

**National Rural Utilities Cooperative Finance Corporation  
Second Quarter Fiscal Year 2018 Results  
January 16, 2018**

Operator: Greetings and welcome to the second quarter fiscal year 2018 investor call.

At this time, all participants are in a listen only mode. A brief question and answer session will follow the formal presentation. If anyone today requires operator assistance during the conference, please press star, zero from your telephone keypad. As a reminder, this call is being recorded.

I'd now like to turn the conference over to Ling Wang. Please go ahead.

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 second-quarter fiscal year 2018 financial results.

Our Senior Vice President and Chief Financial Officer, Andrew Don will discuss our second-quarter 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 similar expressions, whether in the negative or affirmative.

All statements about future expectations or projections are forward-looking statements. Although we believe the expectations reflected in our forward-looking statements are based on 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 US Securities Exchange Commission.

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

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 materials for this event, including the presentation slides and the financial reports, are available on our website at [www.nrucfc.coop](http://www.nrucfc.coop). A replay and co-transcript will be made available on our website after the event.

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

Mr. Andrew Don: Thank you, Ling.

And again, good morning, and thank you for joining us today for National Rural Utilities Cooperative Finance Corporation's call to review our financial performance for our second-quarter of fiscal 2018 for the period ended November 30, 2017.

We provide our results based on Generally Accepted Accounting Principles, or GAAP, in our Form 10-Q, which we filed on January 11, 2018. In addition to our GAAP results, during parts of this discussion, I will refer to certain financial measures that are calculated based on amounts that include adjustments to amounts determined under GAAP and are therefore referred to as adjusted. The primary adjusted metrics include adjusted net income, adjusted net interest income and adjusted net interest yield, adjusted times interest earned ratio or TIER, and 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-Q. It is important to note that we use our adjusted measures to manage 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 the comparable GAAP measures. We therefore believe these adjusted measures are useful to investors in evaluating our performance.

Total assets increased by \$675 million from the May 31, 2017 fiscal year-end date, primarily due to the growth in our loan portfolio of \$458 million, an increase in our cash balances of \$103 million, and an increase in our investment securities of \$247 million, offset by a decrease in our time deposits of \$175 million.

For the six months ended November 30, 2017, we had an increase in CFC distribution loans of \$405 million, an increase in NCSC loans of \$126 million, and an increase in RTFC loans of \$17 million, with these increases partially offset by a decrease in CFC power supply loans of \$91 million.

CFC's gross loan advances to electric borrowers totaled \$1.1 billion during the six month period. Approximately 58 percent of those new advances were for capital expenditures, and 31 percent were made to refinance other lenders' loans.

During the second-quarter, we purchased approximately \$248 million of short- to intermediate-term investment grade fixed-income securities as a supplemental contingent source of liquidity. We classified these securities as held to maturity because our intent is to hold these securities to maturity.

At November 30, 2017, corporate bonds accounted for 85 percent of these fixed-income securities with the remainder consisting of commercial paper, certificates of deposit, asset backed securities, and commercial mortgage backed securities. The average contractual maturity of our investment securities was four years, and the average credit rating was A3/A- from Moody's and S&P respectively.

Our investment portfolio is unencumbered, and these securities generally have active secondary markets under normal market conditions. We intend for our investment portfolio to remain adequately liquid to supplement our primary sources of liquidity.

For the first six months-- ended November 30, 2017, total debt outstanding increased by \$626 million from the May 31, 2017 fiscal 2017 year-end date, primarily to fund the loan growth.

Total equity increased by \$141 million mainly due to GAAP net income of \$188 million for the six months ended November 30, 2017, partially offset by the retirement of patronage capital of \$45 million that was distributed to our members on September 1, 2017.

Our members' equity, which excludes derivative forward value losses, accumulated other comprehensive income, and non-controlling interests, increased by \$24 million at November 30, 2017 from May 31, 2017. The increase was due to adjusted net income of 68 million for the six months ended November 30, 2017, offset by patronage capital retirement of \$45 million.

Our adjusted debt to equity ratio increased to 6.12 to 1 on November 30, 2017, from 5.95 to 1 on May 31, 2017, largely due to an increase in debt outstanding to fund the loan growth.

Over the remainder of the fiscal year, we expect the amount of new long-term loan advances to exceed scheduled loan repayments. In addition, we also expect to continue expanding our investment portfolio. As a result, we expect our adjusted debt to equity ratio to be above the 6 to 1 target at our May 31, 2018 fiscal year-end.

For the six months ended November 30, 2017, CFC generated an adjusted TIER of 1.16 times, which is the same level reported for the same prior year period. Adjusted net income totaled \$68 million for the first six month period compared with \$66 million for the same prior year period. The \$2 million increase in adjusted net income was primarily driven by a favorable shift in the provision for loan losses.

For the six months ended November 30, 2017, adjusted net interest income totaled \$104 million, relatively unchanged from the same prior year period. The increase in interest income of \$18 million for the six month period was offset by approximately the same amount of

increase in adjusted interest expense. The increase in our interest income was driven by a \$892 million or 4 percent increase in our average interest-earning assets as our average yield on these assets remained relatively stable.

