.

Pursuant to the rules and regulations of the Securities and Exchange Commission (SEC), certain financial information has been condensed and certain footnote disclosures have been omitted. Such information and disclosures are normally included in financial statements prepared in accordance with generally accepted accounting principles. Certain prior period amounts have been reclassified to conform with the current period presentation.

At January 1, 2004, the Company adopted FASB Interpretation No. 46 (FIN 46R), Consolidation of Variable Interest Entities, which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. The implementation of this standard did not have an impact on the Company's financial position or results of operations.

Table of Contents

EL PASO ELECTRIC COMPANY AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Restated)

(Unaudited)

Stock Options and Restricted Stock. The Company has two stock-based long-term incentive plans and accounts for them under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Stock options have typically been granted with an exercise price equal to fair market value on the date of grant and, accordingly, no compensation expense is recorded by the Company. Restricted stock has been granted at fair market value. Accordingly, the Company recognizes compensation expense by ratably amortizing the fair market value of the grant over the restriction period. If compensation expense for the option portion of the plans had been determined based on the fair value of the option at the grant date and amortized on a straight-line basis over the vesting period, consistent with the provisions of SFAS No. 123, Accounting for Stock-Based Compensation, the Company's net earnings and earnings per share would have been reduced to the pro forma amounts presented below:

	Three Months Ended March 31,		Twelve Months Ended March 31,	
	2004	2003	2004	2003
	(Restated)		(Restated)	
Net income, as reported	\$ 2,914	\$ 41,678	\$ 21,193	\$ 64,575
Deduct: Compensation expense, net of tax	229	231	915	1,255
Pro forma net income	\$ 2,685	\$ 41,447	\$ 20,278	\$ 63,320
Basic earnings per share:				
As reported	\$ 0.06	\$ 0.85	\$ 0.44	\$ 1.30
Pro forma	0.06	0.84	0.42	1.27
Diluted earnings per share:				
As reported	0.06	0.84	0.44	1.29
Pro forma	0.06	0.84	0.42	1.26

Compensation expense for the restricted stock awards is recognized on a fair value basis and is measured by referencing the quoted market price of the shares at the grant date, amortized ratably over the restriction period. Unearned compensation related to restricted stock awards is shown as a reduction of common stock equity.

Unbilled Revenues. Accounts receivable include accrued unbilled revenues of \$15.0 million and \$16.5 million at March 31, 2004 and December 31, 2003, respectively.

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Restatement of Previously Issued Financial Statements. During the third quarter ended September 30, 2004, the Company determined that certain pre-reorganization AMT credit carryforward assets were overstated and corresponding reorganization-related transmission and distribution assets were understated. To correct this error certain financial and other information contained herein has been restated to reflect the adjustments. See Note G for a discussion of the adjustments.

Table of Contents**EL PASO ELECTRIC COMPANY AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Restated)****(Unaudited)****Supplemental Cash Flow Disclosures (in thousands)**

	Three Months Ended March 31,	
	2004	2003
Cash paid for:		
Interest on long-term debt and financing obligations	\$ 12,690	\$ 14,260
Non-cash financing activities:		
Grants of restricted shares of common stock	21	24

B. Regulation

For a full discussion of the Company's regulatory matters, see Note B of Notes to Consolidated Financial Statements in the 2003 Form 10-K/A.

General

In 1999, both the Texas and New Mexico legislatures enacted electric utility industry restructuring laws requiring competition in certain functions of the industry and ultimately in the Company's service area. In Texas, the Company is exempt from the requirements of the Texas Restructuring Law, including utility restructuring and retail competition, until the expiration of the Freeze Period in August 2005. In April 2003, the New Mexico Restructuring Act was repealed and as a result, the Company's operations in New Mexico will continue to be fully regulated. The Company cannot predict at this time the full effects the repeal of the New Mexico Restructuring Act will have on the Company as it prepares for retail competition in Texas.

Federal Regulatory Matters

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Federal Energy Regulatory Commission. The FERC has been conducting an investigation into potential manipulation of electricity prices in the western United States during 2000 and 2001. On August 13, 2002, the FERC initiated a Federal Power Act (FPA) investigation into the Company s wholesale power trading in the western United States during 2000 and 2001 to determine whether the Company and Enron engaged in misconduct and, if so, to determine potential remedies. The Company reached settlements with the FERC and other parties in 2002 and 2003. Under the terms of the settlements, the Company agreed to refund a total of \$15.5 million of revenues it earned on wholesale power transactions. In July 2003, the FERC approved the settlements and on August 5, 2003, the Company deposited the \$15.5 million into an interest bearing escrow account to consummate the settlements. The Company believes the FERC s order resolved all issues between the FERC and the other parties to this investigation. Under the settlements, the Company has agreed to make wholesale sales pursuant to its cost of service rate authority rather than its market-based rate authority for the period December 1, 2002 through December 31, 2004. This agreement allows the Company to sell

Table of Contents

EL PASO ELECTRIC COMPANY AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Restated)

(Unaudited)

power into wholesale markets at its incremental cost plus \$21.11 per MWh. To the extent that wholesale market prices exceed these agreed upon amounts, the Company will forego the opportunity to realize these additional revenues. Although this provision has not had a significant impact on the Company's revenues through March 31, 2004, the Company is unable to predict the effect, if any, this will have on the Company's revenues for the remainder of 2004.

Texas Regulatory Matters

The rates and services of the Company are regulated in Texas by municipalities and by the Texas Commission. The largest municipality in the Company's service area is the City of El Paso. The Texas Commission has exclusive appellate jurisdiction to review municipal orders and ordinances regarding rates and services within municipalities in Texas and original jurisdiction over certain other activities of the Company. The decisions of the Texas Commission are subject to judicial review.

Deregulation. The Texas Restructuring Law required certain investor-owned electric utilities to separate power generation activities from transmission and distribution activities by January 1, 2002, and on that date, retail competition was instituted in some parts of Texas. The Texas Restructuring Law, however, specifically recognized and preserved the Company's Texas Rate Stipulation and Texas Settlement Agreement by, among other things, exempting the Company's Texas service area from retail competition until the end of the Freeze Period. The Texas Commission recently opened a project (Project No. 28971) to evaluate the readiness of the Company's service area in Texas for retail competition. In this project, the Texas Commission may specify in advance the factors that are important in deciding when and whether to open the Company's service area in Texas to customer choice. One of the key factors that will likely be utilized by the Texas Commission in its determination is the progress that has been made in developing a regional transmission organization in the Company's service area. Public hearings to discuss the readiness of the Company's service area were held on March 4, 2004 in El Paso and on April 2, 2004 in Austin. On April 16, 2004, the Texas Commission published its proposed "strawman" which would define the process and sequence of events for the introduction of retail open access in the Company's Texas service territory. The proposed sequence of events is based upon completion of the listed items in each stage before the next stage is initiated. This would mean that retail competition in the El Paso area would not begin for several years. There is substantial uncertainty about both the regulatory framework and market conditions that will exist when retail competition is implemented in the Company's service territory and the Company may incur substantial preparatory, restructuring and other costs that may not ultimately be recoverable. There can be no assurance that deregulation will not adversely affect the future operations, cash flows and financial condition of the Company.

