Conference Title: Fiscal Year 2022 First-Quarter Investor call

Date: October 13, 2021

Heesun Choi:

Good morning. This is Heesun Choi, director of capital market relations at National Rural Utilities Cooperative Finance Corporation. Thanks for joining us on our fiscal year 2022 first-quarter investor call. It's covered the three-month period from June 1st to August 31st, 2021. Joining our call this morning are Andrew Don, our chief executive officer and Ling Wang, our chief financial officer. Before we begin the presentation, let me remind you that some information provided and comments made during today's call will contain forward-looking statements within the securities act of 1933, as amended, and the exchange act of 1934, as amended. Forward-looking statements, which are based on certain assumptions and describe our future plan strategies and expectations, are generally identified by our use of words not yet, intend, plan, may, should, were, 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 that 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 our forward-looking statements about our current expectations are included in our annual and quarterly periodic reports by the U.S. Securities and Exchange Commission. All the forward-looking statements are made as of today, October 13th, 2021, and we undertake no obligation to update or publicly release any revisions to forward-looking statements to reflect events, circumstances, or changes in the expectations after the statements are made. We will have a Q&A session at the end of this call.

You can ask questions via phone or submit your questions online if you're participating in this event via webcast. We encourage you to take this opportunity to ask any questions you may have. The presentation slides and financial reports are available in our investor relations page on our website at www.nrucfc.coop. A replay and court transcript will be made available in our investor relations page after this event. With that, I will turn this call over to Andrew for his remarks.

Andrew Don:

Thank you, Heesun. Good morning. Thank you for joining us today. CFC continues to have strong operating and business results. I would like to spend the next few minutes going over the areas indicated on this slide to highlight some of our key areas of accomplishment. Following our strong loan growth in fiscal year 2021, we continue to have robust loan demand from our members during the current quarter. For the three months ended August 31st, 2021, our loans to members increased by $456 million, or 2%, to $28.9 billion from $28.4 billion at the fiscal year-end 2021. The increase in loans to members was attributable to an increase in long-term loans of $358 million and an increase in line of credit loans of $98 million. We continue to focus on lending to electric cooperatives as 99% of our loans outstanding consist of loans to rural electric systems. We currently expect growth in long-term loans outstanding over the next 12 months of $696 million.

We believe that the overall quality of our loan portfolio continues to be strong with almost all of our loans to rural electric systems that provide essential services to end consumers. In addition, 93% of our loans are on senior secured basis, which reduces the risk of loss in the occasional event borrowers experience financial distress. In our 52-year history throughout various economic cycles, we have experienced very limited charge-offs, loan defaults, loan delinquencies, and non-performing loans in our electric portfolio. We had no charge-offs during the current quarter and no charge-offs in the electric portfolio since 2013. Ling will get into more specifics on this during her remarks, but in summary, our financial performance continues to be very solid. In the three months ended August 31st, 2021, we generated adjusted net interest income of $81 million and adjusted net income of $54 million.

Our adjusted TIER was 1.27 times, which was well above our goal of 1.1 times, and our adjusted net interest yield was 109 basis points during the first fiscal quarter of 2022, an increase of five basis points from the 104 basis point level for the prior-year quarter. We believe that the COVID-19 pandemic has not adversely affected our primary objective of providing our members with the credit products they need to fund their operations, and that we've been able to successfully navigate the challenges of the COVID-19 pandemic to date. We updated our practices due to a change of the COVID-19 workplace safety and health standards established by Virginia, as they relate to Loudoun County, where we are headquartered as well as guidance provided by the CDC. We continue to monitor developments in the COVID-19 pandemic and our borrower's financial condition and analyze key credit metrics of our borrowers. Historically, the utility sector in which our electric cooperative borrowers operate has been resilient to economic downturns.