The increase in our adjusted interest expense was mainly attributable to the increase in the cost of our short-term borrowings and other variable-rate obligations tied to LIBOR. For the six month period ended November 30, 2017, our adjusted net interest yield decreased slightly to 83 basis points from 86 basis points as compared with the same prior-year period. We expect our adjusted net interest yield to remain at the current level or increase slightly for the remainder of the fiscal year.

For the six months ended November 30, 2017, CFC recorded a benefit for loan losses of \$1 million, compared with a provision for loan losses of \$3 million during the same prior year period. We had no charge-offs or recoveries during the six months ended November 30, 2017. In comparison, we recorded a net charge-off of \$2 million during the six months ended November 30, 2016.

CFC recorded \$119 million of derivative forward value gains during the six months ended November 30, 2017, compared with \$197 million of gains in the same prior year period. The current period derivative forward value gains were attributable to an increase in the fair value of our pay fixed interest rate swaps as interest rates increased across the yield curve since May 31, 2017.

As we have consistently disclosed, the derivative forward value gains or losses reflect the changes in estimated fair value of our interest rate swaps at November 30, 2017 based on the projected movement in interest rates through the maturity of the swap agreements in place at November 30, 2017. As such, these amounts do not represent current period realized cash gains or losses.

As noted previously, in managing our operating performance and for purposes of compliance with our financial debt covenants, we exclude derivative forward value gains and losses from our adjusted net income and adjusted equity calculations.

The overall composition of our loan portfolio at quarter-end November 30, 2017 is largely unchanged from May 31, 2017, with \$24 billion or 99 percent, of our portfolio consisting of loans to rural electric systems and \$372 million or 1 percent, to the telecommunications sectors at quarter-end, comparable with the levels at May 31, 2017.

The percentage of CFC's long-term fixed-rate loans was at 90 percent as of November 30, 2017, similar to the May 31, 2017 level. We typically lend to our members on a senior secured basis, with 92 percent of our loans being senior secured at November 30, 2017, unchanged from the May 31, 2017 level.

At November 30, 2017, we had no non-performing loans in our loan portfolio. As mentioned earlier, we had no charge-offs during the six months ended November 30, 2017. The credit quality of our loan portfolio remains strong with our members continuing to demonstrate solid financial and operational performance.

CFC continues to maintain diverse funding sources so as to never be dependent on any one source. At November 30, 2017, \$4.8 billion or 20 percent of CFC's funding came from our members in the form of short-term and long-term investments, compared with \$4.2 billion or 18 percent at May 31, 2017.

Generally speaking, our total member investments average around \$4 billion. Our member investments are stable and reliable, offering CFC funding with little reinvestment risk as our members have historically consistently invested a large portion of their excess funds with CFC.

Our federal government based funding increased by \$74 million at November 30, 2017 from the prior fiscal year period. During the six months ended November 30, 2017, we advanced \$100 million under the guaranteed underwriter program to fund a portion of the loan growth.

Our capital-market related funding sources decreased slightly by \$23 million at November 30, 2017 from the May 31, 2017 year-end date.

This slide presents CFC's long-term debt maturities from January 2018 through January 2019. As indicated, our total long-term debt maturities over this period are expected to be \$3.2 billion with collateral trust bonds and dealer medium-term notes accounting for approximately \$2.1 billion or 65 percent of the scheduled debt maturities.

The \$700 million collateral trust bonds maturing in February 2018 have a coupon rate of 5.45 percent, and the \$1 billion collateral trust bonds maturing in November 2018 have a coupon of 103/8<sup>th</sup> percent. We expect to replace these bonds with debt at lower interest rates, which should reduce our overall funding cost.

To manage debt maturity towers, in January 2018, we provided a notice to the Rural Utilities Services to pre-pay \$325 million of loans with an original maturity date of April 2026 under the guaranteed underwriter program. This debt redemption will reduce our April 2026 guaranteed underwriter program maturities from \$1 billion to \$675 million.

In addition to the collateral trust bond, medium-term notes and guaranteed underwriter program maturities, we also have a \$250 million note with Farmer Mac maturing in September 2018. With respect to the \$422 million member medium-term notes due over this period, historically, our members have chosen to roll over their investments at maturity.

We believe we have ample sources of liquidity to meet each of these maturities, as will be highlighted in the next slide.

This slide depicts the various non-capital market dependent sources of liquidity that CFC had in place at November 30, 2017, which in the aggregate totaled \$8.7 billion. As reflected by the two red bars on the right hand portion of the slide, CFC has an aggregate of \$6.5 billion of member and non-member short-term debt maturities over the next 12 months.

Based on the net of these amounts, CFC has access to \$2.2 billion, as shown by the green bar, or 1.3 times, as defined liquidity greater than the combined member and non-member short term debt maturity needs. The \$6.5 billion of debt maturities over the next 12 months includes \$3.2 billion of short term investments that our members have with CFC.

As mentioned earlier, our member 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 \$5.4 billion or 2.6 times of 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 November 30, 2017.