Fuel. Although the Company's base rates are frozen in Texas, pursuant to Texas Commission rules and the Texas Rate Stipulation, the Company can request adjustments to its fuel factor to more accurately reflect projected energy costs associated with providing electricity and seek recovery of past undercollections of fuel revenues, subject to periodic final review by the Texas Commission in fuel reconciliation proceedings.

Table of Contents

EL PASO ELECTRIC COMPANY AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Restated)

(Unaudited)

The Company sought to reconcile its Texas jurisdictional fuel costs for the period January 1, 1999 through December 31, 2001 in PUC Docket No. 26194, and on March 10, 2004, the Texas Commission announced its decision. At issue was the Company's initial request to recover an additional \$15.8 million, before interest, from its Texas customers as a surcharge because of fuel undercollections from January 1999 through December 2001. The Texas Commission disallowed approximately \$4.5 million of Texas jurisdictional expenses, before interest, consisting primarily of (i) approximately \$4.2 million of purchased power expenses which the Texas Commission characterized as imputed capacity charges, and (ii) approximately \$0.3 million in fees which were deemed to be administrative costs, not recoverable as fuel. In Texas, capacity charges are not eligible for recovery as fuel expenses, but are to be recovered through the Company's base rates. As the Company's base rates were frozen during the time period in which the imputed capacity charges were deemed to have been incurred, the aforementioned \$4.2 million of imputed capacity charges would be permanently disallowed, and hence not recoverable from its Texas customers. The Texas Commission's decision is subject to appeal by the various parties and the Company is unable to predict the ultimate outcome of any appeals that may be filed in this case.

The Company has incurred similar purchased power costs for the fuel reconciliation period beginning January 1, 2002. The Company believes that it has accounted for its purchased power costs during the reconciliation period beginning January 2002 in a manner consistent with the Texas Commission's decision in PUC Docket No. 26194. However, the Texas Commission has indicated its desire to conduct a generic rulemaking proceeding to determine a statewide policy for the appropriate pricing of capacity in purchased power contracts. There can be no assurance as to the outcome of such rulemaking and its potential impact on the Company with respect to fuel recovery in future reconciliation periods.

New Mexico Regulatory Matters

The New Mexico Commission has jurisdiction over the Company's rates and services in New Mexico and over certain other activities of the Company, including prior approval of the issuance, assumption or guarantee of securities. The New Mexico Commission's decisions are subject to judicial review. The largest city in the Company's New Mexico service territory is Las Cruces.

Deregulation. In April 2003, the New Mexico Restructuring Act was repealed and as a result the Company's operations in New Mexico will continue to be fully regulated. The Company cannot predict at this time the full effects the repeal of the New Mexico Restructuring Act will have on the Company as it prepares for retail competition in Texas.

Fuel. In June 2001, the New Mexico Commission approved a fuel and purchased power cost adjustment clause. On May 31, 2003, the Company submitted a rate compliance filing whereby the Company proposed to continue a base rate recovery of \$0.01949 per kWh and continue the fuel and purchased power cost adjustment to recover the remainder of fuel and purchased power costs. The

Table of Contents

EL PASO ELECTRIC COMPANY AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Restated)

(Unaudited)

Company and all intervenors entered into the New Mexico Stipulation on the Company's compliance filing.

New Mexico Rate Stipulation. On January 21, 2004, the Company and all intervenors to the rate compliance filing entered into and filed the New Mexico Stipulation whereby, among other things, the Company agreed for a period of three years beginning June 1, 2004 to (i) freeze base rates after an initial non-fuel base rate reduction of 1%; (ii) fix fuel and purchased power cost associated with 10% of the Company's jurisdictional retail sales in New Mexico at \$0.021 per kWh; (iii) leave subject to reconciliation the remaining 90% of the Company's New Mexico jurisdictional fuel and purchased power costs not collected in base rates; (iv) continue the collection of a portion of fuel and purchased power costs in base rates as presently collected in the amount of \$0.01949 per kWh; (v) price power provided from Palo Verde Unit 3 to the extent of its availability at an 80% nuclear, 20% gas fuel mix (currently such power is priced at 75% nuclear, 25% gas fuel mix) and (vi) deem reconciled, for the period June 15, 2001 through May 31, 2004, the Company's fuel and purchased power costs for the New Mexico jurisdiction. On April 16, 2004, the presiding hearing officer certified the New Mexico Stipulation and recommended that it be adopted by the New Mexico Commission. On April 27, 2004, the New Mexico Commission approved and adopted the New Mexico Stipulation. The Company will implement the new rates on or about June 1, 2004.

C. Common Stock

Common Stock Repurchase Program

In February 2004, the Board of Directors authorized a new stock repurchase program permitting the repurchase of up to 2 million shares of its outstanding common stock. Since the inception of the stock repurchase programs in 1999, the Company repurchased 15 million shares in total at an aggregate cost of \$171.0 million, including commissions. No common stock was repurchased during the first quarter of 2004. The Company may continue making purchases of its stock at open market prices and may engage in private transactions, where appropriate. The repurchased shares will be available for issuance under employee benefit and stock option plans, or may be retired.

Table of Contents

EL PASO ELECTRIC COMPANY AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Restated)

(Unaudited)

Reconciliation of Basic and Diluted Earnings Per Share

The reconciliation of basic and diluted earnings per share before cumulative effect of accounting change is presented below:

	Three Months Ended March 31,					
	2004			2003		
			Per			Per
Income (Restated)	Shares	Share (Restated)	Income (Restated)	Shares	Share (Restated)	
(In thousands)			(In thousands)			
Basic earnings per share:						
Income before cumulative effect of accounting change	\$ 2,914	47,451,300	\$ 0.06	\$ 2,043	49,306,844	\$ 0.04
Effect of dilutive securities:						
Unvested restricted stock		23,357			5,945	
Stock options		425,645			307,487	
Diluted earnings per share:						
Income before cumulative effect of accounting change	\$ 2,914	47,900,302	\$ 0.06	\$ 2,043	49,620,276	\$ 0.04
	Twelve Months Ended March 31,					
	2004			2003		
			Per			Per
Income (Restated)	Shares	Share (Restated)	Income (Restated)	Shares	Share (Restated)	
(In thousands)			(In thousands)			

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Basic earnings per share:						
Income before cumulative effect of accounting change	\$ 21,193	47,965,274	\$ 0.44	\$ 24,940	49,692,437	\$ 0.50
Effect of dilutive securities:						
Unvested restricted stock		56,162			68,551	
Stock options		368,279			368,987	
Diluted earnings per share:						
Income before cumulative effect of accounting change	\$ 21,193	48,389,715	\$ 0.44	\$ 24,940	50,129,975	\$ 0.50

Options excluded from the computation of diluted earnings per share because the exercise price was greater than the average market price for the periods presented are as follows:

	Three Months Ended		Twelve Months Ended	
	March 31,		March 31,	
	2004	2003	2004	2003
Options excluded	558,745	1,120,580	888,952	875,678
Exercise price range	\$13.77 - \$15.99	\$11.00 - \$15.99	\$11.88 - \$15.99	\$11.00 - \$15.99

Table of Contents

EL PASO ELECTRIC COMPANY AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Restated)

(Unaudited)

D. Commitments, Contingencies and Uncertainties

For a full discussion of commitments and contingencies, see Note I of Notes to Consolidated Financial Statements in the 2003 Form 10-K/A. In addition, see Note B above and Notes B and C of Notes to Consolidated Financial Statements in the 2003 Form 10-K/A regarding matters related to regulation and Palo Verde, including decommissioning, spent fuel storage, disposal of low-level radioactive waste, steam generators and liability and insurance matters.

