National Utilities Cooperative Finance Corporation
Fiscal Year 2017 Results
August 3, 2017

Operator: Ladies and gentlemen, thank you for standing by. Introducing your host, Ling Wang. Thank you, Ms. Wang. You may begin.

Ms. Ling Wang: Hi. Good morning. This is Ling Wang, Vice President of Capital Markets Funding and Relations at National Rural Utilities Cooperative Finance Corporation. Thank you for joining us today to review our 2017 fiscal year results.

With me on the call this morning are Sheldon Petersen, our Chief Executive Officer; and Andrew Don, our Senior Vice President and Chief Financial Officer. Sheldon will provide a business update and Andrew will discuss our fiscal year financial results.

During today's call, we will make forward-looking statements within the Securities Act of 1933, as amended, and the Exchange Act of 1934, as amended. The forward-looking statements are based on certain assumptions and describe our future plans, strategies, and expectations, are generally identified by our use of words such as intend, plan, may, should, will, project, estimate, anticipate, believe, expect, continue, potential opportunity and other similar expressions, whether in the negative or affirmative.

All statements about future expectations or projections are forward-looking statements. Although we believe that expectations reflected in our forward-looking statements are based on our reasonable assumptions, actual results and performance may differ materially from our forward-looking statements.

Factors that could cause future results to vary from forward-looking statements about our current expectations are included in our annual and quarterly periodic reports previously filed with the U.S. Securities and Exchange Commission.

Except as required by law, we undertake no obligation to update or public release any revisions to forward-looking statements to reflect events, circumstances or changes in the expectation after the date of which the statement is made.

We provide our results based on generally accepted accounting principles, or GAAP, in our Form 10-K, which we filed on August 1st. In addition to our GAAP results, during parts of this discussion we will refer to certain financial measures that are based on--that are calculated based on the amounts that include adjustments to amounts determined under the GAAP and are therefore referred to as adjusted.

The primary adjusted metrics include adjusted net income, adjusted net interest income, adjusted time interest earned ratio, or TIER, adjusted debt to equity ratio. We provide a reconciliation of our adjusted measures to the most comparable GAAP measures in our recently filed Form 10-K.

It is important to note that we use our adjusted measures to measure our business and evaluate our results of operations. Additionally, the financial covenants in our revolving credit agreements and debt indentures are based on our adjusted measures rather than comparable GAAP measures. We, therefore, believe these adjusted measures are useful to investors to evaluate our performance.

We will have a Q&A session at the end of this presentation. You can ask questions via phone or submit your questions online if you are participating in this event via webcast. We encourage you to take this opportunity to ask any questions you may have. In addition, all of the material for this event, including the presentation slides and financial reports, are available on our website at nrucfc.coop. A reply and a call transcript will be made available on our website after the event.

With that, I'd like to turn the call over to Sheldon.

Mr. Sheldon Petersen: Good morning, everyone. Welcome and thank you for joining us today.

Fiscal year 2017 was a solid year for CFC on virtually all of our key metrics. I will focus specifically on the business environment in which we're operating. And while loan growth did moderate from the levels we've seen in recent years, it continued in 2017 to represent a strong market position. In addition to the traditional capital expenditure loans we make, we have continued to see a fairly significant new loan volume that is directed toward refinancing of other lender debt. This represents a great opportunity for CFC because these credits are a well-known financial risk profile. We're basically just lowering the interest rates for the borrower, and it gives us an opportunity to add balances to some of our smaller borrowers and give us further diversity among our group of members.

The number of cooperatives that are considered to be 100 percent CFC borrowers and that would be defined as those that rely on CFC for all of their long-term secured debt, actually increased by three during the fiscal year. Our portfolio continues to be heavily tilted toward the high quality distribution sector of the industry. And I'll focus the rest of my comments on that. These cooperatives have had the opportunity to capitalize on the extraordinary interest rate conditions that we continue to see by locking down fixed interest rates. Over 90 percent of our long-term loans now are actually priced on a fixed interest rate, and this represents a significant increase in that proportion from what we might have seen, say, 10 to 12 years ago. As a capital-intensive industry, this positions our cooperatives extremely well for potential future rate increases in the cost of capital.