We have not experienced any delinquencies in scheduled loan payments or received requests for payment deferrals from our borrowers due to the pandemic. We currently believe the pandemic has had very little impact on CFC's business fundamentals and operating results as well as our members' financial conditions. We continue to maintain diverse funding sources to minimize the risk of being dependent on any single source or market. CFC's primary funding source consists of a combination of public and private issuance of debt securities, member investments, and retained members' equity. As a tax-exempt, member-owned cooperative association organization, we cannot issue common and preferred equity. Instead, our members have invested in various short-term and long-term investment programs that we offer. Our short-term member investments have historically been our primary source of short-term funding. The short-term investments from our members have averaged $3.4 billion over the last 12 fiscal quarter-end reporting periods.

Including long-term investments from our members, our member investments have totaled $5 billion on average, over the same reference period. Our member investments have proven to be stable throughout various economic cycles. One of our primary corporate goals is to maintain strong long-term credit fundamentals to preserve and enhance our strong investment-grade credit ratings. On August 6th, 2021, S&P revised its outlook on CFC to stable from negative and affirmed all of our credit ratings based on the updated view that the risk that we would experience substantial further losses stemming from the Winter Storm Uri had diminished. Subsequently, on September 13th, 2021, Fitch affirmed all of CFC's existing credit ratings and stable outlook. As of today, our senior secured credit ratings are A plus from Fitch, A1 from Moody's and A minus from S&P. Our senior unsecured credit ratings are A from Fitch, A2 for Moody's and A minus from S&P. All three credit rating agencies have a stable outlook on CFC.

Following our first sustainability bond issuance in October of 2020, we published our first sustainability bond report in August of this year. The report illustrates our efforts to finance the build-out of improved broadband access for unserved and underserved communities in rural areas. In particular, 100% of the net proceeds from the bond were allocated to finance our members' rural broadband projects. As a member-owned cooperative, we are committed to the mutual interest of our members and the communities they serve. The report also details how CFC defined eligibility, evaluated and selected the 48 projects and includes case studies of four member recipients of the funding from us. Our sustainability bond report is available on the Investor Relations page on CFC's website, which I invite you to view at your leisure. With that, I'll turn it over to Ling.

Ling Wang:

Good morning. This is Ling Wang. Before I get into more specifics, I want to remind you that during our discussion, we will review certain Non-GAAP adjusted financial measures. Please refer to our Form 10-Q for the first quarter ended August 31st, 2021, of our fiscal year 2022 that's filed with the SEC and posted on CFC's website for discussion of why we believe our adjusted measures provide useful information in analyzing CFC's financial performance and the reconciliation to the most comparable GAAP measures. For those of you who are on the phone, I'm on slide seven. Our total assets at August 31st, 2021, were $30.1 billion, an increase of $454 million, or 2%, from May 31st, 2021, primarily due to the growth in our loan portfolio. During the current quarter, our loans to members increased by $456 million to $28.9 billion from the prior fiscal year-end. Loans to distribution members represented the largest increase at $384 million, while loans to power supply members increased by $67 million. And loans to our RTFC borrowers increased by $11 million.

We continue to experience strong loan demand from our members during the current quarter. For the three months ended August 31st, 2021, our long-term loan advances totaled $727 million. These advances consists of $450 million, or 62%, for capital expenditure purposes and $255 million, or 35%, for members' operating expenses, primarily due to increased power costs in ERCOT and higher natural gas prices during the Winter Storm Uri. In comparison, during the same prior-year quarter, long-term loan advances totaled $807 million with $750 million, or 93%, for capital expenditures and $32 million, or 4%, for the refinancing of other lenders' debt. Our members' equity, which excludes cumulative derivative forward value losses and accumulated other comprehensive income, decreased slightly by $3 million. The decrease was due to the CFC Board of Directors' authorization in the first quarter to retire patronage capital of $58 million, which was almost fully offset by the adjusted net income of $54 million for the three months ended August 31st, 2021.