Power Contracts

The Company has not entered into any new financially significant open contracts or power exchange agreements beyond those disclosed in the Company's 2003 Form 10-K/A.

Environmental Matters

The Company is subject to regulation with respect to air, soil and water quality, solid waste disposal and other environmental matters by federal, state, tribal and local authorities. Those authorities govern current facility operations and have continuing jurisdiction over facility modifications. Failure to comply with these environmental regulatory requirements can result in actions by regulatory agencies or other authorities that might seek to impose on the Company administrative, civil, and/or criminal penalties. In addition, unauthorized releases of pollutants or contaminants into the environment can result in costly cleanup obligations that are subject to enforcement by the regulatory agencies. Environmental regulations can change rapidly and are often difficult to predict. While the Company strives to prepare for and implement changes necessary to comply with changing environmental regulations, substantial expenditures may be required for the Company to comply with such regulations in the future.

The Company analyzes the costs of its obligations arising from environmental matters on an ongoing basis, and believes it has made adequate provision in its financial statements to meet such obligations. As a result of this analysis, the Company has a provision for environmental remediation obligations of approximately \$0.8 million as of March 31, 2004, which is related to compliance with federal and state environmental standards. However, unforeseen expenses associated with compliance could have a material adverse effect on the future operations and financial condition of the Company.

Table of Contents**EL PASO ELECTRIC COMPANY AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Restated)****(Unaudited)**

The Company incurred the following expenditures (the majority of which are non-remediation) during the three and twelve months ended March 31, 2004 and 2003 to comply with federal environmental statutes (in thousands):

	Three Months Ended		Twelve Months Ended	
	March 31,		March 31,	
	2004	2003	2004	2003
Clean Air Act	\$ 210	\$ 105	\$ 1,165	\$ 514
Clean Water Act	226	147	728	1,982

The Company is not aware of any active investigation of its compliance with environmental requirements by the Environmental Protection Agency, the Texas Commission on Environmental Quality, or the New Mexico Environment Department. Furthermore, the Company is not aware of any unresolved, potentially material liability it would face pursuant to the Comprehensive Environmental Response, Compensation and Liability Act of 1980, also known as the Superfund law.

Tax Matters

The IRS has disputed whether the Company was entitled to deduct certain payments made in 1996 related to Palo Verde and its treatment of a litigation settlement in 1997 related to a terminated merger agreement. The Company has reached a tentative agreement, subject to final IRS approval, to settle these and all other issues relative to its 1996 through 1998 federal income tax returns. The Company expects the IRS will make a final decision regarding the proposed settlement by mid 2004. Should the proposed settlement be rejected by the IRS, the Company cannot predict the eventual outcome of this matter. However, the Company has established, and periodically reviews and re-evaluates, an estimated contingent tax liability on its consolidated balance sheet to provide for the possibility of adverse outcomes in tax proceedings. Although the ultimate outcome cannot be predicted with certainty, and while the contingent tax reserve may not in fact be sufficient, the Company believes that the amount of contingent tax reserve recorded as of March 31, 2004 is a reasonable estimate of any additional tax that may be due.

Union Matters

On October 2 and 3, 2003, employees in the Company's meter reading and collections areas, comprised of 68 employees, voted in favor of representation by the International Brotherhood of Electrical Workers, Local 960 (Local 960). This vote was certified by the National Labor

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Relations Board (NLRB) on October 14, 2003. In addition, employees in the Company s facilities services area, comprised of seven employees, voted in favor of representation by Local 960 on October 16, 2003. This

Table of Contents

EL PASO ELECTRIC COMPANY AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Restated)

(Unaudited)

vote was certified by the NLRB on October 24, 2003. The Company has begun negotiations with Local 960 on behalf of these employees.

On April 2, 2004, Local 960 filed a petition with the NLRB seeking an election to determine union representation for employees in the customer service area. At a hearing before the NLRB on April 16, 2004, the Company challenged the appropriateness of the employee unit petitioned by Local 960. Both sides filed briefs on April 23, 2004, and a ruling by the NLRB is expected soon.

E. Litigation

The Company is a party to various legal actions. In many of these matters, the Company has excess casualty liability insurance that covers the various claims, actions and complaints. Based upon a review of these claims and applicable insurance coverage, the Company believes that, except as described below, none of these claims will have a material adverse effect on the financial position, results of operations and cash flows of the Company.

On January 16, 2003, the Company was served with a complaint on behalf of a purported class of shareholders alleging violations of the federal securities laws (*Roth v. El Paso Electric Company, et al.*, No. EP-03-CA-0004). The complaint was filed in the El Paso Division of the United States District Court for the Western District of Texas. The suit seeks undisclosed compensatory damages for the class as well as costs and attorneys' fees. The lead plaintiff, Carpenters Pension Fund of Illinois, filed a consolidated amended complaint on July 2, 2003, alleging, among other things, that the Company and certain of its current and former directors and officers violated securities laws by failing to disclose that some of the Company's revenues and income were derived from an allegedly unlawful relationship with Enron. The allegations arise out of the FERC investigation of the power markets in the western United States during 2000 and 2001, which the Company previously settled with the FERC Trial Staff and certain intervening parties. On August 15, 2003, the Company and the individual defendants filed a motion to dismiss the complaint for failure to state a claim upon which relief can be granted. On November 26, 2003, the Court denied the motion to dismiss as to the Company and three of the individual defendants and granted the motion to dismiss as to two individual defendants. On April 13, 2004, the Court granted a motion of the Company and the remaining individual defendants requesting permission to file an interlocutory appeal to the U. S. Court of Appeals for the Fifth Circuit regarding certain legal questions relating to the Court's denial of the motion to dismiss the complaint as to those defendants. On April 27, 2004, the Court entered an order staying the district court proceedings until the Fifth Circuit completes its review. The lead plaintiff filed its motion for class certification on January 9, 2004, seeking to certify a class consisting of all persons who purchased or otherwise acquired Company securities between February 14, 2000 and October 21, 2002. This matter is presently set for trial on March 28, 2005, but such date will likely be extended due to the stay. While the Company believes the lawsuit is without merit and intends to defend itself vigorously, the Company is unable to predict the outcome.

Table of Contents

EL PASO ELECTRIC COMPANY AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Restated)

(Unaudited)

On May 21, 2003, the Company was served with a complaint by the Port of Seattle seeking civil damages under the Sherman Act, the Racketeer Influenced and Corrupt Organization Act, and state anti-trust laws, as well as for fraud (*Port of Seattle v. Avista Corporation, et al.*, No. CV03-117OP). The complaint was filed in the United States District Court for the Western District of Washington. The complaint alleges that the Company, indirectly through its dealings with Enron, conspired with the other named defendants to manipulate the California energy market, which had the effect of artificially inflating the price that the Port of Seattle paid for electricity. On December 4, 2003, the case was transferred to the United States District Court for the Southern District of California for inclusion in the California Wholesale Electricity Antitrust Multi-District Litigation cases pending in that district (re-styled *Port of Seattle v. Avista Corporation, et al.*, No. CV 03-2474-RHW, MDL No. 1403). The Company, together with several other defendants, filed a motion to dismiss on July 29, 2003. Oral argument on the motion to dismiss was held on March 26, 2004, and the Company is awaiting the Court's ruling on the motion. While the Company believes the lawsuit is without merit and will defend itself vigorously, it is unable to predict the outcome of this case.