Our cooperatives continue to operate in a very stable environment with relatively modest new capital investment compared to pre-recession levels. The median growth in total utility plant dollars at the distribution cooperative level was actually up by about 3.5 percent, according to our key ratio trend analysis data. Median kilowatt-hours sales growth that was reported on the KRTA was positive at .5 percent. That number does tend to bounce around a little bit and is certainly weather dependent, but also influenced by the economy, by energy efficiency programs and tools that are now available to users to actually manage their usage. Overall, the industry expects very, very modest growth by historic standards in kilowatt-hour sales. The median annual growth in the number of consumers served increased by approximately .6 percent, again, very modest by historic standards.

In terms of the distribution cooperatives financial performance, our key ratio trend analysis, which represents a compilation of the financials of 809 distribution cooperatives, continues to illustrate continued strength. The median times interest earned ratio a key coverage ratio used in our industry, was reported at 2.62 times, with a modified debt service coverage ratio, again, a key coverage ratio, at 1.83. We saw a slight increase in the median equity to assets ratio rise to 45 percent. And as the cooperatives continue to see lower and lower bad debt expense, write-offs continue to fall and currently stand at about 10 basis points. We attribute that to the concentration of the residential load for electric cooperatives, as well as new metering technology, which allows the utility to really stay on top of that area.

Through NRCA through our state wide organizations of electric cooperatives, CFC and the cooperatives are continuing to stay engaged and the discussion around the key industry issues that face the utility industry, things such as the course correction of the Clean Power Plan, the changing generation mix and its potential impact on grid stability, as well as the influence that technology will have on our industry going forward in the future. However, we continue to believe that we're well positioned to deal with this evolving environment.

And with that, I'll turn the program over to Andrew, who will focus on some of the more specifics in terms of the numbers. Andrew?

Mr. Andrew Don: Great. Thank you, Sheldon. And, again, good morning and thank you all for joining us today for National Rural Utilities Cooperative Finance Corporation's call to review our financial performance for our fiscal year ended May 31, 2017.

For the fiscal year ended May 31, 2017, total assets increased by $935 million from the May 31, 2016 fiscal year-end date, primarily due to a $1.2 billion, or 5 percent, increase in loans to our members. The increase in loans to members was driven by a $1.2 billion increase in CFC distribution loans and a $104 million increase in CFC power supply loans, with these increases partially offset by a decrease of $67 million in national cooperative service corporation loans. The increase in loans outstanding in the electric portfolio was attributable to member advances for capital investments, as well as refinancing other lenders' loans with CFC.

Excluding scheduled loan amortization and other repayments, CFC's gross long-term loan advances to electric borrowers for fiscal year 2017 totaled $2.3 billion. Approximately 54 percent of those new advances were made for capital expenditures and 39 percent were for refinancing loans with other lenders. In comparison, during fiscal year 2016, CFC gross long-term loan advances to electric borrowers totaled $3.3 billion, of which 43 percent was for capital expenditures and 51 percent for refinancing other lender's debt.

As mentioned on prior calls, during fiscal year 2017, CFC completed the sale as only foreclosed asset, that being Caribbean Asset Holdings. As a result, we have no foreclosed assets reported in our consolidated balance sheet at the end of fiscal year 2017.

For fiscal year ended May 31, 2017, total debt outstanding increased by $861 million, or 4 percent, for May 31, 2016 to fund the new loan growth. Short-term debt increased by 404 million, primarily due to an increase of $340 million in dealer commercial pay for outstanding, to a total level of $1 billion, as compared with $660 million in dealer commercial paper for outstanding at the 2016 fiscal year end.

Total equity increased by $281 million during fiscal year ended May 31, 2017, mainly due to net income of $312 million for the year, which was partially offset by patronage capital retirement of $43 million in fiscal 2017. The $312 million in net income was partially attributable to the $179 million derivative forward value gains we had during fiscal 2017. Our member's equity, which excludes CFC's cumulative derivative forward value losses, increased by $91 million at May 31, 2017 from the prior fiscal year-end.

Our adjusted debt to equity ratio increased to 5.95 to 1 at May 31, 2017 from 5.82 to 1 at May 31, 2016 due to a larger increase in adjusted liabilities to fund the loan growth during the fiscal year than the increase in adjusted equity. We generally aim to maintain an adjusted debt to equity ratio at approximately or below 6 to 1. Over the next 12 months, we expect the amount of new long-term loan advances to exceed scheduled loan repayments. However, we expect that we will be able to maintain our adjusted debt to equity ratio around our targeted level.