In July, 2021, the CFC Board of Directors authorized the retirement of allocated net earnings totaling $58 million, of which $45 million represented 50% of the patronage capital allocation for fiscal year 2021, and $13 million represented the portion of the allocation from net earnings for fiscal year 1996 that has been held for 25 years based on CFC's Board of Directors policy. The authorized patronage capital retirement amount of $58 million was returned to members in cash in September 2021. The remaining portion of the amount allocated for fiscal year 2021 will be retained by CFC for 25 years under the current guidelines adopted by our board of directors in June of 2009. Our adjusted debt-to-equity ratio increased to 6.27-to-1 at August 31st, 2021 from 6.15-to-1 in May 31st, 2021. The increase was primarily attributable to a combination of an increasing adjusted liabilities of $468 million from additional debt issuance to fund the long-term growth and the previously mentioned retirement of patronage capital of $58 million in July, partially offset by our current-quarter adjusted net income.

Currently, we expect an increase in long-term loans outstanding of $696 million over the next 12 months. And as a result, we expect our adjusted debt-to-equity ratio will remain above our targeted threshold of 6-to-1 for the next 12 months. For the three months ended August 31st, 2021, CFC generated adjusted net income of $54 million and adjusted TIER of 1.27 times compared with adjusted net income of $57 million and adjusted TIER of 1.28 times for the same prior-year quarter. The $3 million decrease in adjusted net income for the current quarter from the comparable prior-year quarter was primarily driven by an unfavorable shift of $7 million in unrealized losses in our investment portfolio for unrealized gain in the same prior-year quarter, and the increase in the provision of credit losses of $4 million partially offset by an increase in adjusted net interest income of $8 million.

Our adjusted net interest income during the quarter was $81 million, an increase of $8 million, or 11%, from the prior-year quarter. This increase was driven by a combination of an increase in average interest earning assets of $1.6 billion, or 6%, and an increase in adjusted net interest yield of five basis points, or 5%, to 109 basis points. The increase in adjusted net interest field reflected the favorable impact of a reduction in our adjusted average cost of fund of 24 basis points to 2.92%, partially offset by the decrease in the average yield of interest earning assets of 16 basis points to 3.83%, both of which were attributable to the continued lower interest rate environment.

The overall composition of our loan portfolio at August 31st, 2021, remained largely unchanged from the composition at May 31st, 2021, with $28.4 billion, or 99%, of our portfolio consisting of loans to rural electric systems and $431 million, or 1%, to the telecommunication sector. The percentage of CFC's long-term fixed-rate loans were at 89% of total loans as of August 31st, 2021, down 1% from the May 31st, 2021, level. We typically lend to our members on a senior secured basis with 93% of all loans being senior secured at both August 31st and May 31st, 2021. We offer long-term fixed-rate loans to our members for up to 35 years on a senior secured basis. And because of the low interest rate environment, the average rate term selected by our members on long-term fixed-rate advances over the last 12 months has been over 20 years. During the current quarter, we did not have any loan charge-offs, and we did not add any new non-performing or restructured loans. Prior to the Brazos Electric Power Cooperative bankruptcy filing in March 2021, we had not experienced any loan defaults or charge-offs in our electric utility portfolio or in the telecommunication loan portfolio since fiscal years 2013 and 2017, respectively.

Our non-performing loans with four borrowers including Brazos decreased by $5 million to $232 million, or 0.80%, of total loans outstanding at August 31st, 2021, from $237 million, or 0.84%, of total loans outstanding in May 31, 2021. Each of the borrowers with loans outstanding classified as non-performing except for Brazos has continued to make scheduled loan payments. Our allowance for credit losses increased $4 million to $90 million as of August 31st, 2021, from $86 million as of May 31, 2021. The increase was attributable to an increase in the collective allowance of $3 million, along with a slight increase in the asset-specific allowance. Our allowance coverage ratio was at 31 basis points at August 31, 2021, compared with 30 basis points at May 31, 2021. As discussed in prior calls, the Winter Storm Uri had an adverse financial impact on two of our power supply borrowers, Brazos and Rayburn Country Electric cooperatives. As of August 31, 2021, our outstanding loan exposure to Brazos and Rayburn was $86 million and $375 million, respectively, and together totaled $461 million, of which $184 million was secured and $277 million was unsecured.