On November 3, 2003, TNP filed a complaint against the Company with the FERC, asking the FERC to make a determination that TNP has certain rollover rights to network-type transmission service over the Company's transmission system as a result of a power sales agreement between it and the Company which expired at the end of 2002. TNP asserts that it has such rights under the rollover provisions of FERC Order No. 888. The Company has responded to TNP's complaint by contesting TNP's assertion of rollover rights on several grounds. Due to existing transmission constraints, a FERC ruling granting TNP's complaint could adversely impact the Company's ability to import lower cost power from Palo Verde and Four Corners to serve its retail customers, which could result in higher rates for the Company's retail electric customers. A hearing on this matter before an administrative law judge is scheduled for June 15, 2004. The Company cannot predict the outcome of this matter or the effect that an adverse ruling by the FERC might have on the Company or its retail customers.

On February 9, 2004, Enron North America Corp. (ENA) filed suit against the Company seeking payment of approximately \$5.4 million, plus interest and costs, relating to certain natural gas supply contracts (*Enron North America Corp. v. El Paso Electric Co.*, Case No. 01-16034, United States Bankruptcy Court, Southern District of New York). The complaint alleges that ENA entered into two natural gas supply contracts with the Company which automatically terminated as a result of ENA's bankruptcy. ENA contends that, under the terms of the contracts, the Company owes ENA termination payments because the market price of natural gas at the date of termination was lower than the contract price. While ENA acknowledges that the contracts contain a provision (the One-Way Payment Provision) under which the termination payment would be calculated to be zero, ENA seeks a ruling from the court that the One-Way Payment Provision is unenforceable and that the Company should be required to pay termination payments in the amount of approximately \$5.4 million, plus interest and costs. The first of these two contracts covers gas to be supplied by ENA during the months of November and December of 2001 (the 2001 Contract). The Company estimates that the value of the termination payment claimed by ENA under the 2001 Contract is approximately \$1.8 million. The second of these two contracts covers gas to be supplied by ENA during the months of January through December of

Table of Contents**EL PASO ELECTRIC COMPANY AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Restated)****(Unaudited)**

2002 (the 2002 Contract). The Company estimates that the value of the termination payment claimed by ENA under the 2002 Contract is approximately \$3.6 million. Based upon the Company's assessment of the probability of an adverse outcome, the Company expensed \$1.5 million, pre-tax, in 2003 for this matter. On April 19, 2004, the Bankruptcy Court approved a confidential settlement agreement and mutual release by and between ENA and the Company, resolving all issues in the suit. The Company does not expect any further charge to earnings as a result of this settlement.

F. Employee Benefits**Retirement Plans**

The net periodic benefit cost recognized for the three and twelve months ended March 31, 2004 and 2003 is made up of the components listed below as determined using the projected unit credit actuarial cost method (in thousands):

	Three Months Ended March 31,		Twelve Months Ended March 31,	
	2004	2003	2004	2003
Components of net periodic benefit cost:				
Service cost	\$ 1,113	\$ 953	\$ 3,972	\$ 3,472
Interest cost	2,522	2,403	9,729	9,246
Expected return on plan assets	(1,927)	(1,884)	(7,579)	(7,705)
Amortization of:				
Unrecognized loss	843	434	2,145	434
Unrecognized prior service cost	5	5	21	21
Net periodic benefit cost	\$ 2,556	\$ 1,911	\$ 8,288	\$ 5,468

Other Postretirement Benefits

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The net periodic benefit cost recognized for the three and twelve months ended March 31, 2004 and 2003 is made up of the components listed below (in thousands):

	Three Months Ended March 31,		Twelve Months Ended March 31,	
	2004	2003	2004	2003
Components of net periodic benefit cost:				
Service cost	\$ 1,159	\$ 979	\$ 4,095	\$ 3,317
Interest cost	1,756	1,617	6,607	5,886
Expected return on plan assets	(315)	(255)	(1,080)	(1,004)
Amortization of unrecognized gain				(595)
Net periodic benefit cost	\$ 2,600	\$ 2,341	\$ 9,622	\$ 7,604

Table of Contents

EL PASO ELECTRIC COMPANY AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Restated)

(Unaudited)

G. Restatement of Previously Issued Financial Statements

During the quarter ended September 30, 2004, the Company determined that AMT credit carryforward assets pertaining to the pre-reorganization time period were overstated by \$4.5 million and reorganization-related transmission and distribution assets were understated by \$4.5 million. To correct this error, the Company has restated its consolidated balance sheets as of December 31, 2003 and March 31, 2004, the consolidated statements of operations for the three and twelve months ended March 31, 2003 and 2004, the consolidated statements of comprehensive operations for the three and twelve months ended March 31, 2003 and 2004, and the consolidated statements of cash flows for the three months ended March 31, 2003 and 2004. The Company has also restated the notes to consolidated financial statements as necessary to reflect the adjustments.

The effects of the revisions on the consolidated balance sheets as of March 31, 2004 and December 31, 2003 are summarized in the following table (in thousands):

	Previously Reported		As Restated	
	March 31, 2004	December 31, 2003	March 31, 2004	December 31, 2003
Utility Plant:				
Electric plant in service	\$ 1,793,040	\$ 1,784,134	\$ 1,797,557	\$ 1,788,652
Less accumulated depreciation and amortization	608,760	591,613	612,637	595,371
Net plant in service	1,184,280	1,192,521	1,184,920	1,193,281
Net utility plant	1,291,260	1,298,006	1,291,900	1,298,766
Total assets	\$ 1,581,349	\$ 1,595,854	\$ 1,581,989	\$ 1,596,614
Capitalization:				
Retained earnings	\$ 357,980	\$ 354,993	\$ 353,853	\$ 350,939
Common stock equity	503,366	499,822	499,239	495,768
Total capitalization	1,077,525	1,108,544	1,073,398	1,104,490
Deferred credits and other liabilities:				
Accumulated deferred income taxes	130,789	139,605	135,556	144,419
Total deferred credits and other liabilities	379,966	385,283	384,733	390,097

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Total capitalization and liabilities	\$ 1,581,349	\$ 1,595,854	\$ 1,581,989	\$ 1,596,614
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The consolidated statements of operations and comprehensive operations were adjusted by a quarterly increase of \$0.1 million and an annual increase of \$0.5 million in depreciation and amortization expense. Net income and comprehensive income were reduced by \$0.1 million and \$0.3 million for the three and twelve months ended March 31, 2004 and 2003, respectively.