This slide presents CFC's projected sources and uses of cash over the next 18 months from November 30, 2017. As indicated, our total projected cash needs over this time period are approximately \$7 billion with 39 percent of this amount expected to satisfy projected new loan advances and 61 percent to meet maturities of long-term debt. Our loan demand remains

strong, and we expect \$453 million of net long-term loan growth by the end of our fiscal year-end May 31, 2018.

Overall, we expect growth in our loan portfolio of \$843 million over the next 18 months. As mentioned earlier, we also expect to increase our holdings of fixed-income securities, which is presented in the other uses of liquidity category in this chart.

Sources of cash are expected to be generated from the ongoing amortization of the 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 advances and the maturity of the loans we extend to our members, as well as the most attractive cost of funds.

We had limited long-term funding activities during the quarter due to relatively modest loan growth and minimal scheduled debt maturities. That said, during the quarter, we closed two financing transactions to further strengthen our liquidity profile.

In November 2017, we closed an amend and extend transaction under our bank revolving credit facilities to extend the maturity dates of these facilities by one year to November 2020 and November 2022. One bank with a total commitment of \$80 million decided to exit the credit facilities due to their internal return issues. Currently, the total commitment amount under the

two bank revolving credit facilities is \$3.085 billion compared with \$3.165 billion prior to the amendment.

Also in November 2017, we closed a \$750 million committed facility under the guaranteed underwriter program with a five-year draw period. For future potential funding needs, CFC will continue to look to balance capital markets and non-capital markets, 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 with 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.

As indicated, CFC's ratings remain robust. During the second quarter, both Moody's and S&P reaffirmed CFC's credit ratings and outlook. 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 the quality of our portfolio. The credit quality and the performance statistics of our loan portfolio continue to remain strong. 99 percent of our loans are to rural electric systems that have limited rate regulation and are geographically

disbursed across the United States, and 92 percent of our loans are on a senior secured basis with the collateral being utility assets and our members' revenue.

CFC has a long history of low non-performing loans in our portfolio. At November 30, 2017, our loan loss allowance, which is an estimate of probable losses inherent in our loan portfolio, was only 0.15 percent of our loan portfolio. We currently have no non-performing loans in our loan portfolio.

CFC continues to receive strong support from our members, both in terms of new lending business and 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 source of funding for CFC. Our member investments stood at \$4.8 billion at November 30, 2017, representing 20 percent of our funding.

As a member-owned cooperative organization, CFC cannot issue common or preferred equity. However, CFC is committed to grow our equity through retained earnings. Over the last five years, our members' equity has grown 73 percent to \$1.4 billion from \$815 million. CFC will continue to utilize the different funding vehicles that we have established over the years. For short-term funding, our plan is to maintain our deal commercial paper balance below a level of \$1.25 billion for the foreseeable future.

With respect to long-term funding, we will continue to target index-eligible and manageable tranches for public debt capital market offerings while looking to maintain flexibility and availability in our private funding sources, mainly the guaranteed underwriter program and Farmer Mac.

CFC will continue to maintain a more than adequate liquidity reserve from a variety of sources to meet our members' borrowing needs as well as service all of our debt obligations.

At November 30, 2017, CFC had \$3.1 billion committed revolving credit facilities from our relationship banks, \$1.4 billion committed availability in the guaranteed underwriting program and a \$2.3 billion revolving credit capacity by the Farmer Mac secured note placement program.

In addition to these liquidity sources that CFC has had over the years, during the second quarter of fiscal 2018, CFC began expanding on balance sheet liquidity sources to include an investment portfolio consisting of short- to intermediate-term liquid fixed-income securities.

At November 30, 2017, we had \$248 million held to maturity investment securities. We anticipate growing this portfolio to approximately \$500 million by May 31, 2018.

These sources, together with cash, other investments, and scheduled loan amortization and other repayments from our members resulted in CFC having \$8.7 billion of liquidity available at November 30, 2017 to meet the next 12 months of all of the debt maturities of \$6.5 billion, a 1.3 times liquidity coverage ratio.

Excluding debt maturities related to our member investments, which historically have had a higher investment rate; our liquidity coverage ratio would be 2.6 times.

Thank you once again for joining us today to review our results for our fiscal quarter ended November 30, 2017. We appreciate your interest in CFC and look forward to discussing our financial performance and funding plans in the future. I'd like to ask the operator to open the lines for questions and also suggest that you submit questions via the web service that we may respond to those, as well. Thank you.

Operator: Thank you. If you'd like to ask a question on the phone today, please press star, one from your telephone keypad, and a confirmation tone will indicate your line is in the question queue. You may press star, two if you'd like to remove your question from the queue. For participants that are using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for questions.

Once again, that's star, one to ask a question over the phone.

There are no phone questions at this time. Are there any online questions?

Mr. Andrew Don: There don't appear to be any.

Operator: Thank you. Would you like to make some closing remarks?

Mr. Andrew Don: Nope. Again, thank you all for joining us today, and we look forward to talking to you in the future. Please feel free to follow up with any other questions you have. Have a good day.

Operator: Thank you. This will conclude today's teleconference. You may disconnect your lines at this time, and we thank you for your participation.