NON-GAAP FINANCIAL MEASURES

In addition to financial measures determined in accordance with GAAP, management evaluates performance based on certain non-GAAP measures, which we refer to as "adjusted" measures. We provide a discussion of each of these non-GAAP measures and provide a reconciliation of our adjusted measures to the most comparable GAAP measures in this section. We believe our non-GAAP adjusted metrics, which are not a substitute for GAAP and may not be consistent with similarly titled non-GAAP measures used by other companies, provide meaningful information and are useful to investors because the financial covenants in our committed bank revolving line of credit agreements and debt indentures are based on these adjusted metrics and management uses these metrics to compare operating results across financial reporting periods, for internal budgeting and forecasting purposes, for compensation decisions and for short- and long-term strategic planning decisions.

Statements of Operations Non-GAAP Adjustments and Calculation of Adjusted TIER

Our primary performance measure is TIER. TIER is calculated by adding the interest expense to net income prior to the cumulative effect of change in accounting principle and dividing that total by the interest expense. TIER is a measure of our ability to cover interest expense requirements on our debt. We adjust the TIER calculation to add the derivative cash settlements to the interest expense and to remove the derivative forward value gains (losses) and foreign currency adjustments from total net income. Adding the cash settlements back to the interest expense also has a corresponding effect on our adjusted net interest income. We make these adjustments to our TIER calculation for covenant compliance on our revolving credit agreements.

We use derivatives to manage interest rate risk on our funding of the loan portfolio. The derivative cash settlements represent the amount that we receive from or pay to our counterparties based on the interest rate indexes in our derivatives that do not qualify for hedge accounting. We adjust the reported interest expense to include the derivative cash settlements. We use the adjusted cost of funding to set interest rates on loans to our members and believe that the interest expense adjusted to include derivative cash settlements represents our total cost of funding for the period. For computing compliance with our revolving credit agreement covenants, we are required to adjust our interest expense to include the derivative cash settlements. TIER calculated by adding the derivative cash settlements to the interest expense reflects management's perspective on our operations and, therefore, we believe that it represents a useful financial measure for investors.

The derivative forward value gains (losses) and foreign currency adjustments do not represent our cash inflows or outflows during the current period and, therefore, do not affect our current ability to cover our debt service obligations. The derivative forward value gains (losses) included in the derivative gains (losses) line of the statement of operations represents a present value estimate of the future cash inflows or outflows that will be recognized as net cash settlements for all periods through the maturity of our derivatives that do not qualify for hedge accounting. We have not issued foreign-denominated debt since 2007, and as of May 31, 2017 and 2016, there were no foreign currency derivative instruments outstanding.

For operational management and decision-making purposes, we subtract the derivative forward value gains (losses) and foreign currency adjustments from our net income when calculating TIER and for other net income presentation purposes. The covenants in our revolving credit agreements also exclude the effects of derivative forward value gains (losses) and foreign currency adjustments, if any. In addition, since the derivative forward value gains (losses) and foreign currency adjustments do not represent current period cash flows, we do not allocate such funds to our members and, therefore, exclude the derivative forward value gains (losses) and foreign currency adjustments from net income in calculating the amount of net income to be allocated to our members. TIER calculated by excluding the derivative forward value gains (losses) and foreign currency adjustments from net income reflects management's perspective on our operations and, therefore, we believe that it represents a useful financial measure for investors.

Our total equity includes the noncash impact of changes in derivative forward value gains (losses) and foreign currency adjustments that are recorded in net income. In addition, the accumulated other comprehensive income component of total equity includes the impact of changes in the fair value of derivatives designated as cash flow hedges as well as the remaining transition adjustment recorded when we adopted the accounting guidance requiring that all derivatives be recorded on the balance sheet at fair value. In evaluating our leverage and debt-to-equity ratios discussed further below, we make adjustments to equity similar to the adjustments made in calculating TIER. We exclude from total equity the cumulative impact of changes in derivative forward value gains (losses) and foreign currency adjustments and amounts included in accumulated other comprehensive income related to derivatives designated for cash flow hedge accounting and the remaining derivative transition adjustment to derive non-GAAP adjusted equity.

Table 41 provides a reconciliation of adjusted interest expense, adjusted net interest income and adjusted net income to the comparable GAAP measures. The adjusted amounts are used in the calculation of our adjusted net interest yield and adjusted TIER for fiscal years 2017, 2016, 2015, 2014 and 2013.