Table of Contents**EL PASO ELECTRIC COMPANY AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Restated)****(Unaudited)**

The effects of the revisions on the consolidated statements of operations for the three and twelve month periods ended March 31, 2004 and 2003 are summarized in the following table (in thousands, except share data):

	Three Months Ended March 31,				Twelve Months Ended March 31,			
	2004		2003		2004		2003	
	Previously Reported	As Restated	Previously Reported	As Restated	Previously Reported	As Restated	Previously Reported	As Restated
Other operating expenses:								
Depreciation and amortization	\$ 23,059	\$ 23,179	\$ 21,362	\$ 21,482	\$ 88,838	\$ 89,318	\$ 88,378	\$ 88,858
Total other operating expenses	85,011	85,131	86,825	86,945	361,374	361,854	356,427	356,907
Operating income	18,940	18,820	15,534	15,414	83,621	83,141	99,075	98,595
Income before income taxes and cumulative effect of accounting change	4,155	4,035	3,023	2,903	35,167	34,687	39,768	39,288
Income tax expense	1,168	1,121	907	860	13,680	13,494	14,535	14,348
Income before cumulative effect of accounting change	2,987	2,914	2,116	2,043	21,487	21,193	25,233	24,940
Net Income	\$ 2,987	\$ 2,914	\$ 41,751	\$ 41,678	\$ 21,487	\$ 21,193	\$ 64,868	\$ 64,575
Basic earnings per share:								
Income before cumulative effect of accounting change	\$ 0.06	\$ 0.06	\$ 0.04	\$ 0.04	\$ 0.45	\$ 0.44	\$ 0.51	\$ 0.50
Cumulative effect of accounting change, net of tax			0.81	0.81			0.80	0.80
Net Income	\$ 0.06	\$ 0.06	\$ 0.85	\$ 0.85	\$ 0.45	\$ 0.44	\$ 1.31	\$ 1.30

There was no impact on diluted earnings per share due to the restatement.

The effects of the revisions on the consolidated statements of comprehensive operations for the three and twelve month periods ended March 31, 2004 and 2003 are summarized in the following table (in thousands):

	Three Months Ended March 31,				Twelve Months Ended March 31,			
	2004		2003		2004		2003	
	Previously		Previously		Previously		Previously	
	Reported	As Restated	Reported	As Restated	Reported	As Restated	Reported	As Restated
Net Income	\$ 2,987	\$ 2,914	\$ 41,751	\$ 41,678	\$ 21,487	\$ 21,193	\$ 64,868	\$ 64,575
Comprehensive income	3,030	2,957	41,413	41,340	26,676	26,382	49,066	48,773

Table of Contents**EL PASO ELECTRIC COMPANY AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Restated)****(Unaudited)**

The effects of the revisions on the consolidated statements of cash flows for the three months ended March 31, 2004 and 2003 are summarized in the following table (in thousands):

	Three Months Ended March 31,			
	2004		2003	
	Previously		Previously	
	Reported	As Restated	Reported	As Restated
Net Income	\$ 2,987	\$ 2,914	\$ 41,751	\$ 41,678
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization of electric plant in service	23,059	23,179	21,362	21,482
Deferred income taxes	(3,413)	(3,460)	(1,141)	(1,188)
Other operating activities cash flow items	27,450	27,450	(24,418)	(24,418)
Net cash flow provided by operating activities	<u>\$ 50,083</u>	<u>\$ 50,083</u>	<u>\$ 37,554</u>	<u>\$ 37,554</u>

There was no net impact on net cash provided by operating activities, net cash used for investing activities, and net cash used for financing activities on the consolidated statements of cash flows for the three months ended March 31, 2004 and 2003 due to the restatement.

The following Notes to Consolidated Financial Statements have been restated to reflect the correction of the AMT credit carryforward asset overstatement and the reorganization-related transmission and distribution asset understatement: (i) the Stock Options and Restricted Stock disclosure in Note A and (ii) the Reconciliation of Basic and Diluted Earnings Per Share disclosure in Note C.

Table of Contents

Report of Independent Registered Public Accounting Firm

The Shareholders and Board of Directors

El Paso Electric Company:

We have reviewed the condensed consolidated balance sheet of El Paso Electric Company and subsidiary as of March 31, 2004, the related condensed consolidated statements of operations and comprehensive operations for the three-month and twelve-month periods ended March 31, 2004 and 2003, and the related condensed consolidated statements of cash flows for the three-month periods ended March 31, 2004 and 2003. These condensed consolidated financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

As discussed in Note G, the Company has restated the condensed consolidated balance sheet as of March 31, 2004, and the related condensed consolidated statements of operations and comprehensive operations for the three-month and twelve-month periods ended March 31, 2004 and 2003, and the related condensed consolidated statements of cash flows for the three-month periods ended March 31, 2004 and 2003.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of El Paso Electric Company and subsidiary as of December 31, 2003 (restated), and the related consolidated statements of operations (restated), comprehensive operations (restated), changes in common stock equity (restated), and cash flows (restated) for the year then ended (not presented herein); and in our report dated March 10, 2004, except as to Note P, which is as of November 8, 2004, we expressed an unqualified opinion on those consolidated financial statements. Our report referred to a change in the Company's method of accounting for asset retirement obligations in 2003. Our report also referred to the Company's restatement of its 2003 and 2002 financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2003 (restated), is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

KPMG LLP

El Paso, Texas

April 27, 2004, except as to Note G,

which is as of November 8, 2004

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The information contained in this Item 2 updates, and should be read in conjunction with, the information set forth in Part II, Item 7 of the Company's 2003 Form 10-K/A.

Statements in this document, other than statements of historical information, are forward-looking statements that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements, as well as other oral and written forward-looking statements made by or on behalf of the Company from time to time, including statements contained in the Company's filings with the Securities and Exchange Commission and its reports to shareholders, 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 in any forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to: (i) increased prices for fuel and purchased power and determinations by regulators that may adversely affect the Company's ability to recover incurred fuel costs in rates; (ii) fluctuations in economy sales and margins due to uncertainty in the economy power market; (iii) unanticipated increased costs associated with scheduled and unscheduled outages; (iv) the cost of replacing steam generators for Palo Verde Units 1 and 3 and other costs at Palo Verde; (v) the costs of legal defense and possible judgments which may accrue as the result of litigation arising out of the FERC investigation or any other regulatory proceeding; (vi) deregulation of the electric utility industry; and (vii) other factors discussed below under the headings Summary of Critical Accounting Policies and Estimates, Overview and Liquidity and Capital Resources. The Company's filings are available from the Securities and Exchange Commission or may be obtained through the Company's website, www.epelectric.com. Any such forward-looking statement is qualified by reference to these risks and factors. The Company cautions that these risks and factors are not exclusive. The Company does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company except as required by law.

Summary of Critical Accounting Policies and Estimates

The preparation of the Company's financial statements requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and related notes for the periods presented and actual results could differ in future periods from those estimates. Critical accounting policies and estimates, which are both important to the portrayal of the Company's financial condition and results of operations and which require complex, subjective judgments are more fully described in the Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's 2003 Form 10-K/A.

Overview

El Paso Electric Company is an investor owned electric utility that serves retail customers in west Texas and southern New Mexico and wholesale customers in Texas. The Company also periodically sells power to the CFE. The Company owns or has substantial ownership interests in six electrical generating facilities providing it with a total capacity of approximately 1,500 MW. The Company's energy sources consist of nuclear fuel, natural gas, coal, wind powered resources and purchased power. The Company owns or has significant ownership interests in four major 345 kV transmission lines and three 500 kV transmission lines utilized to transfer power from Palo Verde and Four Corners, and owns

Table of Contents

the transmission and distribution network within its retail service territory. The Company is subject to regulation by the Texas and New Mexico Commissions and, with respect to wholesale power sales, transmission of electric power and the issuance of securities, the FERC.