For the year ended May 31, 2017, CFC generated an adjusted times interest earned ratio of 1.16 compared with an adjusted times interest earned ratio of 1.22 times for the prior year. Adjusted net income totaled $133 million compared with $170 million for the prior year. A $37 million decrease in adjusted net income was largely driven by a $32 million decrease in adjusted net interest income and a $7 million negative variance in the provision for loan losses.

For the year ended May 31, 2017, CFC's adjusted net interest income totaled $210 million, as compared to $242 million for the prior year period. The $32 million decrease in adjusted net interest income was driven by a 19 basis point decrease in the adjusted net interest yield to 86 basis points, partially offset by a 6 percent increase in average interest earnings assets. Specifically, for the fiscal year 2017, the average yield on our interest earnings assets decreased by 16 basis points to 4.22 percent, while our adjusted cost of funds increased by 5 basis points to 3.55 percent. The lower average yield on our interest earning assets was due to reduced rates on our fixed rate loans, which was a result of our member's repricing higher rate loans to lower interest rates and lower interest rates on new loans and an overall low interest rate environment. The impact of lower adjusted net interest income resulting from a lower asset yield and higher cost of funds was partially offset by the increases in average interest earning assets, mainly loans to our members.

For fiscal year 2017, CFC recorded a provision for loan losses of $6 million compared with a benefit of $1 million for the prior year. The $7million unfavorable variance was primarily attributable to the increase in our total loans outstanding and an increase in the default rates for loans with higher risk, partially offset by a decrease in default rates for loans with lower risk and a reduction in the specific allowance for individually impaired loans.

We used Standard & Poor's historical U.S. utility sector default table as a proxy for default rates used in determining our allowance for loan loses, because we historically have experienced a limited number of defaults in our loan portfolio.

CFC recorded $179 million of derivative forward value gains during fiscal year 2017 compared with $221 million of forward value losses in the prior year. The derivative forward value gains were primarily attributable to an overall increase in interest rates across the curve during fiscal year 2017. Specifically, the derivative forward value gains or losses reflect the changes in estimated fair value of our interest rate swaps at May 31, 2017 based on the projected movement in interest rates through the maturity of the swap agreements in place at May 31, 2017. As such, these amounts do not represent current period realized cash gains or losses. As noted previously, in managing our operating performance for purpose of our debt covenant compliance, we exclude derivative forward value gains and losses from adjusted net income and adjusted equity calculations.

There have not been any significant changes at year-end May 31, 2017 from May 31, 2016 in the overall composition of our loan portfolio with $24 billion, or 99 percent of our portfolio consisting of loans to rural electric systems and $354 million, or 1 percent, to the telecommunications sector. The percentage of CFC long-term fixed rate loans was at 91 percent as of May 31, 2017 compared with 93 percent at May 31, 2016. The decrease in the percentage of long-term fixed rate loans was due to an increase in line of credit borrowings during the year and as of May 31, 2017.

We typically lend to our members on a senior secured basis with 92 percent of our loans being senior secured at May 31, 2017, the same level as May 31, 2016. As we've reported previously, CFC offers fixed or variable interest rate loans to members for up to 35 years. For fixed rate loans members have the option to fixed interest rate period from one year up to the maturity date of the underlying loan. When the selected fixed interest rate term expires, members may select another fixed rate term, a variable rate, or repay the loan in full.

During fiscal year 2017, CFC had approximately $987 million of loans scheduled to re-price. Of those, CFC was able to retain 98 percent of these loans, which was at the same level as during fiscal 2016. Over the most recent three fiscal years our average retention rate of re-pricing loans has been approximately 97 percent.

We do not have any nonperforming loans at the end of fiscal year 2017. During fiscal year 2017, we had $1.9 million in net charge-offs compared with $214 thousand in net recoveries during fiscal year 2016. The one charge-off during fiscal year 2017 was associated with a telecommunication loan. In CFC's 48-year history there have only been 16 defaults and 6 losses in the electric utility portfolio, which currently accounts for 99 percent of our overall loan portfolio. Of the six losses, we have experienced $19 million in net charge-offs for distribution borrowers and $67 million in net charge-offs for power supply borrowers, for a combined total of $86 million.