Table 41: Adjusted Financial Measures — Income Statement

	Year Ended May 31,				
(Dollars in thousands)	**2017**	**2016**	**2015**	**2014**	**2013**
Interest expense	**$ (741,738)**	$ (681,850)	$ (635,684)	$ (654,655)	$ (692,025)
Include: Derivative cash settlements	**(84,478)**	(88,758)	(82,906)	(73,962)	(56,461)
Adjusted interest expense	**$ (826,216)**	$ (770,608)	$ (718,590)	$ (728,617)	$ (748,486)
Net interest income	**$ 294,896**	$ 330,786	$ 317,292	$ 302,885	$ 263,728
Include: Derivative cash settlements	**(84,478)**	(88,758)	(82,906)	(73,962)	(56,461)
Adjusted net interest income	**$ 210,418**	$ 242,028	$ 234,386	$ 228,923	$ 207,267
Net income (loss)	**$ 312,099**	$ (51,516)	$ (18,927)	$ 192,926	$ 358,087
Exclude: Derivative forward value gains (losses)	**179,381**	(221,083)	(114,093)	39,541	141,304
Adjusted net income	**$ 132,718**	$ 169,567	$ 95,166	$ 153,385	$ 216,783

We consider the cost of derivatives to be an inherent cost of funding and hedging our loan portfolio and, therefore, economically similar to the interest expense that we recognize on debt issued for funding. We therefore include derivative cash settlements in our adjusted interest expense and exclude the unrealized forward value of derivatives from our adjusted net income.

TIER Calculation

Table 42 presents our TIER and adjusted TIER for the years ended May 2017, 2016, 2015, 2014 and 2013.

Table 42: TIER and Adjusted TIER

	Year Ended May 31,				
	2017	**2016**	**2015**	**2014**	**2013**
TIER (1)	**1.42**	0.92	0.97	1.29	1.52
Adjusted TIER (2)	**1.16**	1.22	1.13	1.21	1.29

(1) TIER is calculated based on net income plus interest expense for the period divided by interest expense for the period.

(2) Adjusted TIER is calculated based on adjusted net income plus adjusted interest expense for the period divided by adjusted interest expense for the period.

Adjustments to the Calculation of Leverage and Debt-to-Equity Ratios

We are required under our credit agreements to maintain compliance with certain financial covenants that are non-GAAP measures, including the adjusted leverage and adjusted debt-to-equity ratios. We have been and continue to be in compliance with the covenants under our credit agreements. Management also relies on the adjusted debt-to-equity ratio as a key measure in managing our business. We therefore believe that these adjusted measures, in combination with the comparable GAAP measures, are useful to investors in evaluating performance. We adjust the comparable GAAP measures to:

- exclude debt used to fund loans that are guaranteed by RUS from total liabilities;
- exclude from total liabilities, and add to total equity, debt with equity characteristics issued to our members and in the capital markets; and
- exclude the noncash impact of derivative financial instruments and foreign currency adjustments from total liabilities and total equity.

For computing compliance with our revolving credit agreement covenants, we are required to make these adjustments to our leverage ratio calculation. The revolving credit agreements prohibit us from incurring senior debt in an amount in excess of 10 times the sum of equity, members' subordinated certificates and subordinated deferrable debt, as defined by the agreements. In addition to the adjustments we make to calculate the adjusted leverage ratio, guarantees to our member systems that have an investment-grade rating from Moody's and S&P are excluded from the calculation of the leverage ratio under the terms of the revolving credit agreements.

We are an eligible lender under the RUS loan guarantee program. Loans issued under this program carry the U.S. government's guarantee of all interest and principal payments. We have little or no risk associated with the collection of principal and interest payments on these loans. Therefore, we believe there is little or no risk related to the repayment of the liabilities used to fund RUS-guaranteed loans and we subtract such liabilities from total liabilities to calculate our leverage and debt-to-equity ratios. For computing compliance with our revolving credit agreement covenants, we are required to adjust our leverage ratio by subtracting liabilities used to fund RUS-guaranteed loans from total liabilities.

Members may be required to purchase subordinated certificates as a condition of membership and as a condition to obtaining a loan or guarantee. The subordinated certificates are accounted for as debt under GAAP. The subordinated certificates have long-dated maturities and pay no interest or pay interest that is below market, and under certain conditions we are prohibited from making interest payments to members on the subordinated certificates. For computing compliance with our revolving credit agreement covenants, we are required to adjust our leverage ratio by subtracting members' subordinated certificates from total liabilities and adding members' subordinated certificates to total equity.

We also sell subordinated deferrable debt in the capital markets with maturities of up to 30 years and the option to defer interest payments. The characteristics of subordination, deferrable interest and long-dated maturity are all equity characteristics. For computing compliance with our revolving credit agreement covenants, we are required to adjust our leverage ratio by subtracting subordinated deferrable debt from total liabilities and adding it to total equity.

We record derivative instruments at fair value on our consolidated balance sheets. For computing compliance with our revolving credit agreement covenants, we are required to adjust our leverage ratio by excluding the noncash impact of our derivative accounting from liabilities and equity. For computing compliance with our revolving credit agreement covenants, we are also required to adjust our leverage ratio by excluding the impact of foreign currency valuation adjustments from liabilities and equity. The leverage and debt-to-equity ratios adjusted to exclude the effect of foreign currency translation reflect management's perspective on our operations and, therefore, we believe these are useful financial measures for investors.