The Company faces a number of risks and challenges that could negatively impact its operations and financial results. The most significant of these risks and challenges are the deregulation of the electric utility industry and the possibility of increased costs especially from Palo Verde.

The electric utility industry in general and the Company in particular are facing significant challenges and increased competition as a result of changes in federal provisions relating to third-party transmission services and independent power production, as well as changes in state laws and regulatory provisions relating to wholesale and retail service. In 1999, both Texas and New Mexico passed industry deregulation legislation requiring the Company to separate its transmission and distribution functions, which would remain regulated, from its power generation and energy services businesses, which would operate in a competitive market in the future. New Mexico repealed the New Mexico Restructuring Act in April 2003, and the Company's operations in New Mexico will remain fully regulated. In Texas, the Company's service territory has not yet been deregulated, but the Company is preparing for retail competition. If the Company does not enter retail competition for generating services at the end of the Freeze Period, the Company's generating services will continue to be regulated by the Texas Commission. There is substantial uncertainty about both the regulatory framework and market conditions that will exist if and when retail competition is implemented in the Company's service territory and the Company may incur substantial preparatory, restructuring and other costs that may not ultimately be recoverable. There can be no assurance that deregulation will not adversely affect the future operations, cash flows and financial condition of the Company.

The changing regulatory environment and the potential for unregulated power production have created a substantial risk that the Company will lose important customers. The Company's wholesale and large retail customers already have, in varying degrees, alternate sources of economical power, including co-generation of electric power. In fact, the Company has lost certain large retail customers to self-generation and/or co-generation and has seen reductions in wholesale sales due to new sources of generation. If the Company loses a significant portion of its retail customer base, the Company may not be able to replace such revenues through either the addition of new customers, an increase in rates to remaining customers, or sales in the economy market.

Another risk to the Company is potential increased costs, including the risk of additional or unanticipated costs at Palo Verde resulting from (i) increases in operation and maintenance expenses; (ii) the replacement of steam generators in Palo Verde Units 1 and 3; (iii) an extended outage of any of the Palo Verde units; (iv) increases in estimates of decommissioning costs; (v) the storage of radioactive waste, including spent nuclear fuel; (vi) insolvency of other Palo Verde Participants; and (vii) compliance with the various requirements and regulations governing commercial nuclear generating stations. At the same time, the Company's retail base rates in Texas are effectively capped through a rate freeze ending in August 2005. As a result, the Company cannot raise its base rates in Texas in the event of increases in non-fuel costs or loss of revenue. Additionally, upon initiation of competition, there may be competitive pressure on the Company's power generation rates which could reduce its profitability. The Company cannot assure that its revenues will be sufficient to recover any increased costs, including any increased costs in connection with Palo Verde or other operations, whether as a result of inflation, changes in tax laws or regulatory requirements, or other causes.

Table of Contents

Liquidity and Capital Resources

The Company's principal liquidity requirements in the near-term are expected to consist of interest payments on the Company's indebtedness, operating and capital expenditures related to the Company's generating facilities and transmission and distribution systems, income and other taxes, and reorganization costs related to deregulation in Texas, if and when deregulation occurs. The Company expects that cash flows from operations will be sufficient for such purposes. As of March 31, 2004, the Company had approximately \$44.3 million in cash and cash equivalents, an increase of \$9.9 million from the balance of \$34.4 million on December 31, 2003.

Pollution control bonds of \$193.1 million are subject to remarketing in 2005, and first mortgage bonds of \$175.8 million are scheduled to mature in 2006. The Company expects that these obligations and the \$100 million revolving credit facility, which matures in January 2005 (against which approximately \$40.7 million had been drawn for nuclear fuel purchases as of March 31, 2004) will be refinanced through the capital and credit markets. Additionally, the Company has \$202.2 million of first mortgage bonds which become callable in 2006. The Company's ability to access capital and credit markets may be adversely affected by uncertainties related to operating in a competitive energy market, tight credit markets and debt rating agency actions.

Long-term capital requirements of the Company will consist primarily of construction of electric utility plant and the payment of interest on and retirement and refinancing of debt. Utility construction expenditures will consist primarily of expanding and updating the transmission and distribution systems, possible addition of new generation, and the cost of capital improvements and replacements at Palo Verde and other generating facilities, including the replacement of steam generators in Palo Verde Units 1 and 3.

During the twelve months ended March 31, 2004 and 2003, the Company utilized \$11.6 million and \$78.1 million, respectively, of regular federal tax loss carryforwards. The Company anticipates that existing regular federal tax loss carryforwards will be fully utilized in 2004, should the IRS settlement for the tax years 1996 through 1998 be approved by the IRS, and that the Company's cash flow requirements are expected to include greater amounts of cash for income taxes than has existed in recent years.

The Company contributed an additional \$4.7 million to the decommissioning trust funds in January 2003 and an additional \$3.2 million to one of its retirement plans in September 2003 in order to meet its funding requirements as of December 31, 2002. The Company is continually evaluating its funding requirements related to its retirement plans, other postretirement benefit plans, and decommissioning trust funds.

Since inception of its deleveraging program in 1996, the Company has repurchased or retired with internally generated cash \$567.8 million of first mortgage bonds. First Mortgage Bonds totaling \$17.4 million were repurchased from January to April 2004. Common stock equity as a percentage of capitalization, including current portion of long-term debt and financing obligations, was 45% as of March 31, 2004.

Although the Company is currently at industry averages, the degree to which the Company is leveraged could have important consequences for the Company's liquidity, including (i) limiting the

Table of Contents

Company's ability to obtain additional financing for working capital, capital expenditures, acquisitions, general corporate or other purposes in the future, and (ii) placing the Company at a competitive disadvantage by limiting its financial flexibility to respond to the demands of the competitive market and making it more vulnerable to adverse economic or business changes.

Since the inception of the stock repurchase programs in 1999, the Company has repurchased 15 million shares in total at an aggregate cost of \$171.0 million, including commissions. In February 2004, the Board of Directors authorized a new stock repurchase program permitting the repurchase of up to 2 million shares of its outstanding common stock. No common stock was repurchased during the first quarter of 2004. The Company may continue making purchases of its stock at open market prices and may engage in private transactions, where appropriate. The repurchased shares will be available for issuance under employee benefit and stock option plans, or may be retired.

Historical Results of Operations

	Three Months Ended		Twelve Months Ended		
	March 31,		March 31,		
	2004	2003	2004	2003	
	Actual	Actual	Actual	Actual	Pro forma
	(Restated)	(Restated)	(Restated)	(Restated)	
Income before cumulative effect of accounting change (in thousands)	\$ 2,914	\$ 2,043	\$ 21,193	\$ 24,940	\$ 28,407
Diluted earnings per share before cumulative effect of accounting change	0.06	0.04	0.44	0.50	0.57

Income before the cumulative effect of accounting change for the three months ended March 31, 2004 (restated) increased \$0.9 million, or \$0.02 diluted earnings per share, compared to the results for the same period a year ago (restated). This after-tax increase resulted primarily from decreased non-Palo Verde maintenance expense of \$3.5 million and increased retail sales of \$2.6 million. These increases were partially offset by the following items, which are all presented on an after-tax basis (i) an increase in the loss on extinguishment of debt of \$1.3 million; (ii) increased depreciation and amortization expense of \$1.0 million; (iii) decreased sales and margins on economy sales of \$1.0 million; (iv) increased legal and consulting fees of \$0.7 million; and (v) increased insurance expenses of \$0.4 million.