This slide depicts CFC's loans outstanding by state as of May 31, 2017. CFC has a geographically diverse loan portfolio throughout the United States. Texas continues to be the largest state in terms of loans outstanding from both May 31, 2017 and 2016, accounting for 15 percent of our total loans outstanding at the end of each fiscal year. Texas is also the largest state in terms of number of borrowers with 73 borrowers.

In terms of year-over-year loan growth, CFC's loans outstanding to members increased by $1.2 billion during fiscal 2017 compared to $1.7 billion for the prior fiscal year. Five states accounted for more than 50 percent of the loan growth, with those being Texas, Colorado, Kansas, North Carolina and Hawaii. In addition, as shown on this slide, 10 states accounted for approximately 85 percent of the loan growth during fiscal year 2017. Among the top 5 states with the most growth, the loan growth in Texas was primarily driven by new capital expenditures, while the loan growth in the other states was primarily a result of refinancing other lender's debt.

With respect to credit concentration, at May 31, 2017 the 20 largest borrowers accounted for 23 percent of the loans outstanding, the same level as at May 31, 2016. As of May 31, 2017, our 20 largest borrowers consisted of 10 distribution cooperatives, 9 generation transmission cooperatives and one NCSC associate borrower. The largest total of loans outstanding to a single borrower represented approximately 2 percent of our total loans outstanding.

We have a standby purchase agreement with Farmer Mac and have designated certain loans as approved by Farmer Mac in the standby loan pools. Although these loans remain on CFC's balance sheet, Farmer Mac essentially guarantees any loan losses for these loans. As of May 31, 2017, the aggregate outstanding principle balance under this agreement was $843 million, 42 percent, or $352 million, of these guarantees were to certain of our top 20 borrowers.

CFC continues to maintain diverse funding sources so as never to be dependent on any one source. During fiscal year 2017, our total debt outstanding increased by $861 million to fund the loan growth. Approximately half of our new funding came from capital markets and half of it came from private and federal government based programs. Our funding mix at May 31, 2017 remained relatively unchanged compared to the prior year-end. Specifically, at May 31, 2017, $4.2 billion, or 18 percent of CFC's funding, came from our members in the form of short-term and long-term investments. The $4 billion is very stable and reliable, offering CFC funding with little reinvestment risk, as our members consistently invest a large portion of their excess funds with CFC.

Our private and federal government based funding increased by $413 million and represented 32 percent of our total funding at May 31, 2017. The guaranteed underwriter program and Farmer Mac note purchase agreement continues to provide us stable and attractive spreads. Our capital market related funding sources increased by $437 million at May 31 from the May 31, 2016 year-end date. This increase was primarily due to a $381 million net increase in collateral trust funds outstanding and $340 million net increase in dealer commercial paper outstanding, partially offset by a $284 million net decrease in medium term notes outstanding.

This slide presents CFC's long-term debt maturities over the next 12 months that is from August 2017 through July 2018. As indicated on the chart, our debt maturities over the next 12 months are relatively low. Other than the $700 million collateral trust bonds maturing in February 2018 and $200 million medium term notes maturing during April 2018, we do not have any meaningful debt maturities over the next 12 months. In addition to the debt maturities I just mentioned, we have a total of $425 million of member medium term notes due over the next 12 months. Historically, our members have chosen to roll over their investments at maturity. We believe we have ample sources of liquidity to meet each of the maturities, as will be highlighted in the next slide. The issue of debt to meet the funding requirements to repay the upcoming maturities will be determined in due course, taking into account the maturity schedule of our assets and the most cost effective source of funding.

This slide depicts the various non-capital market sources of liquidity that CFC had in place at May 31, 2017, which in the aggregate totaled $7.8 billion. As reflected by the two red bars on the right hand portion of the slide, CFC has an aggregate of $4.6 billion of member and non-member short-term debt maturities over the next 12 months, which results in CFC having access to $3.2 billion, as shown by the green bar, or 1.7 times a defined liquidity greater than the combined member and non-member short-term debt maturity needs. The $4.6 billion of debt maturities over the next 12 months includes $2.6 billion of short-term investments that our members have with CFC. As mentioned earlier, our member's investments are very stable and reliable funding sources. If we were to exclude short-term debt maturities related to our member investments, we would have access to $5.8 billion, or 3.9 times a defined liquidity greater than our non-member short-term maturities, with these representing both dealer commercial paper maturities and the current portion of long-term debt maturing during the next 12 months from May 31, 2017. As reflected in the bar chart, in addition to cash on hand and time deposits, our core sources of liquidity for meeting cash needs are from the issuance of commercial paper, advances under the guaranteed underwriter program and borrowings under the Farmer Mac facilities.