The State of Texas enacted securitization legislation in June 2021 that offers financing programs for qualifying electric cooperatives exposed to elevated power costs during Winter Storm Uri. We are currently uncertain whether Brazos will utilize the position under the legislation. We currently believe Rayburn is planning to utilize the securitization legislation to finance the elevated power costs. However, there are many factors which may impact the outcome of a securitization transaction and the ultimate collectability of Rayburn's loan outstanding, which we are unable to predict at this time. As of August 31, 2021, our loans outstanding to Rayburn consisted of secured loans totaling $163 million, and unsecured loans totaling $212 million, and Rayburn was current on all of its principal and interest payments due to us.

Our total debt outstanding was $27.8 billion as of August 31, 2021, an increase of $352 million from $27.4 billion as of May 31, 2021, primarily to fund the loan growth. We maintain diverse funding sources, including funding from our members, as well as capital markets and non-capital markets funding to minimize the risk of being dependent on any single source or market. As of August 31, 2021, $5.1 billion of CFC spending came from our members in the form of short-term and long-term investments, an increase of $143 million from $5 billion in May 31, 2021. Our member investments represented 18% of our total debt outstanding at both August 31 and May 31, 2021. At August 31, 2021, our funding under the underwriter program and notes payable with Farmer Mac totaled $9.6 billion, or 35%, of our total debt outstanding, an increase of $343 million from May 31, 2021, primarily due to the $500 million borrowing under the Farmer Mac purchase agreement program offset by the scheduled principal repayment and amortization. Our capital markets-related funding sources totaled $13.1 billion at August 31, 2021, a decrease of $134 million from May 31, 2021.

The decrease was primarily due to the June maturity of a $300 million dealer medium-term note outstanding partially offset by an increase of $115 million in dealer commercial paper outstanding, and a $25 million increase in secure borrowing under a repurchase agreement. At August 31 and May 31, 2021, capital markets-related funding sources accounted for 47% and 48%, respectively, of our total funding. At August 31, 2021, 61% of our total debt was secured and 39% was unsecured, unchanged from May 31,

2021. Our short-term borrowings totaled $5.4 billion and accounted for 19% of our total debt outstanding at August 31, 2021 compared with $4.6 billion, or 17%, of total debt outstanding at May 31, 2021. The increase in our short-term borrowings was primarily due to the $500 million short-term borrowing from under the Farmer Mac note purchase program. A total of $3.6 billion, or 68%, of our total short-term volumes came from members' short-term investments at August 31, 2021, compared with $3.5 billion, or 76%, at May 31, 2021. As we have consistently stated, the investment from our members are a very reliable funding source with little reimbursement risk as our members consistently invest a large portion of their excess cash with CFC.

This slide represents CFC's long-term debt maturities and amortization over the next 12 months from October 2021. Our upcoming debt maturities and amortization consisted of $855 million in collateral trust bonds, $850 million in dealer medium-term notes, $1.4 billion in Farmer Mac notes payable, and $258 million in Guaranteed Underwriter Program. Excluding our member medium-term note maturities, which have traditionally been reinvested with us, we have approximately $3.5 billion of refinancing needs over the next 12 months to fund upcoming maturities from October 2021 to September 2022. We plan to look to utilize both capital markets and non-capital markets funding sources to refinance the upcoming maturities in due course.