Income before the cumulative effect of accounting change for the twelve months ended March 31, 2004 (restated) decreased \$7.2 million or \$0.13 diluted earnings per share, compared to the pro forma results for the same period a year ago (restated). The pro forma net income and earnings per share amounts shown above assume SFAS No. 143 had been applied on a retroactive basis. This after-tax decrease was primarily due to the following items, which are all presented on an after-tax basis (i) the impairment loss on the CIS project of \$10.7 million; (ii) decreased wholesale sales revenue of \$10.4 million primarily related to the expiration of two long-term contracts; (iii) the Texas fuel disallowance of \$2.7 million; (iv) increased insurance expense of \$2.8 million; (v) increased pension and benefits expenses of \$2.5 million; (vi) increased legal and consulting fees of \$2.5 million; (vii) an increase in the loss on extinguishment of debt of \$1.2 million; (viii) increased expenses at Palo Verde of \$1.1 million; and (ix) the settlement agreement with ENA of \$0.9 million. These decreases were partially offset by (i) the 2002 accrual for the FERC settlements of \$9.5 million; (ii) increased retail sales

Table of Contents

of \$7.9 million; (iii) decreased non-Palo Verde maintenance expense of \$4.7 million; (iv) increased investment income of \$2.0 million; (v) decreased interest on long-term debt of \$1.9 million; (vi) decreased energy services operating loss of \$1.8 million; and (viii) decreased regulatory expense of \$1.2 million.

Operating revenues net of energy expenses increased \$1.6 million for the three months ended March 31, 2004 compared to the same period last year, primarily due to increased retail sales of \$4.3 million partially offset by decreased sales and margins on economy sales of \$1.6 million.

Operating revenues net of energy expenses decreased \$10.5 million for the twelve months ended March 31, 2004 compared to the same period last year, primarily due to (i) decreased wholesale sales revenue primarily related to the expiration of two long-term contracts of \$14.0 million; (ii) the Texas fuel disallowance of \$4.5 million; (iii) a \$2.6 million decrease in revenue from the energy service operation; and (iv) the \$1.5 million expensed in 2003 which related to the settlement agreement with ENA. This decrease was partially offset by an increase in retail sales of \$13.0 million.

Comparisons of kWh sales and operating revenues are shown below (in thousands):

<u>Quarter Ended March 31:</u>	<u>2004</u>	<u>2003</u>	<u>Increase (Decrease)</u>	
			<u>Amount</u>	<u>Percent</u>
kWh sales:				
Retail:				
Residential	468,317	431,202	37,115	8.6%
Commercial and industrial, small	454,848	437,563	17,285	4.0
Commercial and industrial, large	303,390	264,741	38,649	14.6
Sales to public authorities	278,904	257,505	21,399	8.3
Total retail sales	1,505,459	1,391,011	114,448	8.2
Wholesale:				
Sales for resale	9,267	9,893	(626)	(6.3)
Economy sales	486,620	615,688	(129,068)	(21.0)(1)
Total wholesale sales	495,887	625,581	(129,694)	(20.7)
Total kWh sales	2,001,346	2,016,592	(15,246)	(0.8)
Operating revenues:				
Base revenues:				
Retail:				
Residential	\$ 40,171	\$ 37,383	\$ 2,788	7.5%
Commercial and industrial, small	36,101	35,705	396	1.1
Commercial and industrial, large	10,290	9,886	404	4.1
Sales to public authorities	16,558	15,889	669	4.2
Total retail base revenues	103,120	98,863	4,257	4.3
Wholesale:				

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Sales for resale	392	390	2	0.5
Total base revenues	103,512	99,253	4,259	4.3
Fuel revenues	31,274	21,497	9,777	45.5(2)
Economy sales	18,964	25,031	(6,067)	(24.2)(1)
Other	2,102	1,705	397	23.3(3)(4)
Total operating revenues	\$ 155,852	\$ 147,486	\$ 8,366	5.7

Table of Contents

Twelve Months Ended March 31:	2004	2003	Increase (Decrease)	
			Amount	Percent
kWh sales:				
Retail:				
Residential	1,969,286	1,869,476	99,810	5.3%
Commercial and industrial, small	2,114,145	2,083,192	30,953	1.5
Commercial and industrial, large	1,235,714	1,164,564	71,150	6.1
Sales to public authorities	1,245,747	1,208,276	37,471	3.1
Total retail sales	6,564,892	6,325,508	239,384	3.8
Wholesale:				
Sales for resale	67,129	647,541	(580,412)	(89.6)(5)
Economy sales	1,791,814	1,985,987	(194,173)	(9.8)
Total wholesale sales	1,858,943	2,633,528	(774,585)	(29.4)
Total kWh sales	8,423,835	8,959,036	(535,201)	(6.0)
Operating revenues:				
Base revenues:				
Retail:				
Residential	\$ 174,247	\$ 165,899	\$ 8,348	5.0%
Commercial and industrial, small	165,830	164,161	1,669	1.0
Commercial and industrial, large	43,698	43,465	233	0.5
Sales to public authorities	73,805	70,966	2,839	4.0
Total retail base revenues	457,580	444,491	13,089	2.9
Wholesale:				
Sales for resale	3,225	20,648	(17,423)	(84.4)(5)
Total base revenues	460,805	465,139	(4,334)	(0.9)
Fuel revenues	132,538	147,671	(15,133)	(10.2)(5)
Economy sales	70,469	65,914	4,555	6.9
Other	8,916	9,651	(735)	(7.6)(4)
Total operating revenues	\$ 672,728	\$ 688,375	\$ (15,647)	(2.3)

- (1) Primarily due to decreased available power as a result of outages at Palo Verde.
- (2) Primarily due to an increase in recoverable fuel expenses, as a result of an increase in the volume of natural gas burned, and an increase in kWh sales.
- (3) Primarily due to increased transmission revenues.
- (4) Represents revenues with no related kWh sales.
- (5) Primarily due to the expiration of a wholesale power contract with TNP on December 31, 2002 and IID on April 30, 2002, and reduced sales to the CFE.

Other operations expense increased \$1.9 million for the three months ended March 31, 2004 compared to the same period last year primarily due to (i) increased legal and consulting fees of \$1.2 million; (ii) increased insurance related expenses of \$0.7 million; and (iii) increased pension and benefits expense of \$0.5 million resulting from declines in the financial markets. These increases were partially offset by decreased regulatory expense of \$0.7 million. Other operations expense increased \$11.8 million for the twelve months ended March 31, 2004 compared to the same

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period last year primarily due to (i) increased insurance related expenses of \$4.6 million; (ii) increased pension and benefits expense of \$4.2 million resulting from declines in the financial markets; (iii) increased legal and

Table of Contents

consulting fees of \$4.1 million; (iv) increased accretion expense of \$3.7 million related to the implementation of SFAS No. 143; and (v) increased Palo Verde expense of \$2.4 million. These increases were partially offset by (i) decreased energy services operations expense of \$5.6 million primarily due to a warranty reserve recorded in the third quarter of 2002 and the cessation of additional marketing activities by MiraSol in 2002 and (ii) decreased regulatory expense of \$1.9 million.