This slide presents CFC's projected sources and uses of cash over the next 18 months from the date of May 31, 2017. As indicated, our total projected cash needs over this time period are $5.4 billion with 44 percent of this amount expected to satisfy projected new loan advances and 56 percent to meet maturities of long-term debt. We expect to see growth in our long-term loans outstanding of approximately $550 million over the next 18 months. Sources of cash are expected to be generated from the ongoing amortization of loans extended to our members, with the balance to be provided by the variety of funding vehicles CFC has established. The timing, size, and tenor of issuance will be dependent on the timing of our loan advance and the maturity of loans we extend to our members, as well as the most attractive cost of funds.

This slide summarizes our major financing activities during fiscal 2017. To fund the loan growth and debt maturities during the past fiscal year, we accessed a variety of long-term funding vehicles totaling $2.7 billion, both on a secured and unsecured basis, including $1.25 billion of collateral trust bond issuances, $650 million of medium term note issuances, $350 million of advances from Farmer Mac, $250 million advances under the guaranteed underwriter program, and $197 million of InterNotes issuance, targeting primarily retail investors.

In addition to these funding activities, CFC continued to extend the maturity dates of our $3.2 billion revolving credit facilities by an additional year. These revolving credit facilities are CFC's primary liquidity facilities. For the potential funding needs, CFC will continue to look to balance capital market and non-capital market secured and unsecured financings, while always looking to access the most attractive cost of funds for our member borrowers.

To conclude our call, I'd like to leave you a few key takeaways when you consider CFC as an investment opportunity. These items are areas that CFC is consistently focused on and represent key credit strengths when viewing CFC as an investment. With regard to ratings, CFC is rated by Fitch, Moody's and S&P Global. Both Fitch and S&P Global reaffirmed CFC's credit ratings and outlook in May 2017. CFC's Board of Directors and management remain highly focused on the long-term strategy of maintaining and improving our credit ratings. As indicated, CFC's ratings remain robust and, as discussed on prior calls, CFC's management and all staff has a certain amount of its annual compensation tied to the levels of CFC's credit ratings. CFC's Board of Directors strongly believes that this incentive structure will align investor interest and management interest to maintaining strong credit fundamentals.

The mainstay of CFC's financial strength is in the quality of our loan portfolio. Similar to CFC, our members are focused on meeting the need of their customer not generating sales or earnings growth to meet shareholder requirements. The loan portfolio is well diversified with 99 percent of our assets to financially sound, strong cash flow generating rural electric systems that have limited rate regulation and are geographically dispersed across the United States. CFC has a long history of low nonperforming loans in its portfolio, reflective of the strong financial condition of our borrowers. In addition, 92 percent of our loans are secured with utility assets and our member's revenue on a senior secured basis.

At May 31, 2017, we did not have any nonperforming loans in our portfolio. As a member-owned cooperative organization, CFC continues to receive strong support from our members both in terms of new lending business and as a valuable funding source. Our members have made significant investments in CFC in the form of short-term investments as well as long-term capital. We view these investments to have limited reinvestment risk, thus providing a stable funding source for CFC. Our member investment stood at $4.2 billion at May 31, 2017, representing 18 percent of our funding. In addition, we have developed numerous sources of funding from both private and public market providers that we will have ready access to capital at attractive rates. CFC will continue to utilize different funding vehicles public and private to maintain our low cost funding structure for the benefit of our members. For short-term funding our plan is to maintain our dealer commercial paper balance below the $1.25 billion level for the foreseeable future. With respect to long-term funding, we will continue to target smaller but index eligible tranches and a consistent issuance pattern for public debt capital market offerings while looking to maintain flexibility and availability in our private funding sources, namely the guaranteed underwriter program and Farmer Mac.