This slide shows the various sources of liquidity that CFC had in place at August 31, 2021. At August 31, 2021, our available liquidity from various sources includes cash in investment, committed bank lines, Guaranteed Underwriter Program and Farmer Mac revolving note purchase agreement, which totaled $6.6 billion. In addition, we expect to receive $1.7 billion from scheduled repayments on long-term loans over the next 12 months. As indicated in the table, we had approximately $7.9 billion of member and non-member debt maturities over the next 12 months as of August 31, 2021. These debt maturities consist of number one, short-term member investments of $3.6 billion. Two, dealer commercial paper of $1 billion. Three, short-term notes payable of $500 million under the Farmer Mac revolving note purchase agreement. Four, borrowing of $225 million under a repurchase agreement, which we repaid in September 2021. And five, the loan term and subordinated debt obligations of $2.5 billion.

Approximately 46%, or $3.6 billion, in debt maturities over the next 12 months are short-term investments that our members have with CFC. We consider our member investments to be a very stable and reliable funding source for CFC. If we exclude a $3.6 billion debt maturity related to our members' short-term investments, we will have a total liquidity equal to 1.5 times or $2.3 billion of liquidity in excess of our non-member related debt maturities during the next 12 months, subsequent to August 31, 2021. Together with the $1.7 billion scheduled long-term loan amortization repayment over the next 12 months, our excess liquidity will have been 1.9 times or $4 billion to meet our non-member related debt maturities in the next 12 months subsequent to our current quarter end. In addition, in September, we received an approval for an additional $550 million commitment under the Guaranteed Underwriter Program, which is not included as available liquidity on this slide. We expect to close the new GUP series in November.

This slide represents CFC's projected long-term debt issuance needs over the next 18 months subsequent to August 31, 2021. Our cash needs are derived from two primary areas, refinancing existing debt maturities and funding loan growth, partially offset by the amortization and repayments of loans for our members. We expect our net loan growth over the next 18-month period to be approximately $971 million. As indicated in the last column, our expected long-term debt issuance over this period of approximately $6 billion, mainly to refinance existing long-term debt maturity. Also note the other sources and uses of cash column in the middle of the slide reflect net increases or decreases to our dealer commercial paper and other short-term outstanding. To meet our financing needs for the remaining fiscal year, we will continue to look to balance capital markets and non-capital market secure and unsecure financings, while always looking to access the most attractive cost of funds for our member-borrowers.

To conclude our call, I would like to leave you with a few key takeaways when you consider CFC as an investment opportunity. These items are the areas that CFC is consistently focused on and represent key credit strengths when viewing CFC as an investment. As indicated earlier, CFC's credit ratings remain strong and stable at A plus, A1 and A minus on a senior secure basis. The overall quality of our loan portfolio continues to be strong with 99% of our loans to rural electric systems and 93% of our loans being on a senior secured basis. We did not have any charge-offs in any of our loan portfolios since the first quarter of our fiscal year 2017. CFC continues to receive strong support from our members, both in terms of new lending business and as a valuable funding source. Our member investments continue to grow and reached $5.1 billion at August 31, 2021, compared with $4.2 billion at our fiscal year-end 2016. Our members' equity has grown by 42% to $1.8 billion from $1.3 billion since May 31, 2016, as we are committed to grow our equity through retained earnings.

We continue to maintain diverse funding sources and demonstrate a healthy liquidity profile. Our funding sources are very well established and have remained stable. Thank you once again for joining us today to review our results for our fiscal quarter-end ended August 31, 2021. 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 operators to open the lines for questions, and also suggest that you submit your questions via the web service so we may respond to those as well. Thank you.

Operator:

Thank you. If you would like to ask a question over the phone lines, please signal by pressing star one on your telephone keypad. If you are using a speaker phone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star one to ask a question. We will pause for just a moment to allow everyone an opportunity to signal for questions. All right, it appears there are no phone questions at this time.

Ling Wang:

Okay. We do not see any questions on the web either. If any of you have any questions, please feel free to contact me after the call. Thank you. Have a good day.

Operator:

This concludes today's call. Thank you all for your participation. You may now disconnect.