The Company abandoned a CIS project and recognized an asset impairment loss of \$17.6 million in September 2003. The Company is now analyzing various options to meet its current and projected CIS needs.

The FERC settlements relate to the settlements with the FERC Trial Staff and principal California parties pursuant to which the Company agreed to refund \$15.5 million of revenues it earned on wholesale power transactions in 2000 and 2001. These settlements were recorded in December 2002.

Maintenance expense decreased \$5.9 million for the three months ended March 31, 2004 compared to the same period last year primarily due to reduced maintenance outages at non-Palo Verde generating stations of \$5.7 million. Maintenance expense decreased \$9.2 million for the twelve months ended March 31, 2004 compared to the same period last year primarily due to (i) reduced maintenance outages at non-Palo Verde generating stations of \$7.7 million and (ii) the timing of refueling and maintenance outages at Palo Verde of \$0.6 million.

Depreciation and amortization expense increased \$1.7 million for the three months ended March 31, 2004 (restated) compared to the same period last year (restated) primarily due to (i) an increase in other depreciable plant balances resulting in increased depreciation of approximately \$0.9 million; (ii) depreciation of the new Palo Verde Unit 2 steam generators of \$0.5 million; and (iii) the implementation of new depreciation rates based on an updated depreciation study resulting in an increase of \$0.3 million. Depreciation and amortization expense remained relatively unchanged for the twelve months ended March 31, 2004 compared to the same period last year.

Taxes other than income taxes remained relatively unchanged for the three and twelve months ended March 31, 2004, respectively, compared to the same periods last year.

Other income (deductions) decreased \$2.1 million for the three months ended March 31, 2004 compared to the same period last year primarily due to losses on extinguishments of debt recorded in 2004 with no comparable amount in the prior period. Other income (deductions) increased \$2.3 million for the twelve months ended March 31, 2004 compared to the same period last year primarily due to an increase of (i) \$3.3 million on investment income related to the decommissioning trust funds and (ii) \$1.1 million related to certain sales tax refunds. These increases were partially offset by a decrease of \$2.0 million related to losses on extinguishments of debt recorded in 2004 with no comparable amount in the prior period.

Interest charges (credits) did not change significantly for the three months ended March 31, 2004 compared to the same period last year. Interest charges (credits) decreased \$8.6 million for the twelve months ended March 31, 2004 compared to the same period last year primarily due to (i) a \$6.2 million decrease resulting from the adoption of SFAS No. 143 and (ii) a \$2.8 million decrease resulting from a reduction of outstanding debt as a result of open market purchases of the Company's first mortgage bonds.

Table of Contents

Income tax expense, excluding the tax effect of a cumulative effect of a change in accounting principle, increased \$0.3 million and decreased \$0.9 million for the three and twelve months ended March 31, 2004 (restated), respectively, compared to the same periods last year (restated) primarily due to changes in pretax income and certain permanent differences and adjustments.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures. During the period covered by this report, the Company chief executive officer and chief financial officer, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) as of March 31, 2004, (the Evaluation Date), concluded that as of the Evaluation Date, the Company's disclosure controls and procedures (as required by paragraph (b) of the Securities Exchange Act of 1934 Rules 13a-15 or 15d-15) were adequate and designed to ensure that material information relating to the Company and the Company's consolidated subsidiary would be made known to them by others within those entities. Subsequent to the Evaluation Date, it was determined that there was a material weakness in the Company's internal controls over financial reporting, as more fully described below. This weakness pertained to the discovery of a mathematical error made in the 1996 financial statements that carried through to the current period. Upon discovery, this error was immediately reported by the Company's financial staff to its senior management, its audit committee and its independent accountants, and the Company's financial statements were thereafter promptly restated. Subsequent to these actions, the Company's CEO and CFO, following consultation with the Audit Committee and outside corporate counsel, have concluded that the Company's disclosure controls and procedures were not effective as the Company's failure over several years to discover and correct an error in the AMT credit carryforward asset account constituted a material weakness in internal controls over financial reporting.

Changes in internal control over financial reporting. There were no changes in the Company's internal control over financial reporting in connection with the evaluation required by paragraph (d) of the Securities Exchange Act of 1934 Rules 13a-15 or 15d-15, that occurred during the quarter ended March 31, 2004, that materially affected, or that were reasonably likely to materially affect, the Company's internal control over financial reporting.

In the third quarter of 2004, the Company discovered an error in its consolidated balance sheets. The error, which was caused by a mathematical miscalculation in a tax return schedule that was reflected in the Company's 1996 financial statements, resulted in a \$4.5 million overstatement of AMT credit carryforward assets and a \$4.5 million understatement of transmission and distribution assets. Because the Company had no procedure for the periodic reconciliation of this account, the error has remained in the Company's financial statements until it was found in connection with its recent IRS settlement. Management promptly brought these matters to the attention of its Audit Committee and independent accountants and determined that it would restate its consolidated balance sheets as of December 31, 2002 and 2003 and March 31 and June 30, 2004, and its consolidated statements of operations, statements of comprehensive operations, changes in common stock equity and cash flows for each annual, quarterly and twelve month period ending on the above dates. Management and the Company's independent accountants have determined that the deficiency in reconciliation procedures constituted a material weakness in the Company's internal controls over financial reporting. The Company's management has implemented new procedures for reconciling and analyzing AMT credit carryforward assets on a timely basis and believes that the controls now in place are adequate to assure that similar errors will not recur.

Table of Contents

PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits: See Index to Exhibits incorporated herein by reference.

(b) Reports on Form 8-K:

<u>Date of Reports</u>	<u>Item Numbers</u>	<u>Financial Statements Required to be Filed</u>
February 17, 2004	7 and 9	None
March 15, 2004	5	None
April 27, 2004	7 and 12	None
May 5, 2004	5 and 7	None

30

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

EL PASO ELECTRIC COMPANY

By: /s/ TERRY BASSHAM

Terry Bassham
Executive Vice President,
Chief Financial and
Administrative Officer
(Duly Authorized Officer and
Principal Financial Officer)

Dated: November 18, 2004

Table of Contents

EL PASO ELECTRIC COMPANY

INDEX TO EXHIBITS

Exhibit

Number Exhibit

10.01 Form of Directors Restricted Stock Award Agreement between the Company and certain directors of the Company. (Identical in all material respects to Exhibit 10.07 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999)

10.02 Form of Directors Stock Option Agreement between the Company and certain directors of the Company. (Identical in all material respects to Exhibit 99.17 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997)

15 Letter re Unaudited Interim Financial Information

31.01 Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.01 Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

In lieu of non-employee director cash compensation, three agreements, dated as of January 2, 2004, substantially identical in all material respects to this Exhibit, have been entered into with Kenneth R. Heitz; Patricia Z. Holland-Branch; and Charles A. Yamarone; directors of the Company.

In lieu of non-employee director cash compensation, one agreement, dated as of January 2, 2004, substantially identical in all material respects to this Exhibit, has been entered into with Wilson K. Cadman; director of the Company.