Table 43 provides a reconciliation between the liabilities and equity used to calculate the leverage and debt-to-equity ratios and the adjusted leverage and adjusted debt-to-equity ratios as of May 31, 2017, 2016, 2015, 2014 and 2013. As indicated in the table below, subordinated debt is treated in the same manner as equity in calculating our adjusted leverage and adjusted-debt-to-equity ratios pursuant to the financial covenants under our committed bank revolving line of credit agreements.

Table 43: Adjusted Financial Measures — Balance Sheet

(Dollars in thousands)	May 31, 2017	2016	2015	2014	2013
Total liabilities	**$ 24,106,887**	$ 23,452,822	$ 21,934,273	$ 21,220,311	$ 21,221,441
Exclude:					
Derivative liabilities	**385,337**	594,820	408,382	388,208	475,278
Debt used to fund loans guaranteed by RUS	**167,395**	173,514	179,241	201,863	210,815
Subordinated deferrable debt	**742,274**	742,212	395,699	395,627	395,729
Subordinated certificates	**1,419,025**	1,443,810	1,505,420	1,612,191	1,765,776
Adjusted total liabilities	**$ 21,392,856**	$ 20,498,466	$ 19,445,531	$ 18,622,422	$ 18,373,843
Total equity	**$ 1,098,805**	$ 817,378	$ 911,786	$ 970,374	$ 811,261
Exclude:					
Prior-year cumulative derivative forward value losses	**(520,357)**	(299,274)	(185,181)	(224,722)	(366,026)
Current-year cumulative derivative forward value (gains) losses	**179,381**	(221,083)	(114,093)	39,541	141,304
Accumulated other comprehensive income [(1)]	**3,702**	4,487	5,371	6,320	7,287
Include:					
Subordinated certificates	**1,419,025**	1,443,810	1,505,420	1,612,191	1,765,776
Subordinated deferrable debt	**742,274**	742,212	395,699	395,627	395,729
Adjusted total equity	**$ 3,597,378**	$ 3,519,270	$ 3,106,808	$ 3,157,053	$ 3,190,201
Guarantees [(2)]	**$ 889,617**	$ 909,208	$ 986,500	$ 1,064,822	$ 1,112,771

(1) Represents the AOCI related to derivatives. See “Note 11—Equity” for a breakout of our AOCI components.
(2) Guarantees are used in the calculation of leverage and adjusted leverage ratios below.

Table 44 displays the calculations of our leverage and debt-to-equity ratios and our adjusted leverage and debt-to-equity ratios as of the years ended May 31, 2017, 2016, 2015, 2014 and 2013.

Table 44: Leverage and Debt-to-Equity Ratios

	May 31, 2017	2016	2015	2014	2013
Leverage ratio [(1)]	**22.75**	29.81	25.14	22.97	27.53
Adjusted leverage ratio [(2)]	**6.19**	6.08	6.58	6.24	6.11
Debt-to-equity ratio [(3)]	**21.94**	28.69	24.06	21.87	26.16
Adjusted debt-to-equity ratio [(4)]	**5.95**	5.82	6.26	5.90	5.76

(1) Calculated based on total liabilities and guarantees as of the end of the period divided by total equity as of the end of the period.
(2) Calculated based on adjusted total liabilities and guarantees as of the end of the period divided by adjusted total equity as of the end of the period. See Table 43 above for the adjustments to reconcile total liabilities and guarantees and total equity to adjusted total liabilities and guarantees and adjusted total equity.
(3) Calculated based on total liabilities as of the end of the period divided by total equity as of the end of the period.
(4) Calculated based on adjusted total liabilities at period end divided by adjusted total equity at period end.

In calculating the required financial covenants in our revolving credit agreements, we adjust net income, debt and total equity to exclude unrealized amounts related to the accounting for derivatives and foreign currency translation. Below we provide additional information on the calculations to derive adjusted TIER and the adjusted debt-to-total equity ratio pursuant to the required financial covenants in our revolving credit agreements.

- Adjusted TIER, as defined in our revolving credit agreements, is calculated based on the sum of (i) interest expense, adjusted to include (ii) derivative cash settlements and (iii) net income prior to the cumulative effect of change in accounting principle, divided by interest expense adjusted to include derivative cash settlements.
- The adjusted debt-to-total equity ratio is calculated based on (i) senior debt, adjusted to exclude (ii) RUS-guaranteed loans, subordinated deferrable debt and members' subordinated certificates divided by (iii) total equity, adjusted to include (iv) subordinated deferrable debt and members' subordinated certificates. Senior debt includes guarantees; however, it excludes:
  - guarantees for members where the long-term unsecured debt of the member is rated at least BBB+ by S&P or Baa1 by Moody's; and
  - the payment of principal and interest by the member on the guaranteed indebtedness if covered by insurance or reinsurance provided by an insurer having an insurance financial strength rating of AAA by S&P or Aaa by Moody's.
- Results of operations related to CAH, including impairment and other comprehensive income amounts, are excluded in calculating both adjusted TIER and the adjusted senior debt-to-total equity ratio.