CFC maintains a more than adequate liquidity reserve from a variety of sources to meet our member's borrowing needs, as well as service all of our debt obligations. Over the past few years, we have proactively sought to reduce maturity towers, increase cash and liquid short-term investments and maintain a variety of committed financing alternatives from both our relationship banks and other sources of financing, most notably from the $3.2 billion committed revolving credit facilities from our relationship banks, the $725 million committed availability and the guaranteed underwriter program and $2.3 billion revolving credit capacity by the Farmer Mac secured note placement program. These sources together with cash and cash equivalents, short-term investments, and scheduled loan amortization and other repayments from members resulted in CFC having approximately $7.8 billion of liquidity available at May 31, 2017 to meet the next 12 months of all of the debt maturities of $4.6

billion, a 1.7 times liquidity coverage ratio. Excluding debt maturities related to our member investments, which historically have had a high reinvestment rate; our liquidity coverage ratio would be 3.9 times.

Thank you once again for joining us today to review our results for our fiscal year ended May 31, 2017. We appreciate your interest in CFC and look forward to discussing our financial performance and funding plans in the future.

II would like to ask the operator to open the lines for any questions and suggest that you also submit questions via the Web service that we may respond to those as well. Thank you.

Operator: Thank you. At this time, we would like to be conducting a question-and-answer session. If you do have a telephone question, please, press star-one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. If at any time you wish to remove your question from the queue, please, press star-two. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys.

We have a question from the phone from Dan Jenkins from the State of Wisconsin Investment Board.

Mr. Dan Jenkins: Hi. Good morning.

Mr. Andrew Don: Good morning. How are you today?

Mr. Dan Jenkins: Pretty good. I had a question looking at page 22 of the 10-K where you show the net interest yield and the adjusted net interest yield.

Mr. Andrew Don: Um-hmm--.

Mr. Dan Jenkins: --It was at 120 and 0.86. You know, that's the lowest it's been over the five years shown there. I guess, you know, given that a large amount of your loans are fixed, you know, is there any concern that, you know, there's enough cushion there in the net interest yield at that level or, is there anything you can do to maintain that or could you comment on that?

Mr. Andrew Don: Sure. No, I mean, as, you know, we kind of mentioned during the call, what we've been seeing obviously a repayment of higher yielding assets. These were loans that were put on some time ago, and, obviously, new loan advances are going out at a lower rates than--as well than what's been, previously in the portfolio. And, you know, part of the reduction in that, kind of net yield has also just been due to timing difference, where we've historically been able to refinance debt that we have outstanding more rapidly than the, loans that are maturing or repaying.

So, we've reached, what I'll call, for the most part, the end of, the refinancing of, some higher cost debt in advance of the repayments of those higher yielding assets. So, it's kind of levelling out a little bit. So, we expect that that kind of level yield will continue. Now as you probably well know we do have a piece of high cost legacy debt that is re-pricing in fiscal '19, and that will obviously change the yield fairly significantly.

We had anticipated this kind of in the average-- or the net yield, for this year, and, we see potentially the same thing, a consistent level during fiscal '18, but then an improvement in fiscal '19. But, again, it's just due to the timing differences of when loans have been kind of being repaid and where the new loans are going off. And, previously, we've been able to refinance some higher cost debt and take advantage of that.

Mr. Dan Jenkins: Okay. Have you looked at or considered maybe taking out that high cost, 10 and 3/8ths percent debt early?

Mr. Andrew Don: --Yeah, we have. Yeah, we've looked at it. And, as a tax exempt or entity, we don't get any tax benefit. So, it would not be an NPV positive transaction. So yes, we certainly look at it on an annual basis and, economically it's not possible really to do that.

Mr. Dan Jenkins: Okay, that's all I had. Thank you.

Mr. Andrew Don: Thank you.

Operator: Once again, ladies and gentlemen, if you do have a question, please, press star-one on your telephone keypad.

Mr. Andrew Don: And, I guess, operator, if we don't have any other questions, we'll conclude the call, at this time. So, thank you all again for joining us today and, we look forward to talking with you in the future. If you have any questions, please, feel free to call us, directly. Thank you.

Operator: Thank you. We have reached the end of the question session and the conference. You may disconnect your lines at this time and thank you for your participation.